Chapter 12

BANKS AS AGENTS FOR GOVERNMENT

Banks and other deposit-taking institutions act as agents for government in a number of ways, incurring significant compliance costs, without experiencing offsetting benefits. These agency activities impact on the operational efficiency of financial institutions, can sometimes impair relationships with customers and distort financial flows. Consequently, the efficiency with which the financial system allocates resources throughout the real economy is adversely affected.

12.1 Financial Institutions Duty and Bank Account Debits Tax

The Terms of Reference provide that the Committee will take account of, but may not make recommendations on, the taxation of financial arrangements. Nevertheless, any Inquiry into the financial system which is concerned with efficiency and with "international competition and integration of financial markets" must have regard to the taxation of financial transactions in Australia.

The taxation of transactions in Australia takes two main forms[1]:

Financial Institutions Duty (FID) is a duty levied on deposits made with financial institutions in all States and Territories except Queensland. The amount of the duty varies by State. The right of financial institutions to pass this duty on to customers has been acknowledged by respective State Governments. In the words of one observer: "Financial institutions are simply a convenient revenue collection agency."[2]

Bank Account Debits (BAD) Tax is a tax on debits made to all accounts which have cheque access. Originally a federal tax, it was handed over to the States in 1990. It applies in all States and Territories except the ACT.

This submission does not explore all the issues associated with FID and BAD Tax. They are many and complex and are discussed in considerable detail in a recent report by Coopers & Lybrand. [3] However, it is useful to consider the implications of FID and BAD tax for competition and competitive neutrality, the efficiency of the financial system and for users of financial services[4].

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1 Other State transaction taxes include financial institutions levy (Norfolk Island), electronic debits duty (Northern Territory), financial institutions debits duty (Tasmania) and credit card transactions duty (Queensland and Tasmania).

2 *The FID Reform Process,* Mr Robert Webster, Executive Director, International Banks and Securities. Association, July 1996

3 *Financial Institutions Duty and Debits Tax: Constraints on Australia's Future in a Global Financial Market, Coopers & Lybrand,* 1996. A useful discussion of the issues is also provided in a recent address on the FID reform process by Mr Robert Webster, Executive Director, International Banks and Securities Association.

4 This assessment draws heavily (but not solely) on the Coopers & Lybrand study. Supporting evidence, including the statistics cited, can be found in that Report.

12.1.1 Adverse impact on the competitiveness of Australian financial institutions

The Coopers & Lybrand study makes a number of specific observations about the future impact of banking technology on FID and BAD tax and on competition. These include the following:

- As the market for financial services becomes better integrated and international in scope, taxing financial transactions will become increasingly anti-competitive and inefficient. Australia is the only nation in the world to tax financial transactions directly. Its financial transactions taxes will not be appropriate in an environment where transaction costs and returns on investment are overriding factors directing the flow of investment and capital. Transactional business will be driven offshore to low cost transaction centres to avoid FID and BAD tax. Institutions able to offer low cost transaction services will enjoy a competitive advantage over their Australian-based counterparts for both Australian and international business.

  Thus, 65% of businesses with annual turnovers in excess of $750 million already maintain offshore foreign currency accounts. 43% of this group cite FID as a major or decisive factor in this decision. One Australian corporate with large US denominated export revenue, established its foreign currency account in Queensland, as a result of which it saves $100,000 per annum.

- In its role as a custodian, the US bank State Street Australia has indirectly used a FID exemption from the NSW Government to attract unit trust investment from Australian resident trustees. As the Coopers study points out: “Attracting new business to New South Wales provides no justification for placing Australian business, which is subject to FID, at a competitive disadvantage.”

12.1.2 Adverse impact on efficiency

The efficiency implications of FID and BAD tax can be viewed in terms of the three different aspects of efficiency.

Operational efficiency

- The administration of FID and BAD tax adds to banks’ costs. In Westpac’s case, the annual cost of collecting FID and BAD tax is estimated at $2.3 million. This cost is not reimbursed by the Government nor directly charged to users, but is ultimately passed on to customers or borne by shareholders.

- Transaction taxes induce businesses to rearrange their affairs artificially and inefficiently. Thus 75% of businesses have implemented group structures specifically to minimise FID and BAD tax (rather than because these were the most efficient structures).

Dynamic efficiency

- 80% of banks consider that FID and BAD tax impede the development of new banking products. Thus, Westpac would like to introduce a cash management service which would automatically transfer funds from accounts in credit to accounts in overdraft. However, transaction taxes on the transfers would eliminate the saving.

