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BANK DEPOSITS: TAX REGULATION OF CONDITIONS

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Abstract: the article is devoted to the Russian experience of the income taxation for bank deposit interest. The authors analyze effects and prospects of taxation bank deposits with an interest rate significantly higher than the market rate.

Key words: bank, tax, bank deposit

Аннотация: статья посвящена исследованию российского опыта обложения доходов по банковским вкладам при процентной ставке, существенно превышающей рыночную, и определению его перспектив.

Ключевые слова: банк, налог, банковский вклад, взаимозависимые лица

The modern Russian taxation draws attention to transactions between related economic agents. Related parties can influence on the conditions or the results of transactions. Such activities are often intended to reduce tax liabilities. In many countries transactions between related parties are controlled by the state. In the Russian Federation in 2012 were introduced amendments to the Tax Code, enhancing transfer pricing regulation in the context of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations [2]. Transactions between interdependent persons, banks as well, should be controlled and their price should be compared with the market price level.

Besides that, conditions of bank loans in the Russian Federation are regulated through thin capitalization rules and limiting the amount of interest that can be expensed for the tax base of corporate profit tax. Tax regulation of bank loans with non–market conditions is a worldwide practice. At the same time regulation the conditions of bank deposits is less common. In the Russian Federation there is a correction mechanism by the personal income tax for bank deposits attracted from individuals on non–market conditions.

For banks deposits are one of the main long–term sources. For customers deposits are a tool for safekeeping and enhancement of savings. Depositors expect profitable conditions on deposits and related income tax reduces the attractiveness investments in bank deposits.

However, in many countries, a significant portion of the interest income from banks, seized by the state in taxes. Interest income received from bank deposits by individuals are included in the common base of the income tax with a progressive rate or taxed at a special rate. For example, interest income from deposits is taxed in Switzerland at the rate of 35%, in Ireland – 41%, Italy – 26% [3], etc.

In many transition countries there is no taxation of interest income from banks in order to stimulate the development of the banking system. Interest on bank deposits is exempt from personal income tax in Belarus, Kazakhstan, Kyrgyzstan, Turkmenistan and Azerbaijan (until the end of 2014.). However, in Armenia and Uzbekistan the tax rate on income from bank deposits is 10%, in Tajikistan – 12%, in Moldova – 7–18%. In Ukraine since July 2014 the personal income tax applied to interest on bank deposits with originally progressive rate (15%, 20% and 25%, but only for deposits of more than 20 000 hryvnia – about 1500 USD). Since August 2014 was established flat rate of 15% for all deposits, regardless of their size.

In Russia, the basic rate of income tax on individuals (13%) does not apply to bank deposits. Interest income from bank deposits is exempt from taxation if the interest rate on them does not exceed the refinancing rate of the Central Bank of the Russian Federation, increased by five percentage points (in the case of rubles deposits) and 9% per annum (in the case of foreign currency deposits) [1]. Interest income in excess of set limits is taxed at the increased rate of the personal income tax 35%. For the actual Central Bank's refinancing rate (8.25%) the limit on ruble deposits is 13.25%. The obligation to calculate, withhold and remit the tax imposed on banks, which are open taxable deposits.

We compared the ratio limit of tax–exempt interest and average rates on short term deposits in rubles from 2001 to July 2014. The average interest rates on deposits were 63% of the limit. Since 2001 until June 2003 limit was three–quarters of the Central Bank's refinancing rate and short term deposit interest rates exceeded the limit in January and February 2001. In other periods the average rates were close to three–quarters of the refinancing rate. Since July 2003 to 2008 limit was raised to the whole Central

Bank's refinancing rate. The gap between the limit and the average level of market interest rates increased. Since 2008 due to the global financial crisis and increase of interest rates, limit was raised to the existing level – the Central Bank's refinancing rate increased by five percentage points. Since 2008 at present, the average deposit rates ranged from 37% to 64% of the tax–exempt interest.

