

Taxing Banks



A joint
submission
to the
International
Monetary Fund

Taxing Banks

A Report submitted to the International Monetary Fund February 2010

Background

This proposal is made in response to a request from the International Monetary Fund (IMF) for comment to be made by civil society and others on the future taxation of banks¹.

As the IMF has noted:

At the September 2009 G-20 Leaders Summit in Pittsburgh, the IMF was asked “to prepare a report for our next meeting with regard to the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system.”

This paper seeks to suggest ways in which the financial sector can contribute fairly and substantially to the cost of government intervention in the banking system.

Basis of preparation of this submission

This submission to the International Monetary Fund has been prepared by Tax Research LLP under the direction of Richard Murphy FCA.

Financial support has been provided for this work by:

- Task Force on Financial Integrity and Economic Development
- Christian Aid UK
- Tax Justice Network International
- Trade Union Congress of the UK

¹ <http://www.imf.org/external/np/exr/consult/2009/index.htm>

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Executive Summary

The IMF has requested that civil society, non-governmental organisations and others comment on the future taxation of banks. The Task Force on Financial Integrity and Economic Development, Christian Aid, the UK's Trade Union Congress, the Tax Justice Network and Tax Research UK have cooperated to prepare this submission which is broad based and reflects the differing concerns of these various organisations, not all of whom have the capacity or authority to endorse each section of it as a result. All these organisations do, however, share concern that the future taxation of banks must be reformed to ensure that banks and other members of the financial services community make greater contribution to the governments of those jurisdictions that host their activities and that they do so in a tax compliant fashion.

We are not lobbyists on finance, nor uniquely concerned with banking. Nor does our interest in these issues date only from this most recent crisis. The organisations involved in this report are concerned, above all, with the impact of financial market systems and structures on human development, and so our interest extends to before the crisis because of the damage these structures and systems have long caused, including in the 'good times'.

The financial crisis has done significant economic damage around the globe, but has had the most immediate human impacts in the developing countries which bear least responsibility. The difference is that shocks in many developing countries have much harsher and potentially permanent impacts. An estimated 120 million extra people will be living on less than \$2 a day in 2010. The ILO estimates that global unemployment will rise to 219-241 million people, the highest on record, with disproportionately damaging effects on women. The World Bank conservatively estimates that the crisis will cause an additional 30-50 thousand infant deaths in sub-Saharan Africa alone - to say nothing of the permanent effects on a generation that a peak in malnutrition is likely to have.²

In addition, however, the opacity of the international financial system has had a profound and damaging influence on development for many years - undermining systems of taxation and facilitating corruption and asset-looting. We see it as vital that the international community seize this moment to address the opacity and lack of international regulatory cooperation that both underpinned the crisis and also damages economic and social development on an ongoing basis.

Our intention in this report - on the basis of the now more or less unanimous recognition of the potential social costs of under-regulated finance - is to present solutions. Having established the case for a greater tax burden on the socially costly finance sector in order to generate funds, including for developing countries, we present a combination of more immediate measures to raise funds, and more structural responses to reduce the damage that the sector can do.

This report assesses the role of banks in our economies, the bases on which they can pay tax and the problems that exist with the current ways in which they are taxed, some of which contributed to the current financial crisis, before making recommendation on ways in which banks might best fulfil their obligation to pay tax for the benefit of society as a whole in the future.

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http://www.europesworld.org/NewEnglish/Home_old/CommunityPosts/tabid/809/PostID/1110/Timefortransparency.aspx and <http://www.oxfamblogs.org/fp2p/?cat=231&paged=2> accessed 5-2-10

In the short term this report recommends that banks make that contribution in two ways. The first is by charging financial transaction taxes on a range of the transactions that they undertake both internationally and domestically.

The report recommends early and widespread adoption of a currency transaction tax charged on both spot and derivative foreign exchange dealing, trades which together are likely to amount to at least \$US900 trillion (fifteen times world GDP) at this time. It is suggested that a tax at a rate of one half of a basis point (one two hundredth of a percent) be applied to these transactions. This would yield a tax revenue if charged worldwide of approximately US\$33 billion having allowed for a cautious fall in trading volumes of approximately 25%, which is above the rate estimated to be likely by recent academic studies. The report suggests that tax evasion is unlikely because data on all these trades is easily collected through current exchange mechanisms that record their flow, and that these can form the basis for collection of these charges.

The report also suggests a broader range of financial transaction taxes. The report estimates that there are some US\$3,150 trillion of exchange traded and over the counter bond, gilt, derivative, swap and other trades annually, of which the majority are exchange traded and relate to interest rates. Margins will, as for foreign exchange, be very low so a tax rate of half a basis point (one two hundredth of a percent) is proposed on these trades, yielding potential revenue of US\$118bn per annum.

In addition the report suggests use of a 'stamp duty' charge similar to that levied in the UK and a number of other countries on share dealing at the rate used in the UK of 0.5% on spot share dealing. Estimates of total spot share dealing per annum are cautiously estimated to be US\$60 trillion. On this basis, and assuming the fall in the value of share trading in 2009 was aberrational, it is estimated that if a tax of 0.5% was applied and trading volumes fell by 25% revenues raised might amount to US\$225 billion per annum.

Total estimated yields from financial transaction taxes amount, therefore, to US\$376bn per annum. It should be noted that because of the incidence of these taxes as described below there will be income tax and perhaps corporate tax losses that cannot be quantified at present but which will partially offset these revenues and as such a lower overall total yield is inevitable.

It is not suggested that these taxes be introduced simultaneously. It is suggested they be introduced in the order noted for three reasons. Firstly, the capacity of the market to absorb these taxes is broadly related to the revenue they might generate. Introducing them in order of scale makes sense to minimise risk of market disruption. Secondly, the technical mechanisms to create a currency transaction tax on foreign exchange are easy to create, but the same is not true as yet for over the counter trades, for example. As such there is a logistical reason for phasing their introduction. The third reason relates to their incidence.

The incidence of any tax is a complex issue. This report estimates that banks have the capacity to pay at least US\$72bn of the sums that might be due in respect of financial transaction taxes out of their reasonably anticipated annual profits. This could, of course, completely cover the sum due in respect of a currency transaction tax on foreign exchange.

That said, the report also recognises that a significant part of the incidence of any financial transaction tax will fall on those persons working for banks and other financial institutions working on the trades and investments subject to the new charges, and with regard to the first two proposed charges this is where any part of the incidence, apart from that falling on bank profitability, is considered likely to arise. This is because the anticipated fall in volumes traded inherent in the calculation of potential revenues due will inevitably result in a fall in the number employed in these activities. This is unavoidable and likely to be consistent with the falls in volumes traded. In addition, those engaged in these particular activities are those most subject to criticism for

the excess rewards paid to some bankers. The capacity for the recovery of the financial transaction tax charges arising from out of current remuneration considered excessive by policy makers and governments worldwide is sufficient to ensure that the combination of falls in the numbers employed and the pay of the remaining engaged in activities some have described as 'socially useless' will mean that the incidence of these financial transaction taxes will fall almost entirely on a relatively small group of bank employees in a fashion consistent with government economic, social and regulatory policy. This is the perverse paradox of the incidence of financial transaction taxes: the incidence is wholly policy reinforcing and consistent with government policy, popular sentiment and economic logic.

The report notes that this logic may not be wholly capable of extension to the third financial transaction tax, the stamp duty equivalent to that already found in the UK. Whilst the impact of any such tax will be minimal in the UK, which already has this tax, the report recognises that the potential impacts on behaviour, employment, investment returns and long term rewards in pensions and life assurance funds need further research, whilst also believing that reform to improve the negative return in equity markets over the last decade will, in any event be required and that such a tax may, as James Tobin always predicted, be beneficial in precipitating such reforms and in enhancing returns by eliminating wasteful and harmful trades. Delay in implementation until such work has been done does, however, make sense at this time albeit that the noted reforms in finance are long overdue and are necessary to achieve the objectives James Tobin set out for the tax that bears his name.

As the report notes, the short term alternative of an insurance charge that some promote as an alternative to financial transaction taxes does not have any of the benefits flowing from adoption of these taxes as noted above, nor can it raise equivalent revenues. In addition, whilst financial transaction taxes should only eliminate marginal trades but leave markets intact with ample liquidity, the proposed rate of the US levy at 15 basis points is well above margins on many of the trades noted in this report and is consequently likely to be harmful to the operation of some markets. This should not be the case for financial transaction taxes which are to be preferred as a result. In addition, levies are likely to be avoidable by relocating assets and liabilities. This is significantly less likely in the case of financial transaction taxes making them more robust revenue collection methods, assisted by the fact that inter-governmental information exchange mechanisms for financial transaction taxes may already exist but do not for levies.

Having considered these issues relating to financial transaction taxes this report also suggests that these taxes cannot be the only way in which banks should be required to make more appropriate financial contribution to the societies that host their activities. The report notes that the contribution of banks by way of tax payment has fallen, along with that of other major corporations for a number of reasons in the last decade or so. Falling actual and effective tax rates have caused this fall in contributions by banks whilst increased tax avoidance activity has contributed to this loss of revenue, as has the global mobility of capital.

The report suggests a range of measures that should be adopted to increase the yield from taxes charged on the profits of banks.

Firstly, we recommend a new form of international accounting standard called country-by-country reporting. The OECD has recently begun a review of this proposed standard. The report recommends that it should be adopted by the International Accounting Standards Board and the Federal Accounting Standards Board in the USA. It would require that every bank report its profit and loss, tax paid and a limited balance sheet for each and every jurisdiction in which it operates. This would have a threefold benefit: regulators would have ready access to information on the risk that a bank's corporate structure creates; tax authorities would know where the banks' profits are located and should therefore be better able to determine whether that allocation is appropriate, and raise challenge to it if necessary; and, finally; shareholders would benefit from enhanced

information on which to appraise the risk inherent in the company in which they have invested. It is stressed that no tax would be raised directly as a result of the adoption of country-by-country reporting, but since the first problem in assessing a bank's profits to tax lies with identifying where they are generated, country-by-country reporting would provide invaluable, timely, efficient and currently unobtainable data to assist that process and tax yields would be bound to increase as a result.

Second, we recommend that jurisdictions adopt General Anti-Avoidance Principles to ensure that artificial transactions created wholly or mainly by banks for the purpose of avoiding their taxation obligations can be ignored when assessing those obligations. There is now a growing body of evidence that when correctly implemented such principles can provide an essential weapon in the armoury of any tax administration seeking to tackle sophisticated tax avoidance.

Third, we recommend that countries adopt binding codes of conduct that must be adhered to by banks with regard to their taxation activities that require them to promote tax compliance. This report defines tax compliance as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes. Such Codes of Conduct have been endorsed by the OECD and are being pioneered in the UK and deserve wider adoption. They will probably deliver greatest benefit when combined with a General Anti-Avoidance Principle.

Finally, with regard to taxes on corporate profits we suggest that bank losses incurred as a result of the current financial crisis but which have been effectively underwritten by society at large should not be allowed to be carried forward indefinitely for offset against future profits. As has been noted with regard to Merrill Lynch's operations in the UK, the losses recorded in 2008 might be enough to ensure it does not pay tax in that country for the next 60 years. This clearly makes no sense if we now expect increased contributions from banks and as such their capacity to carry forward losses must be limited, either to a set number of years or, less desirably, to the limit of the financial support they received at any time during the financial crisis.

Our final recommendation relates to the important issues of banker's bonuses and the role banks play in assisting others avoid their tax obligations. There is almost universal concern about the levels of pay banks make to their staff and the harmful effect these have in distorting social balances within many countries as well as the loss they represent to the shareholders (such as pension funds) in those banks. We do not suggest bonus taxes of the sort currently imposed in the UK. Instead we suggest that a bank should be allowed to pay any member of staff any salary or bonus that it likes but that if the total sum paid is more than ten times average pay in the country where the payment is made (a limit of about £210,000 in the UK for example at present) then the bank should not be allowed to offset that cost against its profits when it comes to calculating the bank's tax liability. This simple adjustment, which has no impact on employment rights or bank employee's tax affairs might have raised up to US\$3.9 billion in the case of Goldman Sachs alone on bonuses paid in January 2010 on the basis of assumptions noted in the report. This source of potential additional revenue cannot be ignored when looking at revenue raising opportunities from banks.

Nor, finally, can the role banks play in tax avoidance (and regrettably, tax evasion – albeit, we stress, by innocently providing facilities that others abuse) through their support for legally backed bank secrecy and the operation of tax haven / secrecy jurisdiction structures be ignored. As the G20 has noted, the opacity of tax havens and the existence of banking secrecy has massively undermined the taxation revenues of many countries and has at the same time permitted enormous illicit financial flows from developing to developed countries to take place undetected by regulatory authorities. Current measures to tackle these issues, such as creation of networks of Tax Information Exchange Agreements will only have limited impact in tackling losses estimated, on varying bases, to exceed US\$250 billion a year. Mechanisms for automatic information

exchange of information between jurisdictions using data already held by all financial institutions for anti-money laundering purposes on the beneficial owners of the financial structures they manage and operate on behalf of clients should be created. The outcome would be that if a state knew that a person who was tax resident in another jurisdiction had a beneficial interest in a financial structure (whether it be a bank account, company, trust, partnership, foundation or anything else) within its domain then they would have to advise the place where that beneficial owner was tax resident of this fact. The Tax Information Exchange Agreements now being negotiated would then be meaningful since the information needed to request further data to enforce tax payment obligations were being settled would then exist and a massive deterrent effect would be created to deter offshore activity. The incidence of the tax charge would fall entirely on tax evaders, and might equal any other charge proposed in this report.

The measures noted here to tackle corporate tax avoidance by banks might raise existing yields from this source, estimated to be US\$120 billion worldwide, by as much as 50%. The incidence will largely fall on the banks: the charges often being disguised within them already by deferred taxation provisions.

The potential revenue streams from enhanced bank reporting on customer activity are much greater still: a significant proportion of the current estimated US\$255 billion lost to tax evasion as a result of bank opacity might be recovered. The incidence would be on those currently tax evading.

In conclusion: there is opportunity to raise substantial additional revenue from banks. We favour the creation of a programme of financial transaction taxes in the short term. We believe they would be effective, and that their incidence, at least for the first types recommended would fall upon banks or a very small group of bank staff, and that the revenue raised would have the benefit of limiting the harmful externalities widely noted to arise from much of the proprietary trading undertaken by those banks.

We also suggest that broader based measures are needed. The yield from corporation taxes on banks is too low, and should be increased by reducing their right to offset losses supported by public funds against their future profits, by enhancing accounting arrangements to make it easier to locate where their profits are recorded, so bringing them into the tax account, by tackling their use of tax avoidance and by requiring changes in their approach to tax management.

Finally, we think that revenue should be raised from the excessive bonuses banks currently pay some of their staff by disallowing tax relief on part of such payment on the basis that it represents a profit distribution, not a reward for effort expended.

We propose that broadly based taxes at low rates are effective for revenue raising purposes because they limit the incentives to avoid taxes by reducing the yield from any one scheme and by ensuring as many loopholes as possible through which revenue may leak are plugged. As a consequence all proposed options might be considered together. That is our reason for presenting a range of recommendations on this occasion which we hope will be considered favourably by the International Monetary Fund.

1 Why tax banks?

Banks are at the heart of what went wrong with our financial system.

It is true one major insurance company (AIG) effectively failed during the recent financial crisis, but no other of anything approaching its stature has.

Hedge funds have folded in large numbers but they are by their very nature volatile and this was to be expected.

Private equity may have attracted much attention for its actions before and during the crisis, including its use of what many consider excessive leverage, much routed through offshore structures, but there is widespread belief that, as with hedge funds, regulation of this previously largely ignored sector is the way in which to tackle the problems it has created.

The lawyers, accountants and auditors who are also key players in this sector have, no doubt, suffered as a consequence of the crisis and may have helped engineer the mechanisms that gave rise to it. But there is little doubt they do not have the financial capacity to contribute significantly to the rebuilding of our economies.

This report is about the capacity of the financial sector to contribute to the cost of the repairing the banking system. It is only the banks that have the capacity to do that from within this sector.

Those banks make substantial profits. They also make use of considerable capital. A list of the world's fifty biggest banks is attached as appendix 1 to this report. They have between them assets of US\$56.7 trillion and capital of \$455 billion.

A survey of the profitability of the top 15 of these banks has been undertaken for 2007 and 2008 for the purposes of this report. This is attached as appendix 2. These largest 15 banks have assets of US\$30trn and capital of \$160 billion. They made profits in aggregate in 2008 before tax of \$35bn. In 2007, before the credit crisis broke, their combined profits were \$205bn. The rate of return on capital in 2008 was 21.8%.

According to data published by International Financial Services London (IFSL) (an organisation supported by the City of London and which promotes UK financial services activity³) in its report entitled Banking 2008:

The global banking industry experienced strong growth in the last few years. Worldwide assets of the largest 1,000 banks grew 16.3% in 2006/2007 to a record \$74.2 trillion. This follows a 5.4% increase in the previous year.

It is clear as a result that the banks noted in Appendix 2 dominate the banking market, representing maybe 40% of all worldwide banking activity between them.

The same report notes:

Pre-tax profits of the world's largest 1,000 banks grew by 22% in 2006/07 to \$786.3bn. This was the fourth successive year of growth. Average global return on capital (pre-tax profits to Tier 1 capital) totalled 23.3% in 2006/07, up 3% on the previous year.

³ <http://www.ifsl.org.uk/output/ReportItem.aspx?NewsID=29> accessed 18-12-09

Such is the scale of potential banking profits that the evidence is clear: if banking is to be repaired, it is banks that will have to pay for the state support they received. This is why the taxation of banks must be the focus of this report.

This issue needs to be addressed as one of priority. Many think it will be some time before banking profits return to 2007 levels. The losses of 2008 and 2009 have changed perceptions of what banks can generate in revenues. Excessive caution may be inappropriate though: if the provisions made for losses on loan portfolios in 2008 and 2009 were as draconian as many suspect then the trend of profitability may be restored sooner than expected: all anticipated losses may now have been recorded⁴. If so, and as appears to be the case in some parts of the sector, banking profits are likely to rise quickly and the level seen in 2006/07 could be restored. It is against this background that this paper suggests tackling the taxation of banks requires urgent consideration.

1.1 *The role of banks in the economy*

Modern banks are complex operations. This is not the place to note all they do: that is not the purpose of this report. It is however appropriate to note that their role is multi-faceted. They are amongst other things:

- 1.1.1 Processors of payments, whether by managing cash, cheques or electronic payments;
- 1.1.2 Places of safe deposit for cash and other assets;
- 1.1.3 Creators of money as issuers of bank notes and providers of credit;
- 1.1.4 Makers of markets in a wide range of financial products;
- 1.1.5 Providers of financial services such as insurance, investment management, corporate advice and trust services;
- 1.1.6 Investors e.g. in some countries banks are major investors in the equity of companies.

All these activities may take place in one bank: some banks will only offer a limited range of them. All fall within the scope of this report, as does the fact that banks do not just offer services, they also act as agents for other taxable persons. So, for example, they hold cash, pay interest, manage funds, deal in equities, bonds, currencies and other financial products on behalf of others as well as themselves, manage companies, estates and trusts, and more besides on behalf of people and the whole range of legal entities that modern law makes available to those undertaking trade and investment. In the process they do of course employ people, buy services, use property, own assets and undertake a wide range of other activities which can in various ways contribute to the tax base. The interaction between a bank and the potential tax base that a jurisdiction may wish to impose upon it is, potentially, very wide.

