Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Major Bank Levy Bill 2017 Inquiry

Agency: Department of the Treasury
Question No: 1
Topic: Legislation – Legislative Instruments
Reference: Written
Senator: Ketter

Question:

1. What is the rationale for the particular amounts as per subsection 5(4) and subsection 6(4) to be determined by legislative instrument as opposed to a formula (for example in subsection 5(2) and subsection 6(2))?

2. What is the rationale for the methods for working out amounts as stated in section 8 to be determined by legislative instrument as opposed to a set legislative formula?

3. What is the reason for including subparagraph (2)(b)(v) in section 5?

   a. Wouldn't the amounts calculated in subparagraphs (2)(b)(i), (ii), (iii) and (iv), subtracted from the total liabilities amount as per paragraph (2)(a) in section 5, provide the applicable liabilities amount for the purposes of the costing in the 2017-18 Budget measure?

   b. Are there "any amounts" that exist for the purposes of the costing in the 2017-18 Budget measure?

Answer:

1. The rationale for particular amounts to be determined by legislative instrument under subsection 5(4) or subsection 6(4)) is to provide flexibility to the way that the Government could respond to any changes that may be required to reduce the levy base or to amounts that should be worked out on a quarterly average basis. If a change of this nature is required, a judgement would need to be made as to whether, in the particular circumstances, the most suitable way to make the change would be to amend the primary legislation or to make a disallowable legislative instrument.

2. Any legislative instrument made under section 8 would set out the method for working out certain amounts that form part of the levy base. As the methodology for working out these amounts would be of a technical and detailed nature, possibly to contemplate a future prudential requirement to manage a future risk situation or event, it would be appropriate for this methodology to be set out in a legislative instrument rather than in the law. The instrument would be disallowable, and could not be used to extend the levy base.

3. As outlined in response to Question 1, the rationale for subparagraph 5(2)(b)(v) is to provide flexibility to the way that the Government could respond to any changes that may be required to reduce the levy base. If a change of this nature is required, a judgement would need to be made as to whether, in the particular circumstances, the most suitable way to make the change would be to amend the law or to make a legislative instrument.

   a. As stated in paragraph 2.25 of the Explanatory Memorandum, the Government agreed to amendments to the major bank levy (as announced in the 2017-18 Budget), that addressed issues raised during the consultation process. As outlined in Table 2.2, these changes were including derivatives on a net basis and deducting an amount for Exchange Settlement Account balances held with the RBA.

b. No.

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Major Bank Levy Bill 2017 Inquiry

Agency: Department of the Treasury
Question No: 2
Topic: Costing
Reference: Written
Senator: Ketter

Question:

1. Can you provide all the assumptions behind the costing of the budget measure?

   a. We want details of all the variables and inputs that have gone into the costing that give the specific numbers in the budget papers, so details of every single relevant number for each of the five banks that go towards each year's revenue figures, both in cash and accrual.

2. What is the average total liability base covered by the levy each year? What growth in liabilities is assumed between each year?

3. Has Treasury assumed in any of the underpinning or explanatory material for the major bank levy that any of the cost of the bank tax is passed through by the major banks to consumers? If so, where and how much of the levy was assumed to be passed on to consumers?

4. Noting the four sets of figures published in the budget papers (Budget Paper 2, page 24; Budget Paper 1, page 3-29; Budget paper 1, page 5-18; Budget paper 1, page 10-24) can we be provided with a reconciliation of these four sets of figures? (broken down by year and quarter) That is, how the levy is accrued over each quarter, when levy payments will be made, the level of company tax deductions that will be applied in each quarter and the reconciliation of interactions with other taxes?

5. Has Treasury provided advice to Government that the changes using the legislative amendments under subsection 5(4) and subsection 6(4) may be required to raise the Budgeted $6.2 billion over the forward estimates?

6. Since budget night, has Treasury done any reconciliation or comparison of the numbers reported by the banks and the Treasury estimates of the levy? If yes, please provide the comparison and the shortfall/surplus, if any.

