HM Treasury

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Taxation of banks and banking competition

Following the recent Treasury Select Committee (TSC) hearing on the CMA's provisional findings on its retail banking market investigation, I understand that you may want to examine the impact of the UK tax regime on competition in the banking market. It may be helpful if I set out how HM Treasury views this.

When considering the taxation of banks, the Government has established a sustainable, long-term basis for raising revenue from the sector, now that the sector is returning to profit. Banks will pay an overall rate of tax on their profit of 28%, falling to 27% in 2017 and 26% by 2020. Banks with profits under £25 million are exempt from the Corporation Tax surcharge, and so will only pay an overall rate of tax on their profit of 19% by 2017, falling to 18% by 2020. This means that banks will be subject to a long-run tax on profit that is the most competitive in the G7 and, for the smallest banks and building societies, the most competitive in the G20.

The Government is also concerned that the taxation of banks should be consistent with its objective to see greater competition within the UK banking sector. This is something to which the Government is very strongly committed, which is why it has taken numerous steps to increase banking competition, including making it easier for customers to compare current accounts and switch providers where they see a better deal, working with the PRA to introduce more proportionate capital and regulatory requirements for new banks, and, through the PRA's and FCA's New Bank Start-up Unit which launched on 20 January, making it even easier for new banks to enter the market.

Looking at the impact of tax on competition in the banking market in the round, the Government's clear view is that the UK's tax regime works very substantially to the benefit of smaller banks and building societies over larger ones:

- The largest banks in the UK are subject to a balance sheet levy, from which smaller banks are exempt.

- The £25m allowance included within the Corporation Tax surcharge provides a clear benefit to banks or building societies with smaller profits.

Taken together, as is clear from publicly available data (including banks' reporting of their bank levy payments in their accounts), this means that the big five banks are subject to additional taxation (by comparison with other companies in the economy) amounting to an effective additional rate of 10 per cent or more as a percentage of profits (taking the bank levy and corporation tax surcharge together), compared to a rate of less than 8 per cent for the small "challenger" banks. For some challengers the effective rate as a percentage of profits is very considerably lower (because they do not pay the bank levy and the £25m allowance included within the Corporation Tax surcharge covers a large proportion or even all of their profits).

There are other features of the tax regime that also benefit the small "challenger" banks. From 1 April 2015 the Government limited the proportion of a bank's profit that can be offset by losses (for tax purposes) to 50 per cent each year. In designing the restriction the Government limited it to losses that had been incurred prior to the measure's start date; exempted losses incurred in a bank's start-up period (five years from the point it starts trading); and included a specific allowance for building societies. As a result many smaller banks and building societies are not impacted by this measure.

The Government of course stands ready to continue to discuss the UK's tax regime and its commitment to increasing competition in banking.

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