⁴ See <http://ftalphaville.ft.com/blog/2010/01/05/119961/barcaps-credit-surprise-snapback/> accessed 5-1-10. Based on analysis by Barclays capital it is suggested that the portfolio of non performing loans held by banks is now very small since most have already been provided. In that case the provision charges for losses on loans portfolios that have been the case of many of the losses recorded in 2008 and 2009 may cease in 2010 or there may even be recoveries, meaning bank profitability might be restored more rapidly than many have predicted.

1.2 *The special case of banks*

It is reasonable to argue as a consequence that banks represent a special case situation within any economy.

As facilitators of the vast majority of transactions in the many states, and as the private creators of over 97% of what is considered money in some economies⁵ the integral nature of banks in developed economies, in particular, is obvious.

Banks' special situation of trust is another characteristic that sets them aside from all other businesses: as recent events have shown, it is hard to imagine another business so able to harm well being through the destruction of value if they were to fail. The consequence is that they are more regulated than almost any other sector of the economy. This could, of course, be a burden and yet that regulation is in itself a barrier to entry for new market participants, who as a result are rarely seen. The consequence is, perversely, a capacity for the banks to generate quasi-monopolistic profits that is seen both in their own market power and in the widespread perception that rewards paid to bankers exceed those that an open market would consider appropriate.

The need to protect society against the failure of banks has given rise to the explicit recent acknowledgement of something previously consensually ignored as it had not been relied upon: that is the implicit guarantee of the state that a bank that fails will either itself be rescued using state funds, or that its depositors will, to large degree, enjoy protection from loss. The consequence is that banks, above all other institutions, have implicit within their structure the risk of moral hazard. The Economist defines moral hazard as meaning "that people with insurance may take greater risks than they would do without it because they know they are protected, so the insurer may get more claims than it bargained for"⁶. In the case of banks that risk is transferred to the state, but the upside potential recorded as profits remains in the private ownership of the banks, as has been recently demonstrated. That gives the state a special interest in banks.

Finally, as providers of liquidity to markets banks play a key macro-economic role in all economies and that of the world as a whole. This makes them more important, and states more vulnerable to them, than is perhaps the case for the vast majority of commercial activity.

For these reasons banks form a special case for consideration when it comes to taxation.

1.3 *In what capacity can banks be taxed?*

As a result of their diverse nature banks can be subject to taxation in a wide variety of ways, of which the following are just examples:

- 1.3.1 On their own income streams
- 1.3.2 On the supply of services
- 1.3.3 On the creation of money
- 1.3.4 As market makers
- 1.3.5 As agents for account holders

⁵ According to the Bank of England in November 2009 notes and coins made up just 2.2% of total UK money supply (M4) http://www.bankofengland.co.uk/statistics/ms/2009/dec/bankstats_full.pdf Table A2.2.1 accessed 6-1-10

⁶ <http://www.economist.com/research/economics/alphabetic.cfm?letter=M#moralhazard> accessed 6-1-10

- 1.3.6 As employers
- 1.3.7 As occupiers of land
- 1.3.8 As regulated entities enjoying monopoly power
- 1.3.9 On the implicit guarantee against failure that they enjoy

This paper recognises the many ways in which banks might contribute to the taxation revenues of a jurisdiction and discusses many of them, It does, however, necessarily concentrate on some particular issues where it is expected that there is consensus for plausible change in the taxation of banks and focuses most of its recommendations on these issues.

1.4 Does a bank ever really pay tax?

Before making recommendations it is important to address a contentious issue, which is whether a bank, as a limited liability corporation can ever pay tax itself, or whether it acts as a mere conduit to transfer tax liability to others.

Those who subscribe to the idea that banks (and other limited liability entities) do not pay tax refer to the theory of tax incidence to support their views. This theory suggests that as legal liability entities are not real people, and just agents for them, and only real people can actually pay tax, the burden of any tax imposed on such an entity is always passed on to others and this has to be determined before the consequence of any tax charge can be determined.

There can be little doubt that the theory of tax incidence has technical validity in economic theory. If, as that theory assumes, corporations are run for their shareholders, and all consequences of corporate behaviour flow to those who engage with the entity in one form or another – this being a view that essentially sees the limited liability entity as little more than a bundle of contractual arrangements - then it follows, as the theory suggests, that if a tax burden on a limited entity cannot be passed on by it to its customers by way of higher prices to its suppliers by way of lower prices or its employees by way of lower wages then the shareholders will suffer the burden of the tax, either through reduced earnings paid by way of dividend or through lower retained earnings, the latter being assumed to be reflected directly in the price of equity in the company.

Unfortunately the impact of tax incidence in practice is less predictable than economic theory suggests likely to be the case. Corporations can readily change where, when and at what rate they pay tax. They do this by relocating transactions and whole businesses, by tax avoiding and by tax arbitraging. If they were not liable for the taxes they pay there would be little logic to any of these actions and it is reasonable to assume they are rational. In addition, when it appears that banks can to some degree choose the incidence of any tax imposed on them (as the current reaction bonus taxes on bankers in the UK shows⁷) there is no reliable basis on which to estimate or predict tax incidence resulting from any given change in policy.

Additionally, it may be a logical error to assume that corporations are mere agents and act as a bundle of contracts. The reality is that corporations are synergistic entities that appear to create worth in their own right. Indeed, if they did not there is no logical reason for them to exist. This does, however, suggest that it is possible for the incidence of a tax to fall upon the corporation itself.

In that case the only rational thing to do is assume that banks are, at least in some cases, as noted in this report, the taxpayer who does bear the burden of the tax charged to them. It is therefore reasonable to think that additional taxes charged to banks might result in those banks making contribution to the governments that have suffered the cost of repairing the banking system. This is assumed in this report unless noted otherwise.

⁷ See <http://www.ft.com/cms/s/0/e29f1eac-fa46-11de-beed-00144feab49a.html> accessed 6-1-10

2 Why change bank taxation now?

It is appropriate to consider whether this is the right time to change bank taxation.

Considerable funds have, in a variety of forms been injected into some banks in particular and into the world's banking system in general with the express aim of shoring up banks' balance sheets so that they are sufficiently robust to be both safe places for depositors and to have sufficient funds to sustain any further reasonable and foreseeable losses that they might suffer in the course of their trading. This process is considered by some to be incomplete and is a potential reason why bank lending has still not returned to the levels governments and others have expected⁸. It could be argued that to raise taxes now might curtail that recovery in bank's balance sheets. This argument does, however, ignore the lead time required for the introduction of almost any serious change in taxation systems. By the time the recommendations made in this report could have effect banks should be in a position to sustain the likely suggested charges to be imposed upon them.

The reasons for additional taxation charges for banks are suggested to be as follows, each of these situations having become publicly apparent since the onset of the current economic crisis in 2007:

- 2.1 The role of banks in creating the current financial crisis is clear;
- 2.2 The inability of banks to guarantee deposits placed with them has become obvious;
- 2.3 The implicit guarantee provided to banks by the jurisdictions in which they operate has been revealed. The resulting capacity for moral hazard has become apparent;
- 2.4 The failure to create credit for those who need it has become explicit and central banks and the governments that back them have had to make facilities available as a consequence from which banks have then profited;
- 2.5 The 'socially useless' nature of some bank activity has been revealed, and the need to curtail it has become clear⁹, as has the over-dependence of some states on revenues apparently derived from this activity;
- 2.6 The ability to generate excess profits which are then paid to employees and not shareholders has become obvious and has, so far, not been curtailed;
- 2.7 The need to finance the recovery is critical;
- 2.8 The threats made by banks to move their income, markets and profits either outside taxation or to areas where tax and regulation is light has become significant and has to be taken seriously¹⁰.

These reasons in combination suggest that this is a timely moment to review both the taxes paid by banks and their role as agents for those who may have tax liability on the transactions banks manage on their behalf.

⁸ See, for example, <http://www.ft.com/cms/s/0/b6073392-f53d-11de-90ab-00144feab49a.html> accessed 6-1-10

⁹ See, for example <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/6096546/City-is-too-big-and-socially-useless-says-Lord-Turner.html> accessed 6-1-10

¹⁰ See for example <http://uk.reuters.com/article/idUKTRE6021LV20100104> accessed 6-1-10

In saying so there are, however, further important issues to consider. The first is the split between short and long term goals.

In the short term one task is simply raising money: there are deficits to be funded. It is important to note that banks do not have to meet that deficit single-handed, and nor is tax payment the only way they can assist in meeting it. Their continued capacity to buy government bonds is an important component in financing such deficits, for example. There is, however, no doubt that some immediate tax reforms that might raise revenue from banks at a time when much of the banking sector appears, extraordinarily, to be the one part of the economy to have shrugged of the recession by the end of 2009 when it did so much to create it.

In the longer term the issue is much broader. There is a widespread perception that tax systems are only of use in raising revenues for government. This is reflected in the Compact Oxford English Dictionary definition of tax, which is¹¹:

a compulsory contribution to state revenue, levied by the government on personal income and business profits or added to the cost of some goods, services, and transactions

This is not a view this report shares. It has been suggested that taxation has five purposes:

- 1) Raising revenue;
- 2) Repricing goods and services in pursuit of social objectives (tobacco, alcohol, carbon emissions etc.);
- 3) Redistributing income and wealth;
- 4) Raising representation within the democratic process because tax is the consideration in the social contract between those governed and the government; and facilitating;
- 5) Rebalancing of the economy through fiscal policy.

These can be summarised as the '5 Rs' of tax: (1) revenue, (2) redistribution, (3) repricing, (4) political representation and (5) economic rebalancing. This report considers the impact of the tax proposals it makes in the first instance in the light of these criteria.

Secondly, this report thinks that Adam Smith's view of the qualities of a good tax system (that it be equitable, certain, convenient and efficient) was appropriate in 1776 but that these qualities are insufficient now. This report suggests that a good tax system be:

- 1) Comprehensive – in other words, it is broad based;
- 2) Complete – with as few loopholes as possible;
- 3) Comprehensible - it is as certain as is reasonably possible;
- 4) Compassionate – it takes into account the capacity to pay;
- 5) Compact – it is written as straightforwardly as possible;
- 6) Compliant with human rights;
- 7) Compensatory – it is perceived as fair and redistributes income and wealth as necessary to achieve this aim;
- 8) Competitive – it does not prevent an activity the community would otherwise encourage;
- 9) Complementary to social objectives;
- 10) Computable - the liability can be calculated with reasonable accuracy;

All of which facilitate the chance that it will be:

- 11) Competently managed.

These are the additional criteria we use for assessing the proposals made in this report.

¹¹ http://www.askoxford.com/concise_oed/taxxx?view=uk

The longer-term systemic changes required to the taxation of banks require complex issues to be considered. For example, when considering revenue issues (objective 1) the potential to raise immediate funds has an obvious flip-side which is whether the proposed measures reduces the likelihood of future crises in terms of both their scale and frequency. Both are important, and short term expediency must not compromise the long term goal.

Repricing, as referred to in objective 2, is also an issue. The relatively favourable tax (and regulatory) treatment of the banking and finance sector, pre-crisis, led to rapid increases in its absolute and relative scale in many jurisdictions. From Iceland to the UK, for example, the outcome of such policy can be traced in the increased share of financial services in GDP during the last thirty years. Only the crisis has revealed to all the dangers of what was perceived by many, including politicians, as a one-way bet. By repricing the services the financial sector provides taxation can redistribute the likely future excess returns to militate against such economic distortions. Perhaps this is most important that when considering the social costs of shadow banking activities.

This broader reflection is also required by objective 3 on redistribution where any proposals have, by definition to be redistributive since additional tax is required to be paid by banks to the government. This does, however, as has been noted above (section 1.4) require consideration of tax incidence. That though will not be enough: it is also important that the incidence of the charges banks make in generating their profits be considered. If those charges have regressive impact on society as a result of a higher proportion of charges falling on those with lowest overall income, then it is clear that any tax charge must seek to correct for this factor as well as ensure an effective increase in tax collection from bank.

There is also no doubt that there is a relationship between the banking sector and political representation. A recent IMF paper finds that the most aggressive US lobbyists were also those most exposed to the sub-prime lending market. This raises at least a question over whether targeted taxation of financial lobbying might be of value socially and to the sector itself.

Finally, the whole issue of raising taxation on banks at this time, and in a sustained counter-cyclical fashion, does of course fit firmly within the context of objective 5, noted above.

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3 Existing taxes on banks

3.1 Overview

Before recommending change to bank taxation it is important to note how they are taxed now, what the strengths and weaknesses of the various taxes being considered might be and how they provide a platform for change.

This section of the report seeks to do that. The review has a UK-centric approach reflecting the origins of this report. The review is therefore, inevitably, an overview.

3.2 Corporation taxes

The most popular perception of a tax charge on a company is that levied on its profits. The charge may have a number of descriptions depending upon the jurisdiction that levies it. There are no such charges in some jurisdictions, most of them commonly described as tax havens.

A tax charge of this nature is conceptually easy: the profits of the entity are subject to tax at an agreed percentage and the resulting charge is paid in settlement of the liability in that simple perception. The reality of the tax is considerably more complex.

3.2.1 Problems with corporation tax

The problems this tax poses include those noted in the following paragraphs.

3.2.1.1 Defining income

Defining the income of a corporation is immensely difficult. The difficulties faced by the world's accounting standard's authorities on both agreeing their own standards, and agreeing a common basis for reporting between them is clear evidence of that. The application of the resulting standards is also immensely troublesome¹². Despite this, and almost without exception, the accounting profits of corporations represent the starting point for assessing their taxation liabilities.

However, it must be stressed that the profit in question is not that about which the corporation itself shows greatest concern, which in the case of a multinational corporation is the consolidated profit declared in its consolidated annual report sent to its members and filed with its relevant regulating stock exchange. That profit, by which the progress of management is assessed, is not taxed. That is because that profit is for an entity that does not legally exist and is based on a select sample of the transactions of the corporations that go to make up the group of companies that publishes that result.

By definition, a group of companies is made up of multiple entities. Each legally exists. Each is, under the laws of most jurisdictions, the entity liable for assessment to a tax charge on profits if it is resident in the jurisdiction in question. But the group as a whole is an accounting construct, based on varying definitions of control of one group member over another which allows the parent company, under those same accounting constructs, to add up the transactions of all the subsidiary companies within that group as if they were its own

¹² See, for example, <http://www.ft.com/cms/s/0/54f91af2-fafb-11de-94d8-00144feab49a.html> accessed 7-1-10.

even though as a matter of fact they are not: legally they belong to the subsidiaries. To further complicate this construct, all intra-group trades between the related entities that make up the group are eliminated from the group accounts so that double counting of transactions does supposedly not take place. That is a laudable goal except that the resulting financial statements do not as a result represent a single cent of the 60% of world trade that is, according to the OECD¹³, that takes place on an intra-group basis. The complexity of defining the income of a corporation is now obvious.

Determining accounting profit using different accounting standards of different jurisdictions is the first problem in taxing corporate profits. This is made more difficult because few jurisdictions (some in south east Asia being obvious exceptions) charge corporations to tax on the profits they declare in their accounts. Almost all adjust that profit for corporation tax purposes. Common adjustments are:

- a. To treat capital gains as a category distinct from income derived from trading;
- b. To disallow the depreciation charges included in accounts as a measure of the wearing out of fixed assets in use and to instead offer capital allowances, usually at higher rates, in their place;
- c. To disallow provisions for costs such as losses on inventory, payables and long term contracts and to only allow such losses when they actually crystallise;
- d. To disallow expenses considered undesirable and conferring non-business benefit e.g. entertaining costs;
- e. To offer additional allowances for expenditure considered of social benefit e.g. research and development activity.

Once such adjustment is made the correlation between accounting and taxable profit becomes more remote. The consequence is that checking that the entire tax base within any corporation has been captured for tax purposes becomes harder to prove. This is an issue that this report addresses by suggesting accounting reforms.

3.2.1.2 Locating where the income is

This problem is compounded by the fact that multinational corporations, by definition, operate in more than one jurisdiction. Each jurisdiction does, of course, have the right to set its own accounting and tax rules. They also set their own rules for the disclosure of accounting information. However, due to the process of tax competition, which has been actively encouraged by bankers, lawyers and accountants, in many cases working from tax havens, there has been competition to not just reduce tax rates (although this has been prevalent) but to also increase tax allowances and to reduce the degree of accounting disclosure required of companies in the jurisdictions in which they operate. The result has been that it has become increasingly difficult to accurately locate the place in which the profit of a multinational corporation such as a bank is located.

A survey by the UK's TUC of the subsidiaries of the four largest banks in the UK in 2008 highlighted this issue. As appendix 3 shows, they had between them 5,400 subsidiaries of which over 1,200 were in recognised tax havens, the largest number being in Cayman. The affairs of most of the companies in these groups are not known to the shareholders of the parent company in which they might invest as they are not accessible from public records. Tax authorities face similar problems in accessing data on the affairs of these companies in many cases.

The consequence is that appropriateness of the apportionment of the income of any bank between jurisdictions – including those with high and low taxes is hard to determine. This is exacerbated by the fluid

¹³

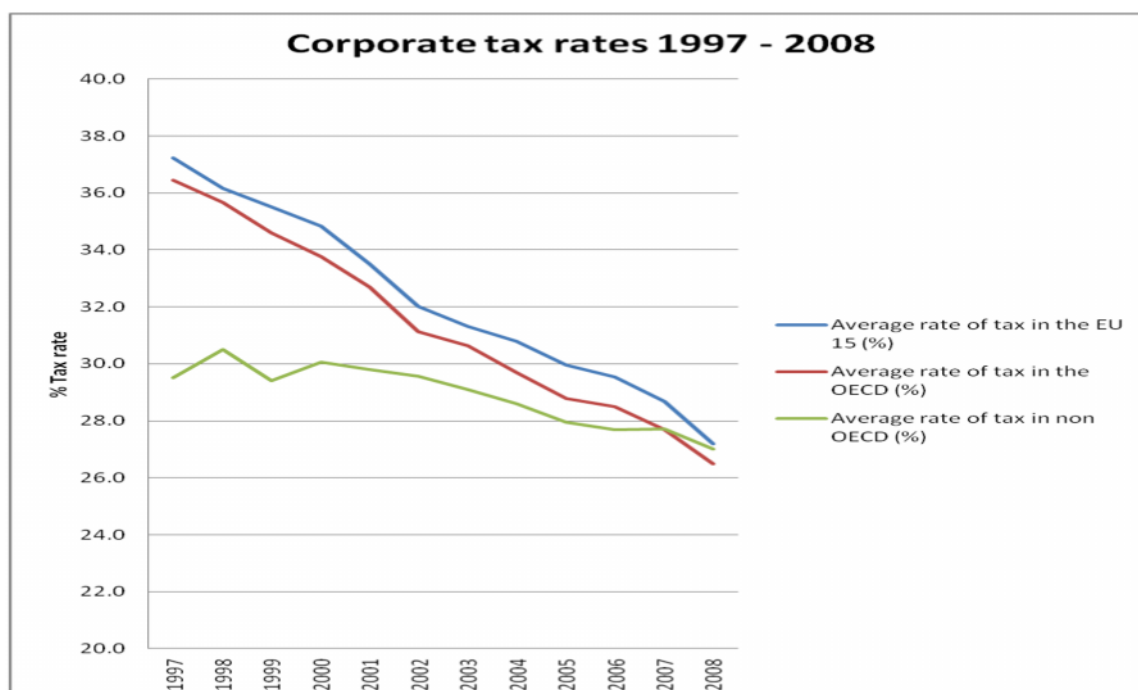
http://www.oecdobserver.org/news/fullstory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html
accessed 7-1-10

nature of financial capital, which is the core product that a bank manages, and the difficulty of applying standard profit apportionment calculations established for transfer pricing¹⁴ purposes by the OECD to the resulting profit arising from it.