- 28% of businesses identified the cost of FID as a major or decisive impediment to the use of EDI for business payments[5]. 38% of banks consider that FID and BAD tax are likely to be major factors limiting the adoption of electronic banking technologies by businesses. (This is because electronic funds transfer systems credit payments to accounts as they occur, preventing their consolidation to take account of the maximum amount of FID payable.)

Allocative efficiency

- FID is an explicit tax on saving. It is payable every time a customer makes a bank deposit. It also discourages savers actively managing their investments so as to maximise the return they receive, as every time a deposit is switched between accounts or between institutions, FID is payable.

- The BAD tax penalises the use of cheques relative to other forms of payment.

- 65% of businesses occasionally or frequently change their treasury investment decisions because of the cost of FID, with the figure rising to 75% for businesses with annual turnover exceeding $1.15 billion.

12.1.3 Inequitable impact on users

The impact on consumers can be viewed according to whether they are personal or business users.

Personal users

- FID is mildly regressive and BAD tax highly regressive, with low income earners likely to have to pay more, relative to their income, than high income earners.

- The cost associated with transactions taxes reduces competition. For example, FID may make it unprofitable for funds invested with one bank to be transferred to another which offers a higher interest rate.

Business users

- FID and BAD taxes raise the cost of financial services relative to those available to overseas competitors of Australian businesses. Thus, Australian banks offer exporters foreign currency accounts. These are subject to FID whereas overseas banks can offer accounts based in foreign countries on which no transactions taxes are payable.

- It is easier for larger Australian businesses than small ones to make their transactions offshore.

- As a proportion of annual turnover, FID also represents a greater relative burden on small businesses. The latter are generally unable to access the FID ceiling which applies to deposits over $2 million. Businesses with a turnover which exceeds $2 billion pay one third as much BAD Tax, as a proportion of annual turnover, as businesses with turnovers of less than $50 million.

[5] Creditors may prefer to receive payment by cheque or in cash rather than electronically so they can accumulate receipts and thus benefit from a lower FID liability.

The priorities of some State Governments in exempting Regional Headquarters and Offshore Banking Units from FID and BAD tax, is to be commended. But subjecting their Australian competitors to these highly inefficient taxes must seriously be questioned. By adding to the costs of Australian companies, State Governments are weakening Australian companies ability to compete, both domestically and internationally. At the same time, it reduces State Government revenue from other sources, such as payroll tax.

12.1.4 Lack of uniformity among the states

There are considerable problems associated with the lack of uniformity in the application of FID among the States. These include:

- the need to monitor changes in seven different FID and BAD regimes, including differences in legislation, interpretation of similar provisions, the ever increasing number of revenue rulings and penalty provisions for non-compliance;

- the compliance costs, noted above, which are increased by this lack of uniformity; and

- the double taxation of inter-jurisdictional transfers. A typical example involved a customer of Westpac, resident in Perth, who requests a NSW fund manager who manages his ADF to transfer the savings to a Westpac bank account in Perth. The trustee of the fund is a NSW Westpac customer. The trustee gives a cheque made payable to the customer to the fund manager, who deposits it in NSW on behalf of the customer for the credit of an account in Perth. A prima facie FID liability in NSW exists as the remitter (the fund manager) is not remitting his own money. The Perth customer will first be charged FID in NSW (as the fund manager will instruct Westpac to deduct FID from the deposit in NSW) and secondly when the funds are credited to his bank account in Perth.[6]

Figure 12.1 shows the complex rules which govern the calculation of FID on interstate transfers.

12.1.5 Conclusion on FID and BAD

It is evident from even the brief summary provided here that FID and BAD tax have adverse effects on competition and competitive neutrality, on the efficiency of the financial system and for users of financial services. It also acts as a disincentive to the active management of savings. The Coopers & Lybrand Report concludes that, in addition, FID and BAD tax fail the standard tax assessment criteria of equity, efficiency, revenue stability, simplicity and public acceptability. While putting FID onto a uniform basis would be a step forward, it would not remove many of the problems identified.

***Recommendation 12.1*: The Federal Government should, as a matter of urgency, work with the States to develop alternative fiscal measures to ensure that FID and BAD tax are abolished by the year 2000, so as to achieve greater competition and efficiency in the financial system and greater equity among those making financial transactions.**

[6] This is a real example which happened to Westpac a few years ago. Further examples can be provided to the Committee, if required.

