Notat

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The Danish Financial Activities Tax

This memorandum gives an overview of the Danish FAT, its effect on the Danish financial sector, and henceforth a description of the background for introducing the FAT.

1. Overview

In compliance with EU regulation, the financial sector in Denmark is exempt from VAT. However, the sector is liable to a financial activities tax (a payroll tax or duty on wages and salary costs, *lønsumsafgift*). The effective tax rate regarding the financial sector is 9.13 per cent in 2010 and 10.5 per cent from 2011.

The base for the payroll tax on financial sector is the sector's total labour costs. Included is any kind of wage payment to the employed including supplements regardless whether they are a wage element or granted separately. When assessing the payroll tax, payments in kind are included to the extend they entitle holiday allowance. Bonus is included if it is payed out as normal income. Payments to labour market pension schemes are also included. Generally, fringe benefits are also included. Payments in form of share options are as a general rule not included in the tax base.

The financial sector is not the only sector subject to the payroll tax. Other sectors that are exempt from VAT are also liable to a payroll tax. The rate of the tax and the tax base differs among sectors as seen in table 1.

Table 1. The Danish payroll tax, basic rules as of 2011

Business engaged in financial activities (banking, insurance, mortgage credit and pension trust companies)	Businesses engaged in lotteries and betting as well as organisations, funds, associations etc.	Businesses engaged in publication or import of newspapers	Other businesses subject to payroll tax
10.5% of labour costs	5.33% of labour costs	2.5% of the value of the business' sale of newspapers	3.08% of labour costs plus taxable profit or minus taxable deficit

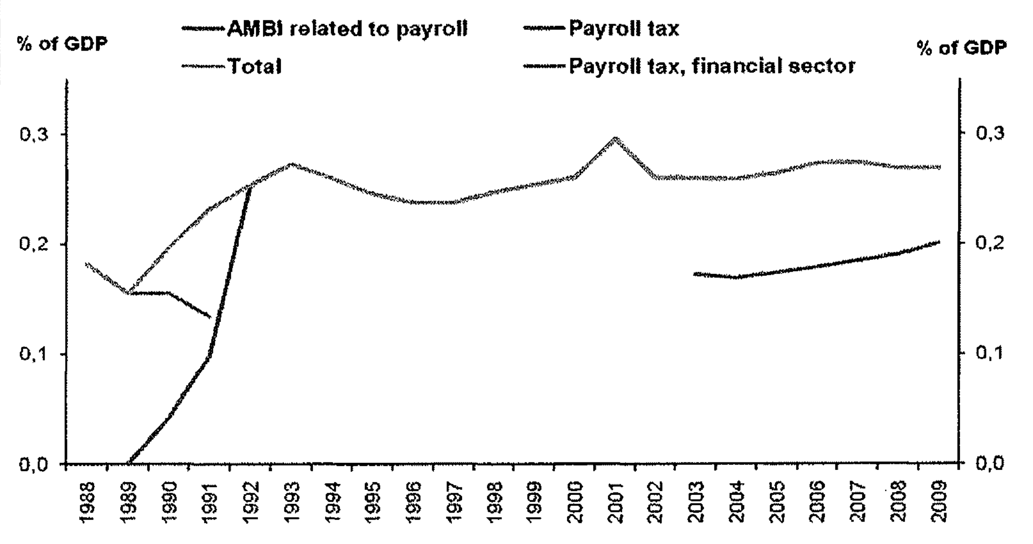
As shown in table 1, the basis of assessment is 10.5 per cent of the business' labour costs for businesses engaged in financial activities, whereas lotteries, tourist information agencies, organisations, funds, etc. are subject to a rate of 5.33 per cent.

For businesses engaged in publication or import of newspapers, the basis of assessment is the value of the business' sale of newspapers, and with a duty of 2.5 per cent. For companies not engaged in either financial services, lotteries or the newspaper industry, the basis of assessment is the business's labour costs plus the taxable profit or minus the taxable deficit, which is taxed at a rate of 3.08 per cent.

