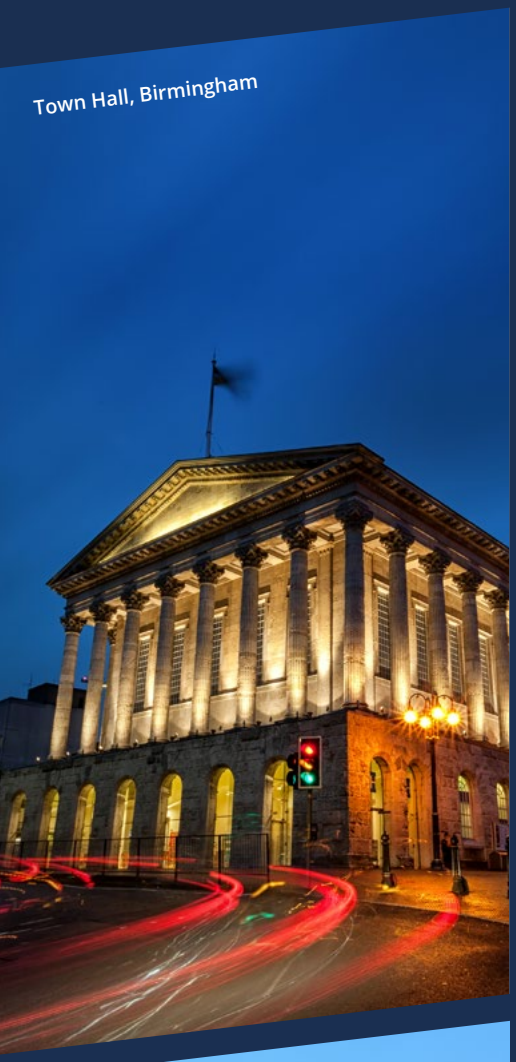
CITY OF LONDON

In association with:

pwc

# The total tax contribution of UK financial services in 2020

13th Edition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# Foreword

"The financial services sector adapted to whole-scale remote working almost overnight, made possible by a skilled and adaptive workforce and investment in technology."

**Catherine McGuinness**
Policy Chair of the City of London Corporation

Undoubtedly, 2020 was a year without precedent. The pandemic cast a long shadow over people's lives and, although a vaccine is now available, it will take time for business to recover.

At the same time, we have seen strong agility and resilience. The financial services sector adapted to whole-scale remote working almost overnight, made possible by a skilled and adaptive workforce and investment in technology.

These factors allowed the financial services sector to provide support to businesses in London and across the UK – for example, by rolling out huge amounts of government-backed loans.

However, the future is uncertain, and we do not yet know the long-term impacts of the pandemic, Brexit and changes in ways of working.

This report is the thirteenth annual study of the total tax contribution of the financial services sector. The data from the 2020 survey largely predates the pandemic, but it illustrates the scale and stability of the sector's contribution to public finances.

This year, the study goes further, to predict how the contribution may change in pandemic times. The rich data we have collected through these studies over time allows us to project the expected reduction in tax receipts.

We hope this data will better inform the public narrative and encourage constructive debate about the value of the financial services sector to the UK economy.

We thank the participating companies for continuing to support the survey in record numbers. Their support allows us to publish data that would not otherwise be available in the public domain.

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# Executive summary

The total tax contribution (TTC) report, now in its thirteenth year, shows the financial services sector's importance in terms of tax contribution, as well as its resilience during a global pandemic.

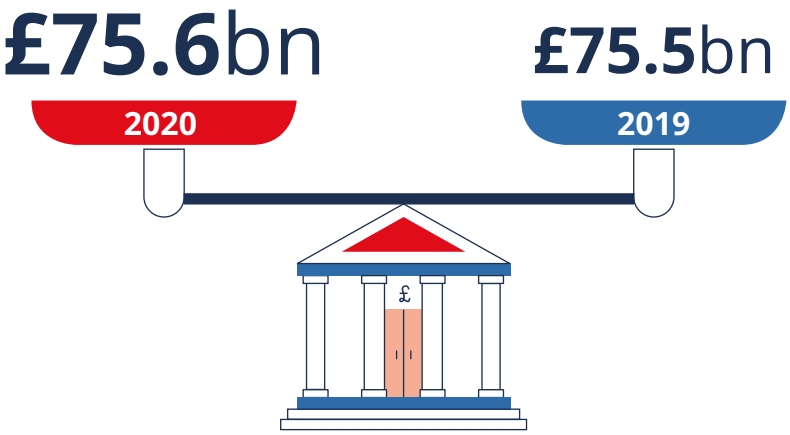
Beyond the tax contribution, the sector has also supported the wider economy since March 2020 in a variety of ways.

The study provides a unique insight into how the total tax contribution of the financial services sector might be affected by the pandemic in the year to 31 March 2021, although the impact of Brexit remains unknown.

# The financial services sector makes an important contribution to public finances

**Financial services firms make a large contribution in taxes to the public finances.**

In the financial year to 31 March 2020, we estimate that the total tax contribution from the sector was £75.6bn, similar to 2019's contribution of £75.5bn.




This amounts to more than

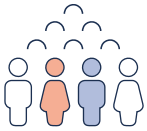
**10%**

**of total government receipts from all taxes.**

The total comprises

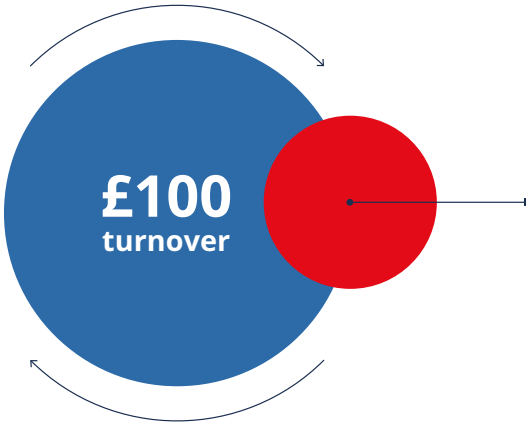
**£34.1bn**

in taxes borne directly by financial services firms.



**£41.5bn**

in taxes collected from their customers and employees.




**£26.50**

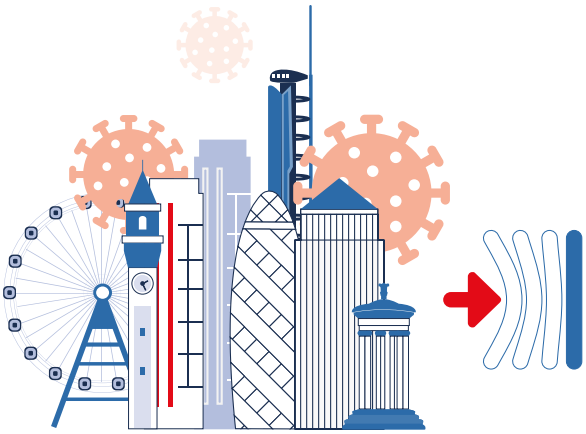
**paid in taxes**

For every £100 in turnover, financial services firms pay the equivalent of £26.50 in taxes.

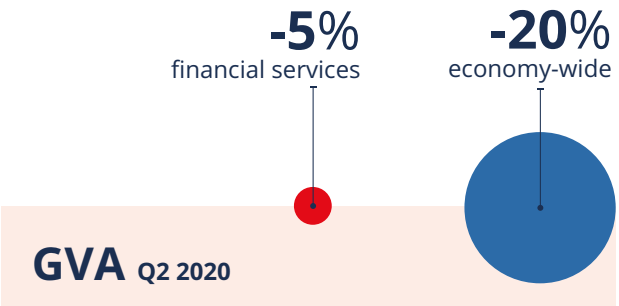
**The contribution made by the sector is particularly striking given that the coronavirus outbreak has caused a recession of unprecedented magnitude. While the pace and path of recovery from the virus is clouded in uncertainty, the financial services sector provides an element of stability.**

# The financial services sector has shown resilience through the crisis, allowing it to support the economy

**The sector's resilience has enabled it to support individuals and other industry sectors during the pandemic.** Economic activity in financial services has remained relatively stable and contracted much less than the wider economy.



**In Q2 2020, gross value added** – a measure of economic activity that can be used to indicate the contribution of a sector to the economy – decreased by

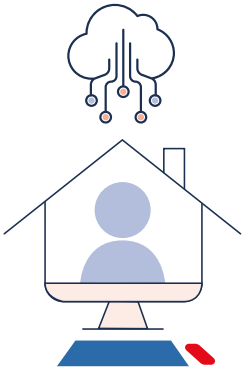



**This comparatively strong performance is in large part due to the regulatory reforms and actions taken by the sector to build up its stability following the financial crisis of 2008.**

**Over the past decade, the sector has invested significantly in new technology,** which has allowed it to transition to remote working. As a result, financial services firms have been able to carry out most of their core activities during the pandemic, which meant just

**4%**

**of the sector's employees were furloughed** using the Coronavirus Job Retention Scheme. Only two sectors (public administration and defence; and energy) furloughed fewer of their employees than the financial services sector.



**This resilience and infrastructure allowed financial services firms to support businesses and individuals throughout the pandemic.**

**Almost**

**1in2**

trading businesses have received some form of financial assistance from the sector since the crisis began.

**Nearly**

**2m**

mortgage payment deferrals were granted – equivalent to one in six mortgages in the UK.

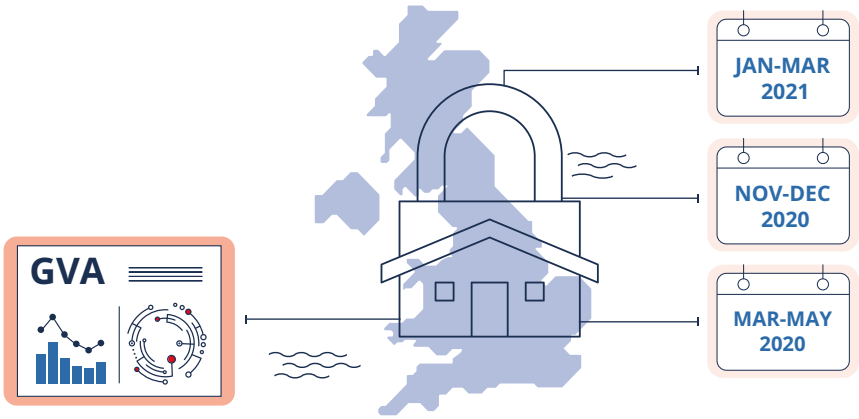
**Over**

**£1.7bn**

payout expected by the insurance industry in claims related to the pandemic.

# The predicted total tax contribution will not drop below 2015 levels, even in the worst case scenario

The reintroduction of a national lockdown in November 2020 and January 2021 is expected to delay the economy's recovery, although their **impact is likely to be less severe than the first lockdown**. For the financial services sector, gross added value is expected to stall.