Answer:

1-4. The levy base was estimated using confidential data sourced from the Australian Prudential Regulation Authority (APRA), uplifted for credit growth over the forward estimates period. The levy base is assumed to grow at 5.9 per cent per annum (around 1.4 per cent per quarter). The growth rate is based on the growth in total liabilities since the introduction of APRA's macroprudential measures in December 2014. The average total levy base for each year is presented in Table 1.

Table 1: Estimated total levy base, $bn

Year	17-18	18-19	19-20	20-21
Average total levy base ($b)	2,600	2,800	2,900	3,100

The implied growth rate from the average annual levy base figures above is not directly comparable to the growth rate assumption since the levy base figures in Table 1 are rounded average estimates for the year.

The annual levy liability is the levy base multiplied by 0.06 per cent. The costing takes into account a range of factors other than gross levy revenue and makes a number of assumptions, including:

- Interactions with corporate income tax given that the levy is deductible for corporate tax purposes.
  - This deduction takes effect with a one year lag since companies usually do not adjust their pay as you go (PAYG) instalment rate, which are provided by the Australian Taxation Office, to incorporate new deductions. The deduction may flow through to PAYG instalments over time but the deduction is quite small relative to the amount of tax paid by the banks.
- Bank responses to the imposition of the levy, which include:
  - some pass-through of the levy to customers, as evidenced by previous behaviour by the banks.
  - consequences for dividend payments and franking credits should profitability impacts have a flow on effect to the amount of dividends they pay out.

As noted in the Explanatory Memorandum, it is not possible to be unequivocal about the ultimate incidence of the levy. However in preparing a costing it is necessary to make specific assumptions as to immediate responses by taxpayers, and such assumptions are not judgements on the merits or justifiability of the assumed responses.

A list of the figures published in the Budget is provided in Table 2.

Table 2: Major bank levy figures published in the Budget

<table>
<tr><th>Budget reference</th><th>Explanation of numbers</th><th>What is presented in the budget</th></tr>
<tr><td>Budget paper 1, Statement 5, page 18</td><td>Gross cash receipts estimates for the major bank levy</td><td>Cash receipts, $m
<table>
<tr><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td><td>2020-21</td><td>Total</td></tr>
<tr><td>0</td><td>1,200</td><td>1,600</td><td>1,700</td><td>1,800</td><td>6,300</td></tr>
</table></td></tr>
<tr><td>Budget paper 1, Statement 10, page 24</td><td>Gross fiscal estimates major bank levy</td><td>Revenue, $m
<table>
<tr><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td><td>2020-21</td><td>Total</td></tr>
<tr><td>0</td><td>1,600</td><td>1,700</td><td>1,800</td><td>1,900</td><td>7,000</td></tr>
</table></td></tr>
<tr><td>Budget paper 2, page 24</td><td>Net fiscal balance estimates for major bank levy including interactions with other taxes</td><td>Fiscal balance, $m
<table>
<tr><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td><td>2020-21</td><td>Total</td></tr>
<tr><td>0</td><td>1,600</td><td>1,500</td><td>1,500</td><td>1,600</td><td>6,200</td></tr>
</table></td></tr>
<tr><td>Budget paper 1, Statement 3, page 29</td><td>Net underlying cash balance estimates for major bank levy including interactions with other taxes</td><td>A major bank levy will be introduced for Authorised Deposit-taking Institutions (ADIs) with licensed entity liabilities of at least $100 billion from 1 July 2017. The $100 billion threshold will be indexed to grow in line with nominal GDP. This is estimated to increase tax receipts by $5.5 billion over the forward estimates period.</td></tr>
</table>

The main difference between the accrual and underlying cash estimates arise because the accrual figure recognises the full levy amount for the year whereas the cash figure only recognises the actual levy amounts which will be paid in that year. For example, in the first year only three out four quarterly cash payments will actually be received but the accrual estimate recognises all four quarterly levy liabilities. The yearly breakdown of the $5.5 billion net cash estimate of the major bank levy is presented in Table 3.