3.2.1.3 Setting the tax rate

The rate of tax to be charged to a bank need not be consistent with that charged to other entities in a jurisdiction. For example, for several years the UK's Crown Dependencies have all operated what has been called a zero / ten model of taxation for corporations where all companies are subject to zero percent taxation on their profits except those in certain regulated parts of the financial services sector, including banks. The European Union accepted that this did not breach its competition and tax policy rules in 2003 (although the overall zero / ten policy is now being abandoned because of other breaches of those policies). This point is important to note: there is no requirement that there be one rate of tax on profits in a jurisdiction.

The trend in tax rates on corporate profits has been markedly downward over recent years. A survey conducted by the author of this report on behalf of the World Bank using data published by KPMG has shown this. Overall headline tax rates on corporate profits have declined as follows using that data:



¹⁴ A transfer pricing arrangement occurs whenever two or more businesses (whether corporations or not) which are owned or controlled directly or indirectly by the same people trade with each other. The term transfer pricing is used because if the entities are owned in common they might not fix prices at a market rate but might instead fix them at a rate which achieves another purpose, such as tax saving. If a transfer price can be shown to be the same as the market price then it is always acceptable for tax. What are not acceptable for tax purposes are transfer prices which increase the cost or reduce the sales value in states which charge higher tax rates and increase the sales value or reduce the costs in states with lower tax rates. The difficulty for many corporations at a time when up to 60% of world trade is within rather than between corporations is that there is no market price for many of the goods or services that they trade across national boundaries because they are never sold to third parties in the state in which they are transferred across national boundaries within the corporation. This gives rise to complex models in which attempts are made to allocate value to various stages within the supply chain within a company, a process which is open to potential abuse.

<http://www.secrecyjurisdictions.com/component/glossary/?id=211> accessed 7-1-10

This graph does not, however, show the full impact of the trends. If tax rates are weighted by the GDP of the locations imposing them rather than being arithmetically averaged as in the standard academically presented calculation as noted above then a very different picture of likely effective tax rates companies would face if their profits were allocated in accordance with the likely locations where their sale will be made emerges, as follows:



This graph shows that simply averaging the declared tax rates of countries understates the likely overall tax rate corporations might owe. This is largely because the USA and some other states with high GDP have headline tax rates that are well above the average of those offered in many much smaller states and to arithmetically average rates means that likely tax if tax was paid where sales are made is understated.

There is a further twist to the tale though: KPMG exclude tax havens / secrecy jurisdictions from their review even though they operate in all the world's major secrecy jurisdictions. If data from them is included¹⁵ and data relating to foreign source income alone in states where this is likely to be high is used rather than that which relates to domestic source income (e.g. Hong Kong and Luxembourg) then for 2008, the only year for which data is available, the following summary based on the 90 jurisdictions used for computational purposes results:

Notional simple average of corporate tax rates	20.30
Corporate tax rate weighted by GDP	32.10
Corporate tax rate weighted by population	29.90

¹⁵ A dataset downloaded from OCRA Worldwide has been used for this purpose. This data, which was extracted in November 2008, relates to the corporate tax rates of the jurisdictions in question as applied to foreign source income. <http://www.ocra.com/jurisdictions/index.asp>

The equivalent data without including the secrecy jurisdiction data from OCRA is

Notional simple average of corporate tax rates	26.77
Corporate tax rate weighted by GDP	32.10
Corporate tax rate weighted by population	29.90

The second and third calculations are the same in each case: the GDPs and populations of the secrecy jurisdictions are so insignificant they do not alter the view shown by the data. However, the arithmetically averaged tax rate now falls to 20.3%. Curiously, the author of this paper found¹⁶ that the fifty largest companies in the UK FTSE index in 2006 had an effective tax rate of 22.5%. UK headline tax rates have been cut by 2% since then.

The essential point is this: data on effective tax rates has to be reviewed carefully and reasons for its composition have to be considered with care, but it seems unlikely that the rates of tax reported by major corporations could occur without the existence of significant tax avoidance and without the rates of tax on foreign source income offered by tax havens / secrecy jurisdictions that allow for the effective diversion of profits to such locations without tax being paid on them as a result. For this reason such activities have to be tackled if banks are now to make a greater contribution to the public purse.

3.3 Indirect taxes

3.3.1 Value added taxes and sales taxes

These taxes appear to have little direct impact on banks. Throughout the European Union and in many other locations that have followed its model of taxes on value added (the USA being the only notable absentee from this club) VAT is not charged on the supply of financial services.

It is true that in some locations taxes equivalent to VAT are now charged on some finance related supplies e.g. insurance. Banking however remains throughout most of the world exempt from such taxes.

This does not, of course, mean that they do not pay such taxes. In an EU style VAT system the tax is charged on the end consumer. If the end consumer is an entity making exempt supplies for the purposes of VAT then it is treated as an end consumer, absorbs the VAT charged to it and, presumably, reflects that in its charging structure to end consumers. As such banks do act as conduits for transmitting a VAT charge to end consumers, but the distribution of that charge is distorted because some who would be charged with VAT if a bank were allowed to charge VAT on its supply would themselves pass that charge on, e.g. many commercial customers of banks. This is not the case in the model that is in use.

Complex models of VAT regulation are required to prevent banks abusing the rules on non-recovery of VAT charged to them because many proved adept at seeking to circumvent this charge.

Because of the nature of banks, where most of their input costs (labour and interest paid) do not carry VAT charges the effective rate of VAT charge they suffer, and so pass on to their customers is low, and likely to be

¹⁶ <http://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf> accessed 21-1-10

much lower than that for most consumer products unless specifically exempted for social purposes e.g. some food, domestic rents, housing costs, education and health.

Obvious questions arise as a result of this policy, the most important being why financial services products do as a result of this policy enjoy a relative subsidy from the state because they can either be charged at lower unit cost to consumers relative to their cost of production than other products and whether the benefit of this is actually passed on to the consumer or whether it is captured in increased profit within the bank.

Consideration of the application of sales and value added taxes to banking fees, and what the impact of their imposition might be, is therefore a factor to be considered in any review of bank taxation. The capacity to increase a tax charge whilst capping overall fees through regulation is a powerful combination of tools that pass the incidence of such a tax charge to banks and not consumers, so enforcing an increased tax contribution from banks to the cost of economic recovery. However, due to the complexity of the issue it is not considered further in this report because the yield is considered likely to be low, and that is the primary requirement of the process currently under consideration.

3.3.2 Stamp duties and transactions taxes

The best known transaction tax in the world at present is that charged in the United Kingdom on share dealing where a tax of 0.5% of the value of transactions undertaken is levied on all deals where title to shares / equities occurs (as opposed to derivative products where the equities themselves are not traded and contracts for difference where the underlying shares are not traded).

Despite what many unfamiliar with this tax might expect it does not appear to have any material impact on trading on the London Stock Exchange (LSE). On that exchange as a whole a comparison of 2009 and 2008 shows the following:

	2009	2008
	Value Traded £m	Value Traded £m
Equity (order book)	1,168,917.2	2,082,695.5
Equities (Non order book)	1,172,939.1	1,420,773.6
Debt Securities (incl Gilts)	8,838,933.7	7,222,645.2
Total Trading	11,180,790.0	10,726,114.3

Note: "Non Order Book" trading includes all business reported to the Exchange for which there is not a trade report automatically generated by TradElect. It includes over the counter trades reported.

The final totals for 2007 were¹⁷:

	2007 Value Traded £m
Equities (Order book)	2,157,846.1
Equities (Non order book)	1,983,975.5

¹⁷ <http://www.londonstockexchange.com/statistics/historic/secondary-markets/dec-2008.xls>

Debt Securities (incl Gilts)	3,561,880.3
Total Trading	<u>7,703,701.9</u>

The substantial fall in the value of equity trading is obvious. The increase in debt trading is even more marked. This has, in no small part, been the consequence of the Bank of England's programme of quantitative easing as a result of which more than £175 billion gilts have been acquired by the bank whilst new gilt issues have risen to fund government deficits.

Gilts are not at present subject to stamp duty in the UK.

As is noted later in this report, the volume of share trading in London exceeds the market's worth by a considerable margin in each year. There appears little doubt that trading is not being prevented by tax charged in that case, albeit the size of the non-order book market suggests that derivate deals are high and rising as a proportion. That noted, the capacity to tax clearly exists and this issue is therefore discussed further later in this report.

Transaction taxes on share dealing are also found in Ireland, where the rate is 1% whilst charges are 0.5 percent in Korea, and tax rates of between 0.15 and 0.3 percent are applied in Australia, Switzerland, Greece, Hong Kong, India and Taiwan¹⁸.

3.3.3 Property taxes

All banks do have at least some limited physical presence somewhere: many have considerable property interests.

There are numerous bases on which property can be taxed but none are likely to contribute significantly or consistently to economic recovery at this stage and as such are not discussed further in this report.

3.3.4 Insurance taxes

As noted above with regard to sales taxes and value added taxes, insurance taxes are now being used as an alternative to value added taxes when these do not apply to insurance products. Banks are significant sellers of insurance based products. The application of taxes on insurance will however be considered under the general heading of sales and value added taxes in this report.

3.4 Employee taxes

All banks, bar some in tax havens, employ staff. In the vast majority of the world's jurisdictions the income of staff is taxed. In many of those cases the bank will act as agent for the government of the jurisdiction in which the staff work to deduct tax, social security and other charges from the pay due to their staff and to pay it on their behalf to the government of the jurisdiction in question.

In this process banks are not neutral paying agents. There is persistent evidence that banks will change the way in which they pay staff in order to minimise their own tax liabilities arising from payroll and social security taxes. In addition, they do within reason change payment arrangements to reduce staff taxation liabilities. Most economists and commentators did, however, presume that this was only to minimise the cost to the bank of employing staff by providing net reward at lowest cost in accordance with modern economic theory that suggests shareholder value as reflected in return to investors is the paramount concern of bank management.

¹⁸ http://www.bruegel.org/uploads/tx_btbbreugel/external_FTParliament_110110.pdf accessed 21-1-10

Recent evidence suggests that this assumption is incorrect. The UK created a tax on banker's bonuses in December 2009, which was set to expire in April 2010. The purpose was specifically to discourage payment of bonuses in the traditional 'bonus season' due for settlement in January 2010. Yield was expected to be relatively modest as it was assumed that the fifty per cent tax rate – equivalent in effect to a super-normal payroll tax, would deter payment. This has not proved to be true. As the Financial Times noted on 8 January 2010¹⁹:

City bankers will suffer little or no impact from the bonus supertax imposed by the government last month, according to a Financial Times poll of leading investment banks.

Most banks, polled in an anonymised survey, said they would absorb all or part of the cost of the one-off 50 per cent tax by inflating their bonus pools, even at the risk of irritating the government and their own shareholders.

It would seem that banks will now pass the incidence of taxation to their shareholders and not to their employees, and that bonus payments – reported to be planned to reach \$65 billion (£40 bn) amongst the biggest investment banks²⁰ – will be almost unaffected by this tax or any other attempt to restrain payment.

It is important to note that if true this sum represents almost one third of the profits of the banks noted in appendix 2. As noted above these banks might represent forty per cent of global banking profits. The bonuses noted do not relate to all banks, only the major investment banks. Allowing for margins in estimation it is not unreasonable to suppose that the bonuses paid might represent 15% of total world banking profits and all those who will receive them have already received what many would consider to be high salaries.

Comment later in this paper on the taxation of bank employees will take the combined factor of the absolute high levels of pay, the high level of pay in relation to profit and the preference for rewarding staff over shareholders into account when suggesting a basis for tax reform in this area.

¹⁹ <http://www.ft.com/cms/s/0/caffc078-fc97-11de-bc51-00144feab49a.html> accessed 11-1-10

²⁰ <http://www.guardian.co.uk/business/2010/jan/08/bonus-time-city-banks> accessed 11-1-10

4 A new tax system for banks

This section is split into two parts. The first deals with short term issues requiring specific decisions targeted wholly at banks and which offer the prospect of immediate revenue raising opportunities from the imposition of financial transaction taxes in differing forms. It is stressed that many of these issues are of concern to the organisations submitting this report because they have customarily been associated with a degree of hypothecation where a part, at least, of the anticipated revenues to be raised have been allocated to support aid budgets established for the benefit of developing countries.

The second section deals with other systemic changes to the taxation system for banks which are likely to have longer term implications. The organisations submitting this report have concern about these issues because they are likely to promote long time development goals by:

- 1) Tackling illicit financial flows through the banking system, often through tax havens / secrecy jurisdictions²¹, many of which originate in developing countries;
- 2) Reducing risk of corrupt funds flowing through the banking system;
- 3) Increasing the tax compliance of banks meaning that more tax is likely to be paid in developing countries, to the advantage of their budgets and reducing their long term dependence on aid. For this purpose tax compliance is defined as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes;
- 4) Reducing inequalities in and between societies and this has been shown to produce social gains within and between communities relating to many of the goals those organisations submitting this report promote e.g. enhanced healthcare, education and environmental outcomes for populations as a whole;
- 5) Reducing the risk of tax evasion which enhances the prospect that developing countries will collect the taxes owed to them.

All these advantages are additional to the objective of securing additional support for the recovery in developed countries economies by raising additional tax revenues from banks.

Short term Goals – Financial Transaction taxes

4.1 Types of financial transaction tax

This report promotes the use of financial transaction taxes (FTTs). It is important to note that this is a generic term covering a number of potential taxes all of which would be charged on trades in differing financial products or commodities.

The main taxes that might be charged are:

4.1.1 Currency Transaction Taxes (CTT)

As Rodney Schmidt has noted²², the CTT is a tax on individual foreign exchange transactions, assessed on dealers in the foreign exchange market and collected by financial clearing or settlement systems. The CTT is

²¹ Secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. That regulation is designed to undermine the legislation or regulation of another jurisdiction. To facilitate its use secrecy jurisdictions also create a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so.

the conceptual successor to the Tobin Tax (TT). The taxes work in the same way but the TT was intended to slow the flow of capital across borders and so enhance monetary policy and prevent or manage exchange rate crises. As a result a TT rate would be sufficiently high to induce a change in behaviour. A CTT on the other hand is intended to raise money without disrupting the market. The CTT rate would be low as a consequence. The so-called Spahn derivative allows for a flexible tax which provides the facility for a low rate that can be rapidly raised to protect a currency during periods of high volatility.²³

There are at present no CTTs in operation in the world.

4.1.2 Stamp duties

Stamp duties (which can pass by a variety of other names as well) are levied on documented contracts (albeit modern forms of the tax no longer require these contracts to be physical and a physical attachment of a stamp is no longer evidence of payment). The most common and relevant form of the charge considered here is levied on spot share trading and in some instances (but not in the case of the UK, which has the best known example of such a tax) on derivatives as well.

Such charges are largely found in British Commonwealth countries or those states that have derived their law from those of the UK, including Australia, Hong Kong, Singapore, Ireland, South Africa and India²⁴. However the tax can also be found in South Korea, Greece, Taiwan and Switzerland. Other states that have had them until relatively recently include Japan (1999), Italy (1998), Sweden and Germany (1991) and the Netherlands (1990)²⁵.

Rates are much higher than for CTTs or a TT, Ireland appearing to have the highest rate at 1%, that in the UK being 0.5% and those elsewhere tending to be between 0.15% and 0.3%.

Despite this Belgian think tank Bruegel, writing for the European Commission, has suggested revenues are significant as the following table shows (Bruegel 2010)²⁶:

²² The Currency Transaction Tax: Rate and Revenue Estimates. A report written by Professor Rodney Schmidt of the North-South Institute, Canada, and published by the United Nations University, 2008 available at <http://www.stampoutpoverty.org/download.php?id=400>

²³ <http://www.docstoc.com/docs/2375003/Comment-on-Paul-B-Spahn%E2%80%90Study-%E2%80%90On-the-feasibility-of-a-Currency>

²⁴ Some data extracted from http://en.wikipedia.org/wiki/Stamp_duty accessed 21-1-10 and the rest from http://www.bruegel.org/uploads/tx_btbbreugel/external_FTTParliament_110110.pdf accessed 21-1-10

²⁵ Report of the UK All Party Parliamentary Group for Debt, Aid and Trade into the requirement for additional development financing to fund the Millennium Development Goals <http://www.stampoutpoverty.org/download.php?id=371> accessed 21-1-10

²⁶ http://www.bruegel.org/uploads/tx_btbbreugel/external_FTTParliament_110110.pdf accessed 21-1-10

Table 1: Revenues from financial transaction taxes in four countries (2001-2008)

	UK		Ireland		Taiwan		South Africa	
	in GBP bn	% of total tax revenues	in EUR bn	% of total tax revenues	in USD bn	% of total tax revenues	in USD bn	% of total tax revenues
2001	2.9	0.9	0.35	1.2	1.9	5.2	0.4	1.6
2002	2.6	0.8	0.30	1.0	2.3	6.5	0.4	1.6
2003	2.6	0.7	0.26	0.8	2.2	5.9	0.6	1.6
2004	2.7	0.7	0.26	0.7	2.8	6.7	1.0	2.1
2005	3.5	0.9	0.32	0.8	2.3	4.8	1.3	2.4
2006	3.8	0.9	0.41	0.9	2.9	5.9	1.5	2.5
2007	4.2	0.9	0.61	1.3	4.1	7.8	1.4	1.9
2008	3.2	0.7	0.42	1.0	3.0	5.5	1.4	1.9

Sources: HM Revenue & Customs, Revenue Irish Tax & Customs, Ministry of Finance (ROC), South Africa Revenue Services, IFS.

Note. UK data refer to fiscal year.

Some, rare states, such as Taiwan also apply the tax to trading in debt instruments²⁷.

4.1.3 Bank debit taxes

These taxes have operated in a number of South American states although the one best known, in Brazil, was withdrawn in 2007. The tax works by charging a flat rate of tax on all debits charged to a bank account in a period. As a result virtually all payments (inter-account transfers being one major exception in most cases) are subject to a tax charge which is applied to the account by the bank as agent for the government of the jurisdiction at the end of agreed charging periods.