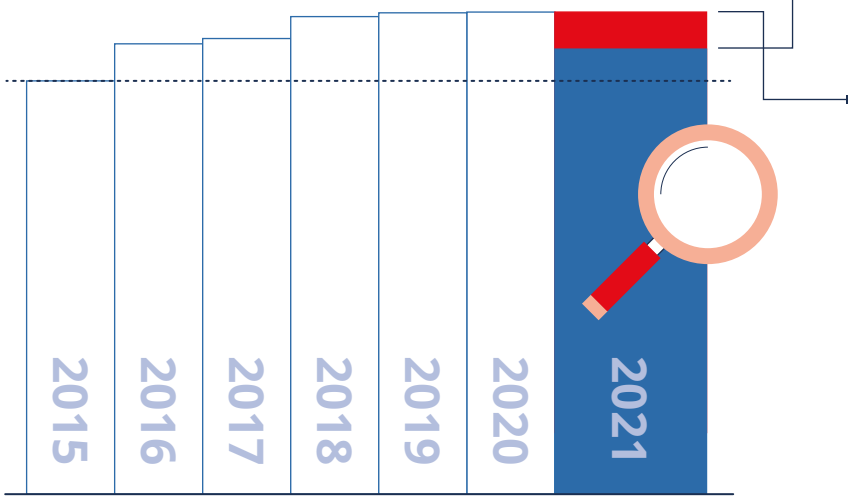



## Total tax contribution of the financial services sector

Using TTC surveys carried out over the past decade, we find that changes in the gross value added of the financial services sector have resulted in a broadly similar change in total tax contribution.

Based on the latest gross value added data and our predictions, **we estimate that the total tax contribution of the financial services sector in the year ended 31 March 2021 will be between**

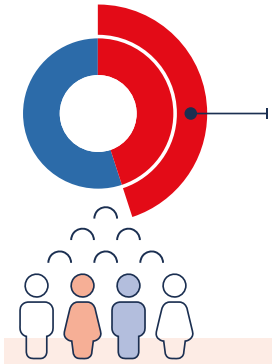
**£71.1**bn and **£75.7**bn




**In other words, even our most pessimistic projections suggest that the total tax contribution in 2020/21 will not fall below its 2015 value.**

Over the past decade, the financial services sector's total tax contribution has become less dependent on corporation tax and more dependent on taxes not linked to profit, such as employment taxes. In a pandemic, when profits fall, other taxes fall less and the total tax contribution is more stable.

# Employment taxes are the largest element of the total tax contribution, but new ways of working, accelerated by the pandemic, may change this



**Employment taxes make up**

**45%**

**of the total tax contribution** because of the many skilled jobs the sector provides – or

**£34.5bn**

**in employment taxes.**

This means the sector, with its

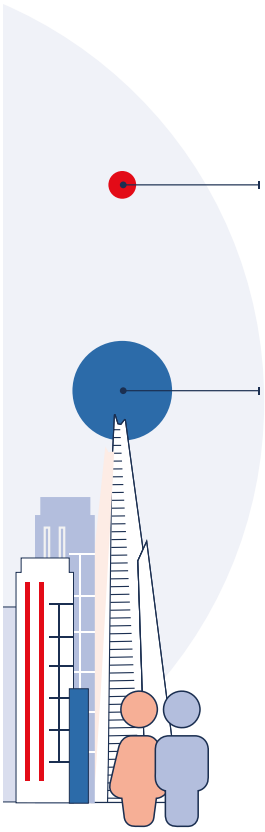
**1.1m workers**

**3.2%** of the UK workforce

makes a contribution amounting to

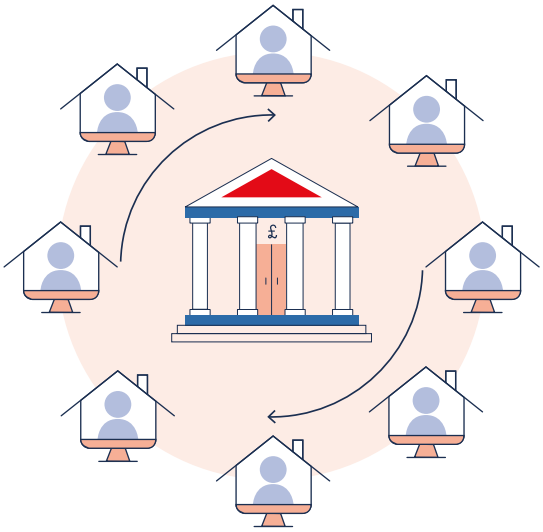
**11.1%**

**of total employment taxes in the UK.** However, changing working practices will affect this contribution in future.

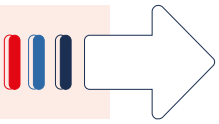


Advances in technology are leading to new roles in financial services. **Jobs will be created in emerging technologies, fintech and cyber security, although some may be lost as a result of automation.**

**Technological changes are also leading to new ways of working, a trend accelerated by the COVID-19 lockdowns, which necessitated remote working and virtual interaction with customers.**



# Looking forward



With increasing credit risk, decreasing interest rates and a reduced demand for insurance in some areas, the financial services sector faces challenges in the months and years ahead.

Technological advances and new ways of working mean the sector must accelerate the change to digitisation and develop new products. From providing emergency loans to managing increased insurance claims, the sector has a role to play in supporting businesses and communities as the economy recovers from the pandemic.

The way forward is uncertain, however, particularly with the introduction of a third national lockdown and the transition to new trading arrangements between the UK and the EU following Brexit. If the economic recovery is weaker than expected, the financial services sector will suffer too.

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Chapter 1

# The economic impact of the pandemic on the financial services sector

Over the past 12 years, this report has highlighted the contribution made by the financial services (FS) sector in taxes to the public finances and the creation of skilled jobs.

Chapter 3 shows that, in the year to 31 March 2020, the FS sector contributed £75.6bn in taxes, which is 10.1% of total government receipts from all taxes.

In the same period, employment taxes made an even more significant contribution. We estimate that the financial services sector paid £34.5bn in employment taxes – or 11.1% of government tax receipts from employment.

In this thirteenth edition of the report, we have included additional research and analysis to highlight the sector's role in the wider economy. Its infrastructure and resilience have enabled it to support businesses by administering large numbers of government loans.

# Impact of COVID-19 on the economy

In Q2 2020, the output of the financial services sector fell by

**4.6%**

compared with an economy-wide fall in GDP over the same period of

**19.8%**

On 23 March 2020, UK Prime Minister Boris Johnson announced that the UK would respond to the coronavirus outbreak by introducing a national lockdown. Non-essential retail was closed, and workers were encouraged to work from home and avoid social contact where possible.

The impact of these measures on the economy was immediate, with activity in the hospitality and accommodation sectors almost entirely stopping, whilst construction and manufacturing output fell markedly.

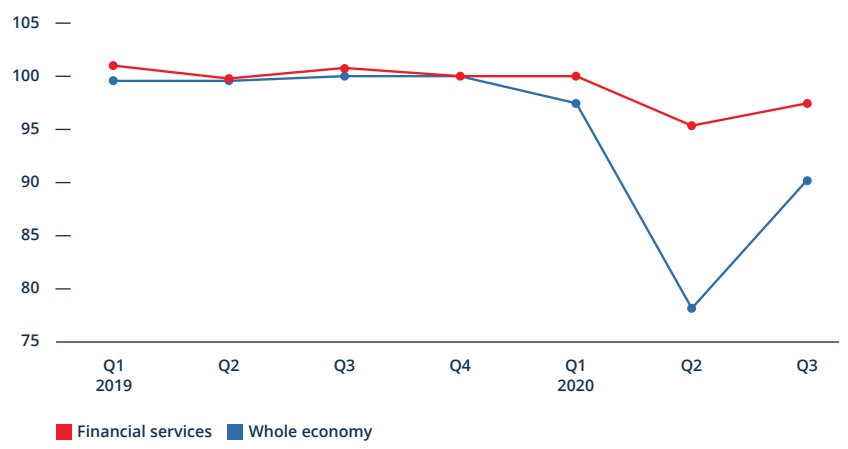
As shown in Figure 1, the overall effect of the virus on the UK economy was to reduce gross domestic product (GDP) in the second quarter of 2020 by 19.8%. The impact of the virus on the FS sector was noticeably less pronounced, with output in the sector reducing by 4.6% over the same period.

The next section further investigates the resilience of this sector to the economic impacts of COVID-19.

As the government began to reduce social distancing restrictions from June onwards, the economy started to recover. In the third quarter of 2020, UK GDP grew by a record 15.5%. This growth was largely driven by growth in the hospitality and accommodation sectors, which were boosted by the government's Eat Out to Help Out scheme, as well as by the increased popularity of domestic 'staycations'.

Over the same period, FS sector output grew by a comparatively smaller 2.2%, though this is largely because the contraction of the FS sector in the second quarter of 2020 was far less than that of the whole economy. Despite the economy making significant progress since its initial steep contraction in the second quarter of 2020, both economy-wide and FS sector output still remained below pre-pandemic levels in the third quarter of 2020.

**Figure 1: Economic growth, Q1 2019 to Q3 2020 (Q4 2019 = 100)**




Source: Office for National Statistics (ONS).

# Resilience of the financial services sector

In May 2020, credit card borrowing was

**11%**

lower than in May 2019.

To investigate the resilience of the FS sector, we use a statistic called gross value added (GVA), a measure of economic activity that can be used to indicate the contribution of a sector to the economy.[1] This statistic is useful as it enables us to evaluate the performance of the FS sector over time, with increases in GVA showing that the sector is growing in size, and decreases indicating that the sector is shrinking.

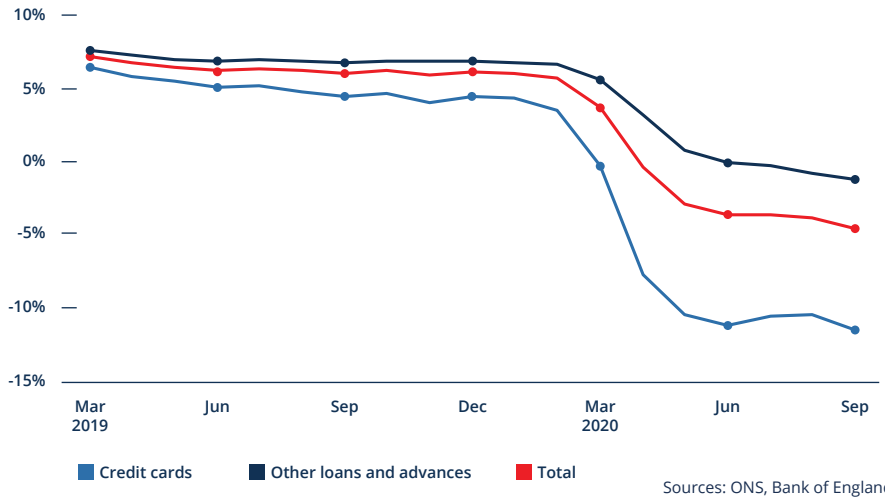
The impact of the virus on the FS sector was less severe than on other sectors, with its GVA falling from £31.2bn in Q1 2020 to £29.8bn in Q2 – a fall of 4.6% compared with an economy-wide fall of 19.8% over the same period. The sector's resilience is in large part the result of actions taken by the sector since the financial crisis of 2007-08. These actions have led the Financial Policy Committee of the Bank of England to express its confidence in the sector to "withstand severe market and economic disruption".[2]

Within financial services, the banking subsector accounts for most of the fall in GVA, with its GVA down from £17.7bn in Q1 2020 to £16.6bn in Q2. The closure of bank branches at the start of lockdown and the lacklustre performance of the wider economy largely accounted for this fall.

However, the negative impact was not uniformly spread across banking: households responded to the virus by borrowing less, while businesses, which had liabilities to meet in the face of reduced trading, borrowed more.

