ISSN: 2350-0328
International Journal of Advanced Research in Science, Engineering and Technology
Vol. 8, Issue 1 , January 2021

# Empiric theory of assessing the impact of taxes on the banks' performance

**Abdullaev Zafarjon Alijonovich**

PhD, Acting Associate Professor of "Finance and Accounting" department of Tashkent State University of Economics (Tashkent city).

**ABSTRACT:** Any form of disproportion in the taxation of the commercial banks' performance can have a general economic impact. Empirical analysis of the impact of taxation on the structure of capital and liabilities of banks, in turn, is an essential scientific source in testing and confirming concepts in the theory of optimization of banks' taxation. This article discusses the issue of optimizing taxation of banks by studying the empirical analysis of the impact of taxes on the commercial banks' performance. In addition, the article evaluates the results of empirical research on the impact of corporate income tax and VAT on the capital structure and financial services of commercial banks and presents appropriate developed conclusions.

**KEY WORDS:** banks, corporate profit tax, tax rate, credit, financial services, tax incentives.

## I. INTRODUCTION

In many countries, new and improved systems of banking regulation are being introduced, including tax schemes aimed at the banking sector. Taxes on the activities of commercial banks can be used not only as an important source of revenue for the state budget, but also as tools to change the behavior of banks [1].
According to existing theories, when optimizing the taxation of commercial banks it is significant to reduce current discrimination in the tax regime of debt and private capital, which can cause an increase in financial stability and capitalization of the banking system.
A number of empirical analyzes have been conducted to assess the impact of taxation on the structure of banks' capital and liabilities, which, in turn, serve as crucially important scientific sources in testing and confirming assumptions in scientific theories on improving the taxation of banks.

## II. LITERATURE REVIEW

In the opinion of Chamley, based on the theories of optimal taxation of capital, in the development of tax policy it is recommended to avoid taxes on capital growth, dividends and interest income, which, first of all, directly affect capital [2]. In addition, from the point of view of Atkeson et al., in the stationary state, zero-rate tax on capital gains is considered optimal, if additional restrictions are not capital-dependent, otherwise it is not optimal [3]. Andrew thinks, if capital expenditures are deductible for capital purchases from the taxable base, capital gains tax at a generally-accepted rate is not considered a violation [4]. However, Andrew noted that the optimal tax system would consist of a positive tax rate on capital gains and a zero tax rate on labor income, provided that public procurement after deducting gross investment does not exceed gross capital gains. This contradicts the findings of Chamley and Judd, who argue that the optimal tax system for the payment of exogenous flows of public procurement is a zero-rate tax on capital in the long run, in which tax revenues are provided at the expense of labor-disrupting taxes [2,5]. According to Petrucci, in a small open economy with perfect capital flow, capital is taxed at a zero rate based on sources of capital taxation, and if taxation is based on residency, income from wealth should be subsidized [6]. When economists interpret the theoretical approaches to capital taxation differently, it can be concluded that taxation of capital is not a right concept. Income received from capital is not a base similar to labor income, which can be taxed, because the value of tax efficiency is determined only by future consumer prices. It is obvious that the level and order of taxation of income received from capital will undoubtedly have a direct impact on the scale, forms and provision of financial services of financial intermediation.

ISSN: 2350-0328
International Journal of Advanced Research in Science, Engineering and Technology
Vol. 8, Issue 1 , January 2021

Boadway and Keen think, that optimal taxation of capital gains and financial services (perhaps, in a smaller amount but still with increasing degree) is a persistent political problem in many countries, but theoretical analysis often focuses more on the positive effects of taxation than developing optimal policies [7].
In general, the solution to the scientific debate on taxation of financial services is usually based on the theorem "Optimal Taxation and Public Production: I-Production Efficiency" [8]. The basic concept of this theorem is the principle of taxation that "taxes should be levied on final consumption, not on intermediate transactions". In particular, according to Boadway and Keen, the application of this theorem to financial services results in the following: financial services purchased by consumers are taxed at a relatively low rate; financial services purchased by enterprises should not be taxed at all [7].

## III. RESEARCH METHODOLOGY

Monographic observations and descriptive statistical methods have been widely used in the research. Herewith, the results of empirical research on the impact of corporate income tax and VAT on the activities of banks have been estimated.

## IV. ANALYSIS AND RESULTS

Corporate income tax has become an issue of top priority for banks, and empirical research published in the last decade has been reflected in the increase in the number of cases (Figure 1).