A summary of the rates used prepared by the Philippines government²⁸ when considering such a tax in 2006 was as follows:

²⁷ Bruegel 2010, above

²⁸ <http://www.congress.gov.ph/download/cpbdbdebttax.pdf>

Bank Debit Taxes in Latin America

Country	Year	Tax Rate	Gross Revenue	
			In % of GDP	In % of Tax Revenue
Argentina	1989	0.70	0.66	4.30
	1990	0.30	0.30	2.00
	1991	1.05 ^a	0.91	5.40
	1992	0.60 ^a	0.29	1.50
	2001	0.50	1.45	7.40
	2002	0.60	-	9.60
Brazil	1994	0.25	1.06	3.60
	1997	0.20	0.90	2.80
	1998	0.20	0.90	3.00
	1999	0.22 ^a	0.83	2.90
	2000	0.34 ^a	1.33	4.80
	2001	0.36 ^a	1.45	4.20
Colombia	2002	0.30	-	6.10
	1999	0.20	0.73	5.50
	2000	0.20	0.60	5.30
	2001	0.30	0.80	5.70
Ecuador	2002	-	-	5.30
	1999	1.00	3.50	26.70
	2000	0.80	2.33	17.10
Peru	1990	1.41 ^a	0.59	6.40
	1991	.81 ^a	0.46	5.00
Venezuela	1994	0.75	1.30	7.70
	1999	0.50	0.90	7.90
	2000	0.50	0.40	3.70
	2002	0.75	-	12.70

The World Bank has organised a number of studies into the effectiveness of these taxes. The conclusions of one said²⁹:

FINDINGS

- Especially at higher rates, these taxes have coincided with significant financial disintermediation.
- For each dollar raised through a bank debit tax, up to 28 cents in Venezuela, up to 41 cents in Colombia, and up to 47 cents in Ecuador, was lost to disintermediation.
- No significant disintermediation [has been noted] in Brazil.

CONCLUSIONS

- At low rates and for a limited time, bank debit taxes can be used as a quick and effective way to generate revenue.
- At higher rates and/or over an extended period of time, the taxes lead to significant welfare losses and financial disintermediation.

These taxes are avoidable in a number of ways. Firstly cash can be used; secondly barter is possible; thirdly the transaction can be settled outside the country. These responses, and others, are collectively called disintermediation.

²⁹ <http://info.worldbank.org/etools/docs/library/155725/globaldialogues/dl17/pdf/kirilenko.pdf>

It is interesting to note that Brazil, which has the most financially developed economy of those who have used such taxes, suffered little loss to disintermediation from the tax. All the other Latin American states that used these taxes did so in response to an economic crisis. The resulting losses may not therefore be solely due to the tax. Brazil did not use it for this purpose.

It is, however, important to note that these taxes clearly have incidence upon the users of bank accounts and only have secondary consequences for the banks themselves, whose liability to pay tax may, because of disintermediation, be reduced as a result of such a charge. For that reason such taxes, whilst important for other reasons are not considered further here. The rest of this section of this report considers currency transaction taxes and stamp duties as the basis for revenue raising as a consequence.

4.2 *Currency transaction taxes*

Currency transaction taxes operate on a very narrow range of transactions: those that relate to currency trades. Rodney Schmidt (Schmidt 2008, hereafter)³⁰ has estimated that:

A CTT of 0.5 basis points levied only on the US dollar against all other currencies, would yield an annual revenue of US\$28.38 billion. A CTT on the euro alone would yield US\$12.29 billion; on the yen alone, US\$5.59 billion; and on pound alone, US\$4.98 billion.

A coordinated CTT of 0.5 basis points on all the major currencies would yield an annual revenue of US\$33.41 billion. This is only US\$5.03 billion more than a tax on the US dollar alone, since most foreign exchange transactions occur among the major currencies, and most involve the dollar. A coordinated CTT on all the major currencies except the dollar would yield revenue of US\$21.24 billion. A coordinated tax on just the euro and pound together would yield US\$16.52 billion.

These are recent and perhaps the most robust calculations of the yield from a pure CTT made to date since they cover all markets in a currency. As Schmidt notes, they are lower than past estimates because rates proposed are now much lower than in the past as awareness of the narrowness of dealer margins has grown and because unlike early proponents of the Tobin tax these estimates are simply aimed at raising revenue, and not altering market behaviour.

Dean Baker et al (Baker 2010, hereafter)³¹ have prepared an estimate of revenue that a CTT applied in the USA might raise, estimating this to be US\$15.7 billion if there was no reduction in trading volume as a result of a 0.01% tax, falling to US\$7.8 billion if trading volume by value halved. These estimates are less than Schmidt's, largely because the USA has, at most, 40% of the world trade in foreign exchange.

The differences also reflect the wide differences in proposed tax rates and tax bases. Historically estimates have tended to discount volumes traded to allow for evasion, although Schmidt largely dismisses the risk of this, as do other more recent authors, suggesting collection methods are now so automated this is unlikely to occur, a view with which this report concurs. All estimates guess the fall in transaction volumes due to the tax-induced increase in spreads. Schmidt offered a table of CTT revenue estimates:

³⁰ 2008, as noted previously

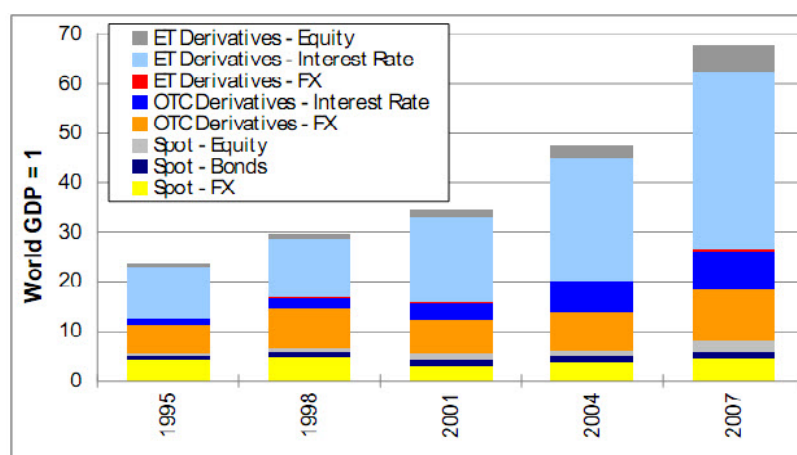
³¹ The Potential Revenue from Financial Transactions Taxes by Dean Baker, Robert Pollin, Travis McArthur, and Matt Sherman, The Center for Economic and Policy Research in Washington and the Political Economy Research Institute at the University of Massachusetts-Amherst, <http://www.cepr.net/documents/publications/ftt-revenue-2009-12.pdf>

Source	Rate a	Base b	Estimate c
Felix and Sau (1996)	25	global 1995	300
Frankel (1996)	10	global 1995	166
Nissanke (2004)	1–2	global 2001	17–31
Spratt (2006)	0.5	global 2004	24

Notes: a) Basis points, b) The year indicates which of the triennial BIS surveys of foreign exchange market activity the study uses, c) US\$ billions, annual.

This might be contrasted with a recent reported estimate for the revenue to be raised from financial transaction taxes by the Austrian Institute for Economic Research³² (AIER 2009 hereafter). According to an article in the Financial Times by Peer Steinbrück, then German Finance Minister in September 2009 this Institute estimated that a global tax at 0.05 per cent could yield up to \$690bn a year, or about 1.4 per cent of world GDP³³. The report in question does not appear to state the same figure, but the contrast with the potential revenue that is suggested might be raised by a currency transaction taxes, noted above, is stark. That is because the estimate in question is for a more broadly based financial transaction taxes (see next section) and the above, much lower sums, remain the best estimates for a CTT in isolation.

There are a number of reasons why a CTT will raise substantially less than a full range of FTTs. According to Bruegel, in their work submitted to the European Commission, the profile of financial trading is as follows:



Source: BIS, WFE, IMF.

Note. ET=exchange traded; OTC=over the counter; OTC derivatives turnover data and spot-currency turnover data are based on the BIS triennial survey conducted in April of every third year. We multiplied by 250 the April daily average value to get an estimate of annual turnover. Turnover data for commodity markets is not available.

Volumes are expressed as proportions of World GDP. It will be noted that foreign exchange related products are not the largest by volume in the financial transactions market but they are in terms of

³² A General Financial Transaction Tax: A Short Cut of the Pros, the Cons and a Proposal: WIFO Working Papers, 344/2009 http://www.wifo.ac.at/wwa/jsp/index.jsp?fid=23923&id=37001&typeid=8&display_mode=2

³³ <http://www.ft.com/cms/s/0/25afd1d4-a905-11de-b8bd-00144feabdc0.html> accessed 22-1-10






spot transactions. It is important to note that these ratios do vary widely. For example, as the AIER note in their report, the volume of financial transactions relative to GDP is by far highest in the UK where in 2007, it was 446.1 times higher than GDP. This, they note is the highest ratio in the world.

It is also important to note that markets are concentrated. According to one source³⁴ the largest foreign exchange traders are:

Top 10 currency traders % of overall volume, May 2009		
Rank	Name	Market Share
1	 Deutsche Bank	20.96%
2	 UBS AG	14.58%
3	 Barclays Capital	10.45%
4	 Royal Bank of Scotland	8.19%
5	 Citi	7.32%
6	 JPMorgan	5.43%
7	 HSBC	4.09%
8	 Goldman Sachs	3.35%
9	 Credit Suisse	3.05%
10	 BNP Paribas	2.26%










Between them these ten banks have more than 79% of the foreign exchange market.

The currencies traded are also limited. The Bank for International Settlements suggests they are as follows³⁵:

Most traded currencies			
Currency distribution of reported FX market turnover			
Rank	Currency	(Symbol)	% daily share (April 2007)
1	 United States dollar	USD (\$)	86.3%
2	 Euro	EUR (€)	37.0%
3	 Japanese yen	JPY (¥)	17.0%
4	 Pound sterling	GBP (£)	15.0%
5	 Swiss franc	CHF (Fr)	6.8%

³⁴ Euromoney FX survey [FX Poll 2009](http://www.euromoney.com/press/FX_Poll_2009) quoted at http://en.wikipedia.org/wiki/Foreign_exchange_market accessed 22-1-10

³⁵ <http://www.bis.org/publ/rpfx07t.pdf> quoted at http://en.wikipedia.org/wiki/Foreign_exchange_market accessed 22-1-10

6	 Australian dollar	AUD (\$)	6.7%
7	 Canadian dollar	CAD (\$)	4.2%
8-9	 Swedish krona	SEK (kr)	2.8%
8-9	 Hong Kong dollar	HKD (\$)	2.8%
10	 Norwegian krone	NOK (kr)	2.2%
11	 New Zealand dollar	NZD (\$)	1.9%
12	 Mexican peso	MXN (\$)	1.3%
13	 Singapore dollar	SGD (\$)	1.2%
14	 South Korean won	KRW ()	1.1%

The total is 200% to reflect the fact that all transactions have two sides to them. The heavy emphasis upon the US dollar is reflected in the estimates for potential tax collection on varying currencies noted by Schmidt, as referred to above.

Other	14.5%
Total	200%

What becomes immediately apparent is that this tax, levied solely on transactions, would relate to a limited number of currencies and collection would depend upon compliance by a relatively limited number of banks, all already highly regulated. In that case prima facie a currency transaction tax appears one of the easiest of taxes to envisage, establish and operate.

To be effective a CTT would need to have the following attributes³⁶:

- It could be implemented relatively easily and cheaply, using existing market infrastructure and networks
- It would capture the vast majority of transactions carried out in a particular currency globally
- It would be set at a sufficiently modest level as to neither distort the market nor provide incentives for financial institutions to move outside current systems in order to avoid paying.

Hillman et al³⁷ have demonstrated that this is possible. As Avinash Persaud, President, Intelligence Capital Limited and former head of currency research at JP Morgan, UBS Philips and Drew and State Street Bank and former visiting scholar at the IMF has said of their proposal, published by Stamp Out Poverty:

It was with some apprehensiveness .. that Intelligence Capital accepted the invitation to provide an objective and expert opinion on the feasibility of a unilateral currency levy. You never know where good research will take you until the end. I am now convinced that given the Basel Capital Adequacy Accord for internationally systemic banks, the Financial Action Task Force on money laundering and

³⁶ From Taking the Next Step: Implementing a Currency Transaction Development Levy, by David Hillman, Sony Kapoor and Stephen Spratt <http://www.stampoutpoverty.org/download.php?id=350> accessed 22-1-10, (Hillman et al 2006 hereafter)

³⁷ *ibid*

the new continuous linked, real-time settlements system for global foreign exchange, that a currency transaction development levy would now be relatively easy for any country to adopt, hard for any bank to evade and possible for most countries to implement unilaterally.

Persaud addresses the important points in his observation: the necessary structures to ensure that a CTT can be operated have already been created for other purposes. The tax piggy banks existing information systems and existing exchange mechanisms that are already heavily regulated. All that is then needed is a collection system. As Hillman et al note in the same report one way of doing this (and no doubt there are others) would be for:

The CTT [to] be levied unilaterally on all Foreign Exchange transactions in a particular currency wherever they take place in the world. The levy can be collected in an inexpensive and efficient way at the point of transaction settlement through either the Continuous Linked Settlement Bank (CLS Bank) or the real time gross settlement mechanisms (RTGS) that are run for all major currencies by their respective central banks. The fact that all Foreign Exchange transactions are electronic makes collection cheaper and evasion very difficult. A levy on the euro will need a consensus from all euro area members. However, countries such as the UK, Switzerland, Sweden, Norway and Denmark could implement a CTT unilaterally for little expense in cost, time and effort, if they so wished.

Technical issues would, of course, arise. They always do. The important point is that they are points of detail which could, without doubt, be overcome. One issue that will not need to be overcome is that of derivative trading that is not exchange traded (i.e. the over the counter market, largely undertaken inter-bank). These transactions are, like those in the spot and exchange registered derivative markets registered through the SWIFT trading system. As such mechanisms to collect data on them and ensure that they do not fall out of tax exist. The cost of using such mechanisms for recording transactions is also so low that so long as the tax itself is at a low rate Hillman et al show that the chance of the tax being evaded is low. Use of tax havens is also not relevant; the necessary collection data is assembled at central bank level and the location of the transactions domicile for legal and accounting purposes is not relevant for this purpose.

This then leaves the rate for a CTT to be considered. Proposed rates are expressed in basis points, where a basis point is one one-hundredth of one percent or 0.01%. As will be noted from the work of Rodney Schmidt who has summarised potential tax rates proposed over time, those suggested rates have fallen quite dramatically as thinking on this issue has developed and now tend to fall in the range of 0.01% to 0.005% (one to one half of a basis points) in recent proposals. It is important to note that this rate is relevant for currency transaction taxes: it does not imply the same rate need be used for taxes on other form of financial transaction. These rate proposals are based on evidence prepared by Rodney Schmidt that worldwide average spreads on currency transactions in 2005/05 were 2.98 points with an average variation across markets of about 1 basis point, which suggests that that capacity to pay a tax at these suggested rates might exist.

Schmidt estimates plus those of Stephen Spratt et al in 2006 are the best available, suggesting a potential yield exceeding US\$30 bn per annum at a rate of 0.005% or half a basis point. This allows for a decline in estimated trading volume at this rate of tax of 14% using calculations prepared by Rodney Schmidt and considered the best currently available.

The paucity of available data on these issues did encourage additional work to be undertaken on the capacity to pay a CTT and its possible incidence for the purpose of this report. Data from the Bank for International Settlements is probably the most reliable on the volume of foreign exchange trading. It said in 2007 that³⁸:

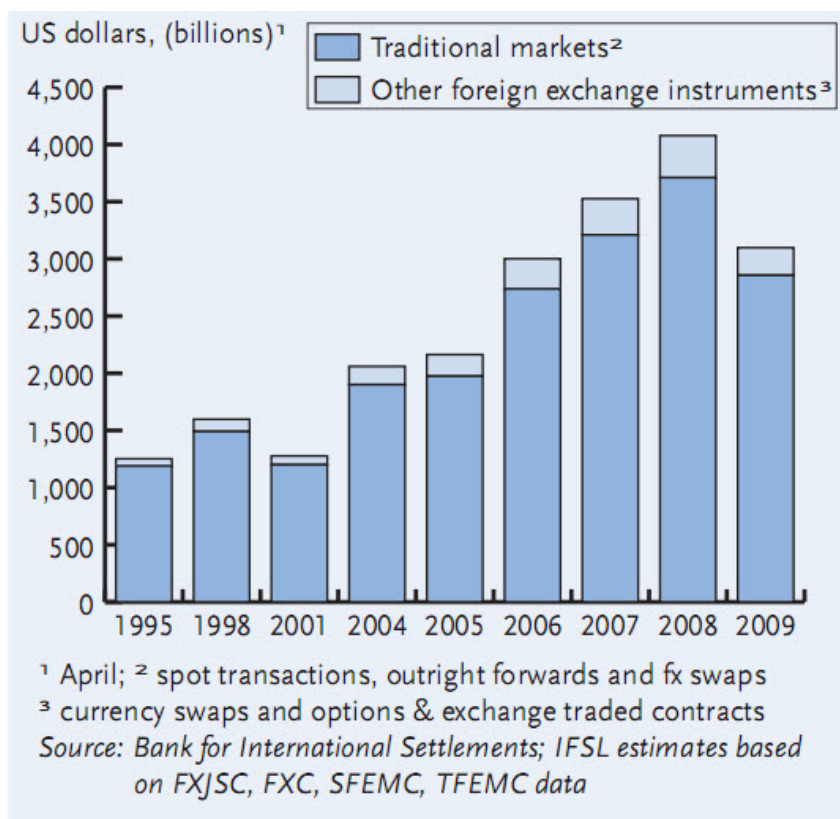
The April 2007 data on turnover in traditional foreign exchange markets highlight several important features of the evolution of these markets. First, average daily turnover has grown by an

³⁸ <http://www.bis.org/publ/rpfx07t.pdf>

unprecedented 69% since April 2004, to \$3.2 trillion. This increase was much stronger than the one observed between 2001 and 2004. Even abstracting from the valuation effects arising from exchange rate movements, average daily turnover rose by 63%.

Turnover between reporting dealers and non-financial customers .. more than doubled. Consequently, the share of turnover resulting from transactions between reporting dealers, i.e. the interbank market, fell to 43%, despite growth in this segment being slightly lower than in the previous three-year period.

Another view of the market is provided by International Financial Services London (IFSL) which is supported by the City of London and promotes UK financial services activity. Their September 2009 study on Foreign Exchange³⁹ notes daily volumes of traded foreign exchange as follows:



Of the market the vast majority is either 'spot' i.e. traded at the instant or due for settlement in less than 7 days i.e. very short term cover likely to be speculation and not relating to real underlying trade.

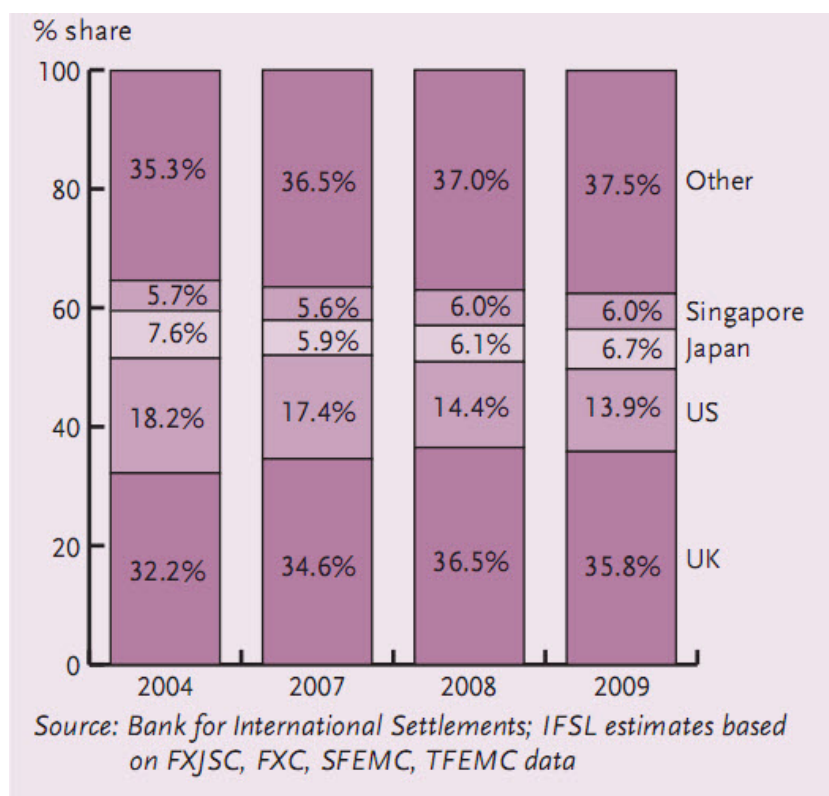
Assuming a 250 day working year this market may be worth \$800 trillion a year using 2007 data, and over \$925 trillion using 2008 data. 2009 data is, of course, incomplete. A figure of \$900 trillion is used for the purposes of this report.