The decline in household borrowing was largely driven by falls in consumer spending as non-essential businesses closed, and by consumers' increasing caution in a period of uncertainty. In May 2020, credit card borrowing was 11% lower than at the same time in the previous year, while total borrowing was down 3% (see Figure 2).

**Figure 2: Consumer credit (year-on-year growth rate; seasonally adjusted)**



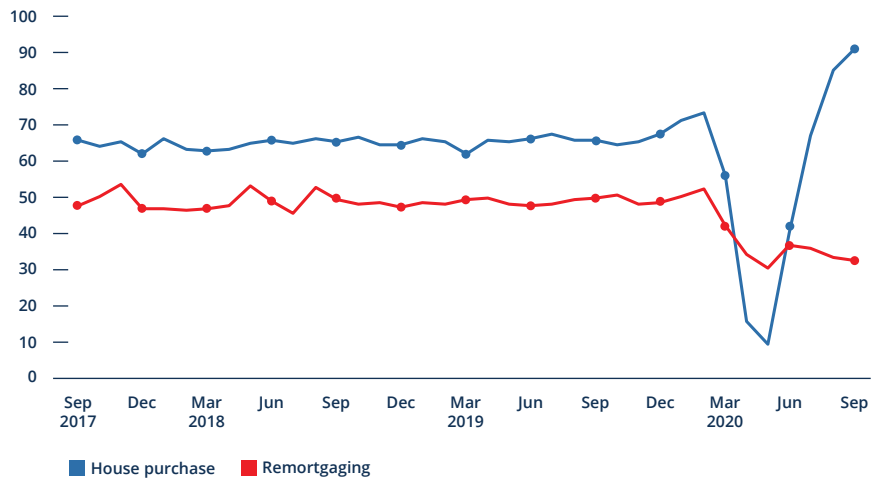

Sources: ONS, Bank of England.

1 GVA is equal to the total value of the goods and services that have been produced in the sector, less the cost of the inputs and raw materials that are directly attributable to the production of those goods and services.

2 www.bankofengland.co.uk/financial-policy-summary-and-record/2020/march-2020

A key external factor contributing to the fall of GVA in the banking subsector was the freezing of the property market during the initial months of the lockdown, which had a dramatic effect on mortgage lending (see Figure 3). In April 2020, mortgage approvals totalled 56,600 – almost half the number in March (111,000). However, once restrictions on the property market were lifted, the market rebounded strongly, with monthly mortgage approvals reaching 136,000 by September 2020.

**Figure 3: Mortgage approvals (thousands; seasonally adjusted)**




Source: Bank of England.

*Key statistics: financial support offered by the banking subsector*

**27m**

interest-free overdrafts

**1.9m**

mortgage payment deferrals, equivalent to

**1in6**

mortgages in the UK

**992,400**

payment deferrals on credit cards

**686,500**

payment deferrals on personal loans

Source: UK Finance.

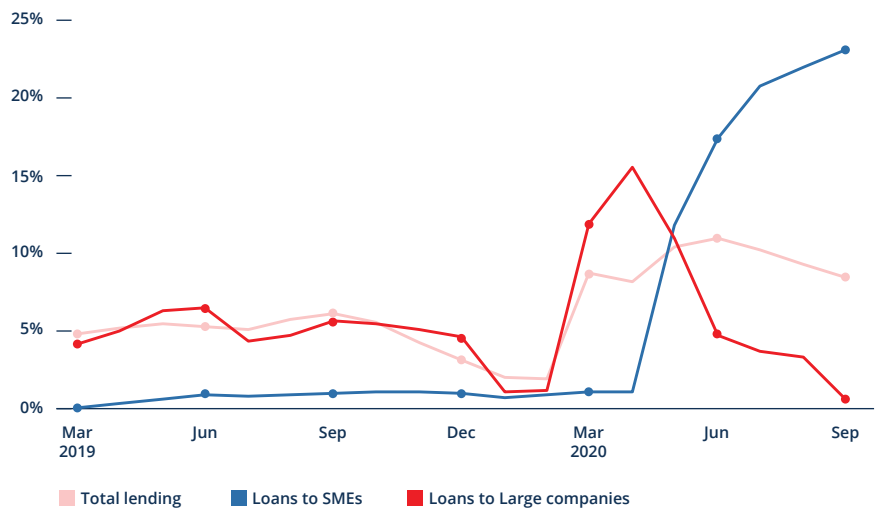
While households were able to reduce their spending during the first national lockdown, businesses had to rely on borrowing to honour obligations on their leases and towards their staff. Figure 4a shows that lending to small and medium-sized businesses in July 2020 was 21% higher than at the same time in the previous year, while total lending was 10% higher. Lending to large businesses was also up on the previous year, though by a comparatively smaller increase of 4%. This is because large businesses have access to a wider source of funding than small and medium-sized businesses, which rely more on borrowing from banks. Large businesses can, for example, use intercompany loans to shift funds to business units experiencing cash shortfalls.

Figure 4b shows that this increase in borrowing helped to support four key sectors (construction, real estate, transport and manufacturing) at the height of the pandemic. The real estate and manufacturing sectors experienced the largest increases in net lending in March compared with February, with net lending to these sectors increasing by £7.7bn and £7.0bn, respectively.

This increase in borrowing was only possible due to the rapid response of the banking subsector to the national lockdown, with most high-street banks offering government-backed loans to businesses affected by the pandemic. These schemes have provided companies with more than £60bn of funding since mid-March.[3]

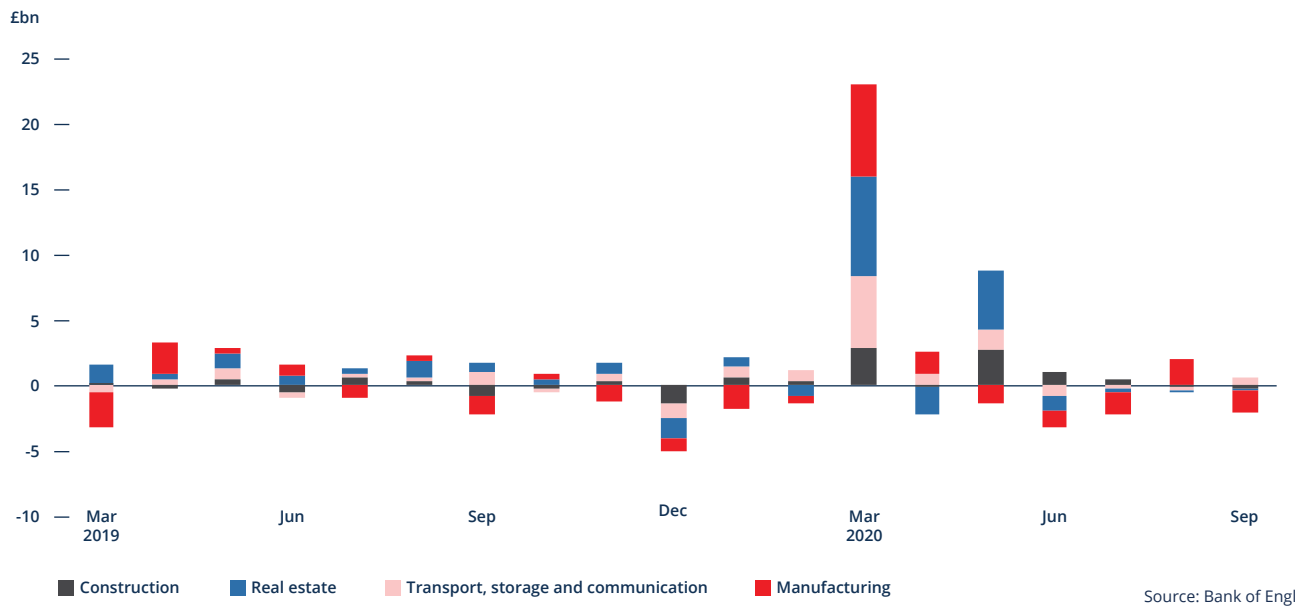
The financial assistance provided by the FS sector has been, and will continue to be, essential to the economy's recovery from the virus. Without these loans, many businesses adversely affected by the virus would have been forced to close. According to an ONS survey, almost half of businesses (that have not permanently stopped trading) have received some form of financial assistance from the sector since the crisis began.[4]

**Figure 4a: Annual growth of lending to businesses (%)**




Source: Bank of England.

**Figure 4b: Headline flows for lending to four key sectors (£bn; monthly changes)**



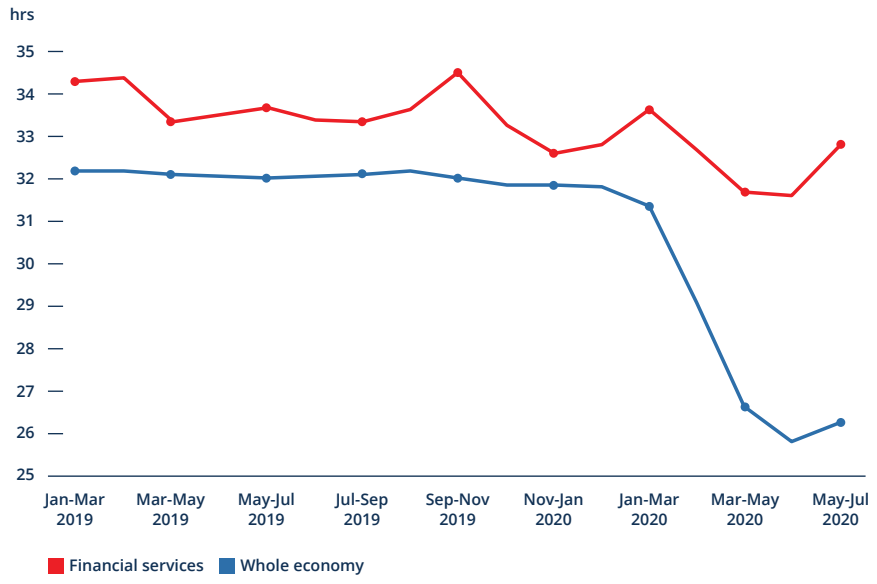

Source: Bank of England.

**39%**

of employees in the FS sector said they had worked from home in the past, compared with an economy-wide average of 28%.[5]

The FS sector as a whole has coped well with the worst effects of the pandemic. In part, this is because the sector has been able to carry out most of its core activities throughout the crisis. While the average weekly hours worked for the whole economy fell dramatically in the first quarter of 2020, the fall in hours worked in the FS sector was significantly lower (Figure 5). In part, this is due to the sector's investment in recent years in technologies that enable remote working. In a survey conducted by the ONS prior to the pandemic, 39% of financial services staff said they had worked from home in the past, compared with an economy-wide average of 28%.[5]

**Figure 5: Average weekly hours worked by sector, 2019-20**




Source: ONS.

3 These loan schemes include: Coronavirus Business Interruption Loan Scheme (CBILS), Coronavirus Large Business Interruption Loan Scheme (CLBILS) and the Bounce Back Loan Scheme (BBLS).

