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**EFFECTIVE TAXATION OF FINANCIAL INSTITUTIONS:
INTERNATIONAL COMPARISON**

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**ЭФФЕКТИВНОЕ НАЛОГООБЛОЖЕНИЕ ФИНАНСОВЫХ УЧРЕЖДЕНИЙ:
МЕЖДУНАРОДНОЕ СРАВНЕНИЕ**

Abstract. *Most advanced and developing economies review and re-examine the relevance of fiscal and banking policy regimes due to the systemic downturn in the global financial crisis. The existing fiscal gap and financial market disorders led to the introduction of new taxes and mandatory fees for banks for double-edged reasons – bridging the fiscal gap and bank capital regulation. In a harsh economic condition, most banks required the governments to rethink the taxation policy for financial institutions. Most policymakers and researchers are devising diverse proposals on optimal taxation which meet the needs of both parties. This paper studies the international bank taxation policies and recent development and examines the opportunities for the introduction of optimal taxation for banks in the banking system of Uzbekistan.*

Keywords: *taxation for banks, optimal taxation, tax position, multiple taxation method, Uzbekistan.*

Аннотация. *Наиболее развитые и развивающиеся страны пересматривают и повторно исследуют актуальность режимов налогово-бюджетной и банковской политики в связи с системным спадом в условиях глобального финансового кризиса. Существующий бюджетный дефицит и нарушения финансового рынка привели к введению новых налогов и обязательных сборов для банков по обоюдострым причинам - преодолению бюджетного разрыва и регулированию банковского капитала. В тяжелых экономических условиях большинство банков требовало от правительств переосмысления налоговой политики для финансовых учреждений. Большинство политиков и исследователей разрабатывают разнообразные предложения по оптимальному налогообложению, отвечающие потребностям обеих сторон. В данной статье исследуются политика налогообложения международных банков и последние разработки, а также исследуются возможности введения оптимального налогообложения для банков в банковскую систему Узбекистана.*

Ключевые слова: *налогообложение банков, оптимальное налогообложение, налоговая позиция, множественный метод налогообложения, Узбекистан.*

Annotatsiya. *Ko'pgina rivojlangan va rivojlanayotgan milliy iqtisodiyotlar jahon moliyaviy inqirozidagi tizimli pasayish tufayli fiskal va bank siyosati rejimlarining dolzarbligini qayta ko'rib chiqmoqdalar. Mavjud fiskal bo'shliq va moliya bozoridagi buzilishlar ikki tomonlama sabablarga ko'ra banklar uchun yangi soliqlar va majburiy to'lovlarni joriy etishga olib keldi - fiskal bo'shliqni bartaraf etish va bank kapitalini tartibga solish. Qattiq iqtisodiy sharoitda aksariyat banklar hukumatlardan moliya institutlari uchun soliq siyosatini qayta ko'rib chiqishni talab qilishdi. Ko'pgina siyosatchilar va tadqiqotchilar har ikki tomonning ehtiyojlarini qondiradigan optimal soliqqa tortish bo'yicha turli xil takliflarni ishlab chiqmoqdalar. Ushbu maqolada xalqaro soliqqa tortish siyosati va so'nggi rivojlanish jarayoni o'rganilib, O'zbekiston bank tizimida banklar uchun maqbul soliqqa tortishni joriy etish imkoniyatlari ko'rib chiqildi.*

Kalit so'zlar: *banklar uchun soliqqa tortish, maqbul soliqqa tortish, soliq holati, ko'p soliqqa tortish usuli, O'zbekiston.*

I. INTRODUCTION

In bank-based financial systems of developing and transition countries, banking system gains a central position in economic growth and stability (Komolov, 2015). Therefore, most developing economies regularly take measures for ensuring banking system resilience through different regulative instruments.

After global financial crisis both developed and developing countries strengthened the bank regulation strategies due to sudden failure in global banking system. Bank capital regulation was the main measure and the most reliable safety net for keeping the banks solvent. However, insolvent fiscal condition sparked the debates over taxing solvent profit-oriented entities – banks. Policy makers, academics, and regulators sought the best approach to taxing financial institutions and their activities in the financial markets with two reasons: (a) ensuring banking system stability through preventing them carrying out overly risky activities and (b) tightening the capital regulations (Chaudhry et al, 2014). However, this trend is going in diverse directions with a variety of financial measures and economic principles. As in Adam Smith's (1776) principles, fairness and efficiency in taxation can be used to balance the regulatory and fiscal taxation of banks. Because after global financial crisis, bank taxation debates moved to the agenda of several international financial organizations due to spread of global financial turbulence and inadequacy of pre-crisis regulatory framework to cope with large financial shocks.

