EUROPEAN CENTRAL BANK

EUROSYSTEM

**EN** **ECB-PUBLIC**

# OPINION OF THE EUROPEAN CENTRAL BANK

**of 16 December 2019**

**on**

**taxes on assets of certain financial market participants and additional corporate income taxes on certain credit institutions**

**(CON/2019/44)**

## Introduction and legal basis

On 11 October 2019, a draft legislative proposal on taxes on assets of certain financial market participants was introduced into the Lithuanian Parliament (the 'draft law on financial market participants' asset tax').

On 6 December 2019, a draft legislative proposal amending the Law on corporate income tax imposing an additional tax on profits of banks and credit unions was introduced into the Lithuanian Parliament (the 'draft law on credit institutions' income tax'). The draft law on financial market participants' asset tax and the draft law on credit institutions' income tax are collectively referred to as the 'draft laws'.

The ECB has decided to deliver an own initiative opinion on the draft laws, since it has not been formally consulted on the draft laws by the Lithuanian authorities.

The ECB's competence to deliver an opinion is based on the second subparagraph of Article 127(4) of the Treaty on the Functioning of the European Union in conjunction with the sixth indent of Article 2(1) of Council Decision 98/415/EC[1], as the draft laws concern rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

## 1. Purpose of the draft laws

*Draft law on financial market participants' asset tax*

1.1. The draft law on financial market participants' asset tax would impose an obligation on certain financial market participants to pay a monthly tax of 0.03 % of the value of financial market participants' assets, subject to certain exemptions, deductions and exceeding a certain threshold.

1.2. Under the draft law, the tax applies to banks, branches of foreign banks licensed in Member States of the European Union (EU) and the European Economic Area (EEA) that are established

1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

in Lithuania, branches of foreign banks licensed in non-EU/EEA countries that are established in Lithuania, credit unions, central credit unions, consumer credit lenders and credit lenders.

1.3. According to the draft law, the tax base for banks, branches of foreign banks, central credit unions and credit unions will be the average annual assets excluding funds at the Lietuvos bankas, funds lent to the State, cash, tangible and intangible assets, own funds calculated as the simple average of the value of assets at the end of four quarters of the preceding calendar year, in excess of EUR 300 million.

1.4. The tax base of the consumer credit lenders and credit lenders will be the average annual amount of disbursed consumer credit or credit related to real estate, which remains to be repaid, calculated as the simple average of the annual amount of disbursed consumer credit or credit related to real estate, as the case may be, which remains to be repaid at the end of four quarters of the preceding calendar year, in excess of EUR 300 million.

1.5. The draft law provides a series of exemptions from the tax, as follows: (1) for a one-year period following the application to banks (including banks licenced in EU/EEA Member States, which have established branches in Lithuania) or central credit unions of measures provided for in a recovery plan, or adoption of a decision to reorganise such banks or central credit unions, (2) during the period of a moratorium declared with respect to a bank (including a branch of a bank licenced in a country other than an EU/EEA Member State), central credit union, credit union, or a bank licenced in an EU/EEA Member State, which has established a branch in Lithuania, and (3) if a taxpayer is subject to bankruptcy or restructuring, or bankruptcy proceedings are initiated against a foreign bank, which has established a branch in Lithuania.

1.6. As noted in the explanatory memorandum to the draft law, the purpose of this draft law is to enable the financial market participants referred to in the draft law to increase their contribution to the State budget revenue, needed to finance public services and meet public obligations.

*Draft law on credit institutions' income tax*

1.7. The draft law on credit institutions' income tax would impose an obligation on certain credit institutions, namely, commercial banks, branches of foreign commercial banks, credit unions and central credit unions (collectively referred to as 'credit institutions'), to pay an additional profit tax at the rate of 5 % of the taxable profits of the credit institution.

1.8. The base for the additional profit tax shall be the taxable profit of the credit institutions, calculated by deducting from the taxable income of the credit institution the allowable deductions, non-taxable income, deferred tax assets and other amounts prescribed by the draft law, in excess of 2 million euros.