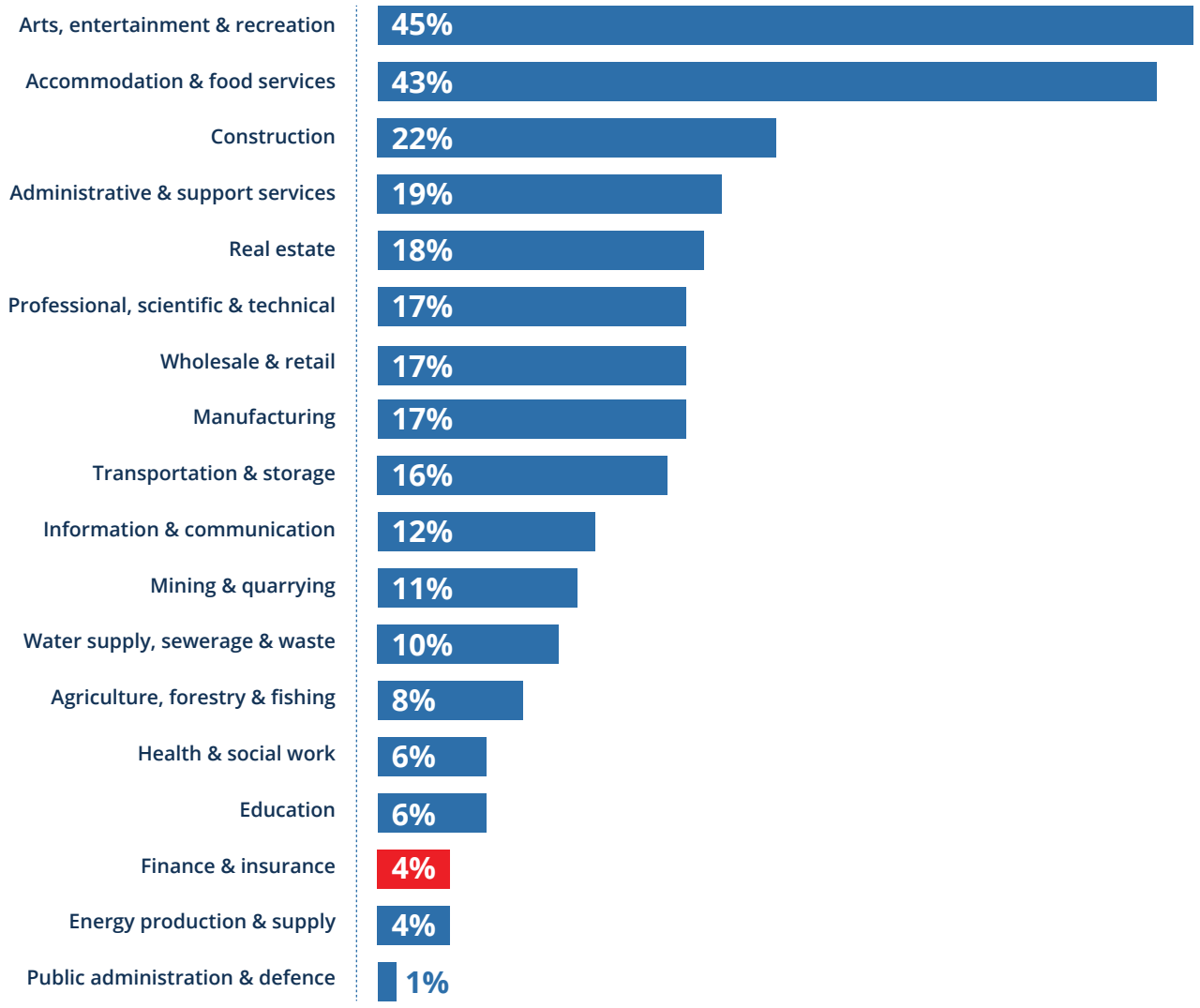
4 www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/businessimpactofcovid19surveybicsresults

5 www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/technologyintensityandhomeworkingintheuk/2020-05-01

The FS sector has been able to continue operating at almost normal levels during the crisis, so it has required less government support than most sectors. As of July 2020, only 4% of financial services employees were furloughed, which meant 96% of staff were working as normal throughout this period. Only two sectors (energy; and public sector administration and defence) furloughed fewer of their employees than financial services firms (see Figure 6).

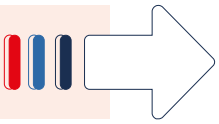
The worst affected sectors furloughed more than 40% of their staff, drawing on the Coronavirus Job Retention Scheme (CJRS). The scheme provides grants to private sector employers to pay 80% of the wages of employees who would otherwise have lost their jobs (up to a maximum of £2,500 per person per month).

Figure 6: Proportion of workers furloughed on the CJRS as of 31 July 2020




Source: ONS.

# Looking forward



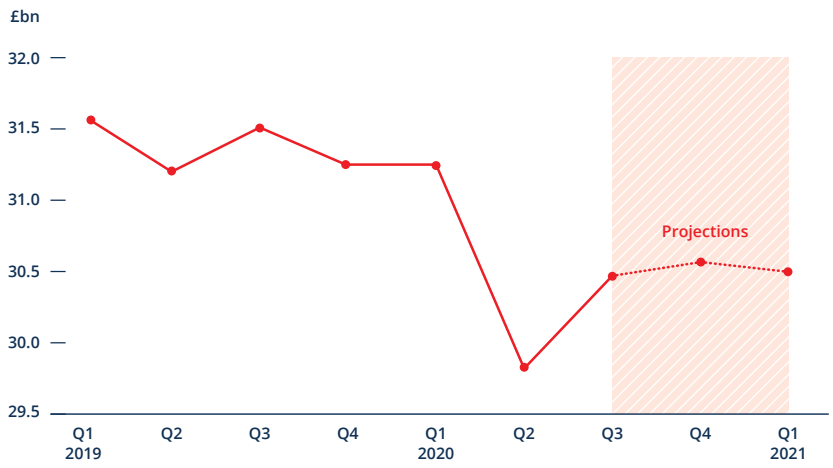
England returned to a national lockdown for four weeks in November 2020, and then once again in January 2021, with national restrictions likely to last until at least mid-February. The reintroduction of national restrictions is expected to put a significant dent in the economy's recovery, as well as the recovery of financial services. While the sector grew by 2.2% in the third quarter of 2020, Figure 7 shows that its growth is expected to stall from the fourth quarter of 2020 onwards as a result of the national lockdown.[6]

Despite this, it is expected that the impact of the second and third national lockdowns will be less severe than the first. This is largely due to the investment that businesses have made since the first national lockdown to enable remote working, as well as procedures put in place by some industries to remain open while enforcing social distancing.

In contrast to the first lockdown, the property market is expected to remain open throughout this period, so we would not expect to see a reduction in mortgage approvals of the same magnitude as the first lockdown.

The transition to new trading arrangements between the UK and the EU will put further downward pressure on the recovery of the FS sector. Financial services firms lost their passporting rights from 1 January 2021 – these rights had enabled UK-based firms to sell their services in the EU without having to go through time-consuming and expensive application processes. Until an EU-wide arrangement for the sector is agreed, UK firms will have to comply with the requirements of individual member states.

**Figure 7: Financial services sector gross value added (constant prices; £bn)**




Source: ONS, PwC analysis.

6 These projections are taken from the 'slow recovery' scenario in the January edition of PwC's *UK Economic Outlook*. We have used estimates from this scenario, rather than from PwC's more optimistic 'quick recovery' scenario, as we believe the risks are weighted to the downside in Q1 2021 (as a result of the third national lockdown).

# Summary

The financial services sector plays an essential role in the economy. It provides credit to households and firms, fuelling economic growth throughout the economy, whilst contributing significant tax payments (as shown in Chapters 2 and 3) that can be used to fund public services.

The sector has so far proved resilient to the worst economic impacts of the virus. This has enabled it to play an even bigger role in the economy, with many businesses becoming increasingly reliant on the loans it administers.

However, the way forward is uncertain. If the economy's recovery is weaker than expected, the financial services sector will suffer too.

Chapter 2

# Potential evolution of the financial services sector's tax contribution in 2021

This study provides a unique insight into the total tax contribution (TTC) of the financial services sector over the next year, in light of the economic impact of the COVID-19 pandemic.

We use the gross value added (GVA) projections (outlined in the previous chapter) to estimate the contribution that financial services companies are projected to make to the UK public finances through their taxes in the year to 31 March 2021. This estimate includes corporation tax, employment taxes, VAT and stamp duty, among others.

To produce this estimate, the study follows the widely used approach of estimating the tax buoyancy of the sector. Here, tax buoyancy means the degree to which the total tax contribution of the financial services sector responds to changes in the sector's GVA, with GVA being used as a proxy for the sector's tax base.[7] The estimated tax buoyancy is then applied to our GVA projections for financial services over the next year in order to project the sector's likely TTC over the same period.

Using this approach, this study estimates that the TTC of financial services companies in the year to 31 March 2021 will be between £71.1bn and £75.7bn. This suggests that the TTC of the sector is expected to fall slightly from the previous year, which is estimated at £75.6bn (as outlined in Chapter 3).

However, even our most pessimistic projection (the lower end of this range, £71.1bn) suggests that the TTC of the sector will not fall below its 2015 value. This demonstrates the resilience of the sector, with both its GVA and TTC expected to remain at high levels despite the coronavirus pandemic.

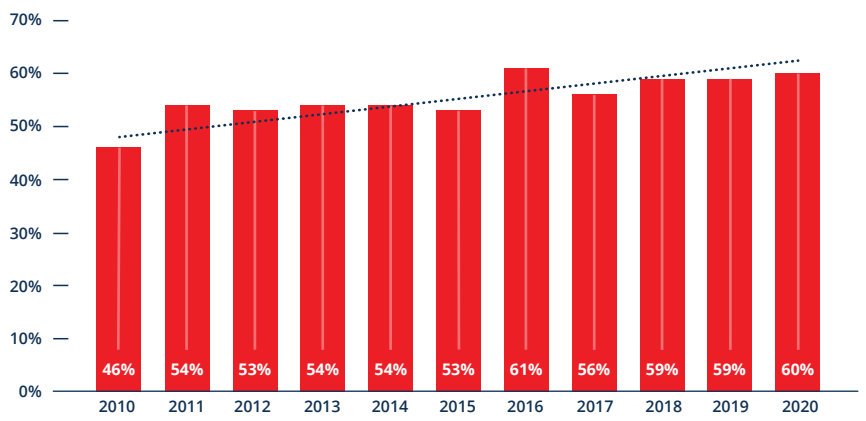
# Relationship between GVA and TTC

To estimate the total tax contribution of the financial services sector in 2021, we use the relationship between the total tax contribution of the sector and its GVA. Whilst the former is a measure of a sector's contribution to the public finances, the latter is a measure of the level of economic activity within a sector, and its contribution to the economy as a whole. GVA can be used as a proxy for the sector's tax base as it provides an indication of the sector's level of economic activity (as discussed in Chapter 1).

In Figure 8, we use data from our long-established study (combined with GVA data from the ONS) to show that the TTC of the financial services sector as a proportion of its GVA has risen over the past decade. This is because, while both TTC and GVA have risen in nominal terms over the past decade,[8] TTC has increased at a faster rate. The TTC of the FS sector has increased from £53bn in 2010 to £76bn in 2020, whilst the GVA of the sector has increased from £117bn to £127bn over the same period. In turn, the TTC as a proportion of GVA has increased from 46% in 2010 to 60% in 2020.

This trend likely reflects increases in the tax buoyancy of the sector over time, whereby annual increases in GVA result in even larger increases in TTC. We expect this increase in the tax buoyancy of the sector is in large part due to changes in the profile of the tax system over the past decade. Over time, successive governments have introduced new taxes on the sector and increased the rate of taxes already levied on the sector (as outlined in Chapter 3).