However, there is a different view with developing and transition economies. Developing financial sector, or newly restructured in some countries, did not suffer from all three waves and implications of the global financial crisis. In particular, banking system transition from Soviet-inherited traditional model to modern dynamic banking has required a large body of studies devoted to the analysis of banking industry liberalization, privatization and regulation in all post-soviet economies. Banking system performance and its role in economic growth has been strengthened through structural reforms in financial sector and the role of banking industry in economic profile of transition economies of Central Asia. From the early establishment of national banking system, researchers investigated the bank-specific issues, mainly focusing on bank solvency, liquidity, capital requirements, payment and transaction systems, foreign exchange regulation and role of banks in capital markets and overall economic growth.



II. LITERATURE REVIEW

Although fiscal issues are likely to exert a significant influence on banks' behaviour, the taxation of the financial sector has received little attention (Caminal, 2003). The macroeconomic consequences of the taxation of the banking sector are analyzed in the theories of fiscal repression that stress the link between the efficiency of the financial sector and the process of capital accumulation (Demirgüç-Kunt and Huizinga, 1999). From a more micro-economic point of view, the standard optimal taxation theory suggests that intermediate goods and services should not be taxed (the connected distortions to the production process make taxing these markets more costly than taxing the final outputs). Given that banks operate both with firms and retail consumers, the loss of efficiency connected with the distortion engendered by the taxation of banks depends on who is actually bearing the fiscal burden. For these reasons, it is important to assess both if banks actually bear the burden of taxes formally levied on their activities and, should this not be the case, onto which category of clients they can manage to transfer it. Given our finding of the adverse effects of liquidity requirements, the argument by Admati, DeMarzo, Hellwig, and Pfleider (2011) that capital requirements can be designed to substitute for liquidity requirements is reinforced.

2.1. International Taxation Practices in Banking

In many economies, banks are subject to general taxation (personal and corporate income taxes), in spite of particular fiscal regulations which tax authorities treat banking system differently in some economies. A variety of taxes on financial institutions have been recently proposed or enacted in order to (a) to address the budgetary expenditures shifted by financial crisis (ex-post), b) to accumulate reserve funds to address future crises (ex-ante), c) to strengthen banks' stability and efficiency positions and to target levels of bank risks, d) to manage and mitigate systemic risk in banking system.

Cross-border studies in taxation practices of banking systems shows that from fiscal and regulatory point of view, taxes for banks and other financial institutions can be divided into five main categories:

1. Corporate income tax
2. Value-added tax
3. Labour taxes
4. Bank taxes / levies
5. Tax for financial instruments

Recent global financial crisis has prompted the reconsideration of taxation of financial institutions, with practice outstripping principle (Keen, 2015). Most of suffered countries, especially developed economies revised bank taxation policies and made significant amendments for fiscal and financial regulation purposes. The United Kingdom, for instance, introduced a Bank Levy in 2015, levied at

7.5 basis points on banks' uninsured debt obligation to encourage banks to move away from risky funding models that threaten the stability of the financial sector and economy (HMRC, 2016). Ten European Union member countries, essentially, France, Germany and Sweden have introduced special taxes for banks. Generally, responses of governments to global financial shocks after 2015 in a wider horizon are common in purpose but diverse in measures. Recent developments in financial industry tax are so significant that one should study their effects in the profile of financial industry at all. Especially, amendments in G 20 were a milestone in

new stage of taxation of financial services. In line with shifts in tax rates and fee amounts in abovementioned countries, new taxes and mandatory fees were introduced in order to keep financial institutions stucked to capital regulations and meeting public budget constraints.

Cost-of-Equity Tax Deduction Allowance. The International Monetary Fund proposed a financial sector tax policy in parallel with HM Treasury and the U.S. Congress. In mid 2015, the IMF released a report on new tax reforms in global scale titled «Debt Bias and Other Distortions: Crisis-Related Issues in Tax Policy» which highlighted the alternation of corporate tax to debt and equity tax for banks. The cost-of-equity tax deduction allowance can be introduced by allowing banks to increase volume of deductions at an equal level with risk-free rate of return on their equity.

Global Financial Transactions Tax. In the same period, Her Majesty's Treasury of the United Kingdom proposed a multilateral financial transactions tax by issuing a report «Risk, Reward and Responsibility: The Financial Sector and Society». As HM Treasury described, this tax has four key principles: (1) implementation at a global level; (2) minimal distortionary impact; (3) assurance of financial stability; and (4) be fair and measured (HM Treasury, 2015).