The amount outstanding at any point because of the short term nature of the trade is much smaller than the market value implies: \$11,145 billion in June 2007, for example⁴⁰. Margins as Schmidt has noted, are very small by implication but IFSL does not comment upon them.

³⁹ http://www.ifsl.org.uk/upload/CBS_Foreign_Exchange%202009.pdf

⁴⁰ *ibid*

As previously noted, foreign exchange trading is distributed. This is demonstrated by the following data from IFSL⁴¹:



The UK has a massively disproportionate share of this trade in relation to the rest of the world. As such it is likely to collect a disproportionate part of any tax revenues, an issue that would need to be addressed when considering the use of those taxation revenues.

Calculating a tax rate requires two further assumptions. The first is the rate by which the market will decline given the rate of tax charged, and the second is the capacity of the market to pay a tax. Schmidt, as noted, has dealt with the first of these issues, suggesting a fall in volumes trade of 14% if a rate of one half a basis point were to be used for the purposes of this tax (0.005%). The capacity to pay is an issue little considered elsewhere and requiring a broader consideration for which original research has been undertaken for this report.

The IMF's considerations are aimed at raising additional revenues from banks. Banks are not the only institutions that might be affected by a FTT. They are, however seen as the most significant financial intermediaries to whom such a tax might, in the first instance be applied. It is therefore important to have a greater understanding of the banking sector that might be most affected by such a tax.

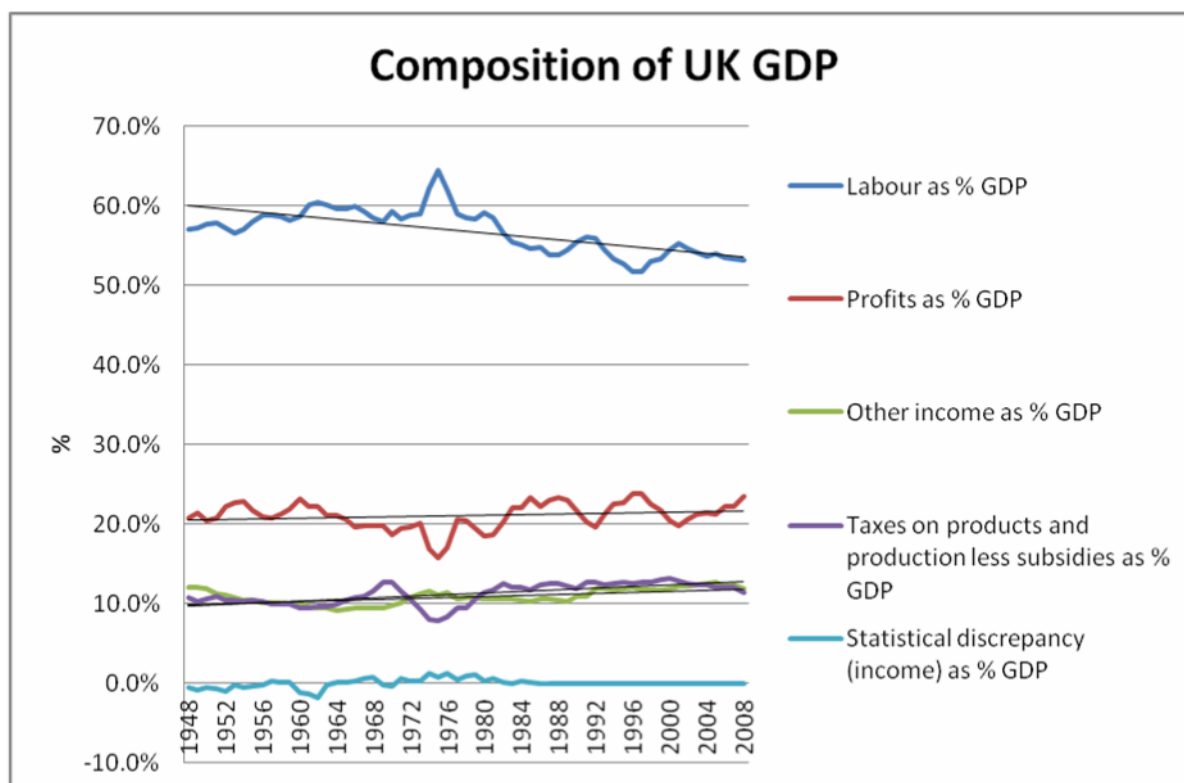
As noted in section one of this report, a list of the world's fifty biggest banks is attached as appendix 1 to this report. They have between them assets of US\$56.7 trillion and capital of \$455 billion. Appendix 2 shows that the largest 15 banks have assets of £30 trn and capital of \$160 billion. They made profits in aggregate in 2008 before tax of \$35bn. In 2007, before the credit crisis broke, their combined profits were \$205bn. As IFSL have noted pre-tax profits of the world's largest 1,000 banks grew by 22% in 2006/07 to \$786.3bn and although it may be unwise to assume banking profits will rise to previous peaks for the time being their capacity to

⁴¹ http://www.ifsl.org.uk/upload/IFM_IN_THE_UK_11_2009.pdf

recover from the initial impact of the recession has been remarkable. For this paper a future total banking profit capacity of \$600 bn per annum is assumed. At this level bank profits represent approximately 1% of world GDP⁴².

A breakdown of world GDP by originating category (e.g. labour, profits, etc) was not sourced for the preparation of this report. For this reason available data from the USA and UK GDP is being used as a proxy for the purposes of this report. The US represents 23.3% of world GDP⁴³.

UK GDP can be analysed as follows (the term 'profit' being used as shorthand for the gross operating surplus of corporations in the following graph):



Source: UK Office for National Statistics⁴⁴

Labour is at the end of 2008 53.2% of UK GDP, profits before interest and tax 23.5%, other income (rents, etc) 11.9% and taxes on production 11.25%.

In the USA the profile is different⁴⁵. At end 2008 labour reward is 55.6% of GDP, profits after interest and excluding small companies are 9.4% of GDP, small business profits are 7.6%, interest is 5.6%, taxes on production were 6.8%, rents were 1.5% and the consumption of capital goods (split between rent, profits and small business earnings, but without allocation given) amounted to 12.7%.

⁴² Data from the IMF, World bank and CIA all converging on world GDP being approximately US\$60 trillion in nominal terms, source [http://en.wikipedia.org/wiki/List_of_countries_by_GDP_\(nominal\)](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)) accessed 25-1-10

⁴³ [http://en.wikipedia.org/wiki/List_of_countries_by_GDP_\(nominal\)](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal))

⁴⁴ <http://www.statistics.gov.uk/statbase/tsdataset.asp?vlnk=574&More=Y> accessed 17-8-09

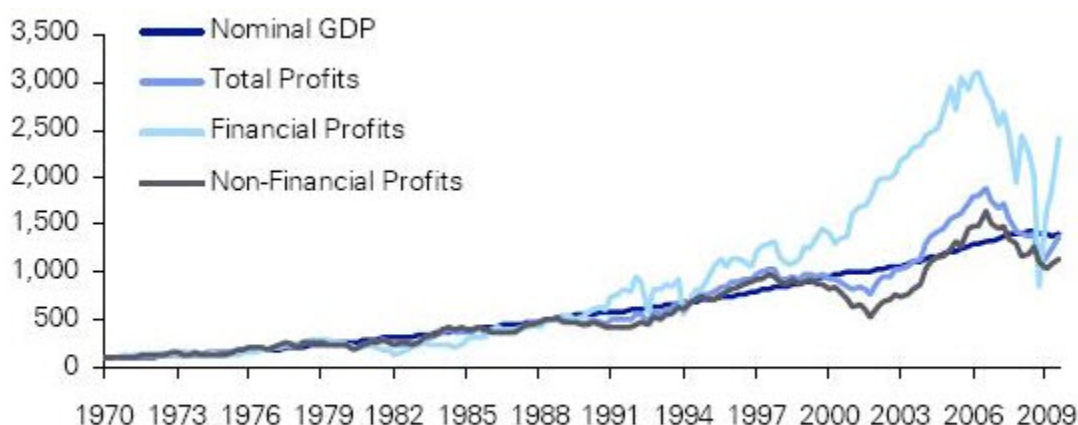
⁴⁵ http://www.bea.gov/newsreleases/national/gdp/2009/txt/gdp3q09_3rd.txt

After adding in half of US capital consumption to large company profit a total of 15.8% is noted. If the US rate of small company profit is deducted from the UK total for total company profit the rate is 15.9%. Some degree of similarity seems likely in that case.

Assuming that fixed capital is replenished and requires profit retention to finance it then it is reasonable to assume that profits available for distribution from large companies amount to about 9.5% of GDP.

65% of world GDP is made in the USA, Canada, the European Union, Japan and Australia⁴⁶, which are the locations where most profit from the trades noted in this report will also be located. The noted profit ratio is only likely to be appropriate in these places. This means likely world profits might be about US\$4 trillion.

The composition of financial profits as compared to other profits has been highlighted by Deutsche Bank in the following graph⁴⁷ of US financial and non-financial profits rebased against Nominal GDP rebased at 100 in 1970:



Source: Deutsche Bank, Bloomberg

As is clear, the 2008 aberration of bank losses has been eliminated: it is financial profits alone that have recovered, and their performance remains out of kilter with GDP growth indicating they are the only reliable source for any payment of payment of a financial transaction tax if labour is not to bear the burden.

Of the total profit estimate on the basis of assumptions made here it seems plausible, using the data noted above, that 15% arises in banks. The Bank of International Settlements in a report referred to above noted that 43% of all foreign exchange trades are purely between banks. Banks also benefit as a counter-party from any of the other trades as well. It is therefore plausible to think that more than 50% of the burden of any currency transaction taxes would fall on banks, a ratio probably distorted by the very high salary costs paid to those undertaking such trades, noted in section 4.4 of this report.

Having created this scenario the question of what rate of additional tax loss banks might reasonably expect to bear when a CTT is created, which in turn sets the benchmark for other rates, can be addressed.

As noted above, effective tax rates around the world suggests that after allowances and ring fences (available through tax havens, etc) effective corporate tax rates are likely to be between 18.5% and 20.7% in 2008.

⁴⁶ From [http://en.wikipedia.org/wiki/List_of_countries_by_GDP_\(nominal\)](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)) by extrapolation

⁴⁷ <http://ftalphaville.ft.com/blog/2010/01/25/133331/the-bank-problem-in-a-single-chart/> accessed 25-1-10

Assuming an effective tax rate of 20%, which accords with likely UK average rates at present⁴⁸, then banks are likely to already pay about \$120 billion in tax per annum on their profits. If, however, headline rates of tax weighted by world GDP were charged on their profits the work by the author of this paper, noted above, Murphy shows that the effective rate of tax might be as high as 32%, indicating that the headline rate of tax anticipates 12% more tax paid than is actually settled.

This would suggest that banks should at least be willing to settle this sum in additional tax i.e. \$72 billion.

Assuming the rest of the corporate profit sector bore at least the same amount as a charge the total targeted revenue should be not less than \$150 billion. This is 3.75% of world wide profits on the basis calculated here.

The implications is clear: there is ample capacity within the banking sector to bear the additional tax charge proposed by Schmidt at a rate of 0.005% on global foreign exchange trading yielding a little in excess of US\$30 billion per annum and allow ample opportunity for additional financial transaction taxes to be levied as well. The capacity to pay this tax from within the banking system does exist.

4.3 Other financial transaction taxes

As Baker 2010 notes, foreign exchange spot markets are by no means the only activity on which financial transaction taxes may be charged. Shares and equities, bonds, options and derivatives of many forms, futures and swaps can all also be assessed. Estimating trading volumes for each of these asset categories is the first task to be undertaken in determining the potential revenue that might be raised from taxing traders in these assets.

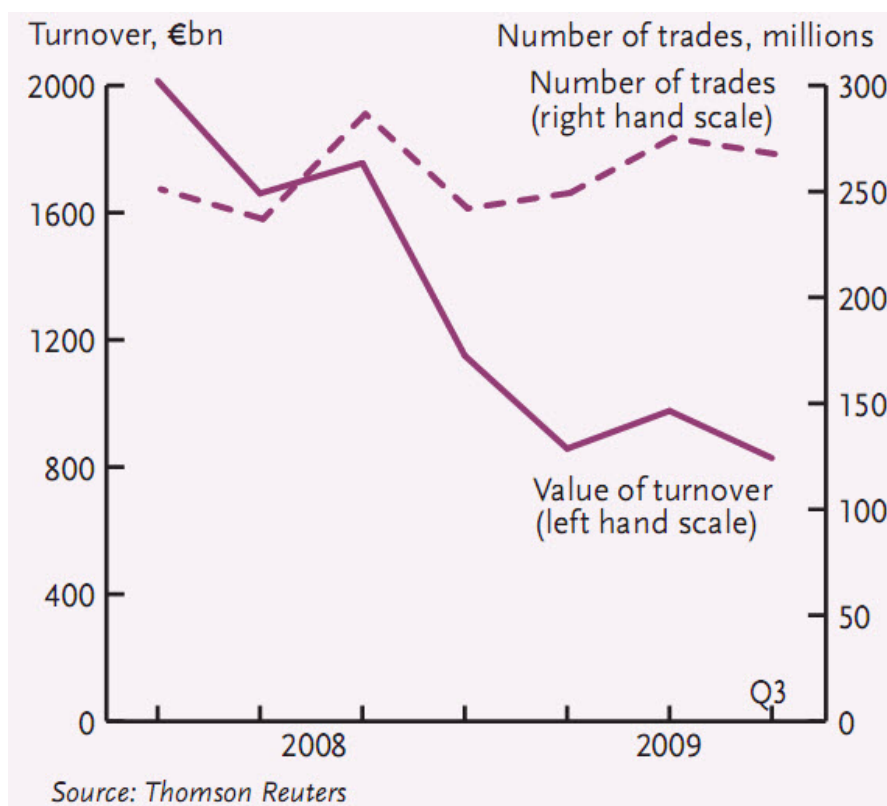
The total value of the London Stock Exchange at 31.12.08 was £1,326 billion⁴⁹. As noted in section 3.3 of this report, in 2008 the exchange trading in the equity of these companies amounted to £2,083 billion. The over the counter market is dealt with separately later in this report. Trading was, therefore, 1.57 times market value, and this in a market where a financial transaction tax already applies. In 2009 the ratios were different. The market had increased in value after a long rally to £1,731 billion⁵⁰ but trading was lower at £1,168 billion: a ratio of 0.88 times trade to value. As IFSL have noted, it is the fall in value traded despite rising prices which is significant here, as this graph of the trade in UK equities shows⁵¹:

⁴⁸ <http://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf> with trend extrapolated to allow for change and changes in UK headline rate

⁴⁹ <http://www.londonstockexchange.com/statistics/historic/main-market/mm-dec08.pdf> table 8

⁵⁰ <http://www.londonstockexchange.com/statistics/historic/main-market/fs-december-09.xls> accessed 25-1-10

⁵¹ <http://www.ifsl.org.uk/upload/City%20Indicators%20Bulletin%20November%202009.pdf> accessed 25-1-10



Of particular note is the fact that the market has not collapsed despite a fall in the value of trades undertaken by more than 50% in less than two years. For those who fear that the imposition of financial transaction taxes will destroy market liquidity and end functioning markets this is a clear indication that this is not the case.

The fall in trades has, perhaps, another more prosaic reason. As IFSL note elsewhere the returns on equities have reached a low point when measured over decades, with average yields in the decade to June 2009 being minus 1% in Japan, break even in Switzerland, minus 4% in the USA, break even in France, minus 1% in Germany, minus 4% in the UK and overall minus 2% globally⁵². IFSL say equity market returns worldwide averaged minus 42% during 2008, which no doubt influenced the volume and value of trading but as they also note over the long term, equities have historically produced higher returns than other forms of investment. It is therefore reasonable to think trading volumes will revive.

At 30 November 2009 the Dow Jones Global Total Stock Market Index had a capital value⁵³ of US\$37,916 billion. If the same ratio of trading were to be found in all 65 exchanges that make up this index as is found in London (and logically London should have a below average trading ratio as it has a transaction tax now, at 0.5%) then total share trading annually would be US\$59,528 billion a year.

IFSL suggest⁵⁴ that at 30 September 2009 the market value of world equity markets was even higher at US\$43,886. If so trading might exceed US\$68,900 billion a year.

⁵² http://www.ifsl.org.uk/upload/CBS_Equity%20Markets%202009.pdf accessed 25-1-10

⁵³

http://www.djindexes.com/mdsidx/downloads/fact_info/Dow_Jones_Global_Total_Stock_Market_Indexes_Fact_Sheet.pdf

⁵⁴ http://www.ifsl.org.uk/upload/IFM_IN_THE_UK_11_2009.pdf

The lower figure of \$60 trillion for share dealing will be used for the purposes of this report. The assumption on trading ratios in London being below average is supported by data from Bruegel, in their report, previously noted.

The trend with regard to bonds on the London market was the reverse of that for equities, largely because of interest rate volatility and a shift to the security bonds have to offer plus increased volumes of gilt issues in the year as the UK government sought to finance its debt. Total bond trading in the year was £8,838 billion. Note however that this includes exchange traded derivative products as well as direct trading. This was an increase from £7,222 billion the previous year⁵⁵. Total exchange trade derivative trading vastly outweighs bond trading and for the purposes of this report data on exchange traded derivative products is used to estimate trading volume as noted in the following paragraphs.

With regard to over the counter derivatives the Bank for International Settlements⁵⁶ (BIS hereafter) notes:

Activity in OTC derivatives markets was vibrant in April 2007. Average daily turnover in OTC foreign exchange and interest rate contracts went up by 73% relative to the previous survey in 2004, to reach \$4,198 billion in April 2007.

This data does, however appear to include foreign exchange dealing which may mean it duplicates data noted above. IFSL reports trading in derivatives as follows⁵⁷:

\$ trillion (except contracts traded)				---% change---	
	2006	2007	2008	2007	2008
OTC market					
Notional value	414.8	595.3	592.0	44	-1
Gross market value	9.8	15.8	33.9	62	114
Gross credit exposure	2.0	3.3	5.0	60	54
Exchange-traded derivatives					
Notional value	69.4	79.1	57.9	14	-27
Turnover	1807.7	2288.0	2213.3	27	-3
Contracts traded (bn)	12.0	15.6	17.8	30	14

Source: Bank for International Settlements, Futures Industry Association

Exchange traded derivatives relate to equities and bonds. The figure for 2008 is used for the purposes of this report.