In total, the revenue from the Danish payroll tax in 2009 was approximately 4.5 billion DKK or 0.25-0.3 per cent of GDP. Since the introduction of the payroll tax in 1990 the total tax revenue has been rather constant at the level of approximately 0.25-0.3 per cent of GDP, cf. figure 1. From 1988-1991 a corresponding tax, the AMBI was in effect.

The bulk of the revenue from the payroll tax stems from the financial sector, cf. figure 1. The share of revenue from the financial sector could be assumed to be 2/3 of the total revenue in the whole period.

Figure 1. Revenue, Payroll tax and AMBI, all sectors and financial sector, per cent of GDP 1988-2009



Source: Statistics Denmark.
Note: Data is relating not only to the financial sector, but all sectors subject to AMBI and payroll tax. The reason for the jump in total payroll tax in 2001 is unknown.

Deemed on the trend in revenue alone, there is no indication that the payroll tax has had a negative impact on the activity in the affected sectors. The turnovers from businesses engaged in publication or import of newspapers have declined in the period. Therefore, other affected sectors will have increased slightly in share of GDP.

2. The payroll tax on the financial sector

As regards the financial sector the effective rate of the payroll tax has been relatively stable at a level of approximately 9 per cent since 1990 when the payroll tax was introduced. The effective rate was unchanged at 8.55 per cent until 1996. From 1996 until 2000 the payroll tax was gradually increased to reach an effective rate of 9.13 per cent in 2000, which has been the effective rate from year 2000 until last year. From 2011 the total burden on the financial sector labour costs are at a 10.5 percent rate. The specific rates of the payroll tax are summarised in table 2.

Table 2. Payroll tax rates in the financial sector [1]

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Rate on 100 per cent of wages and salary costs	-	-	-	-	-	-	-	4,66	4,82	4,87	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	10,5
Additional rate on 90 per cent of wages and salary costs	-	-	-	-	-	-	-	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	4,5	-
Rate on 190 per cent of cent of wages and salary costs	4,5	4,5	4,5	4,5	4,5	4,5	4,5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total effective rate	8,55	8,55	8,55	8,55	8,55	8,55	8,55	8,71	8,87	8,92	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	10,5

Source: The Danish Ministry of Taxation
Note [1]: Including the AMBI from 1990-1991 (see section 4 below).