Russian personal income taxation of bank deposits interest rate that is much higher than the market average, has a distinct regulatory nature. The rate of 35% was established in 2001 to prevent the payment of wages under the guise of bank deposits interest. In the 1990s shadow income payments by the use of banking and insurance schemes were spread. Paying wages meant charge of social contributions and the personal income tax. Instead of wages, in the case of the banking scheme, individuals got income in form of a substantially inflated interest on bank deposits, which until 1997 were exempt from taxation, and since 1997 were taxed only if they exceed the Central Bank's refinancing rate [4]. An additional advantage of such a scheme was a legal opportunity to pay income regularly, every month. To make these schemes unprofitable Tax Code established the increased tax rate of 35% for interest income from bank deposits, individual insurance payments and income in the form of the material gain (if an interest on the use of borrowed resources (credit) is less than two thirds of the current refinancing rate established by the Central Bank in rubles and less than 9% in foreign currency). The maximum rate of unified social tax of 26% and the personal income tax rate of 13% leaded to costs of wages for about 31% from the after–tax amounts (including taxes from employer and employee). Social contributions with the maximum rate of 30% increase costs of wages to 33.1% and do not exceed the rate of personal income tax on bank deposits in the amount of 35% (or 54% comparing with after–tax amount).

Tax regulation of bank deposit on non–market conditions in Russia differs from tax regulation of transfer pricing:

– Tax regulation of bank deposit interest focus on the conditions of individual deposits. While the regulation of transfer pricing affects primarily legal entities;

– Regulation of transfer pricing involves definition the market conditions at the time of the transactions. However, the Russian personal income tax establishes a threshold of taxable interest for all deposits. For deposits in foreign currency it is the absolute index of 9% and for deposits in rubles taxable interest is tied to the refinancing rate, but also as absolute index (five percentage points), not a relative one (as a percentage of the refinancing rate).

With the development of tax legislation the threshold of taxable interest began to lose its relevance as a way to adjust the taxes paid as a result of transactions between related parties. Nowadays the banks would find it difficult to use the shady schemes of income payment in form of a deposit interest instead of wages. Currently no Russian bank offer deposits that are taxed.

The exemption from taxation the basic amount of interest on deposits makes investments in other instrument (for example, in securities) less attractive. Income from securities is an object of the personal income tax at a rate of 9% (for tax residents). In this regard, the Russian Finance Ministry has initiated a discussion of increasing the tax on interest income from deposits. In 2013 were offered two projects in order to equalize tax treatment for different types of individual investments: (1) decreasing of the limit for taxable interest rate to the Central Bank's refinancing rate, increased by three percentage points (ruble deposits) and 6% per annum (foreign currency deposits); (2) setting the maximum amount of bank deposit interest income exempt from the personal income tax (it is noteworthy that the option to extend the basic personal income tax rate of 13% to the income on deposits is not considered).

In our opinion, the intersection of different targets in the interest taxation (regulating (the existing order), fiscal (decreased limit) and social (taxation of high income from deposits)) has a negative impact on attraction of deposits from individuals and on the whole Russian banking system.

Both projects are associated with higher costs of tax administration. Banks and tax authorities will have to raise additional staff. Banks will be required to install a system to track the movement of deposits and calculation of a tax. Evidently, both projects will have a negative impact on investors, leading to a decrease in the deposits attracted by banks.

However, the first project is less painful and costly, since a very limited number of deposits would be taxed. According to our research in September 2014 there were only 35 deposits in 23 banks in Russia with the interest rate more than the Central Bank's refinancing rate plus three percentage points (8.25%+3%). The highest rate (13%) offered Dagenergobank (other deposits rate of this bank are 11.75% and 11.5%), rate of 12% was offered three banks, 11.35% – two banks. Analyzed deposits are long–term and have high minimum deposit amount (from 7 to 15 million rubles (approximately from 200 to 420 thousand USD) in Dagenergobank).

The second project is about an establishment of a tax on deposits with interest income over a certain (and rather large) amount according to the vertical equity principle (the rich should pay more than the poor). It will make deposits less profitable for wealthy clients and will encourage them to seek other investments types, such as securities. On the one hand, such possible migration of capital could be a positive trend. On the other hand, many Russian banks will lose major depositors, some of which will go to offshore areas. The implementation of this proposal is connected with high possibility of a significant capital outflow from the country.

These proposals are more likely to affect small banks that do not have full access to the interbank market or the stock market. In reduced price competition between banks investors will prefer more reliable and well–known "players". Small bank will face the problem of funding sources, the reduction of credit and eventually closure.

The changes in individual taxation of interest income from bank deposit require a comprehensive analysis of the following effects and adjustments to regulation of non–market conditions in the banking business.

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