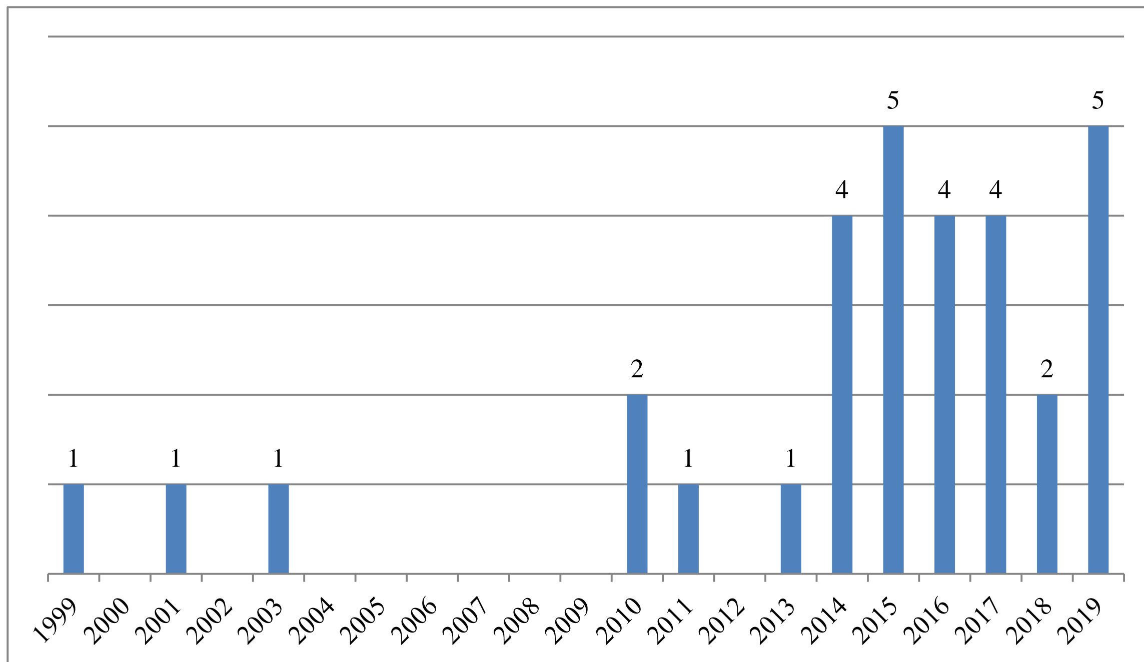


**Fig.1 Number of published scientific articles [9]**

This is due to the recent global financial and economic crisis, which has caused considerations on the existence of a preferential tax regime for debt. Milonas has noted that in response to gradual changes in taxation, banks have been adjusting their capital structure, raising the income tax rate by 1 percentage point to reducing the ratio of private capital to total assets by 15 basis points. The increase in corporate income tax rates will influence the choice of financing and operations of banks, and the behavior of banks will vary depending on the level of capitalization [10, 11]. The impact for tax increases and decreases was of symmetrical nature, but the impact was stronger on banks that were not large and had high capitalization. Finally, high taxes can reduce banks' ability to survive a crisis and retain soundness. The provision of tax incentives to encourage private capital has resulted in the increase in banks' equity, which has increased the bank's capital ratio by 8.83% after the implementation of these tax reforms. With the gradual abolition of this tax mechanism, the negative impact on the private equity ratio can be observed [12]. Restrictions on tax incentives for debt financing in the corporate tax system have a positive impact on the equity ratio of banks, and introduction of

ISSN: 2350-0328

International Journal of Advanced Research in Science, Engineering and Technology

Vol. 8, Issue 1 , January 2021

tax incentives for equity raises average equity ratio of banks by about 13.5% [13]. An analysis of the impact of taxes on the capital structure of banks has revealed that changes in tax rates have a more significant impact on leverage, especially for small and slow-developing banks. In addition, it is stated that changes in tax rates do not change leverage in banks with limited regulatory capital [14].

One of the most essential issues in taxation is the tax burden, and introduction of 1a tax on the activities of banks does not imply that banks will ultimately pay taxes. So, who will be the bearer of a tax burden? This is because banks can transfer the tax burden to their customers by raising interest rates on loans and lowering interest rates on deposits, as well as increasing brokerage costs [15]. For these reasons, it is important to empirically assess whether the tax burden on taxes paid by banks actually falls on banks and what category of customers the banks transfer the tax burden to. In particular, the research by Chiorazzo and Milani has determined that the transfer of corporate income tax and VAT paid on imported resources to banks' counterparties had an impact on pre-tax profits [16]. Demirguç-Kunt and Huizinga studies have found that the transfer of direct taxes from local and foreign banks to bank customers to a certain extent results in the increase in taxable profits of banks [17,18].

In addition, the empirical analysis shows that there is a small correlation between the increase in profitability of banks with foreign capital and profit tax rates, which is due to the fact that in some countries low income tax is levied on the profits of foreign banks and to some extent serve as the tool for attracting foreign investments in the national economy. Regression analyzes by Albertazzi and Gambacorta have revealed that an increase in the corporate income tax rate had a positive effect on the interest rate on loans and a negative effect on the volume of loans under conditions of the absence of changes in the volume of the deposit market. Income received from paid services, by contrast, has always been shown to be negatively related to the tax rate. Herewith, it has been found that a large part of the corporate income tax paid by banks is able to transfer approximately 90% of the tax burden to customers [19]. Moreover, in the regression analysis conducted by Toshmatov and Abdullayev on the basis of pre-tax profit, accrued profit tax, VAT paid on imported goods (works, services) and total assets from the financial statements of commercial banks for 2013-2018, profit with profitability of commercial banks are supposed to have a positive correlation between the profitability of commercial banks and profit tax paid [20].