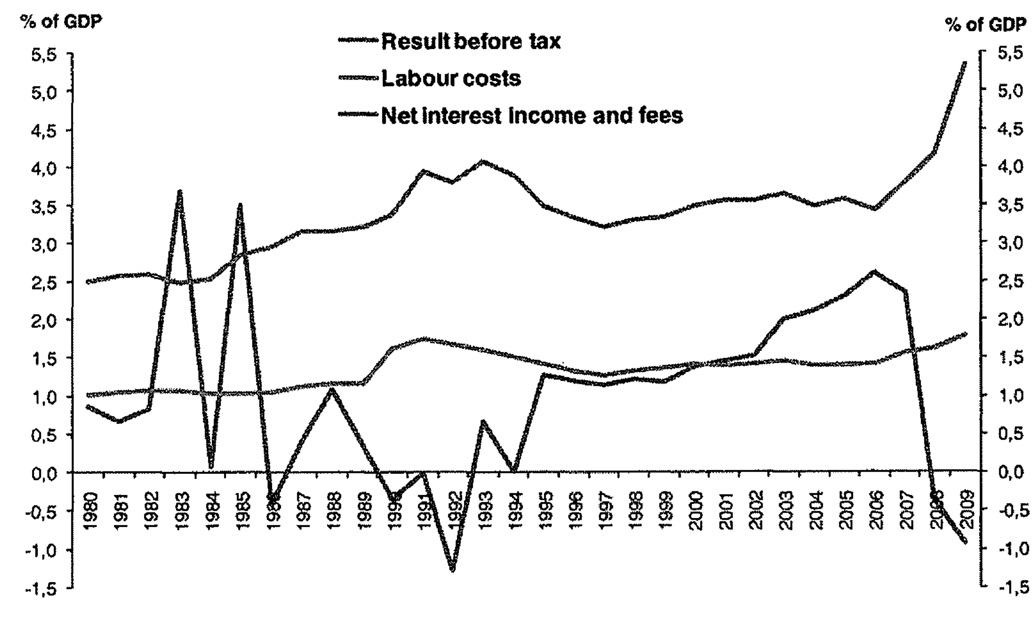
3. Development

There is no indication that the activity in the financial sector has been reduced as a result of the payroll tax.

Measures available for the financial sector activity (pre-tax profits, labour costs as well as net income from interests and fees) do not leave the impression that the payroll tax (or the AMBI) has caused a decrease in financial sector activities cf. figure 2.

Though the pre-tax profit of the financial sector has shown large fluctuations since 1980, the developments in labour costs and income from interests and fees show that the financial sector has grown at a faster rate in comparison to the rest of the economy. The financial sectors labour expenses have increased from 1 to just below 2 per cent of GDP from 1980 to 2009. This increase has occurred after the introduction of the AMBI in 1988. Furthermore, from the mid 1980s the financial markets have undergone legislative liberalizations and the mobility of financial activities has increased due to technological developments. Both trends point in the direction of more global competitive financial markets throughout the period.

Figure 2. Financial sector activity, per cent of GDP 1980-2009



Source: The Danish bankers Association and The Danish FSA

Hence, the trend in total labour expenses does not indicate that financial sector activity has been affected negatively by the introduction of the payroll tax.

However, the relative increase in the financial sectors share of GDP may have been a general trend in developed countries. It is not possible to determine what the activity in the financial sector would have been in the absence of the payroll tax.

There is no concrete evidence of the final incidence of the financial activity tax and thus to what extent it has been shifted to the consumers of the financial services.

4. Background on the AMBI and the payroll tax

Before the introduction of the payroll tax in 1990 the financial sector was subject to pay AMBI from 1988-1991 of a similar base.

As of 1988 the so-called AMBI came into force. The AMBI – a labour market contribution paid by employers to the state on the basis of companies' production and sale of goods and services – was a new labour market contribution of 2.5 per cent on companies' VAT basis. For VAT-exempt companies, a special basis of calculation was introduced. When it would not be possible to assess an ordinary sale as is the case in the financial sector, the tax was calculated on the basis of the company's total labour costs instead. For companies in the financial sector the AMBI was 2.5 per cent of the company's total labour costs with an additional 90 per cent.

The AMBI was introduced during the reorganising of a range of labour market taxes. The reason for reorganising the labour market taxes was a worsening of Danish competitiveness and a desire to lower costs for businesses competing on foreign markets and was part of a comprehensive tax reform in 1987. Since the introduction of the AMBI was only part of a greater reform, it is not possible to evaluate the effect of the individual tax isolated.

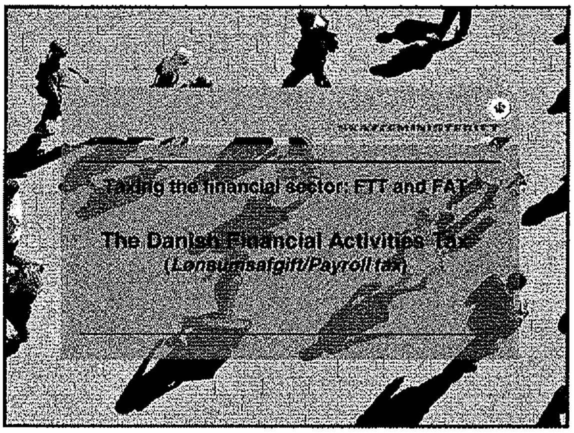
In July 1990 the payroll tax was introduced targeting only the financial sector. The tax was a counter-measure to a reduction in the corporate tax rate from 50 to 40 per cent. The payroll tax rate was 2 per cent and the base was the same as the AMBI; the company's total labour costs with an additional 90 per cent.