With regard to over the counter trades, the risks traded in that market, rated by notional value outstanding, were as follows according to IFSL⁵⁸:

⁵⁵ <http://www.londonstockexchange.com/statistics/historic/main-market/fs-december-09.xls> accessed 25-1-10

⁵⁶ <http://www.bis.org/publ/rpfx07t.pdf> accessed 25-1-10

⁵⁷ <http://www.ifsl.org.uk/upload/Derivatives%202009.pdf>

⁵⁸ *ibid*

Notional amounts outstanding in December

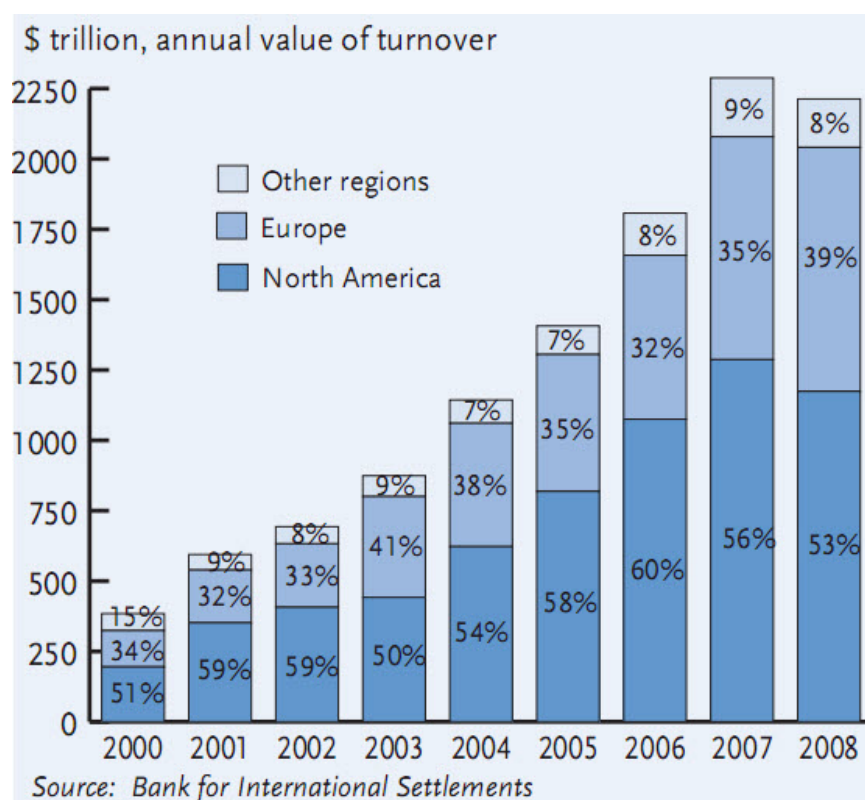
\$ trillion	2002	2004	2006	2007	2008
Interest rates	102	191	292	393	419
Foreign exchange	18	29	40	56	50
Credit default swaps	---	6	29	58	42
Equity-linked	2	4	7	8	6
Commodity	1	1	7	8	4
Unallocated	18	27	43	71	71
Total contracts	142	259	418	595	592
% share					
Interest rates	71.8	73.7	69.7	66.0	70.7
Foreign exchange	13.0	11.3	9.6	9.4	8.4
Credit default swaps	---	2.5	6.9	9.7	7.1
Equity-linked	1.6	1.7	1.8	1.4	1.1
Commodity	0.7	0.6	1.7	1.4	0.7
Unallocated	12.9	10.3	10.3	12.0	12.0
Total contracts	100.0	100.0	100.0	100.0	100.0

Source: Bank for International Settlements

The market is dominated by interest rate swaps.

IFSL note the gross value of the market has risen considerably because of increased risk within it.

IFSL report the annual value of exchange traded derivatives as follows:



What IFSL do not provide is data on turnover for the OTC market. However, based on Bank for International Settlement data noted above this may be as high as \$4,198 billion a day, or on the basis of 250 trading days a year, \$1,049 trillion a year. Eliminating the 9.5% share relating to foreign exchange and equities leaves a residual estimate of \$950 trillion a year.

Summary of estimated transaction volumes:

Based on the sources noted in this report the best available estimates of annual trading volume in these markets, worldwide, is:

	US\$ Trillions
Shares / equities traded on a market	60
Exchange traded derivatives including those relate to interest rates and gilts	2,200
Foreign exchange trading	900
Over the counter, derivative and swap trading	950
Total	4,110

This is a sum approximately 67 times world GDP.

The tax that might be collected on the foreign exchange element of this sum, allowing for reduction in market volumes is, as noted above, approximately US\$33 billion per annum at a tax rate of 0.005%, implying a reduction in trading volume of approximately 26% based on these estimates. It should be noted that assumption of such a reduction is commonplace e.g. Baker 2010 considers this in the possible range of trading outcomes.

It is commonplace to assume a tax rate of 0.5% on spot share dealing based on the UK stamp duty rate which has caused no appreciable harm to trading on the UK stock market, and which has been used as the basis for estimating trading volumes in this report. At this rate and assuming a 25% fall in traded volume, mainly in US markets where volumes are high, the yield could be US\$225 trillion per annum.

Exchange traded and over the counter derivative trading is likely to behave in a fashion similar to that for foreign exchange with margins being very much smaller than on spot share trading. The total value of these markets may be £3,150 trillion per annum. Assuming a fall of 25% and a rate of 0.005% the likely yield from a financial transaction tax might be \$118 trillion per annum.

Based on the sources noted in this report the best available estimates of annual trading volume in these markets, worldwide, is:

	US\$ billions
Shares / equities traded on a market	225
Foreign exchange trading	33
Exchange traded and over the counter derivatives including bond dealing	118
Total	376

This compares with Baker 2010 who estimate revenue, with a 25% trading reduction, of US\$265 bn per annum for the USA alone and the AIER estimate of US\$690bn.

A number of important issues should, however, be noted. Firstly, data on the share / equities market is based on 2008 data partly because better information was available at the time work was undertaken and also because trading volumes were unusually depressed in 2009 due to the plunge in stock prices and other events associated with the economic crisis. Trading volume in 2008 was also down considerably in the USA from 2007, so the year does not provide an abnormally high base year for calculation. If however trading volumes stay at 2009 levels the estimate for revenue noted here will be too high.

Secondly, of the noted revenue arising on equity trading Baker 2010 estimates \$162 billion per annum will, on consistent assumptions with those used here, arise in the USA and in total just over \$110 billion of revenue will arise outside the USA. This disproportionate revenue raising capacity within US markets is consistent with findings in analysis of other markets e.g. that of Schmidt 2008 noted in section 4.2, who suggests \$28 billion of the £33 billion capacity to tax on foreign exchange could rise on the US dollar alone.

Priorities and Incidence

Two matters follow on from these calculations. The first is the establishment of an order of priority for creating these financial transaction taxes and the second a consideration of the implications with regard to incidence. The theory of tax incidence suggests that a tax charge must end up on an individual, not a legal liability entity.

In terms of ease of introduction a currency transaction tax on foreign exchange dealing is the first of these taxes that should be introduced. There are three reasons for suggesting this to be the case. Firstly, as has been shown by the Stamp Out Poverty campaign in its technical analysis of this tax it is possible for it to be introduced one currency at a time and with little risk of either tax evasion or avoidance arising, and with very little technological change in information data systems that already exist required to create the mechanism for actually collecting the tax. This has, therefore, to make this a priority for introduction as an effective tax that has both short and long term significant revenue raising potential. The incidence of this tax is also relatively easy to predict and manage, as is noted below.

Secondly, taxes on bond dealing could follow: these are exchange traded in very high volumes (much larger than equities even ignoring derivative trades) on exchanges where data collection for tax recovery purposes will be easy to secure. Interest swap trades are akin to much bond trading, the intention of rate hedging often being similar in many cases and these constitute the next potential market to address before other derivative, swap and over the counter trades follow, all of which do, however, have the advantage of being contained within a limited market space for the calculation of incidence impact, again as noted below. It would not be necessary for all markets and all trades to be subjected to tax at the same time: an important issue when it comes to preventing market disruption from exposure to new systems.

Finally, and despite the fact that some markets already exist in which transaction taxes on equities are already levied at the rate proposed in this (and other) reports this might be the last tax to be introduced. There are three reasons. Firstly, the scale of the impact is greatest and, secondly, the incidence issues are therefore the widest. Thirdly, this measure might, because the charges relate to assets traded much more widely and outside the narrow market of banks and commercial clients, have greatest impact on investor behaviour. This is, of course, one of the planned consequences and one of the principle attractions of this tax, and for reasons noted below these may well be positive for those invested in equities but in that case the incidence may arise in a way that suggests that the change should take place at a time when labour markets might be more robust than at present. It is with this in mind that the ordering of priorities is suggested.

Having suggested an order of priority for introducing these taxes their incidence must be considered. It is clear that the levels of tax that are suggested might be paid could not be borne by banks alone. Their capacity for additional tax payments from banks has been estimated to be at least \$72 billion per annum, in calculations above. This is important: if the order of priority noted here is adopted then there is, as would be considered desirable for as long as possible the possibility that these taxes could have incidence primarily upon the banks themselves and be settled out of their cash flow with consequent tax effect only upon their corporation tax

settlements (and it is at least plausible that the financial transaction taxes paid might not be considered a charge deductible for corporation tax purposes, which we would recommend).

Taking the example of a currency transaction tax on foreign exchange first, the entire estimated sum to be collected from this tax will be, it is suggested, within the capacity of banks to pay out of their profits.

This of course need not necessarily happen and as such steps would need to be taken to ensure this is the case. However, before considering such steps it is important to note an important issue referred to hereafter in this report as the perverse paradox of financial transaction taxes. These taxes are assumed to give rise to a fall in the volume and / or of the total value of transactions undertaken in all markets affected by them. In general a fall in value of transactions of 25% has been assumed in this report, a broadly commonplace assumption in estimating the impact of these taxes which Schmidt 2008 suggests to be too cautious. That fall in value can arise because volumes are maintained but values fall, a situation found in the UK stock / equity market in 2009, but broadly speaking it is more likely that the imposition of this tax will render some transaction previously undertaken marginally economic or even loss making and as such it is likely that transaction volume will fall to generate revenue reduction.

The major cost of trading in this market, which is largely undertaken between a very limited range of banks – often, as noted on a pure inter-bank basis - or with a limited range of large commercial counterparties operating what are, in effect, their own in house banks usually called treasury departments, is labour. Those employed in this sector are relatively small in number and often very highly remunerated: the exact target of many recent policies seeking to curtail excessive pay in the banking sector. If there are smaller volumes of transactions and smaller profits made as a result both the number employed in the activity and the average pay of those remaining in it are likely to fall to compensate for two things: firstly reduced volumes and secondly the fact that out of margins on the remaining trades undertaken a tax of up to (on the basis estimated here) one third of the margin might be paid. The impact of a fall in value and volume of 25% followed by the loss of margin out of the remaining trade of up to 33% means that in combination cost reductions of up to 50% will be required in this sector.

That cost reduction is likely to have an impact on labour in the sector, but that labour comprises (in the main) the prime target of many attempts to curtail bankers' pay. It so happens that social policy with regard to raising a financial transaction tax achieves the goal that policy makers have sought on bankers' pay: one curtails the other.

It is at this point that the perverse paradox arises: in the scenario described, and assuming the rational response of banks to cut both numbers employed and payments of bonuses in a market where trading volume has fallen and margins have been cut occurs then there is no reason at all for the incidence to spread more widely. The tax imposed will, at the rates suggested, happen to match in value the saving in cost incurred by the bank. In other words, if it undertakes 25% fewer trades, with consequent cuts in staff costs, and pays smaller bonuses on the remaining trades to reflect the reduced profits earned as a consequence of the tax it can save at least as much in costs as it pays in currency transaction taxes.

A numerical example (and the numbers are, it is stressed, purely illustrative) might help. If total charges on trading amount to, say \$400 bn at present, and an FTT reduces this by 25% then so long as the tax is less than one third of the trading margin (as is believed very likely to be the case on the basis of rates proposed here) then the overall fall in revenues is \$100 billion with tax paid to offset this of no more than (and maybe somewhat less than) \$100 billion then the tax paid is likely to broadly speaking match costs saved with the same likely net return to capital arising despite the change in market volumes. As a consequence there would be no need in this case for incidence to move outside the bank – and there would also be no net loss of

corporation tax. Assuming those who lost employment were also re-employed, and given the qualifications of those involved this is likely, although there will probably be a loss of income tax revenue it will be relatively small and much less than the currency transaction tax raised. The only possible losers in this scenario would be in the trading and dealing sector, which is the policy intended outcome of many governments, already announced.

The same incidence issues might also arise with the next phases of the tax as they are introduced as suggested here: trading in gilts, bonds, swaps, derivatives and over the counter contracts will largely (but not entirely) be within the same trading circle, and given the low rates on bonds and gilts will have only limited impact on long term investors of the sort noted below with regard to equities. Therefore it is likely that the perverse paradox noted above will also apply here: most of the impact of the proposed charge will fall on bankers in the sector of that activity that has been described as 'socially useless'. There will be employment consequences arising, but with phasing of implementation into the period when it is reasonable to expect economic recovery to be in progress (as is almost inevitable as collection mechanisms for these taxes will take time to create) the rate of disruption within the labour markets will be small. The social benefits that James Tobin expected to arise from his tax should, however result: the implications of this incidence is the outcome he forecast i.e. reduced trading at lower risk with sand having put in the motion of the relentless advance of financial markets with dubious social net benefit resulting.

Matters only change significantly when the charge would be extended to creation of stamp duties on shares at the rates currently found in the UK, and then, because the UK already has such a charge with little likely consequence in the UK. As the predictions of Baker 2010 and this report suggest when combined, maybe 70% of this charge, or in excess of \$160 bn per annum, is likely to arise in the US or on US traded securities (which are, however, of course held outside the USA as well as within it). The perverse paradox may still work: the reduction in trading volume will result in significant cost savings which will be reflected in falls in employment and earnings in the sector, but in this case (and especially outside the UK) these are unlikely to be constrained to within small groups working in banks in major financial centres and a small range of major corporate entities. That is because, firstly it is clear that banks cannot absorb this level of charge and secondly they will have limited reason to do so because the ownership of equities is widely diverse, albeit through collective investment vehicles like pension and life assurance funds in the main. The employment impacts of any change could, therefore fall well outside the banking sector in this case and be more diversified as well as a result. This would need careful consideration before rates of tax could be finalised and the impact of the trade could be fully assessed. This is a major reason for suggesting that this reform is the last to be considered with regard to financial transaction taxes.

There is one final point to note: regulators need have no concern that a 25% fall in trading volume will harm the efficiency of markets: as the London Stock Exchange has shown in the last two years, trading volume can fall by more than that amount without any threat to liquidity or viability. The markets are entirely safe from negative repercussions of a financial transaction tax.

Longer term goals – systemic reform of taxation systems

4.4 Corporation taxes

Corporation tax is the most basic way in which a bank can contribute to the well being of society and the rebuilding of the economy after the collapse of banking in 2007.

As noted in section 3 of this report corporation taxes on banks exhibit a number of serious weaknesses which it is easy for banks to exploit to their own advantage. The weaknesses of particular concern that are addressed in the following sections of this report are:

1. Individual companies within groups are taxed, banking groups are not taxed as a whole.
2. Individual companies within groups can be resident in one or more jurisdictions⁵⁹.
3. Due to the mobile nature of bank capital it is relatively easy for banks to relocate the place in which they record their income between companies and jurisdictions.
4. In the process of relocating the entity and place that records the income of bank it is also relatively easy to change the time when income is recognised e.g. by using non-coterminous accounting year ends, and by arbitraging the tax laws and regulations of different states and their varying accounting standards, which can in combination lead to very different taxable consequences for different sides of an intra-group transaction.
5. These factors in combination create opacity which provides increased opportunity for tax avoidance (and nothing in this report suggests banks participate in illegal tax evasion).

It is this opportunity for tax avoidance that the recommendation this report makes with regard to corporation tax address. There are three key recommendations. They are:

1. That opacity of bank reporting for accounting and taxation purposes be reduced by the introduction of country-by-country reporting;
2. Codes of Conduct be introduced for use by banks, their advisers and the governments that with to assess them to tax; and
3. Tax avoidance be tackled using a General Anti-Avoidance Principle.

In combination these three recommendations facilitate identification of a banking group, its risk assessment for taxation purposes and tackle the potential for tax avoidance within it whilst indicating that there is clear need for a change in approach to bank taxation required of the management of banks if they are to meet society's new expectations of them in the aftermath of the current recession.

In addition we recommend two further changes to corporation taxes on banks but for different reasons. These further changes are:

1. The losses sustained by banks during the current recession should only be capable of carry forward for offset against profit for a limited period;
2. Tax on same payments by banks to their staff should not be subject to tax relief by way of offset against income earned as they represent distributions of profit.

These issues are addressed in turn in this report.

⁵⁹ Note the word jurisdiction is used deliberately: places with the right to levy a tax on corporate profits need not be states in their own right. A jurisdiction is for this purpose consider any place, whether a nation state or not, with the legal right to tax (or not tax) profits recorded by persons, natural or legal,

4.4.1 Requiring disclosure on a country-by-country reporting basis

Country by country reporting is a form of segment reporting for multinational corporations promoted by civil society organisations⁶⁰. Discussion of country-by-country reporting is well advanced and it has been or is currently subject to active discussion by, amongst others, the International Accounting Standards Board, the Organisation for Economic Cooperation and Development and the European Parliament.

Country-by-country reporting differs from existing standards on segment reporting by multinational corporation (US Standard SFAS 131 and ISAB standard IFRS 8) in that it would require disclosure of the following information, without exception and without exemption on the grounds of claimed immateriality by each Multinational Corporation (MNC) in its annual financial statements:

1. The name of each country in which it operates;
2. The names of all its companies trading in each country in which it operates;
3. What its financial performance is in every country in which it operates, without exception, including:
 - Its revenues, both third party and with other group companies;
 - Its cost of sales, split between third parties and intra-group transactions;
 - Labour costs and employee numbers;
 - Financing costs split between those paid to third parties and to other group members;
 - Its pre-tax profit;
4. The tax charge included in its accounts for the country in question split as noted in more detail below;
5. Details of the cost and net book value of its physical fixed assets located in each country;
6. Details of its gross and net assets in total for each country in which operates.

Tax information would need to be analysed by country in more depth requiring disclosure of the following for each country in which the corporation operates:

1. The tax charge for the year split between current and deferred tax;
2. The actual tax payments made to the government of the country in the period;
3. The liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;
4. Deferred taxation liabilities for the country at the start and close of each accounting period.

Revenue information will also require additional analysis. If sales too any state are more than 10% different from the figure from any state then data should be declared on both bases so that there is clear understanding of both the source and destination of the sales a multinational group makes.