## V. CONCLUSION AND PROPOSALS

In general, the main result of empirical research is that the taxation of bank profits is equivalent to the taxation of loans, and this has a significant impact on the income structure of the banking sector. Based on the results of the empirical research, we can conclude that the burden of income tax paid by commercial banks will be fully borne by bank customers. This once again confirms the fact that the bank's shareholders are interested in net tax returns. That is, an increase in taxes in favor of corporations, in turn, causes an increase in the price of banking products, as this guarantees a higher return to shareholders.

Taxation impacts pre-tax profit of commercial banks and its structural components (net interest income, interest-free income), operating expenses, loan loss provisions. Thus, the income tax paid by commercial banks and the VAT paid will result in the increase in the value of financial services provided. This implies that the corporate income tax of banks and the VAT paid on the resources received are transferred to the bank's customers and influence the profit before the tax is paid. Based on the above conclusions, the following is proposed to optimize the taxation of commercial banks and eliminate disparities:

- reduction of the profit tax rate to the level of the general profit tax rate, introduction of the procedure for full accounting of VAT received;
- proportional accounting of VAT received and application of VAT at the standard rate to the bank's paid services;
- introduction of reduced VAT on financial products (primarily using the “mobile-ratio” method for “B2B”).

## REFERENCES

[1]Devereux M. P. and et al.,“Can Taxes Tame the Banks? Evidence from the European Bank Levies”,Saïd Business School WP 2015-5. http://dx.doi.org/10.2139/ssrn.2563634.

[2]Chamley C., “Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives”, Econometrica, Vol. 54, No.3, pp. 607-622, 1986.

[3]Atkeson A., Chari V.V. and Kehoe P.J., “Taxing Capital Income: A Bad Idea”, Federal Reserve Bank of Minneapolis Quarterly Review,23, pp.3-17,1999.

[4]Andrew Abel B., “Optimal Capital Income Taxation“,NBER Working Paper No. w13354,p.40,2007. https://www.nber.org/papers/w13354.

[5]Judd K.L., “Redistributive Taxation in a Simple Perfect Foresight Model”, Journal of Public Economics, 28, pp.59-83,1985.

[6]Petrucci A. “Optimal income taxation in models with endogenous fertility”, Centro Studi Luca d'Agliano Development Studies Working Paper N228, p.29, 2007.
[7]Boadway R. and Keen M., “Theoretical Perspectives on the Taxation of Capital Income and Financial Services”, Taxation of Financial Intermediation: Theory and Practice for Emerging Economies,p.443, 2003.
[8]Diamond P.A. and Mirrlees J.A., ”Optimal Taxation and Public Production: I—Production Efficiency”and ”Optimal Taxation and Public Production II:Tax Rules”, American Economic Review,61, 8-27 and 261-78, 1971.
[9]Gawehn Vanessa, “Banks and Corporate Income Taxation: A Review”, Working Paper N48, p. 32, 2019. https://en.wiwi.uni-paderborn.de/fileadmin/cetar/TAF_Working_Paper_Series/TAF_WP_048_Gawehn2019.pdf
[10]Schandlbauer A., “How do financial institutions react to a tax increase?”, Journal of Financial Intermediation, Elsevier, vol. 30(C), pp. 86-106, 2017.
[11]Kristoffer M., “Bank Taxes, Leverage, and Risk”, Journal of Financial Services Research, Springer;Western Finance Association, vol. 54(2), pp. 145-177,2018.
[12]Martin-Flores Jose-Maria and Moussu Christophe, “Is bank capital sensitive to a tax allowance on marginal equity?”, European Financial Management, Vol. 25, Issue 2, pp. 325-357, 2019.
[13]Schepens G., “Taxes and bank capital structure”, Journal of Financial Economics, 120(3), pp.585–600, 2016.
[14]Bond S. and et al., “Regulation, tax and capital structure: evidence from administrative data on Italian banks”, Bank of Italy Occasional Paper No. 361,p. 62, 2017.
[15] Capelle-Blancard G. & Havrylchyk O., “The Ability of Banks to Shift Corporate Income Taxes to Customers”, Working Papers 2013-09, CEPII research center. http://www.cepii.fr/pdf_pub/wp/2013/wp2013-09.pdf.
[16] Chiorazzo V. & Milani C. “The impact of taxation on bank profits: Evidence from EU banks”, Journal of Banking & Finance, Elsevier, vol. 35(12), pp. 3202-3212, 2011.
[17] Demirgüç-Kunt A., Huizinga H., “Determinants of commercial bank interest margins and profitability: some international evidence”, World Bank Economic Review 13, pp.379-408, 1999.
[18] Demirgüç-Kunt A., Huizinga H., “The taxation of domestic and foreign banking”, Journal of Public Economics 79, pp. 429-453, 2001.
[19] Albertazzi U & Gambacorta L., “Bank profitability and taxation”, Journal of Banking & Finance, Elsevier, vol. 34(11), pp.2801-2810, 2010.
[20]Toshmatov Sh. A., Abdullaev Z.A., “Impact of taxation on banks’ profit”, Moliyachi malumotnomasi, №11 (95), pp.12-17, 2019.