However, in 1992 the European Court of Justice declared the AMBI illegitimate. Having foreseen this, in 1991 the Danish government proposed to abolish the AMBI. But as there was no desire to reintroduce the previous employer taxes, it was decided to raise the VAT rate from 22 to 25 per cent instead.

Before the abolishment of the AMBI in 1992, all companies in the financial sector were thus liable to the AMBI as well as the payroll tax. With the AMBI rate of 2.5 per cent and the payroll tax of 2 per cent, financial companies were subject to a 4.5 per cent rate with an additional 90 per cent resulting in an effective rate of 8.55 per cent on total wages and salary costs as shown in table 2.

Due to the fact that the all businesses (including VAT exempt companies) had paid the AMBI, raising the VAT would not affect the group of VAT exempt companies as did the AMBI. Therefore it was decided to broaden the payroll tax base to include all companies with VAT exempt activities, which were previously subject to the AMBI. Until this point the payroll tax had only been levied on the financial sector. The payroll tax was set to correspond to the 3 per cent point VAT rate increase. As a result all companies previously subject to the AMBI were now subject to the payroll tax.

As a result, from 1992 and onwards all VAT exempt companies became subject to the payroll tax. Financial companies were still subject to a 4.5 per cent tax, while other companies were only subject to a 2.5 per cent rate with a base of 1. 9 times total labour costs.



Outline

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1. Background for the Danish FAT
2. Basic rules regarding the Danish FAT
3. Effects of the FAT on the Danish financial sector
4. Broadening the Danish FAT base?
5. The way forward: An internationally coordinated FAT?

1. Background for the Danish FAT

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1988-1991: AMBI - 2.5% rate on 190% of total labour costs for all VAT-excempt companies (including the financial sector)

1990-1992: Payroll tax targeted at the financial sector – 2% rate, same base as the AMBI. The tax was a counter-measure to a reduction in the corporate tax rate from 50 to 40%.

1992-: All VAT exempt companies became subject to the payroll tax. Financial companies were still subject to a 4.5% tax, while other companies were only subject to a 2.5% rate with a base of 1.9 times total labour costs.

2. Basic rules regarding the Danish FAT

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Table 1. The Danish FAT, basic rules as of 2011

Business engaged in financial activities (banking, insurance, mortgage credit and pension trust companies)	Businesses engaged in lotteries and betting as well as organisations, funds, associations etc.	Businesses engaged in publication or import of newspapers	Other businesses subject to payroll tax
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2. Basic rules regarding the Danish FAT

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Activities subject to tax: Banking, insurance, mortgage credit, pension funds

Tax base = wages (including contributions to pension schemes) + fringe benefits + bonuses (if paid out as normal income)

Current tax rate: 10.5%

Revenue: 0.25-0.3% of GDP

2. Basic rules regarding the Danish FAT

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Table 2. Payroll tax rates (FAT) in the financial sector [1]

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Rate on 100 per cent of wages and salary costs	-	-	-	-	-	-	-	4,66	4,82	4,87	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	5,08	10,5
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Rate on 190 per cent of wages and salary costs	4,5	4,5	4,5	4,5	4,5	4,5	4,5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total effective rate	8,55	8,55	8,55	8,55	8,55	8,55	8,55	8,75	8,87	9,07	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	9,13	10,5

Source: The Danish Ministry of Taxation
Note 1: Including the AMBI from 1990-1991.