**Figure 8: Financial services sector TTC as a proportion of GVA (%)**




Source: ONS, City of London.

To estimate the relationship between TTC and GVA, we use econometrics – an analytical technique that uses economic theory, mathematics and statistical methods to quantify the relationship between two or more variables (such as tax and GVA).[9] This approach has been widely used by other studies to project the tax contributions of different sectors, regions and countries.[10]

Using this approach, we estimate a tax buoyancy for the sector of 0.96, which implies that a 1% increase/decrease in the gross value added of the FS sector will increase/decrease its total tax contribution by 0.96%. This finding is in line with the results of similar studies, which generally find a one-to-one relationship between output and taxes (in our case, GVA and TTC) over the long term.

7 More precisely, for the purposes of this study, tax buoyance is defined as equivalent to the percentage change in the total tax contribution of the financial services sector resulting from a one percentage change in the sector's gross value added.

8 Inflation will account for some of this increase in the gross value added and total tax contribution of the financial services sector. Despite this, it is still possible to make meaningful comparisons between the two indicators in each year of the sample period.

9 For a detailed explanation of this methodology, please refer to appendix 1.

10 For an overview of similar studies, see the IMF's 2020 article, *Challenges in Forecasting Tax Revenue*.

# Looking forward: GVA and TTC projections

Having estimated the relationship between GVA and TTC, it is possible to use our forecasts of the sector's GVA over the next year to project the TTC over the same period. Figure 9a presents our projections for the GVA of the FS sector – mainly that the GVA of the FS sector will fall to £121.5bn in the year to 31 March 2021, down from £125.4bn in the previous year.

As outlined in the previous chapter, this expected fall is largely due to the COVID-19 pandemic, which has had a negative impact on the whole economy. As a result of the fall in financial services GVA, we expect the TTC of the sector to drop to £73.4bn in the year to 31 March 2021, down from £75.6bn in the previous year (as shown in Figure 9b).

The COVID-19 pandemic is an almost unprecedented event that makes it more challenging to project economic indicators such as GVA and TTC. To account for this uncertainty, in Figure 9 we have constructed a 90% predictive interval for the projected TTC of the FS sector. This interval suggests that, if the GVA of the sector falls to £121.5bn in 2021 (as projected by our analysis), then on 90 occasions out of 100, the sector's total tax contribution will be between £71.1bn and £75.7bn.

We would consider the lower end of this range to be more plausible, as previous research has indicated that tax buoyancies are generally higher during recessions, in some cases even doubling. If the tax buoyancy of the FS sector during the COVID-19 pandemic is greater than one (our central estimate is 0.96), then the projected fall in GVA will result in an even larger reduction in the TTC of the sector. It should be noted, however, that even the lower end of this range (£71.1bn) would equate to a fall in TTC that is relatively muted compared with the expected falls in the tax contribution of other sectors. This is largely due to the resilience of the financial services sector to the worst economic effects of the pandemic, as shown in Chapter 1.

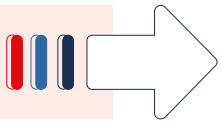


Figure 9a: FS sector GVA in 2020 (actual) and 2021 (projected)

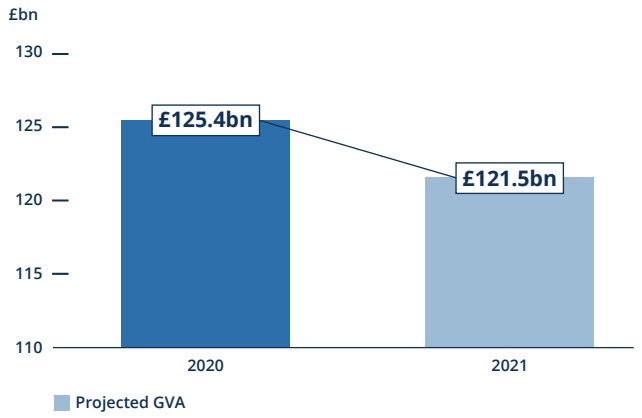
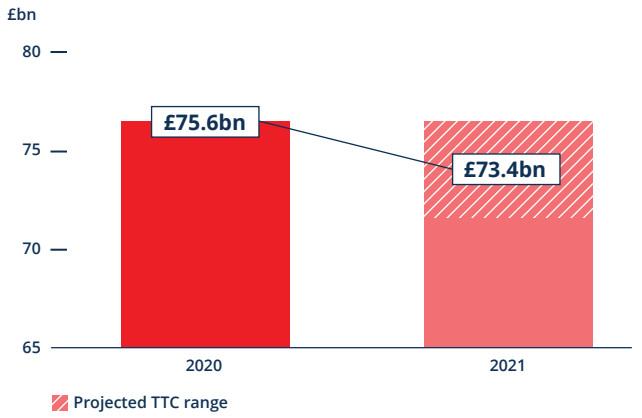



Figure 9b: FS sector TTC in 2020 (actual) and 2021 (projected)




Sources: ONS, City of London, PwC analysis.

The projected falls in GVA in 2020 result in similar reductions in TTC. However, even in our most pessimistic scenario (the lower end of the TTC projections), the TTC of the FS sector is not expected to fall below its 2015 value. Its GVA and TTC are expected to remain high despite the coronavirus pandemic.

As outlined in the previous chapter, this is in part the result of actions taken by the sector and regulators to build up resilience following the financial crisis of 2007-08. Investment in remote working has also enabled the sector to function at close to normal levels throughout the pandemic.

## Summary

In this chapter, we use our projections for the gross value added of the financial services sector in the year to 31 March 2021 to project the TTC of the sector over the same period. We project that the TTC of the sector will fall to £73.4bn in the year to 31 March 2021, down from £75.6bn in the previous year. This fall is relatively muted, compared with the expected falls in the tax contribution of other sectors, due to the sector's resilience to the worst economic effects of the virus.

Chapter 3

# Total tax contribution of the financial services sector in 2020

We carried out a survey of FS companies to understand the contribution they make to the UK public finances through their taxes, and to support the economic analysis in this report.

While corporation tax is often the focus of attention, the largest element of the TTC is employment taxes, followed by corporation tax and VAT. The survey looks beyond corporation tax to estimate the TTC of companies in the sector, including other taxes such as employment taxes, VAT and stamp duty.

The results of the survey can be found in this chapter. We estimated that in the year to 31 March 2020, the total tax contribution from the FS sector was £75.6bn – amounting to more than 10% of total government receipts from all taxes. This includes £34.1bn in taxes borne directly by FS firms and £41.5bn in taxes collected from FS employees and customers. Employment taxes make up 45% of the FS sector's TTC – a contribution of £34.5bn or 11.1% of all government receipts from employment.

This chapter explores how ways of working in financial services firms are changing as automation increases, which has been accelerated by the pandemic.

We look back at the increasing significance of employment taxes over the past decade and the decreasing significance of corporation tax. We consider what this means in a pandemic, where taxes not linked to profits become a more significant part of the TTC, leading to stability in the contribution.

# Key components of the total tax contribution

We estimate that the UK financial services sector's TTC was around £75.6bn in the year to 31 March 2020, representing 10.1% of government receipts for all taxes. This estimate uses data on tax payments provided by the 53 companies participating in the 2020 study and extrapolates this to the sector as a whole, as set out in Figure 10.

**Figure 10: Total tax contribution of the UK FS sector in the year to 31 March 2020**

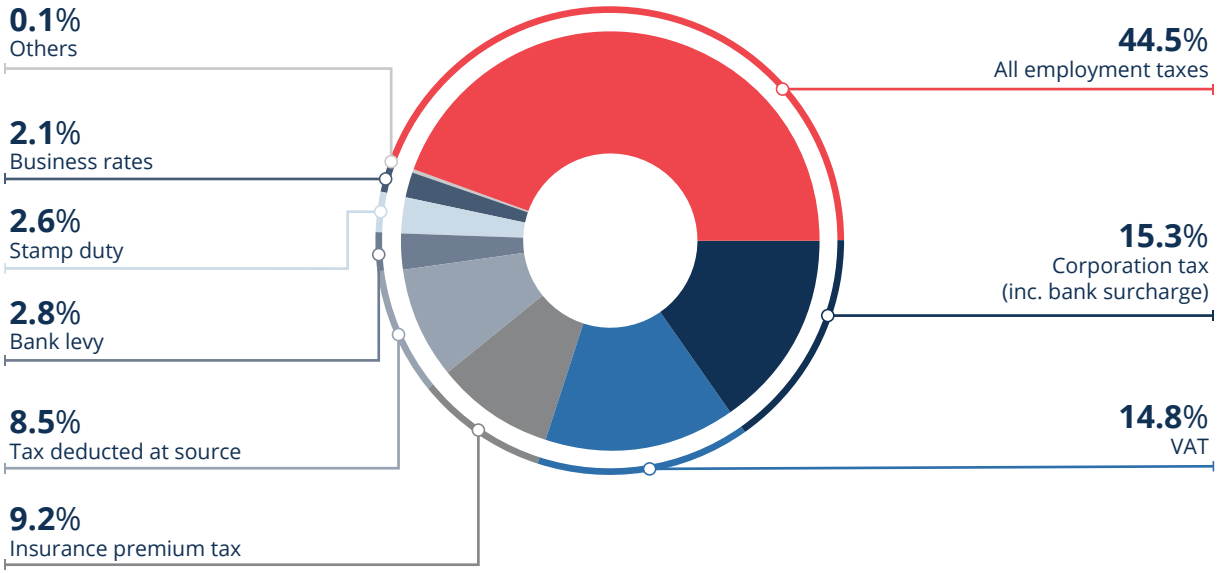
| | FS companies in the study 2020<br>£billions | Extrapolated to the FS sector 2020[11]<br>£billions | % of government receipts 2020[12]<br>% |
|---|---|---|---|
| **Corporation tax** | £3.8bn | £11.8bn | |
| **Bank surcharge** | £0.9bn | £1.5bn | |
| **Bank levy** | £2.2bn | £2.5bn | |
| **Other taxes borne** | £9.6bn | £18.3bn | |
| **Total taxes borne** | £16.5bn | £34.1bn | **4.6%** |
| **Total taxes collected** | £18.0bn | £41.5bn | **5.6%** |
| **Total tax contribution** | £34.5bn | £75.6bn | **10.1%** |

11 The extrapolation totals for taxes borne, taxes collected and TTC are estimates. We extrapolate survey data to obtain taxes borne and taxes collected (which in turn add up to TTC). Extrapolation is based on survey trend data and HMRC figures for corporation tax, bank surcharge and bank levy receipts paid by the financial services sector. We use the ratios of (1) corporation tax, surcharge and bank levy to taxes borne; and (2) corporation tax, surcharge and bank levy to taxes collected for different FS subsectors, as established in the study. HMRC figures can be found in HMRC *T11.1A Corporation tax, bank levy and bank surcharge net receipts 2020* and adjusted for the change to Quarterly Instalment Payments in 2020.

12 Government receipts are from: Office for Budget Responsibility (OBR) *Economic and fiscal outlook*, alongside Budget 2020, Table 2.8 Current receipts (on a cash basis).

A look at the key components of financial services firms' total tax contribution shows that employment taxes make up the largest contribution from the sector (44.5%), followed by corporation tax including surcharge (15.3%) and VAT (14.8%) (Figure 11).