Table 3: Net major bank levy estimates (Underlying Cash Balance, $m)

Year	17-18	18-19	19-20	20-21	Total
Net major bank levy estimates (UCB, $m)	1,200	1,400	1,400	1,500	5,500

Paragraphs 1.43 to 1.58 of the Explanatory Memorandum explain in detail when and how levy payments will be made. The levy will be payable quarterly in arrears. With the exception of the levy liability for the September quarter of 2017 which will be deferred by a quarter i.e. due and payable on or before 21 March 2018. The corporate tax deduction due to levy payments is expected to be claimed by the banks when they remit their income tax return.

5. No

6. Treasury has undertaken a reconciliation of the numbers reported by the banks. The reconciliation has confirmed that the estimates published in the Budget remain appropriate.

The greater part of what is claimed to be a shortfall is explained by:

- credit growth over the forward estimates, which increases the size of banks' balance sheets; and
- interactions with other taxes — most notably corporate income tax — and the timing of payments associated with those taxes.

Treasury cannot provide a detailed disaggregation or reconciliation against the banks' numbers, as that would raise taxpayer confidentiality issues.

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Major Bank Levy Bill 2017 Inquiry

Agency: Department of the Treasury
Question No: 3
Topic: Process
Reference: Written
Senator: Ketter

Question:

1. Were the measures for exchange settlement accounts and the "netted" treatment of derivatives part of the original policy set out in the budget? If not, is it correct to say that these measures were introduced after budget night but before the legislation was introduced into the House of Representatives?

2. The explanatory memorandum says that "In designing Option 2 (the original policy) these risks (functioning of capital markets) had been identified and were a focus for consultation. *Those consultations suggested that these risks could be more significant in Australia than the initial assessment.*"

   Could the committee receive a copy of the document outlining the full set of risks that were noted in the development of Option 2?

   Can we have the version of the document that was current at 6:30pm budget night?

   Could the committee receive a copy of the document outlining the full set of risks still outstanding for Option 3?

Answer:

1. As reflected in paragraph 2.25 of the Explanatory Memorandum, the Government agreed to amendments to the major bank levy (as announced in the 2017-18 Budget), that addressed issues raised during the consultation process. As outlined in Table 2.2 of the Explanatory Memorandum, among these changes were including derivatives on a net basis and deducting an amount for Exchange Settlement Account balances held with the RBA.

2. The document of the sort suggested by the questions does not exist.

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Major Bank Levy Bill 2017 Inquiry

Agency: Department of the Treasury
Question No: 4
Topic: Other
Reference: Written
Senator: Ketter

Question:

1. What are the current margins for trading in short-term and REPO markets currently? (say last 12 months)

2. What are the anticipated effects of the levy on margins, buy/sell spreads and liquidity in short term and REPO markets?

3. How will internal RMBS be treated under the levy?

Answer:

1. Reliable data on the size of margins are not publicly available. However, repo operations of banks around the world are generally seen as a low margin business.

It is difficult to estimate the margins that banks earn on their repo activity because they depend on the individual banks' business models, the nature of the investments and source of funding associated with each transaction.

2. It is difficult to gauge whether the proposed levy will have an impact on the repo market. To the extent that certain types of repo or short-term money market activity have very low margins, a tax could reduce their willingness to participate in these transactions due to the impact on their profitability. On the other hand, smaller banks could become more active in these markets.

While there is no publicly available information on the contribution of banks' trading operations in short-term money markets to their overall profit results, repo operations are a small part of the business of the major banks.

3. Due to the accounting treatment of intercompany transactions, liabilities that relate to internal RMBS are included in the levy base.

Capturing liabilities that relate to internal RMBS means that the levy gives equal treatment to various ways of meeting liquidity requirements set by APRA, as liabilities that relate to the funding of high-quality liquid assets (such as government bonds) are also captured.