Financial Crisis Responsibility Fee. In 2016, the U.S. President Barack Obama proposed Financial Crisis Responsibility Fee as an alternative to cost-of-equity tax deduction allowances to alter debt-to-equity ratios. This tax is widely referred to as a tax which imposes a 0.15% levy on liabilities of financial firms that hold more than \$50 billion in assets.

DeFaizo Tax. On December 3, 2015, U.S. Representative Peter DeFazio introduced a bill titled «Let Wall Street Pay for the Restoration of Main Street Act» to fund job creation and deficit reduction. The bill envisions 0.25 per cent tax on the value of transacted stock and 0.02 per cent tax on the value of instruments involved in futures and swap transactions. Adoption of this tax, as according to Congressman DeFazio's estimates, would raise \$150 billion revenue a year.

2.2. Taxation Practice of Financial Institutions in Uzbekistan

During the ongoing transition process to market economy, Uzbek banking system has been experiencing a cluster of in-depth structural reforms and modernization. One of key focus areas in system-wide transition was decentralization and restructuring in the banking sector. Creation of a modern banking system took place in Uzbekistan on gradual basis: cancellation of Soviet-inherited bank ownership structure, introduction of corporate bank structure, financial sector liberalization, and provision of lending for firms and individuals, which were strictly prohibited in former Soviet laws. In particular, Uzbekistan didn't try to force process of liberalization of the banking sector, placing emphasis on quality and timeliness of carried-out reforms. Number of banks increased under diversified ownership status: public, private and joint stock.

Despite different ownership types and capital structures, all banks are taxed under the same procedure. However, distinguishing feature is that Uzbek banking system follows a distinct system of taxation. In most advanced states unified and simplified taxation method - corporate tax and general VAT are imposed. Because an increase in corporate income taxes reduces lending, bank efficiency and social values due to standard negative income effects. In contrary, Uzbek banks are taxed based on multiple taxation principle (Table 1). Uzbek banks are exempted from land tax and corporate tax principles are not introduced in order to guarantee profitability of banks in any financial conditions faced in transition and modernization process. VAT taxes are levied from limited types of financial services in order to keep the market power of banks in balance.



Table 1. Dynamics of imposed taxes for financial institutions in Uzbekistan in 2012-2015, %

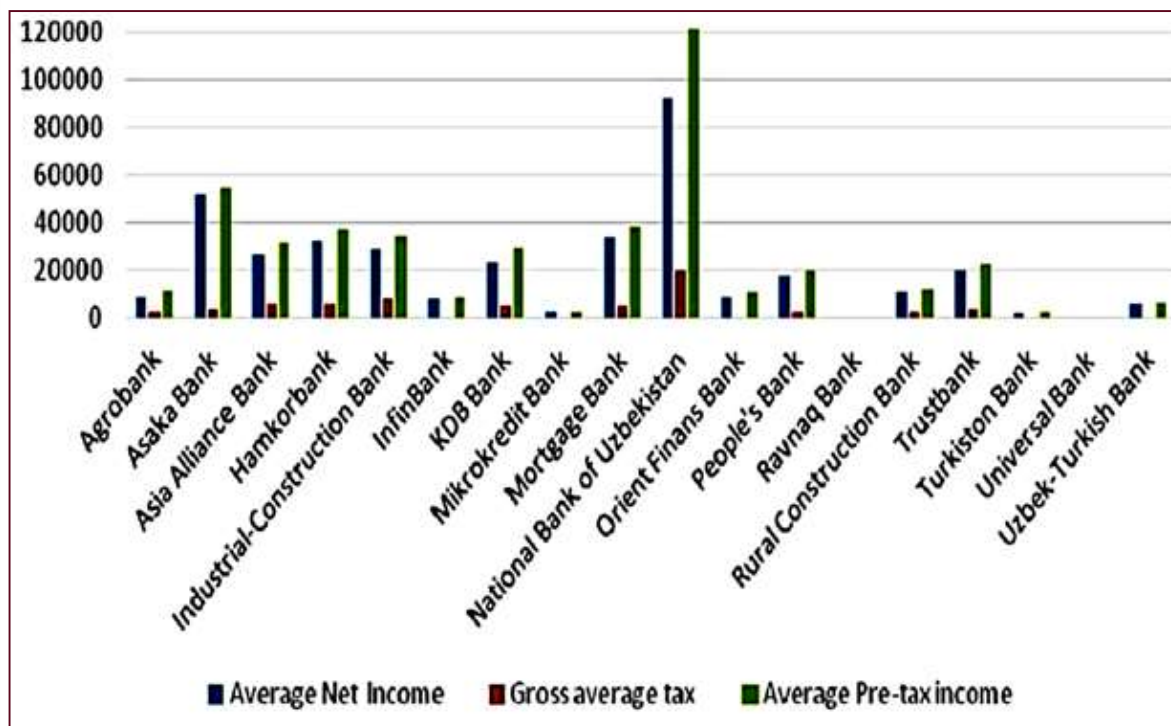
Type of tax	2012	2013	2014	2015
Income tax	15.0	15.0	15.0	15.0
Mandatory contribution to pension fund (from profit)	1.6	1.6	1.6	1.6
Mandatory levy to Road Fund of Uzbekistan (from profit)	1.4	1.4	1.4	1.4
State trust fund for reconstruction, overhaul and equipping of educational and medical institutions under the Ministry of Finance	0.5	0.5	0.5	0.5
Social infrastructure development tax	8.0	8.0	8.0	8.0
Property tax	3.5	3.5	4.0	4.0