**Figure 11: Key components of financial services total tax contribution in 2020**




Source: Survey participants. Chart shows the average result.[13]

The TTC comprises taxes borne and taxes collected. Taxes borne are all the taxes levied on a company, which are a cost to the business and will affect its financial results, such as employer National Insurance contribution (NIC) or corporation tax.

Taxes collected are generated from the jobs FS companies create and the services they provide to customers, and are part of their indirect contribution to tax revenues.

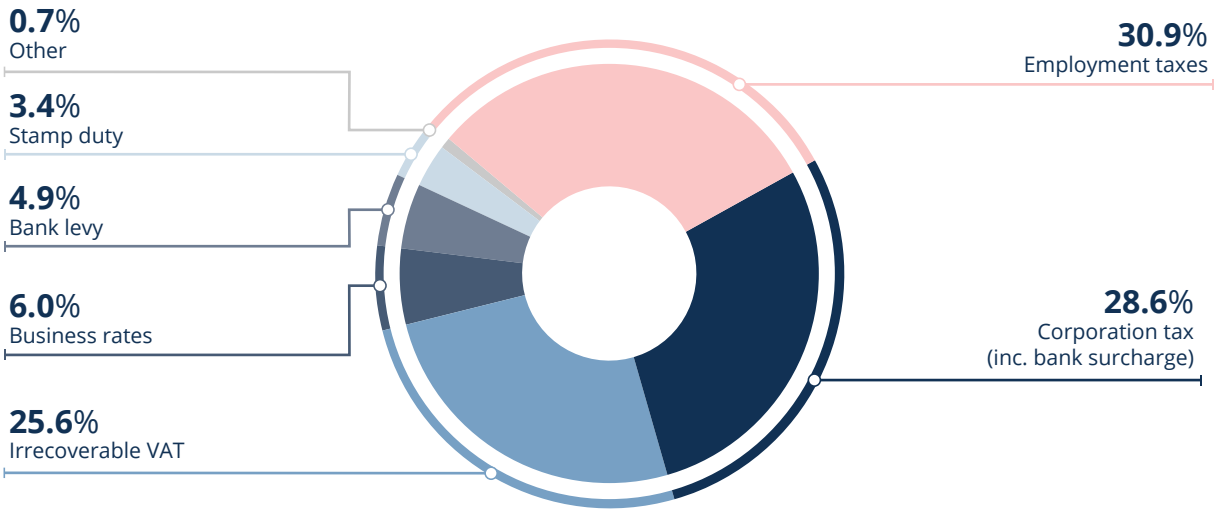
These taxes are collected from employees as well as customers, and companies are responsible for administering and paying these taxes to the government. Employee income tax and net VAT are examples of taxes collected. We look at these in more detail on the following page.

13 The methodology gives equal weight to each company included and the profile for individual subsectors may differ.

# Taxes borne in 2020

Employment taxes remain the largest component of taxes borne (30.9%), closely followed by corporation tax including bank surcharge (28.6%) (Figure 12).

**Figure 12: Taxes borne by FS companies in 2020**




Source: Survey participants. Chart shows the average result.
Note: Employment taxes borne include employers' National Insurance contributions (NIC), PAYE settlement agreements (PSA) and net apprenticeship levy.

Some taxes borne are sector-specific, such as the bank levy and the bank surcharge. Other taxes, such as irrecoverable VAT, while not exclusive to the FS sector, represent a significant share of these firms' taxes borne (25.6%).[14] Irrecoverable VAT arises because many financial services activities are VAT exempt, so companies cannot recover the VAT they incur on their purchases.

In short, while much attention is focused on the corporation tax paid by companies, this is not the largest or only tax borne. For every £1 of corporation tax paid, £2.48 is paid in other taxes borne.

14 For further details of individual taxes, please see the glossary in Appendix 3.

# Taxes collected in 2020

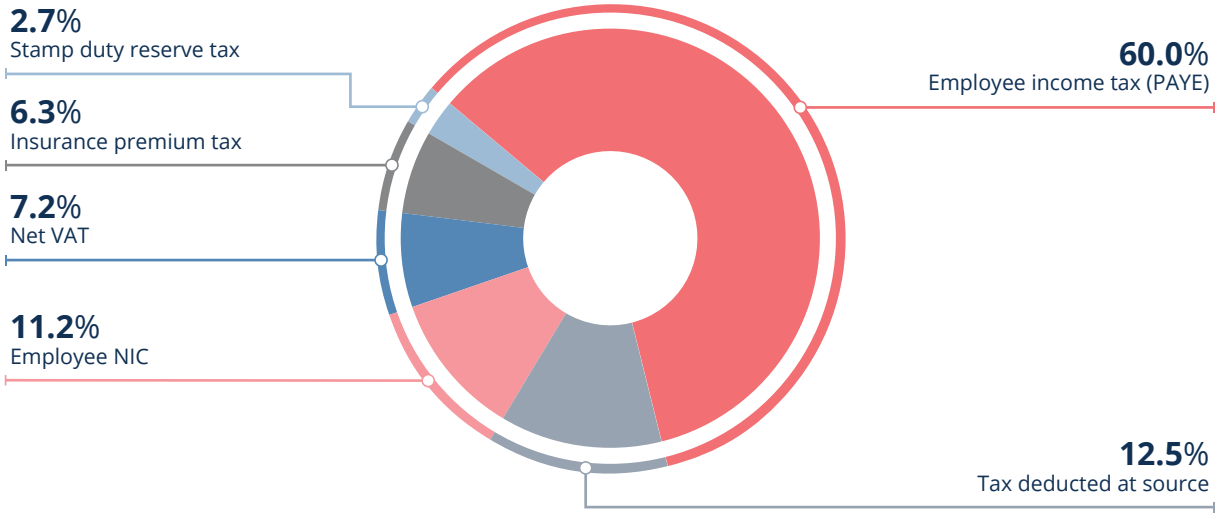
Figure 13 shows the profile of the taxes collected by the companies in the study. Similar to taxes borne, employment-related taxes make up the largest element of taxes collected by the FS sector. Employee income tax (60.0%) and employee National Insurance contributions (11.2%) account for close to three quarters of taxes collected.

This is followed by taxes deducted at source (12.5%), such as tax deducted from annuities paid by life insurers,[15] and sector-specific taxes, such as insurance premium tax (6.3%), a tax collected by general insurance companies on insurance premiums.

**71.2%**

of taxes collected are from employee income tax and employee National Insurance contributions.

**Figure 13: Taxes collected by FS companies in 2020**



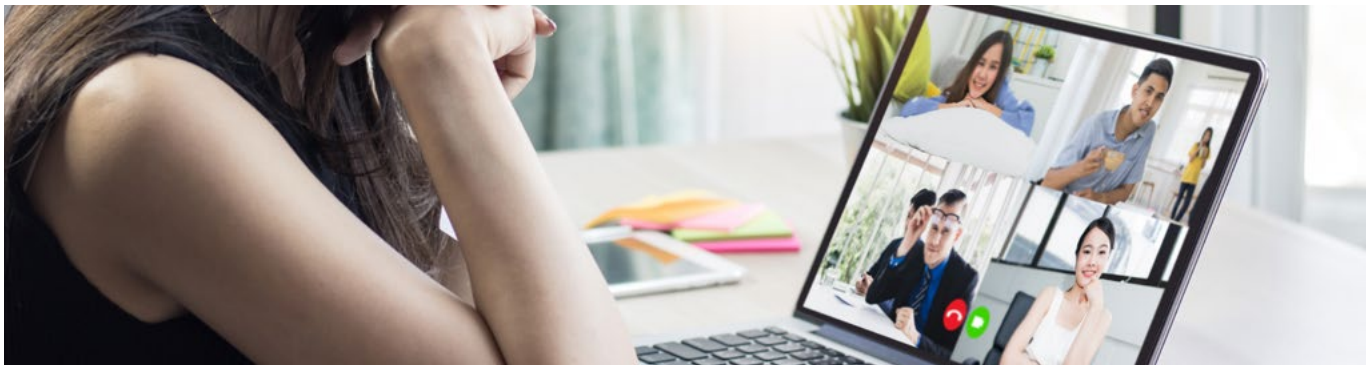

Source: Survey participants. Chart shows the average result.

15 See the glossary in Appendix 2 for details on different taxes.

# The significance of employment in the financial services sector

Employment and job creation are important ways in which the FS sector contributes to the UK economy. As the previous section showed, employment taxes account for the largest share of taxes borne and collected by FS companies. These taxes provide a more stable source of revenue for the government than corporation tax receipts, which can be volatile, particularly in the aftermath of the pandemic.

As ways of working in the sector change, a result of both the pandemic and, more broadly, from advances in technology, the contribution made by the sector in employment taxes may also change. While jobs will be created in areas such as fintech, there will be losses in others, including high-street bank branches.



# Employment taxes paid by the financial services sector as a whole

Using our study data, we estimate that the FS sector generates total employment taxes of around £34.5bn.[16] In total, the sector employed 1.1m people[17] on 31 March 2020, an increase of 0.4%[18] over the previous year. Employment in the sector represents 3.2% of the total UK workforce,[19] but generates 11.1%[20] of government tax receipts from employment, emphasising the sector's contribution in skilled jobs.

Another way of looking at this is the amount paid to the public finances in employment taxes for every employee. Employment taxes per employee amounted to £31,620[21] on average, including taxes borne by the companies and those collected from employees.

16 Extrapolation has been carried out using average employer NIC per employee, employee NIC and PAYE per employee for the employees in different subsectors of the study, together with trends in employment taxes per employee. Extrapolation is an estimate only.

17 Office for National Statistics, *Labour market overview, UK: October 2020 – Financial & insurance activities*.

18 Between March 2019 and March 2020. Office for National Statistics, *Labour market overview, UK: October 2020 – Financial & insurance activities*.

19 March 2020. Office for National Statistics, *Labour market overview, UK: October 2020 – Financial & insurance activities.*

20 Calculation of the proportion of government receipts is the extrapolated employment taxes as a percentage of government receipts for income tax under PAYE (excluding self-assessment) and all NIC receipts. Total government receipts are obtained from the Office for Budget Responsibility (OBR), *November 2020 Economic and fiscal outlook – supplementary fiscal tables: receipts and other,* Table 3.3 Current receipts (on a cash basis – forecast).

21 The average employment tax per employee was calculated by taking the total employment taxes for the survey population and dividing it by the total number of employees in the population.

# Changing ways of working as a result of new technologies

Advances in digitisation and technology are changing ways of working in the FS sector and reducing face-to-face provision of services. While this has been a developing trend in recent years, the pace of change has accelerated during 2020 as COVID-19 lockdowns necessitated remote working and virtual interaction with customers.

Technological development has already influenced employment in the financial services sector over the past decade, particularly with the growth of online services contributing to the closure of high-street bank branches. However, the associated job losses have largely been restricted to the lower end of the pay scale and have been offset by the creation of new jobs over this period. So the overall effect on employment and employment taxes has been relatively minor to date. Data from the ONS shows an increase in employment in the FS sector of 0.4% in the year to 31 March 2020.

The pandemic has accelerated the impact of automation for customers and employees. For customers, lockdown meant the closure of all high-street bank branches, encouraging those who were initially reluctant to move to telephone or online services to try a new method of banking. Having made the transition, this is likely to lead to a permanent change.

For employees, the FS sector's investment in technology infrastructure in recent years has allowed it to respond to the pandemic in an agile way. Many employees were able to work from home with minimal disruption, which meant the sector avoided the worst economic impacts. The fact that FS businesses have been able to carry on through the pandemic shows that there is a way forward in the face of disruption.