This disclosure has a wide range of benefits. In the current context it will:

1. Assist identification of those entities that make up a banking group;
2. Assist identification of the income streams, costs, assets, liabilities, profits and tax liabilities of banking groups and apparent discrepancies between them;
3. Allow the relative performance of banks to be better assessed;
4. Allow the relative performance of banks in different jurisdictions to be assessed;
5. Enable investors and other providers of capital to banks to appraise:
 - a. the use that is made of that capital and their prospect of its recovery if the bank were to fail;

⁶⁰ For a more detailed explanation see <http://www.financialtaskforce.org/2009/06/17/country-by-country-reporting-holding-multinational-corporations-to-account-wherever-they-are/> accessed 21-1-10

- b. the corporate governance risk inherent in the bank's group structure;
 - c. the geo-political risk of the bank in which they have invested;
 - d. the sustainability of the tax charge of the bank by taking into consideration the proportion located in tax havens and therefore likely to be subject to challenge from other revenue authorities;
 - e. the likely proportion of profit relocated through intra-group activity.
6. Enable tax authorities to appraise whether a bank is likely to be considered tax compliant. In this context tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

These benefits would also, without doubt, assist banking regulators in their work and would therefore be of direct benefit to the International Monetary Fund, but in the context of the current issue being considered the importance of country-by-country reporting is that it supplies data to all tax authorities with which banks will engage simultaneously and consistently so that each has an opportunity to appraise whether the overall profit declared within its is likely to represent a reasonable proportion of the overall profit of the group in proportion to trading activity undertaken in that jurisdiction. As a consequence it can determine whether that declared profit is the fair starting point for determining the profits to be assessed to tax. Unless this can be done as cost effectively and as quickly as country-by-country reporting will allow banks will always seek to circumvent requirements for all and accurate geographical disclosure of their performance to the likely detriment of tax authorities in all jurisdictions bar tax havens. This measure is, therefore, an essential first step to securing additional revenues from banks.

4.4.2 Codes of Conduct

The OECD has promoted the use of Codes of Conduct to regulate the behaviour of banks. Banks were recognised as tax intermediaries who were of particular concern to tax authorities worldwide by the OECD Tax Intermediaries⁶¹ project in 2008. The UK is seeking to pioneer their use but has yet to introduce its proposed Code⁶².

Civil Society Organisations have promoted the use of Codes of Conduct for some time, and that suggested here was discussed with the OECD when it was formulating its policy on this issue. CSOs believe that there is a contract between all limited liability entities and the jurisdictions that, quite literally, grant them their licence to operate. If that relationship is to be fruitful to both parties each must benefit and in exchange for the grant of limited liability it is suggested that banks, along with other limited liability entities have a duty to be tax compliant. As previously noted, tax compliance is in this context seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

The following proposed Code of Conduct was published by the Tax Justice Network and Association for Accountancy and Business Affairs⁶³ in 2007. It seeks to codify that behaviour which would be considered tax complaint and offers incentive to banks and others to adopt that approach to their taxation affairs whilst encouraging tax advisers and jurisdictions to change their approach to taxation to facilitate this activity.

⁶¹ http://www.oecd.org/document/23/0,3343,en_2649_34897_40252183_1_1_1_1,00.html accessed 15-1-10

⁶² http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_030008 accessed 15-1-10

⁶³ http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code_short.pdf ACCESSED 15-1-10

A Code of Conduct for Taxation

Objective

This Code of Conduct relates to the payment of taxes due to a State or other appropriate authority designated by it.

Scope

This Code applies to:

- 1. Governments and their agencies in their role as tax legislators, assessors and collectors;*
- 2. Taxpayers, whether individuals, corporate bodies or otherwise;*
- 3. Tax agents, whether they are undertaking tax planning or assisting with tax compliance.*

Application

It is intended that this Code be voluntarily adopted by States and should be used to guide the conduct of taxpayers and their agents who choose to comply with it whether or not they reside in a State which has adopted the Code.

The Code

The Code is divided under six sections, each of which includes three statements of principle.

1. Government

- a. The intention of legislation is clear and a General Anti-Avoidance Principle ('Gantip') is in use;*
- b. No incentives are offered to encourage the artificial relocation of international or interstate transactions;*
- c. Full support is given to other countries and taxation authorities to assist the collection of tax due to them.*

2. Accounting

- a. Transparent recording of the structure of all taxable entities is available on public record;*
- b. The accounts of all material entities are available on public record;*
- c. Taxable transactions are recorded where their economic benefit can be best determined to arise.*

3. Planning

- a. Tax planning seeks to comply with the spirit as well as the letter of the law;*
- b. Tax planning seeks to reflect the economic substance of the transactions undertaken;*
- c. No steps are put into a transaction solely or mainly to secure a tax advantage.*

4. Reporting

- a. Tax planning will be consistently disclosed to all tax authorities affected by it;*
- b. Data on a transaction will be consistently reported to all tax authorities affected by it;*
- c. Taxation reporting will reflect the whole economic substance and not just the form of transactions.*

5. Management

- a. Taxpayers shall not suffer discrimination for reason of their race, ethnicity, nationality, national origin, gender, sexual orientation, disability, legal structure or taxation residence;*

and nor shall discrimination occur for reason of income, age, marital or family status unless social policy shall suggest it appropriate.

- b. All parties shall act in good faith at all times with regard to the management of taxation liabilities;*
- c. Taxpayers will settle all obligations due by them at the time they are due for payment.*

6. Accountability

- a. Governments shall publish budgets setting out their expenditure plans in advance of them being incurred, and they shall require parliamentary approval;*
- b. Governments shall account on a regular and timely basis for the taxation revenues it has raised:*
- c. Governments shall account for the expenditure of funds under its command on a regular and timely basis.*

Enforcement

States seeking to comply with the Code will voluntarily submit themselves to annual appraisal of their Conduct. These appraisals will in turn be reviewed by a committee of independent experts appointed by participating States. Differences of opinion will be resolved by binding arbitration.

Any taxpayer or agent wishing to comply with the Code may do so. A State should presume that a person professing compliance with the Code has done so when dealing with any tax return they submit. In consequence the administrative burdens imposed upon that person should be reduced. In the event of evidence of non-compliance being found any consequential penalty imposed should be doubled.

It is readily apparent that the attitude of society towards banks has changed. Banks no longer enjoy the licence to operate with impunity that they once had. This needs to be reflected in their behaviour both within and between states and would be best evidenced by their willingness to contribute to the cost of maintaining the governments of all those jurisdictions in which they operate in a tax compliant fashion. This Code of Conduct encourages that and accords with the principles that the IMF has been tasked with in undertaking its review of bank taxation and as such is recommended here.

4.4.3 General Anti-Avoidance Principles

It will be noted that the first objective of the Code of Conduct referred to in the preceding section is:

The intention of legislation is clear and a General Anti-Avoidance Principle (“Gantip”) is in use

This report recommends the widespread adoption of such principles into law (when they become General Anti-Avoidance Provisions: the terms are inter-changeable). Clarity provides taxpayers with the greatest possible certainty as to the liabilities they should expect to pay⁶⁴. This in turn reduces uncertainty in the administration of taxation and so increases its effectiveness.

Clarity is usually associated with the use of straightforward language: language is frequently abused by those who place meaning upon words that it is clear that the legislative authority creating the law did not intend. A

⁶⁴ Smith, A, 1776, The Wealth of Nations

General Anti-Avoidance Principle⁶⁵ seeks to prevent such abuse by suggesting how legislation should be interpreted by the Courts to restrict abuse by governments, taxpayers and tax advisers alike.

It is stressed that a General Anti-Avoidance Principle and not a General Anti-Avoidance Rule should be used: rules are abused by accountants, lawyers and bankers who see them as something to be got round whereas principles arm governments with the power to over-rule the sort of abuse that those professions promote. As one accountant rather famously once said⁶⁶:

No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken.

A principles based approach overcomes this issue.

The idea behind a General Anti-Avoidance Principle is simple: if a step is added to a transaction with the sole or principal aim of securing a tax advantage (which is defined as a saving in tax) then that step in the transaction is ignored for tax purposes. In other words, it tackles pre-meditated attempts to subvert the intention of tax legislation.

Such legislation has, admittedly, had varying success when it has been used. By general consent it has been broadly successful in Australia and has the potential to be so in South Africa. The UK Crown Dependency of Jersey uses one with great success when addressing tax abuse by those resident there. By broad consent a General Anti-Avoidance Principle has been problematic in Canada⁶⁷. This appears to be because Canadian courts sought to interpret the principle as if it were a rule. There is little doubt that to be effective any such principle requires, that courts be directed to interpret it in ways that promote the purpose or object underlying the relevant Tax Act (whether that purpose or object was expressly stated in the Act or not). This did not seem to happen in Canada.

A possible form of wording for a General Anti-Avoidance Principle is included in appendix 4 to this report.

4.4.4 Restricting tax loss carry forward

It is not yet clear just what the likely level of taxable losses made by banks during the recession might be, not least because tax losses arise at different times to those recorded for accounting purposes. We know Royal Bank of Scotland lost £24 billion in 2008, for example⁶⁸ but what we do not know when this will be recognised for tax. Much of the recorded loss relates to accounting provisions. These may well not be allowed for tax offset until they are crystallised as real losses. The impact when they are realised will however be significant, and banks are choosing how to locate these losses for tax. For example, as The Times⁶⁹ noted in August 2008:

⁶⁵ For an explanation of General Anti-Avoidance Principles see Freedman, J 2004 http://denning.law.ox.ac.uk/tax/documents/BTR_version_inaugural_lecture.pdf accessed 15-1-10.

⁶⁶ <http://www.guardian.co.uk/business/2004/mar/18/budget2004.budget2004> accessed 21-1-10

⁶⁷ For example see http://assets.cambridge.org/97805218/87779/excerpt/9780521887779_excerpt.pdf accessed 21-1-10

⁶⁸ <http://news.bbc.co.uk/1/hi/business/7911722.stm> accessed 19-1-10

⁶⁹ http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article4543223.ece accessed 19-10

[A] filing with the US Securities and Exchange Commission showed that [Merril Lynch] is unlikely to pay corporation tax in the UK for decades after it charged \$29 billion of its recent investment losses to Merrill Lynch International, its UK subsidiary.

It was suggested that this would mean Merrill Lynch would not pay tax on its UK profits for the next sixty years if they accrued at the rate previously enjoyed. This, of course, is a simplistic analysis but it highlights the fact that substantial losses have been incurred by banks, that those losses have in effect been underwritten by the state and yet those losses can, under the tax systems of many countries be carried forward indefinitely for offset against future profits with the potential consequence that the contribution the sector makes to governments to compensate for the cost of its own bail out might be very small indeed for some considerable time. This situation requires remedy if that contribution is to be made.

There seem to be a number of potential responses, the appropriateness of each of which will differ depending upon local tax rules and the action local jurisdictions have taken to assist banks, but which might be summarised as:

- a) Time limiting the carry forward of banking losses. This time period might be quite short. If it is, for example, expected that the recession will be over in 2011 all losses from periods prior to 2009 might be prevented from offset against profits thereafter, meaning profits from 2012 onwards (at the latest) should be taxed in full;
- b) Restricting the losses by the amount of support supplied to the bank at any time, even if subsequently repaid. This targets the measure in a very specific way but does not necessarily recognise the systemic support supplied to the banking system in general. If that systemic support were not recognised some banks would suffer no loss restriction at all and that may afford them an unfair competitive advantage;
- c) Restricting the types of loss that may be carried forward e.g. losses on businesses and individual loans may be carried forward whilst those resulting from the investment banking activities seen to be problematic might be restricted. However, this would create enormous difficulty in categorising losses and may as such be unworkable.

The difficulty of dealing with the issue of losses retrospectively (which most tax authorities are unwilling to do) is considerable. Without doing so, however, the prospect of raising significant revenues from banks in the form of corporate taxation in the long term is low and this is why this issue needs high priority now because failure to do so creates the risk of a very real moral hazard that losses underwritten by state are used for private gain to reduce payments due by those who have acted recklessly to the state. In the current political and social climate this must be unacceptable.

4.4.5 Insurance style levies

Insurance style levies on banks have been discussed since the onset of the current banking crisis and recession but have only recently come into vogue as a result of the Obama administration's support for such a levy⁷⁰. It was noted by Reuters⁷¹ in November 2009 that this was the solution the IMF was then considering with regard to this issue. However, later comment indicates that this may no longer be the case⁷².

⁷⁰ See <http://www.ft.com/cms/s/0/31a0f9f2-00a1-11df-ae8d-00144feabdc0.html> accessed 19-1-10

⁷¹ <http://www.reuters.com/article/idUSTRE5A71HU20091108> accessed 19-1-10

⁷² <http://www.imf.org/external/pubs/ft/survey/so/2010/INT011110A.htm> accessed 19-1-10

The logic of such charges is that categories of assets that are likely to create risk are assessed for a fee designed to raise a pool of funds over time that either a) recompenses a government for costs already incurred or b) reduces the cost of future bail outs.

In principle such funds seem appealing, but there are significant problems with them. First of all there is risk that a new form of charge, unless backed by international methods of cooperation and anti-avoidance procedures to be levied on what, all would agree, are highly mobile assets will inevitably give rise to significant avoidance behaviour by banks. Such avoidance would inevitably threaten potential yield, especially when planned to be levied over a period as long as ten years, as proposed by the Obama administration in the USA.

Secondly the charge is paradoxical in that it will be levied on highest risk activity but must presume continuation of that activity to ensure its success in raising revenue, without (as noted with regard to financial transaction taxes, elsewhere in this report) the apparent prospect of reducing externalities at the same time. This assumption looks particularly dubious when the rate of proposed charge is 15 basis points on short term liabilities, many of which relate to trades in the assets that might be subject to financial transaction taxes on which, as noted above, margins can be much lower than this. As noted in the Financial Times in January 2010⁷³ the consequence is that some markets, such as the repurchase market in some bonds, could be destroyed by such a levy, which is unlikely to be its objective. This would not happen if financial transaction taxes were levied instead, these being specifically designed to preserve markets whilst raising taxes.

Thirdly, and again paradoxically, if, as is believed likely, the levy might be offset against profits subject to corporation tax the potential tax yield from that tax will be reduced, and unless this has been proposed because bank losses are so great that the prospect of corporation tax payment is minimal then there is clear risk of additional loss arising as a result.

Finally, the national basis for such a charge will simply encourage tax haven activity and increased opacity in the banking system which is contrary to the need for enhanced governance at this time.

For these reasons such charges may be expedient in the short term but appear to play little long term goal in raising additional revenue from banks to address the problems they have caused.

4.5 Employment taxation

The bonuses paid to bankers are controversial. The salaries they pay to most of their staff are not.

Bonuses paid to bankers can be addressed in a number of ways. The UK has announced a scheme to do so by whereby a 50% tax charge is made on a bank paying any bonus in excess of £25,000 to a banker during a limited period of time ending in April 2010. Originally forecast to raise £550 million in revenue on the assumption that this would have a significant impact on the bonuses banks would pay, the anticipated yield now runs to several billion pounds as it appears bonus payments have been little altered as a consequence of the tax charge⁷⁴.

⁷³ <http://www.ft.com/cms/s/0/da14dad8-0928-11df-ba88-00144feabdc0.html>

⁷⁴ http://online.wsj.com/article/BT-CO-20100115-708527.html?mod=WSJ_latestheadlines accessed 21-1-10

President Obama's levy on banks appears to be a specific response to bonuses he calls "obscene"⁷⁵.

Neither issue does, however, address the systemic issue relating to banker's bonuses or the taxation issues flowing from them: the UK measure is specifically a one-off charge and the US charge is unrelated to pay, although it is hoped (without obvious reason for expectation being fulfilled based on the evidence of reaction to the UK charge) that it may reduce the banks' capacity or willingness to pay bonuses.

A systemic tax response seems significantly more appropriate. In this context it is important to note that investment banks have historically set aside at least half of their net revenue to pay employees⁷⁶. This immediately suggests the obvious solution to this problem. The reality is that in most businesses profits are a residual. Broadly speaking profit is calculated as revenues less costs, which the entity seeks to minimise and which it should pay at the lowest rate available if the organisation seeks to profit maximise, leaving a net benefit (it is hoped) for shareholders. It is obvious that the bank remuneration model does not accord with this standard economic principle of the economic behaviour of firms. For investment banks, in particular, employee costs would appear to be the return that is maximised. What distinguishes these banks from other service based suppliers is that their business model makes the employees profit participants ahead of shareholders in the distribution of the resulting rewards distribution. This is the only explanation for banks continuing to pay bonuses in preference to shareholder returns, as has become commonplace⁷⁷. In that case though, and given that these rewards do not appear related to employment cost but revenue generation, it is apparent that banks effectively see themselves as having two classes of equity provider, one of which is shareholders and the other is senior employees, with the latter having higher claim on profit distribution than the former.

In that case bankers' bonuses appear to be akin to profit distributions, not wage payments. Whilst the base level of salary paid by banks to those enjoying the bonuses causing concern might be considered remuneration for labour services, the bonus pools are not. In that case it would appear logical to treat them as if they are profit distributions for corporation tax purposes (even if not for the purposes of other taxes, where treatment as remuneration remains appropriate, guaranteeing as it does appropriate payment at source).

The consequence of treating these payments as profit distributions is that they would not then be offset against corporation tax profits, so increasing the level of those taxable profits (possibly quite considerably given that half of total sales are supposedly distributed as remuneration to staff, much as bonuses now not tax allowable). A significant increase in corporation tax payments due by banks would result, subject to the anti-avoidance issues with regard to that tax already noted above.

Setting the level at which corporation tax disallowance would arise would be important to ensure this measure would be effective. This cannot be based on contractual issues determined by the bank and its staff. For example, if only bonuses were disallowed these would be rapidly recategorised. Likewise if only remuneration paid in cash were so categorised other forms of payment would be used. In that case an absolute limit has to be set. A ratio to median earnings in the location in which the bonus was paid would seem most equitable for

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http://www.bostonherald.com/business/general/view/20100114obama_seeks_tax_on_banks_calls_bonuses_obscene/

⁷⁶ <http://www.reuters.com/article/idUSTRE60I53X20100119> accessed 21-1-10

⁷⁷ <http://www.independent.co.uk/news/business/news/big-bonuses-at-citigroup-despite-huge-losses-1873109.html> ACCESSED 21-1-10

this purpose, fulfilling in the process the aim of tax to both reprice undesirable transactions and to redistribute income. It is suggested that all remuneration charged in a period in excess of ten times median earnings of the jurisdiction in which they are recorded be disallowed for this purpose. In the United Kingdom this would at the time of writing mean that any remuneration paid to a bank employee in excess of approximately £210,000 per annum would be disallowed for corporation tax purposes.

It has recently been reported that Goldman Sachs' 32,000 employees might enjoy average bonuses⁷⁸ of £380,000 for 2009. Assuming a base level of salary of £100,000 each on average (and this is an assumption) this might suggest tax disallowance on this basis of about £270,000 each or £8.6 billion in all. At the UK corporation tax rate of 28% (which approximates to the OECD average as noted in section 3, above) of 28% this would raise total revenue of about £2.4 billion (US\$3.9 billion) for this one bank alone. This policy is recommended for this reason.

4.6 Systems for disclosure

The G20 Summit in London in April 2009 said in its final communiqué that:

*We are committed to developing proposals, by end 2009, to make it easier for developing countries to secure the benefits of a new cooperative tax environment*⁷⁹.

That new environment is built around the concept of information exchange, most particularly in the form of Tax Information Exchange Agreements (TIEAs).