2. Basic rules of the Danish FAT (cont.)

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To summarize:

Included in the base:
- Total labour costs
- Bonuses if payed out as normal income
- Payments to labour market pension schemes
- Generally fringe benefits

Not-included in the base:
- Taxable profits
- "Above-normal" taxable profits
- Payments in form of stock options

3. Effects of the FAT on the Danish financial sector

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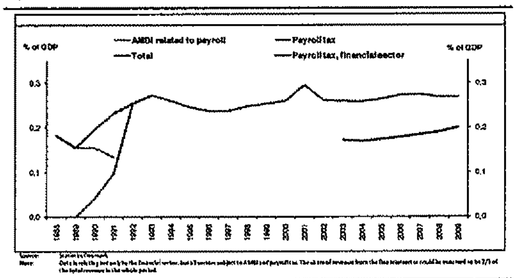
Figure 1. Revenue, Payroll tax and AMBI, all sectors and financial sector, % of GDP 1988-2009



3. Effects of the FAT on the Danish financial sector

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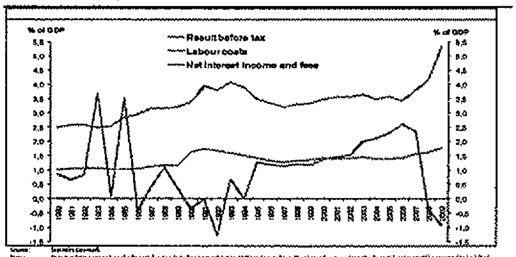
Figure 2. Financial sector activity, % of GDP 1990-2009



4. Broadening the Danish FAT base?

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Arguments can be made for and against adding the following to the Danish FAT base:

- The value of stock options and similar forms of non-wage compensation
- Taxable profits (as defined under the corporate income tax) or
- "Above-normal" taxable profits (Taxable profits minus a normal rate of return)
- What about taxable deficits?

A broadening of the base to include taxable profits was proposed in 2009 but ended up as an increase in the rate instead.

4. Broadening the Danish FAT base? (cont.)

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An example: Broadening the FAT base including taxable profits

Mio. DKK	2005	2006	2007	2008	2009
Result before tax	35.320	42.415	39.702	-8.458	-15.579
Tax	8.252	8.963	7.102	-313	-80
Annual result	27.169	33.453	32.600	-6.144	-15.499
Equity	171.640	215.392	244.010	232.543	242.903
Equity * interest rate (government bond)	5.836	8.185	10.492	9.999	8.745
"Above-normal" profit	29.484	34.230	29.210	-16.457	-24.324
1,25% tax on "above-normal" profits	369	428	365	-206	-304
1,25% tax on taxable profits/deficits	442	530	496	-81	-195

4. Broadening the Danish FAT base? (cont.)

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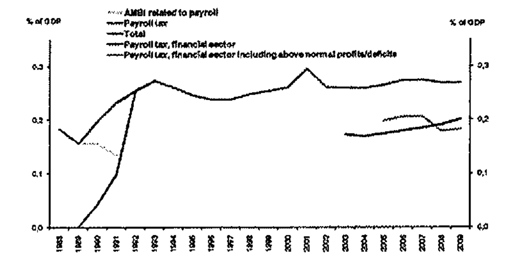
An example: Broadening the FAT base incl. "above-normal taxable profits/deficits



4. Broadening the Danish FAT base? (cont.)

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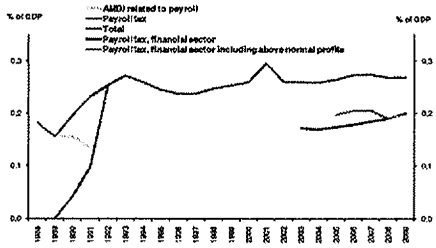
An example: Broadening the FAT base incl. "above-normal taxable profits



5. The way forward: An internationally coordinated FAT or a FTT?

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For what purpose?

- Creating revenue
- Reduce risktaking

Which countries?

- G20
- EU
- National level

Which base?

- Wage/labour costs
- Profits/above-normal profits
- Others

Which rate?