Source: Center for Economic Research, 2015

In many market economies, emphasis has been placed on taxes on bank liabilities by supporting their potential role as a provider of tax revenues to government budget and regulative tool of banking system. But in Uzbekistan's practice, bank liabilities are not the fulcrum tax base – net income and bank owned properties are subject to small scale taxation.

Therefore, existing difference line between bank assets and profit margin is the comparatively the same in all banks (Figure 1).

Despite proximity in profit margin and paid taxes of banks, tax positions reveal the context of current taxation practices in Uzbekistan. Considering socially oriented principle of transition



Source: Author's data compilations from annual bank reports

Figure 1. Averaged Income Generation and Taxation of Selected Uzbek Banks in 2013-2018, million UZS.

to market economy, state owned banks often involve in government's social programs like employment support, start-up loans, rural housing and development projects, farmer support tranches, student loans etc. which are fully initiated by the government as interest free or privileged loans and tranches. As a response to activeness of banks in public social schemes in financial services, the government covers the banks losses from social support. This practice regularly shows a negative impact on banks' tax positions due to tax in default derived from expectations of compensations from public budget. Therefore, tax positions vary in different amplitudes and scales.

In global financial crisis Tax burden and its optimal rate for bank profits are main issue in many transition economies. In some of them, commercial banks are heavily taxed via multiple taxation system. All taxes are structured around fiscal stability purposes rather than bank capital regulation. In Uzbekistan's context, regulative taxation and optimal tax burden are examined through effective tax rate and fixed profit/income tax paid by a bank for a whole financial year.

In sum, the negative impact on lending, efficiency and social value associated with income taxes is significantly lower than that associated with a tax on deposit liabilities. In terms of government value, income taxes dominate taxation of non-deposit liabilities under our benchmark parameterization.

CONCLUSIONS

This paper has formulated more optimal model of a taxation of financial institutions, predominantly banks which may be a necessary tool for keeping the optimal balance of fiscal and monetary equally. The author evaluated the combined impact of current taxation policy for financial institutions on capital regulation, liquidity requirements and fiscal stability in the context of Uzbekistan's banking system. Taking the specifics of emerging and transition economies into account, following conclusions and recommendations are drawn as main research findings:

1. This small scale research uncovered the strong interdependence tax policy for banks and bank lending, bank efficiency, social value and regulatory capital ratios. This result suggests the existence of optimal levels of regulatory capital, which are likely to be highly bank- specific, depending crucially on the configuration of risks a bank is exposed to as a function of the chosen business strategies.

2. Taxing the banks for the volume of capital is one of the best methods often proposed to central banks of most economies. In context of Uzbekistan, author proposes the use of scaled taxation method for banks' capital. It may enable the balance and equality in taxation through bank capital – bank profit dilemma.

3. As mentioned, current taxation practice of Uzbekistan includes the VAT tax for selected financial services such as bank intermediation and leasing. In the context of banking system liberalization, exemption from VAT taxes for bank profits from these services.

Overall, our results suggest that optimal bank taxation can be a clue in ensuring the stability of banking sector and fiscal system in Uzbekistan. However, our preliminary assumption matches the final outcomes: taxes serve for capital regulation as well, which can be seen from the insignificant difference in effective tax rate for each bank and for the whole banking system.



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