

Financial Services

Limited utility of METR analysis for financial services

- METR calculated on physical assets only, which represent a small portion of total capital.
- High METRs for the financial sector therefore do not necessarily mean that financial institutions are excessively taxed relative to companies in other sectors.

What the METR Analysis Shows

- METRs in the financial sector tend to be high relative to other sectors in all countries surveyed.
- Largely because interest is exempt from VAT. Interest is main source of income, so a small percentage of VAT paid can be reclaimed.
- Main variations based on income tax treatment of interest, capital gains & dividends.

What the METR Analysis Shows

FINANCIAL SECTOR METRS IN 10 AFRICAN COUNTRIES

ZAM	RSA	RWA	TZ	LES	MAU	MAD	MOZ	NAM	SL
30.0%	29.8%	28.0%	28.1%	51.0%	-34.0%	29.1%	57.0%	43.1%	28.0%

What explains the variations?

- Ratio of fee income to interest income
 - Countries with sophisticated financial sectors tend to have more fee-based service income
 - Countries where banks earn much of their income from forex dealing also have more non-interest income
- In Mauritius, many banks operate in offshore sector with lower tax rates
- Tax deductibility of pension/retirement fund contributions; tax treatment of earnings in pension/retirement funds
- Tax treatment of capital gains and dividends
- VAT treatment of equipment imported for leasing

Conclusions and Recommendations

- Tax policy can affect growth and innovation in the financial sector, e.g.,
 - Tax treatment of derivatives can foster or impede development of financial markets and risk management
 - Definition of capital gains can affect individual and corporate investment decisions, especially in areas like private equity
 - Tax treatment of dividends and capital gains also affects investment decisions
 - VAT treatment of leasing
- Lower tax rates for dividends & capital gains can encourage productive investment
- Need proper definition of capital gains. Definition based on timing easier to administer than “intention” test