In part, giving employees freedom and flexibility has helped them to adapt to disruption, and there is the potential for FS companies to tap into previously inaccessible skills and talent. However, if employees no longer need to be physically present in their workplace and can increasingly be drawn from a global talent pool, this has implications for employment taxes.

Looking forward, some jobs will be lost due to automation, but others will be created. The fintech workforce in financial services is projected to increase, focusing on emerging technologies including blockchain, artificial intelligence (AI), machine learning, robotics and the cloud. With automation comes enhanced risk of cyber attacks, fraud, money-laundering and data misuse, which will require experts in cyber security. Current employees will be able to upskill in data analytics, and AI will take on repetitive tasks, allowing workers to focus on more rewarding aspects of their job.

The contribution that the FS sector makes through employment and employment taxes is significant and emphasises the importance of ensuring that the UK remains a competitive business environment for financial services in the future.

# Resilience as a result of a changing profile of taxes

This section looks back and explores how the profile of taxes borne has changed over the past decade to become more dependent on employment taxes and less on profit taxes. While this means the TTC is more stable when profits are low, as during the pandemic, the total tax rate – a measure of taxes borne compared with profit – will increase.

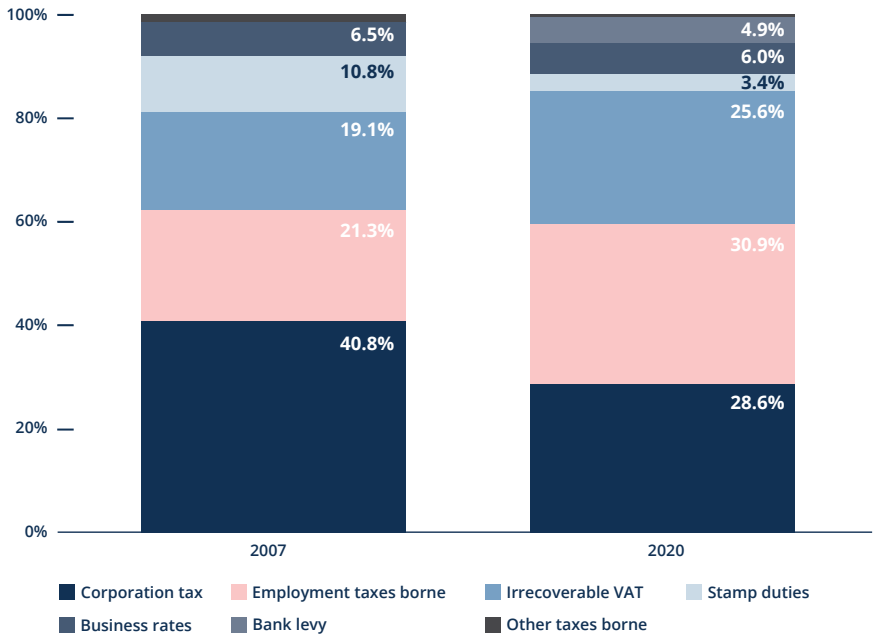
Non-profit-related taxes now account for

**71.4%**

of taxes borne.

This is the latest in a series of TTC studies carried out for the City of London Corporation. Compared with the first study, which was conducted in 2007, we can show how the make-up of financial services tax contributions have changed over time.

**Figure 14: The changing profile of taxes from 2007 to 2020 – taxes borne**




Source: Survey participants providing data in each year.

Figure 14 shows that the sector's tax profile has shifted away from taxes that are more dependent on profit, such as corporation tax, towards taxes that are a more stable revenue source for the government, such as employment taxes. In 2007, corporation tax was 40.8% of total taxes borne, while employment taxes accounted for only 21.3%.

By 2020, this had changed, with employment taxes accounting for the largest share of all taxes borne (30.9%), and corporation tax (including surcharge) decreasing to 28.6%. This changing profile was driven by a decrease in statutory corporation tax rate and the legacy of the financial crisis.

An increase in the rate of NIC increased employment taxes over the same period. Changing operational models also had an influence on the tax profile, particularly for irrecoverable VAT, which also increased. For example, following the financial crisis, FS companies have invested in IT and infrastructure, outsourced administrative business functions and moved towards employing more contractors, all of which has increased the cost base and driven up irrecoverable VAT. In addition, new taxes that are not profit-related have been introduced, such as the bank levy and the apprenticeship levy.

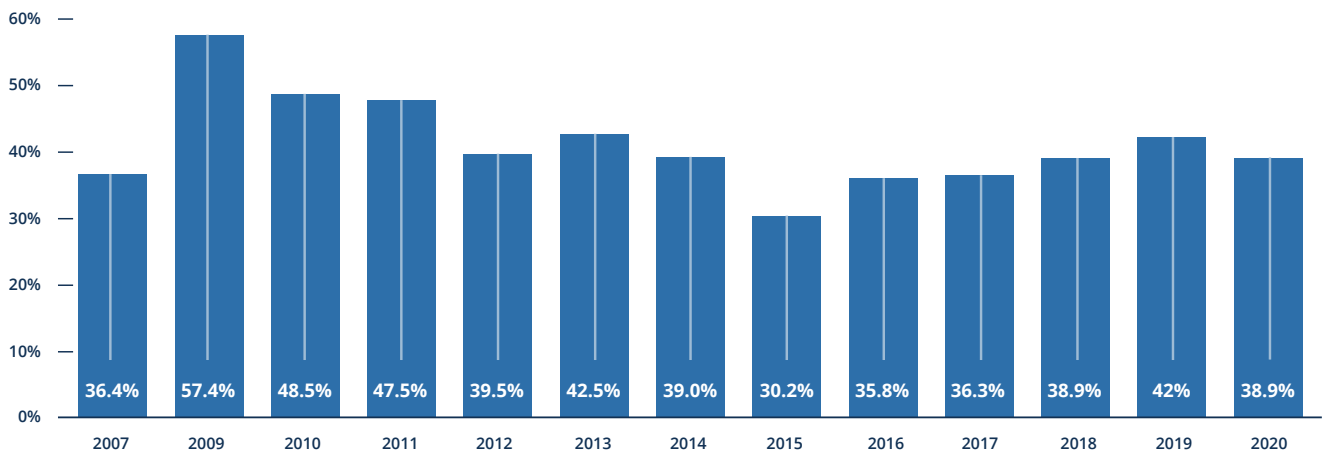
The outcome is that non-profit-related taxes now account for 71.4% of taxes borne, compared with 59.2% in 2007. In pandemic times, this profile means that, as profits fall, the TTC will fall to a lesser extent, a finding that supports the economic analysis.

# Tax payments as a share of profit and turnover

The FS sector pays 38.9% of its profits in taxes. We call this the total tax rate (TTR), a measure of the cost of taxes borne in relation to profit. Figure 15 shows the trend in TTR over time. In the 2009 study, the average TTR rose sharply above the rate in the first study (in 2007). This was due to profits falling markedly between the two years as a result of the financial crisis. In this period, corporation tax payments fell in line with declining profit, while payments of the other taxes borne remained more stable, increasing the TTR as a result.

In the years following the financial crisis, as the economy recovered, profits increased, causing the TTR to decrease. We may expect to see the TTR increase following the pandemic, a reflection of the significance of non-profit-related taxes and an indicator of resilient total tax contributions.

**Figure 15: Trend in TTR**




Source: Survey participants.

Focusing on turnover, more than a quarter of turnover is paid in taxes borne and collected. On average, for the participants in the study, TTC as a percentage of total UK turnover was 26.5%, comprising 11.7% of taxes borne and 14.8% of taxes collected. The percentage in 2020 is the highest level since the survey began; for every £100 of turnover, an amount equivalent to £26.50 is paid in taxes.

The FS sector plays a significant role in the UK government's tax receipts, with employment taxes remaining the most important component of this total. The pandemic, together with advances in technology, will affect the tax base in different ways. It is important, given this uncertainty, to ensure that the UK remains a competitive business environment for the FS sector in the UK.

# Looking forward

The FS sector makes a substantial contribution to the public finances through taxes, but there have been changes to the make-up of the contribution over the past decade. While the survey showed that the contribution for the latest year was more than £75bn, looking forward, the pandemic and changing ways of working will create challenges for the sector. As new ways of working emerge, and employees and customers use more technology to interact, physical location will become less important. Technology is not bound by international borders and a competitive business environment is increasingly important, particularly in a sector where a significant part of the TTC arises from employment taxes. The dependence of the FS sector's TTC on non-profit-related taxes such as employment taxes indicates that the level of TTC is likely to be sustained through the pandemic.

Manchester city centre

# Appendix

# Appendix 1 – 2021 TTC projection methodology

To investigate the impact of the gross value added (GVA) of the financial services (FS) sector on its total tax contribution (TTC), we estimate a linear regression using ordinary least squares. We regress the log of real TTC in each year ($TTC_t$) against the log of real GVA over the same time period ($GVA_t$), and the log of the real TTC in the previous year ($TTC_{t-1}$). Our model also includes a full set of year effects ($\lambda_t$) to absorb aggregate time series variation.

**Technical annex model 1.1**

$$TTC_t = \beta_0 + \beta_1 GVA_t + \beta_2 TTC_{t-1} + \lambda_t + \varepsilon_t$$

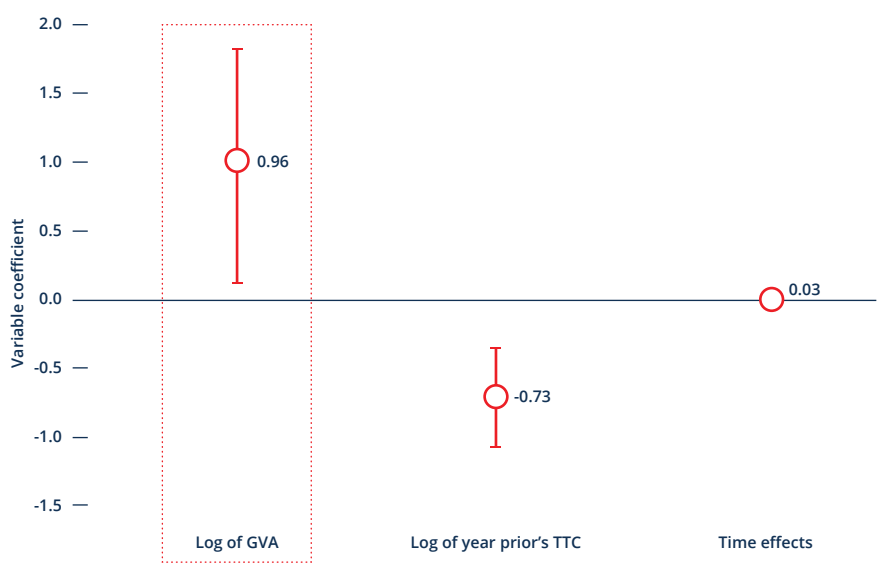
where $\varepsilon_t$ denotes an error term.