1.9. Credit institutions' annual profits of up to 2 million euros shall not be subject to additional profit tax.

1.10. The additional profit tax shall apply as of 1 January 2020 and be in effect for a three year period.

1.11. As explained in the draft law, the main purpose of the draft law is to ensure that the financial sector contributes to a greater extent to the fulfilment of social and other public obligations, whereas currently credit institutions are subject to a favourable tax treatment compared to other corporates in Lithuania.

## 2. General observations

2.1. The ECB has consistently advised that taxes on financial institutions should be considered in relation to the dual objective of: (a) ensuring a more equitable distribution of the costs arising from the financial institutions' potential failure between taxpayers and the financial sector; and (b) addressing the risks that the failure of financial institutions would pose[2]. Using the proceeds of any ad hoc taxes imposed on banks for general budgetary purposes would be undesirable to the extent that such taxes would place undue burdens on banks, hampering the provision of credit with a knock-on effect on growth in the real economy[3]. The proceeds from taxes on financial institutions should be ring-fenced to avoid using them for general fiscal consolidation purposes[4].

2.2. In addition, imposing any ad hoc taxes on banks for general budgetary purposes should be preceded by a thorough analysis of potential negative consequences for the banking sector to ensure that such taxes do not pose risks to financial stability and the provision of credit, which could eventually adversely affect growth in the real economy. This might in turn result in banks offering less favourable terms to their customers when providing loans and other services and may also induce certain banks to cut back on their activities, leading to a reduction in the availability of credit and creating uncertainty for these banks[5].

2.3. The introduction of the tax should be carefully considered with regard to its impact on the profitability of affected financial institutions, and thereby on their internal capital generation capacity which in turn affects both their resilience to adverse shocks and the ability to extend credit and support the real economy. In this context, the differences in the situation of individual banks must be taken into account, as must the potential impact of other relevant regulations that are being introduced in Lithuania and in the Union. In particular, the situation of weaker banks and banks that may be disproportionally affected and record losses as a result of the proposed tax should be fully analysed.

2.4. In the light of the foregoing, and in line with its previous opinions[6], the ECB has concerns that the draft law on financial market participants' asset tax could have a material adverse effect on the Lithuanian financial system and trigger potential undesired distortions with respect to bank business models. The ECB urges the Lithuanian authorities to assess the impact that the introduction of this tax would have on the stability of the Lithuanian financial system.

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2 See paragraph 2.1 of Opinion CON/2019/40, paragraph 2.1 of Opinion CON/2016/01, paragraph 3.1.1 of Opinion CON/2015/43, paragraph 2.1 of Opinion CON/2013/44, paragraph 2.1 of Opinion CON/2011/29 and paragraph 3.2.1 of Opinion CON/2010/62. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

3 See paragraph 2.1 of Opinion CON/2019/40, paragraph 3.1.1 of Opinion CON/2015/43.

4 See paragraph 2.1 of Opinion CON/2019/40, paragraph 3.2.1 of Opinion CON/2010/62.

5 See paragraph 2.1 of Opinion CON/2016/01, paragraph 3.1.1 of Opinion CON/2015/43, paragraph 2.1 of Opinion CON/2011/29 and paragraph 3.2.2 of Opinion CON/2010/62.

6 See paragraph 3.2 of Opinion CON/2019/29, paragraph 2.4 of Opinion CON/2019/40, paragraph 2.4 of Opinion CON/2016/01, paragraph 2.2 of Opinion CON/2013/44, paragraph 2.2 of Opinion CON/2011/29 and paragraph 3.2.2 of Opinion CON/2010/62.

2.5. Regarding the draft law on credit institutions' income tax, it is recommended that the draft law is accompanied by a comprehensive impact assessment regarding the introduction of this tax.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 16 December 2019.

[signed]

*The President of the ECB*

Christine LAGARDE