Figure 12.1

INTERSTATE TRANSFERS --- ALL STATES

The following matrix can be used as a 'ready reckoner' to determine whether a FID liability exists when a deposit is made in one state for crediting of an account in another state. For example :

> If a deposit is received in Tasmania for credit to an account in NSW, the deposit in Tasmania will be dutiable at the Tasmanian FID rate of 0.06%, unless the deposit comprises of, or includes, customers own cheques* or transfer between accounts**, which are to be treated as non-dutiable and should be excluded from FID calculation.

* NOTE : 'Own cheques' are defined as cheques drawn by the customer on their Westpac account held in the State where the deposit is being made (the Remitting State).

** NOTE : 'Transfer between accounts' are defined as Paperless (Card initiated) or Westpac Withdrawal forms.

	ACCOUNT DOMICILE (State where the deposit account is held)
Deposited in New South Wales	**Vic, SA, WA, Qld, NT, Tas, ACT** FID payable at the NSW rate of 0.06% except for OWN CHEQUES/TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $2M or over.
Deposited in Victoria	**NSW, SA, WA, NT, Tas, ACT** No Interstate FID payable.
	Queensland FID payable at the Vic rate of 0.06% for ALL deposits made by Cash &/or Cheque. Paperless or Paperbased withdrawals (ie Cards or a RED withdrawal form) are exempt (treat as Transfer Max. $1,200 for deposits of $2M or over
Deposited in Western Australia	**NSW, Vic, SA, NT, Tas, ACT** FID payable at the WA rate of 0.06% for ALL deposits made by Cash and/or Cheque. Paperless withdrawals or Paper withdrawals from Westpac accounts held in W.A. are exempt. Max. $1,200 for deposit of $2M or over.
	Queensland FID payable at the W.A. rate of 0.06% for ALL deposits. Max. $1,200 for deposits of $2M or over

	ACCOUNT DOMICILE (State where the deposit account is held)
Deposited in Queensland	**ALL STATES** No FID payable in Qld
Deposited in Northern Territory	**NSW, Vic, SA, WA, Qld, Tas & ACT** FID payable at the NT rate of 0.06% for TOTAL deposit. Max. $1,500 for dep. of $2.5M or over NOTE : OWN CHEQUES and TRANSFERS ARE DUTIABLE.
Deposited in Tasmania	**NSW, Vic, SA, WA, Qld, NT, ACT** FID payable at the Tas rate of 0.06% except for OWN CHEQUES/TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $2M or over.
Deposited in Australian Capital Territory	**NSW, Vic, SA, WA, Qld, NT, Tas** FID payable at the ACT rate of 0.10% except for OWN CHEQUES/TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $1.2M or over
Deposited in South Australia	**NSW, Vic, WA, Qld, NT, Tas, ACT** FID payable at the SA rate of 0.065% except for OWN CHEQUES/TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $1,846,154 or over.

FID SCALES

NSW Vic WA Tas	.06 Cents per each $100.00 Max $1,200 for deposits of $2M or over
SA	.065 Cents per each $100.00 Max $1,200 for deposits of $1,846,154 or over
NT	.06 Cents per each $100.00 Max $1,500 for deposits of $2.5M or over
ACT	.10 Cents per each $100.00 Max $1,200 for deposits of $1.2M or over
Qld	NO FID

12.2 Financial Transaction Reports Act 1988

The objective of the Act is the prevention and detection of offences connected with the cash economy, including the laundering of money associated with criminal activity, particularly drug trafficking and tax evasion. The Act requires cash dealers[7] to:

- verify the identity of signatories to accounts;
- report to the Australian Transaction Reports and Analysis Centre (AUSTRAC) all cash transactions of $10,000 or more, and all suspicious transactions, irrespective of their value or whether they involve cash; and
- report all telegraphic instructions for the transfer of funds into or out of Australia.

Westpac accepts that banks have a responsibility to assist the Government in its efforts to prevent tax evasion, money laundering and other illegal activities. But it believes this can be achieved more efficiently and that the costs of doing so should be reimbursed by Government from the taxation revenue generated as a result of banks' efforts on behalf of the wider community.

12.2.1 Account opening procedures

The existing requirement that cash dealers identify customers before opening an account using the '100 point identification system' was introduced in 1990. It has since been modified to make it less onerous, but nevertheless remains a significant problem for banks and other deposit-taking institutions.