TIEAs are primarily designed for the exchange of information between those states and jurisdictions denied full Double Tax Agreements, usually because they are considered tax havens, or as this report would prefer to call them, secrecy jurisdictions⁸⁰.

The object is simple; the execution as noted below is harder. The issue is that capital is mobile, and so is income, and when this fact is combined with the availability of bank secrecy, secrecy about the ownership, management and accounts of both corporations and trusts in many of the world's jurisdictions and the ready transmission of money through banking networks which have heavy presences in locations where secrecy appears to be greatest the opportunities for tax abuse are considerable.

No one knows for sure how much tax is lost as a result of funds being hidden from the view of tax authorities through the use of tax havens /secrecy jurisdictions, banking secrecy, corporate and trust secrecy, the use of offshore credit card facilities⁸¹ and other such structures. A review in 2009⁸² noted that

⁷⁸ <http://www.guardian.co.uk/business/2010/jan/18/goldman-delays-bonus-news-supertax> accessed 21-1-10

⁷⁹ http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf

⁸⁰ Secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. That regulation is designed to undermine the legislation or regulation of another jurisdiction. To facilitate its use secrecy jurisdictions also create a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so.

⁸¹ See http://www.justice.gov/tax/John_Does_Decl_DReeves.pdf accessed 21-1-10

⁸² <http://www.dfid.gov.uk/Documents/publications/research/oxford-tax-evasion-report.pdf> accessed 21-1-10

the most widely quotes estimates of that loss were prepared by the Tax Justice Network⁸³ and Alex Cobham in 2005. The data used is related and the resulting estimates are approximately US\$255 billion of revenue loss for all countries as a result of approximately US\$11.5 trillion of assets being held offshore and unaccountably. The OECD use a lower estimate of assets held offshore, prepared however some years earlier, estimated at between US\$5 and US\$7 trillion. This excludes some of the asset categories included in the Tax Justice Network work and the difference in view may be smaller than it first appears as a result.

The reality is that there will always be difficulty in estimating the value of assets which by definition the owners wish to render unmeasurable. What is beyond dispute is that without the operation of banking secrecy and the availability of the opacity secrecy jurisdictions provide⁸⁴ this tax would not be lost in anything like the amount that happens now, which is why the G20 focussed on this issue.

Because the information that is being sought for exchange purposes does in many cases come from bank accounts, for the transmission of illicit cash flows is the aim of all money laundering including tax evasion, the provision of better information by banks to those authorities that need it is a critical issue in enhancing the contribution that banks can make to recompense for the costs they have imposed on governments around the world. Such is the potential scale of resources released funds may well be available for other purposes as well.

4.6.1 Problems with TIEAs

The likelihood of raising these funds is limited given the timidity of the current approach adopted to enhancing information exchange processes. These concentrate upon the signing of Tax Information Exchange Agreements (TIEAs). Once a location has twelve such agreements it is currently considered internationally cooperative for information exchange purposes even though there are well in excess of 200 tax administrations in the world that might potentially benefit from information exchange. The level of disparity between current acceptable goals and the ultimate target to be achieved in terms of TIEA coverage is some indication of the scale of the problem to be addressed.

TIEAs also incorporate an inherent problem. A request for information under a TIEA must provide or state:

- (a) the identity of the person under examination or investigation;
- (b) what information is sought;
- (c) the tax purpose for which it is sought;
- (d) the grounds for believing that the information requested is held within the jurisdiction of which request is made;
- (e) to the extent known, the name and address of any person believed to be in possession of the requested information.

⁸³ http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf accessed 21-1-10

⁸⁴ For extensive information on this issue see <http://www.secrecyjurisdictions.com/index.php> accessed 21-1-10

The reason for the low number of information requests becomes obvious immediately. There is considerable secrecy within tax havens. This is either created by law e.g. those that establish banking secrecy, or through the combination of legal entities and professional services designed that the activities of those availing themselves of those facilities are opaque. As a consequence it is, for example, exceptionally difficult to link bank accounts operated by a company in turn controlled by a trust with a particular taxpayer in another jurisdiction who may or may not be settler and / or beneficiary of that arrangement. In consequence the existence of TIEAs is immaterial: the reality is that they have little or no practical value in very many cases because the 'smoking gun' required to trigger the information request either does not exist or cannot be created to the standard required by the Tax Information Exchange Agreement process.

4.6.2 Alternatives to TIEAs

There are alternatives to TIEAs. The OECD itself promotes a multilateral version of the TIEA meaning that in principle fewer agreements are in total required, but this leaves the fundamental problem of the agreement intact. The real alternative to the TIEA model of tax information exchange on request is automatic information exchange.

The most significant automatic information exchange in current use is the European Union Savings Tax Directive which only to interest income paid to accounts held in individual's names. This has made the whole arrangement extraordinarily easy to avoid, allowing tax evasion to continue. The use of a simple trust or cheap offshore company has removed any account from the information exchange process.

For this reason the Directive is at present (January 2010) subject to negotiation for revision and potential extension. In so doing the European Union is recognising an important issue: if information exchanged is to be meaningful it has to be linked to the person who has beneficial ownership of the structure that currently hides their ownership of offshore assets from view. For this reason the revised European Union Savings Tax Directive includes provision in some circumstances for those offshore structures to be 'looked through' using the information held by financial services providers required by anti-money laundering laws worldwide that they identify the real beneficial owners of all funds, structures and arrangements they manage on behalf of clients and that this data on beneficial ownership be used as the future basis for information exchange in Europe.

This provides a model that could and should be used worldwide to tackle tax abuse. If TIEAs exist, allowing a jurisdiction to make effective follow up enquiries if they think a person tax resident in their territory is using an offshore arrangement to evade tax, then a jurisdiction does not need to know the precise level of interest, profits, gains or other income accruing to offshore structures created by, owned by, or which benefit people resident within their jurisdictions benefit from to enable them to make an effective enquiry under a tax information exchange agreement. They simply need to know:

1. That such a structure exists (a bank account qualifying by itself as a structure for this purpose);
2. What each component (trust, company, or foundation) is called;
3. Who manages it;
4. Where it banks;
5. Who in the jurisdiction that is being reported to benefits from it.

If this data were available it is likely that almost every country in the world could and would substantially increase the number of tax information exchange requests that they might make using the proposed network of Tax Information Exchange Agreements.

What is therefore required is that this information, which the regulatory authorities of every single jurisdiction subject to IMF /FATF regulation must have available to it, be automatically exchanged with the jurisdictions in which the beneficiaries of those structures are located; that location to be identified by both the place of main residence of a beneficiary and by the country which issues them with their passport (with those places that issue passports of dubious repute to be specifically blacklisted for anti-money-laundering identification purposes).

The technical processes involved are relatively straightforward to resolve compared to those required to define the nature of income which may, or may not, be subject to information exchange, especially given that the problems of associating entities of the sorts noted with the 'warm human beings' who benefit from their existence have now been widely addressed for anti-money laundering purposes.

If such information could not be sent directly between states then the Financial Action Task Force / Board appears an obvious intermediary given its role in the anti-money land erring area, to which this data relates. The World Bank or IMF appear to be other obvious intermediary custodians of data for exchange purposes.

With this data Tax Information Exchange Agreements become meaningful: the 'smoking gun' required to make them useful would exist and the deterrent effect of this would be enormous, with potential significant increases in tax yields, as noted above.

To achieve this, however, banks must drop their opposition to information exchange. It is of course essential that banks protect private information. But information required to ensure tax is paid in the right place at the right time by the right person is not private information, it is data that is due to a state. Steps must be taken to ensure that banks cooperate in the supply of data for this purpose as a reciprocal obligation in return for the support states supplied to them when they needed financial assistance that only the state could supply.

Appendix 1

The 50 biggest banks in the world

Rank	Name	Country	Assets \$m	Capital \$m	Date
1	Royal Bank of Scotland Group plc	UK	3,483,179	14,355	31.12.08
2	Deutsche Bank AG	Germany	3,068,724	2,035	31.12.08
3	Barclays Bank plc	UK	2,977,491	3,035	31.12.08
4	BNP Paribas SA	France	2,891,948	19,267	31.12.08
5	Credit Agricole SA	France	2,303,497	38,138	31.12.08
6	UBS AG	Switzerland	1,881,246	273	31.12.08
7	J P Morgan Chase Bank National Association	USA	1,746,242	1,785	31.12.08
8	Societe Generale	France	1,574,478	1,011	31.12.08
9	The Bank of Tokyo Mitsubishi UFJ Ltd	Japan	1,494,350	12,000	31.3.09
10	Bank of America NA	USA	1,471,631	3,020	31.12.08
11	Banco Santander SA	Spain	1,462,493	5,569	31.12.08
12	UniCredit SpA	Italy	1,456,892	9,313	31.12.08
13	ING Bank NV	Netherlands	1,441,673	731	31.12.08
14	Industrial & Commercial Bank of China Limited	China	1,430,038	48,954	31.12.08
15	HSBC Bank plc	UK	1,340,437	1,155	31.12.08
16	Citibank NA	USA	1,231,154	751	31.12.08
17	Calyon	France	1,194,749	7,533	31.12.08
18	China Construction Bank Corporation	China	1,107,350	34,250	31.12.08
19	Credit Suisse Group	Switzerland	1,092,764	43	31.12.08
20	Sumitomo Mitsui Banking Corporation	Japan	1,089,483	6,668	31.12.08
21	Agricultural Bank of China Limited	China	1,028,045	38,106	31.12.08
22	Bank of China Limited	China	1,018,860	37,203	31.12.08
23	Credit Suisse International	UK	975,713	8,542	31.12.08
24	Bank of Scotland plc	UK	933,978	1,920	31.12.08

25	ABN Hambro NV	Netherlands	929,103	2,580	31.12.08
26	Intesa Sanpaolo SpA	Italy	886,349	9,246	31.12.08
27	Commerzbank AG	Germany	871,110	2,615	31.12.08
28	Rabobank Nederland	Netherlands	854,891	-	31.12.08
29	Fortis Bank SA	Belgium	817,580	-	31.12.08
30	Natixis	France	774,363	23,874	31.12.08
31	Banco Bilbao Vizcaya Argentaria SA	Spain	756,096	2,559	31.12.08
32	Mizuho Corporate Bank Limited	Japan	717,683	10,740	31.12.08
33	Mizuho Bank Limited	Japan	683,342	6,518	31.12.08
34	Danske Bank S/A	Denmark	662,970	1,307	31.12.08
35	Nordea Group	Sweden	660,546	3,622	31.12.08
36	Bayerische Hypo-und Vereinsbank AG	Germany	638,988	3,353	31.12.08
37	Wachovia Bank NA	USA	635,476	455	31.12.08
38	Lloyds Banking Group plc	UK	632,390	2,194	31.12.08
39	The Norinchukin Bank	Japan	626,936	34,320	31.12.08
40	Landesbank Baden-Wurtemberg	Germany	342,121	1,978	31.12.08
41	Royal Bank of Canada	Canada	595,328	10,730	31.12.08
42	DZ Bank AG	Germany	595,082	4,219	31.12.08
43	Banque Federative du Credit Mutuel	France	592,480	1,814	31.12.08
44	Bayerische Landesbank	Germany	587,524	4,954	31.12.08
45	KfW Bankengruppe	Germany	550,127	-	31.12.08
46	The Hongkong and Shanghai Banking Corporation Limited	Hong Kong	549,681	2,902	31.12.08
47	Wells Fargo Bank NA	USA	538,958	520	31.12.08
48	National Australia Bank Limited	Australia	512,244	11,488	31.12.08
49	Bank for International Settlements	Switzerland	510,901	1,122	31.12.08
50	Commonwealth Bank of Australia	Australia	468,864	16,026	31.12.08
	Totals		<u>56,687,548</u>	<u>454,793</u>	

Source: <http://www.bankersalmanac.com/addcon/infobank/bank-rankings.aspx> accessed 18-12-09

Appendix 2

Profitability in 2007 and 2008 of the world's biggest 15 banks

Rank	Name	Country	Assets \$m	Capital \$m	Date	Profit pre tax	
						2008 \$m	2007 \$m
1	Royal Bank of Scotland Group plc	UK	3,483,179	14,355	31.12.08	(15,043)	17,924
2	Deutsche Bank AG	Germany	3,068,724	2,035	31.12.08	(8,447)	11,985
3	Barclays Bank plc	UK	2,977,491	3,035	31.12.08	11,249	14,152
4	BNP Paribas SA	France	2,891,948	19,267	31.12.08	5,774	15,148
5	Credit Agricole SA	France	2,303,497	38,138	31.12.08	1,724	6,599
6	UBS AG	Switzerland	1,881,246	273	31.12.08	(25,717)	(3,118)
7	J P Morgan Chase Bank National Association	USA	1,746,242	1,785	31.12.08	2,773	27,805
8	Societe Generale	France	1,574,478	1,011	31.12.08	5,419	2,468
9	The Bank of Tokyo Mitsubishi UFJ Ltd	Japan	1,494,350	12,000	31.3.09	1,225	8,904
10	Bank of America NA	USA	1,471,631	3,020	31.12.08	4,428	20,924
11	Banco Santander SA	Spain	1,462,493	5,569	31.12.08	16,524	15,308
12	UniCredit SpA	Italy	1,456,892	9,313	31.12.08	7,350	12,612
13	ING Bank NV	Netherlands	1,441,673	731	31.12.08	(2,188)	15,127
14	Industrial & Commercial Bank of China Limited	China	1,430,038	48,954	31.12.08	20,974	15,171
15	HSBC Bank plc	UK	1,340,437	1,155	31.12.08	9,307	24,212
			<u>30,024,319</u>	<u>160,641</u>		<u>35,351</u>	<u>205,222</u>

Asset and capital source data as per appendix 1

Profitability figures are income pre tax from continuing operations from audited financial statements for the dates shown with reported comparative figures shown for 2007 (The Bank of Tokyo Mitsubishi 31.3.09 and 31.3.08). All figures have been translated to US\$ using average official exchange rates published by HM Revenue & Customs for the relevant periods.

Appendix 3

Subsidiaries of the UK's four largest banks in 2008

UK Major Bank Use of Tax Havens according to their 2008 Annual Return Data (separately supplied by HSBC; HROS has not filed data)										
	Total		Lloyds		Barclays		HSBC		RBS	
Total number of companies in group	5400		769		1064		2008		1559	
Companies in tax havens, as below	1260	23.3%	132	17.2%	324	30.5%	547	27.2%	257	16.5%
1 Cayman Islands	262	20.8%	17	12.9%	143	44.1%	36	6.6%	66	25.7%
2 Jersey	170	13.5%	60	45.5%	37	11.4%	43	7.9%	30	11.7%
3 Hong Kong	141	11.2%	3	6.1%	11	3.4%	120	21.9%	2	0.8%
4 Ireland	119	9.4%	0	0.0%	16	4.9%	22	4.0%	81	31.5%
5 Guernsey	68	5.4%	7	5.3%	18	5.6%	32	5.9%	11	4.3%
6 Bahamas	63	5.0%	7	5.3%	2	0.6%	50	9.1%	4	1.6%
7 Netherlands	53	4.2%	7	5.3%	9	2.8%	18	3.3%	19	7.4%
8 British Virgin Islands	51	4.0%	7	5.3%	4	1.2%	33	6.0%	7	2.7%
9 Luxembourg	49	3.9%	3	2.3%	16	4.9%	20	3.7%	10	3.9%
10 Isle of Man	46	3.7%	2	1.5%	29	9.0%	9	1.6%	6	2.3%
11 Bermuda	32	2.5%	0	0.0%	1	0.3%	24	4.4%	7	2.7%
12 Switzerland	30	2.4%	1	0.7%	7	2.2%	17	3.1%	5	1.9%
13 Singapore	27	2.1%	2	1.5%	8	2.5%	16	2.6%	1	0.4%
14 Malaysia (Labuan)	25	2.0%	1	0.8%	2	0.6%	22	4.0%	0	0.0%
15 Panama	25	2.0%	1	0.8%	0	0.0%	24	4.1%	0	0.0%
16 Mauritius	14	1.1%	0	0.0%	6	1.9%	8	1.5%	0	0.0%
17 Malta	14	1.1%	0	0.0%	2	0.6%	12	2.2%	0	0.0%
18 Philippines	12	1.0%	0	0.0%	2	0.6%	10	1.8%	0	0.0%
19 Cook Islands	11	0.9%	0	0.0%	0	0.0%	11	2.0%	0	0.0%
20 Gibraltar	10	0.8%	4	3.0%	3	0.9%	0	0.0%	3	1.2%
21 Liechtenstein	8	0.6%	2	1.5%	1	0.3%	4	0.7%	1	0.4%
22 Uruguay	5	0.4%	2	1.5%	0	0.0%	2	0.4%	1	0.4%
23 Monaco	5	0.4%	0	0.0%	2	0.6%	3	0.5%	0	0.0%
24 Portugal (Madeira)	3	0.2%	1	0.8%	2	0.6%	0	0.0%	0	0.0%
25 Barbados	3	0.24%	0	0.0%	0	0.0%	3	0.5%	0	0.0%
26 Dubai (United Arab Emirates)	3	0.24%	0	0.0%	0	0.0%	3	0.5%	0	0.0%
27 Liberia	2	0.2%	0	0.0%	2	0.6%	0	0.0%	0	0.0%
28 Netherlands Antilles	2	0.2%	0	0.0%	0	0.0%	0	0.0%	2	0.8%
29 Brunei Darussalam	2	0.2%	0	0.0%	0	0.0%	2	0.4%	0	0.0%
30 Bahrain	2	0.16%	0	0.0%	0	0.0%	2	0.4%	0	0.0%
31 Cyprus	1	0.1%	0	0.0%	0	0.0%	0	0.0%	1	0.4%
32 Seychelles	1	0.1%	0	0.0%	1	0.3%	0	0.0%	0	0.0%
33 Macau	1	0.08%	0	0.0%	0	0.0%	1	0.2%	0	0.0%
Total	1260	100.0%	132	100.0%	324	100.0%	547	100.0%	257	100.0%

Source: UK Trade Union Congress <http://www.tuc.org.uk/economy/tuc-15906-f0.cfm> accessed 7-1-10

Appendix 4

Possible wording of a General Anti-Avoidance Principle

1. If when determining the liability of a person to taxation, duty or similar charge due under statute in the UK it shall be established that a step or steps have been included in a transaction giving rise to that liability or to any claim for an allowance, deduction or relief, with such steps having been included for the sole or one of the main purposes of securing a reduction in that liability to taxation, duty or similar charge with no other material economic purpose for the inclusion of such a step being capable of demonstration by the taxpayer, then subject to the sole exception that the step or steps in question are specifically permitted under the term of any legislation promoted for the specific purpose of permitting such use, such step or steps shall be ignored when calculating the resulting liability to taxation, duty or similar charge.
2. In the interpretation of this provision a construction that would promote the purpose or object underlying the provision shall preferred to a construction that would not promote that purpose or object.

Note: this text was submitted for consideration by the UK's House of Commons in July 2009 but was not enacted. <http://www.publications.parliament.uk/pa/cm200809/cmbills/122/amend/psc1220307a.1075-1078.html>

About the author

Richard Murphy is a chartered accountant and graduate economist. He was senior partner of a London firm of accountants for more than ten years. He has also been a serial entrepreneur.

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