**Technical annex table 1.1: Variables included in our modelling specification**

| | Variable | Definition | Data source |
|---|---|---|---|
| Dependent variable | $TTC_t$ | Log of the total tax contribution of the FS sector at time *t* | City of London & PwC analysis |
| Explanatory variables | $GVA_t$ | Log of the gross value added of the FS sector at time *t* | ONS |
| | $TTC_{t-1}$ | Log of the total tax contribution of the FS sector at time *t-1* | City of London & PwC analysis |
| | $\lambda_t$ | Yearly time effects | N/A |

The results from our analysis are set out in Technical annex 1.1. The key variable of interest is 'Log of GVA', which has a coefficient of 0.96. This represents the 'tax buoyancy' of the financial services sector, indicating that a 1% increase/decrease in the gross value added of the sector will increase/decrease its total tax contribution by 0.96%. **As GVA is expected to decline by 3.1% in the year to 31 March 2021, our estimated tax buoyancy of 0.96 suggests that TTC will decline by a comparatively smaller 2.9%.** The TTC of the sector in the year to 31 March 2020 was equal to £75.6bn, so this fall of 2.9% equates to a TTC of £73.4bn in the following year.

**Technical annex 1.1: Key drivers of FS sector total tax contribution**




Source: PwC analysis.

# Appendix 2 – 2020 TTC survey results and methodology

**53**

companies provided data on all their UK tax payments for accounting periods in the year ending 31 March 2020.

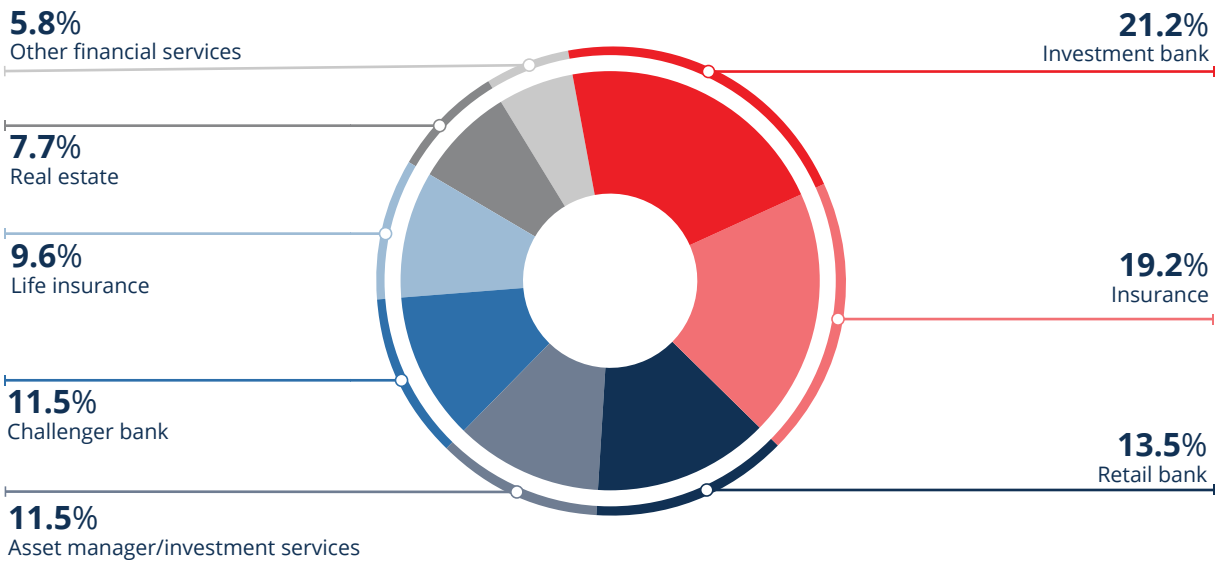
Data was provided by 53 FS companies on all their UK tax payments for accounting periods in the year ending 31 March 2020. The results are a measure of cash taxes paid, covering both taxes borne by companies and taxes collected from employees and customers.

PwC has anonymised and aggregated the data provided by the FS companies to produce the study results. PwC has not verified, validated or audited the data and cannot therefore give any undertaking as to the accuracy of the study results. Where we refer to data published by the government and HMRC, this is clearly indicated.

The 53 companies in the sample include different financial services subsectors: banks (including UK, foreign and challenger banks), insurers (including life and general) and other financial services sectors (asset managers, including real estate assets, and investment services). The 53 firms participating in the survey employ 37% of total UK FS employees. Figure 16 below provides a detailed breakdown of participants by sector.

Figure 17 on the next page provides the figures for taxes borne and collected for our survey participants.

**Figure 16: Survey participation by sector**[22]




Source: PwC analysis.

22 The real estate subsector includes those acting as asset managers of real estate assets.

Figure 17: Taxes borne and collected by survey participants in the year ending 31 March 2020

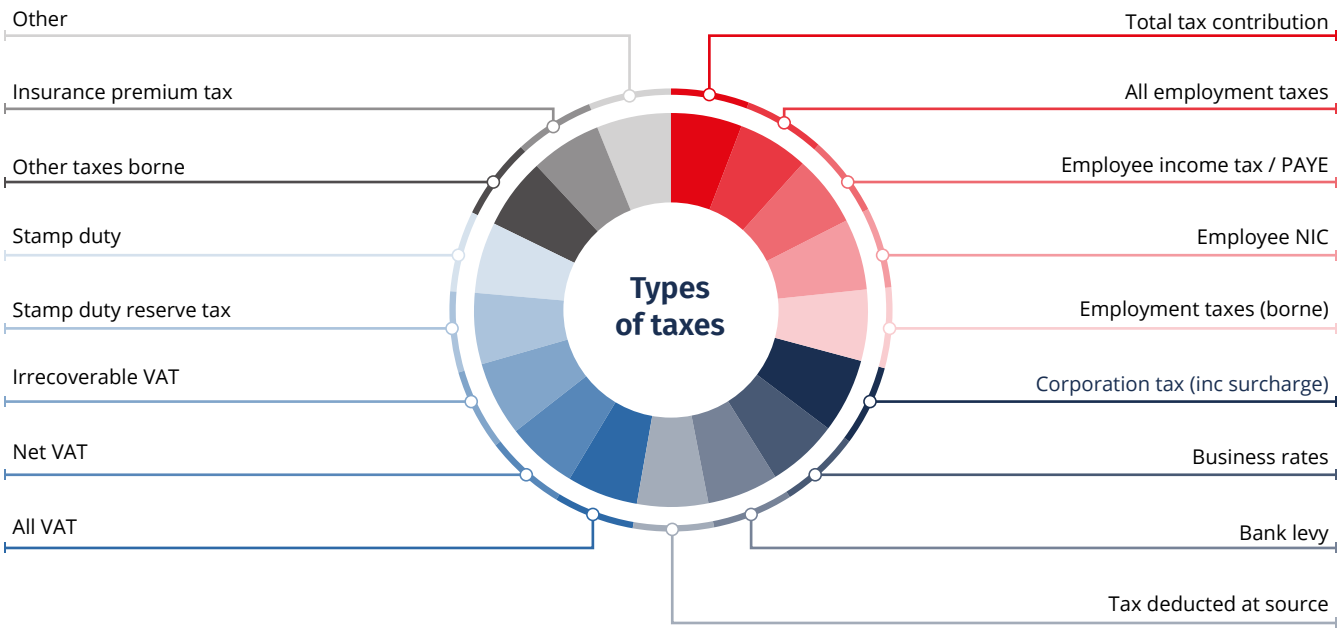
| Taxes borne | | £millions |
|---|---|---|
| Profit taxes | Corporation tax | 3,792.3 |
| | Bank surcharge | 944.0 |
| Property taxes | Bank levy | 2,185.8 |
| | Business rates | 660.3 |
| | Stamp duty land tax | 100.0 |
| | Stamp duty/stamp duty reserve tax | 345.0 |
| People taxes | PSA (tax on benefits) | 68.1 |
| | Employer NIC | 3,541.6 |
| | Apprenticeship levy (net of use) | 94.3 |
| Product taxes | Irrecoverable VAT | 4,647.7 |
| | Insurance premium tax | 18.3 |
| | Air passenger duty | 9.4 |
| | Fuel duties | 4.1 |
| | Vehicle excise duties | 58.8 |
| | Customs duties | 0.1 |
| Planet taxes | Landfill tax | 0.7 |
| | Carbon reduction commitment | 8.0 |
| | Climate change levy | 11.6 |
| **Total taxes borne** | | **16,490.1** |
| **Taxes collected** | | |
| Profit taxes | Tax deducted at source[23] | 3,088.3 |
| Property taxes | Stamp duty reserve tax | 767.5 |
| People taxes | Income tax under PAYE | 8,960.6 |
| | Employee NIC | 1,626.1 |
| Product taxes | Net VAT | 783.8 |
| | Insurance premium tax | 2,829.3 |
| **Total taxes collected** | | **18,055.6** |
| **Total tax contribution** | | **34,545.8** |

23 Tax deducted at source from, for example, interest, royalties, subcontractors, PAYE on annuities, withholding tax on property income dividends and others (see Appendix 3).

# Appendix 3 – Glossary of taxes

This section provides further detail on individual taxes.

**Figure 18: Colour code used to identify the taxes paid by financial services companies**



## Taxes borne include:

| | |
|---|---|
| Bank corporation tax surcharge | This was introduced in 2016 and is an 8% surcharge tax on the taxable profits of banks. |
| Bank levy | This was introduced in January 2011, designed to encourage banks and building societies to adopt less risky funding profiles. It is charged as a percentage of total chargeable equity and liabilities, with a higher rate applying to short-term (and therefore higher risk) equity and liabilities than to long-term equity and liabilities. |
| Irrecoverable VAT | When a business supplies goods and services to its customers it generally charges VAT, and offsets against this any VAT it has incurred on purchases used to run the business (input VAT). Where the services offered by a company are VAT exempt, VAT is not charged to customers. This is the case for many financial services activities, so these companies cannot recover their input VAT, leading to irrecoverable VAT. |
| Apprenticeship levy | This was introduced in 2017 and is a levy on UK employers with annual pay bills in excess of £3m, at 0.5% of the annual pay bill. The revenue from the apprenticeship levy is intended to fund new apprenticeships, and the amounts claimed by participants to pay for apprenticeship training is also captured by the TTC framework. Net apprenticeship levy is the amount of levy paid less the amount of the levy used to fund apprenticeships. |

## Taxes collected include:

| | |
|---|---|
| Tax deducted at source | Tax is deducted at source on certain payments made by financial services companies and paid to HMRC. Tax is deducted at source from:<br>– royalty payments<br>– interest paid to companies in some circumstances<br>– PAYE deducted by insurance companies that administer pension funds<br>– property income distributions made by real estate companies. |
| Insurance premium tax (IPT) | This is collected by insurance companies on insurance policies sold (excluding life insurance policies). |
| Stamp duty reserve tax (SDRT) and stamp duty (SD) | Stamp duty reserve tax is paid on shares traded electronically. It is a tax borne where a company trades shares on its own account and a tax collected where a company trades shares on behalf of a third party.<br>Stamp duty is paid on shares traded using a physical document. |
| Net VAT | Companies account for VAT on their value added – that is, output VAT charged on the services sold by financial services companies (where these aren't exempt services) less input VAT. Net VAT is treated as a tax collected. |
| PAYE settlement agreements (PSA) | A PAYE settlement agreement enables employers to make a single annual payment to HMRC to settle all tax and NIC due on certain expenses and benefits provided to employees. |

## Economic glossary

| | |
|---|---|
| Tax buoyancy | Tax buoyancy means the degree to which the total tax contribution of the financial services sector respond to changes in the sector's gross value added (GVA), with GVA being used as a proxy for the sector's tax base. |

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