The Senate Standing Committee on Legal and Constitutional Affairs undertook an Inquiry in 1993 into the effectiveness of the Act.[8] In a submission to the Committee, the ABA advised that the estimated 1993 annual operating cost for account openings by banks was $21.7 million[9], broken up as follows:

Table 12.1
1993 COST OF ACCOUNT OPENINGS BY BANKS

• Staff costs	$20,644,000
• Other branch costs	$221,000
• Other administrative costs	$841,000
TOTAL	**$21,706,000**

Source: *Checking the Cash, A Report of the Senate Standing Committee on Legal and Constitutional Affairs, 1993*

[7] These include financial institutions, insurance companies, securities dealers, futures brokers, trustees, issuers of travellers' cheques, payroll companies, casino operators, bookmakers, etc.
[8] *Checking the Cash, A Report on the Effectiveness of the Financial Transactions Reports Act, 1988*
[9] This is in addition to establishment costs over the period of $6.4 million. CUSCAL estimated the recurrent cost for credit unions at $10 million.

These costs are associated with the time taken to open new accounts, the costs of computer storage, and so on. In the year ended 30 June 1996, Westpac estimates that the cost of the customer identification component of the new account opening procedures was $0.5 million.[10]

But the problem is not just one of cost. It also reduces competition, as the inconvenience involved in opening new accounts with new financial institutions discourages customers from transferring their business between institutions. Finally, there is the additional difficulty that arises where a customer brings the wrong identification and becomes frustrated when the bank will not accept it.

The Senate Standing Committee recommended that:

> "... the present account opening requirements of the FTR Act should no longer be a minimal procedure. Instead the Act should impose upon cash dealers an obligation to take reasonable steps to satisfy themselves of the identity of signatories to an account."

It further suggested that cash dealers should have the discretion to depart from the standard procedures where the circumstances warrant, with AUSTRAC auditing compliance with their statutory duty to satisfy themselves of the identity of their customers.

To date, the Report has not been discussed in the Senate or adopted by the Government.

The present signatory identification procedures are inflexible and impose considerable direct and other efficiency costs on cash dealers, discourage competition (by making it more difficult for customers to change banks) and can impair the relationship institutions have with their customers. They also exclude some people from legitimate access to the banking system due to major difficulties complying with the procedures.[11]

At the same time, it is questionable whether these procedures are any more successful in discouraging false accounts associated with such activity as drug trafficking and tax evasion than those cash dealers themselves would use in the absence of statutory rules. Financial institutions have every reason to verify the identity of customers.

***Recommendation 12.2*: The account opening procedures imposed on cash dealers under the Financial Transactions Reports Act should be amended in accordance with the Senate Committee's recommendation, with cash dealers being obliged to take reasonable steps to satisfy themselves of the identity of signatories to an account.**

10 The apparent discrepancy between the ABA and Westpac figures appears to reflect the greater degree of automation now used and the fact that, the ABA figures are the total cost of account openings, not just the additional customer identification component.

11 In its evidence to the Committee, the Victorian Council of Financial Supervisors for Civil Liberties claimed that groups facing difficulties included pensioners, Aborigines, persons living in remote locations, recent arrivals in Australia, homeless youths and non-residents.

12.2.2 Significant cash transaction reports

Between 1 July 1990 and 31 March 1993, 1.6 million significant cash transactions were reported by cash dealers to AUSTRAC, the majority being by the four major banks. The Senate Committee noted that compliance costs of reporting substantial cash transactions were both substantial and far greater than was anticipated by the Government when the legislation was introduced in 1987.

While 90% of these reports are delivered electronically, the costs are still significant.[12] An ABA survey of 18 member banks indicated the 1993 annual operating costs of significant cash transaction reporting was $2.5 million, broken up as follows:

TABLE 12.2
TRANSACTION 1993 COST OF SIGNIFICANT CASH REPORTING BY BANKS

•	Staff costs	$2,108,000
•	Other branch costs	$117,000
•	Other administrative costs	$229,000
	TOTAL	**$2,454,000**

Source: *Checking the Cash, A Report of the Senate Standing Committee on Legal and Constitutional Affairs, 1993*

The Committee was unable to form a view as to the value of the information collected, but did conclude that "efforts must be taken to contain the costs imposed on cash dealers".

During the year ended 30 June 1996, Westpac provided significant numbers of reports to AUSTRAC on substantial cash transactions, suspect transactions and telegraphic transactions. It estimates that this cost the Bank $0.6 million per annum.[13]

12.2.3 Why should cash dealers carry the cost?

In evidence to the Senate Committee, the Australian Taxation Office indicated that taxation revenue had increased by over $30 million as a direct result of use of AUSTRAC data (apparently the total amount generated over the period 1988-1993), mainly as a result of suspect transaction reports. It was confident that the revenue yield, especially from significant cash transaction reports, will increase over the coming years.

Whatever the benefits of the Act to the community, it must be asked which other industries have to bear such a large cost burden without reimbursement from the Government and what the rationale for this might be.

[12] No estimate of compliance costs associated with suspect transaction reporting was provided, but these are far smaller in number. Nor was any estimate provided of the cost of reporting telegraphic transactions, as this requirement was only introduced late in 1992.

[13] This figure includes the cost of reporting all three types of transactions, whereas the ABA figures only include significant cash transaction reporting.

This is more than an academic argument. Banks not unnaturally seek to recoup these costs of acting as agent for Government in other ways from their customers or alternatively the costs are borne by shareholders.

Recommendation 12.3**: A proportion of the costs incurred by cash dealers in complying with account opening procedures and <u>all</u> the costs of reporting substantial, suspicious and telegraphic transactions should be reimbursed from the additional tax collected.**

Recommendation 12.4: **If this is not done, the costs incurred by banks should be credited against the fees payable for their prudential supervision (See recommendation 7.25).**

12.3 Taxation Laws Amendment (Tax File Numbers) Act 1988

The objective of this legislation is to prevent tax avoidance and assist the Australian Taxation Office in detecting this when it occurs. As with the Financial Transaction Reports Act, the Government has looked to deposit-taking institutions to undertake activities on its behalf so as to enforce the law, but without reimbursing them for the costs they incur in the process.

These compliance costs are not insignificant. A survey of 18 ABA member banks early in 1992 (representing 91% of the industry's assets and 99% of branches and agencies) indicated that $25.5 million of establishment costs were incurred by respondents over the five years to 31 December 1991 (see Table 12.3).

Table 12.3
BANK TAX FILE NUMBER ESTABLISHMENT COSTS, 1987-1991

• systems development costs	$14,600,000
• staff expenses	$4,700,000
• capital costs	$800,000
• legal and other costs	$5,400,000
TOTAL	**$25,500,000**

Source: Australian Bankers' Association

On-going (annual) costs incurred by banks in 1991 in complying with the Tax File Number legislation are set out in Table 12.4.

Table 12.4
ANNUAL BANK TAX FILE NUMBER COSTS, 1991

•	staff costs	$2,900,000
•	other branch costs	$100,000
•	other administrative costs	$3,100,000
	TOTAL	**$6,100,000**

Source: Australian Bankers' Association

Westpac estimates that the costs it incurred in complying with the requirements of the tax file number legislation, as well as collecting Tax File Number withholding tax and non-resident withholding tax, amounted to $965,000 during the year ended 30 June 1996.

The Government receives a very significant benefit from the Tax File Number System. The then Treasurer, in his Press Release No. 47 of 25 May 1988, claimed that over $2.1 billion would be earned as a result of this initiative over ten years. Customers and shareholders of deposit-taking institutions should not be required to carry the burden of assisting this outcome.

***Recommendation 12.5*: All the costs incurred by deposit-taking institutions in connection with administration of the Tax File Number system should be reimbursed.**

***Recommendation 12.6*: If this is not done, the costs incurred should be credited against the fees payable for their prudential supervision (See recommendation 7.25).**

12.4 Investigations, Subpoenas and Legal Inquiries

Banks are required to produce records subpoenaed by Courts, Royal Commissions, requested by Law Enforcement Agencies, the Australian Taxation Office and so on. As litigation often centres on money, this is hardly surprising, but it involves a major cost to the banking industry which is rarely recognised.

Westpac, for example, employs the equivalent of 6 full-time staff Australia-wide to produce records. The annual cost it incurs in meeting these requests is estimated to amount to $1.23 million. It is difficult to see how these costs can be recovered, but one approach may be to credit them against the cost of prudential supervision. (See recommendation 7.25.)

***Recommendation 12.7*: The costs incurred by banks and other deposit-taking institutions in responding to official requests for information should be credited against the fees payable for their prudential supervision.**