



A Code of Practice on Taxation for Banks

Consultation Response Document
December 9, 2009

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Executive Summary

Following the Chancellor of the Exchequer's statement to the House on 16 March 2009, Budget 2009 announced that Her Majesty's Revenue and Customs (HMRC) would publish a Code of Practice on Taxation for Banks (the Code) for the banking sector, to encourage banks to comply with both the letter and the spirit of the law. The consultation document was published on 29 June 2009 and the period for comment ran to 25 September 2009.

The consultation document explained why the Code was being introduced, and asked banks, their advisers and other interested parties to consider specific issues relating to the administration and implementation of the Code.

Respondents provided specific comments on the wording of the Code and the difficulties that would be encountered in complying with the Code. This is discussed in more detail in Chapter 2.

In light of these comments, the Government has decided to make changes to the wording of the Code to better target it, and enable it to lead to better relationships between banks and HMRC. The updated Code is at Annex A.

The Code asks banks to ensure that they:

- have proper governance around tax, integrated into business decision-making;
- establish an appropriate relationship with HMRC, following the principles set out in the Review of Links with Large Business; and
- undertake tax planning only to support their business operations, not to achieve unintended and unexpected tax advantages (i.e. tax results that are contrary to the "intentions of Parliament").

Chapter 1 Introduction

The Code was introduced as a result of Government concerns about banks engaging in tax avoidance, and undertaking transactions that they contend are within the letter of the law, but which are contrary to the spirit of the law. The consultation document explained how the Code would encourage all banks and organisations providing banking services operating in the UK to adopt best practice in relation to their tax affairs and to comply with the spirit, and not just the letter, of the law.

The Code describes the approach expected by the Government of banks to governance, tax planning and engagement with HMRC. This should introduce more transparency and lead to a behavioural change in those banks that have been engaging in tax avoidance.

The purpose of the consultation was to explore issues arising from the implementation of a Code of Practice on taxation for banks. This highlighted some areas of concern around the adoption and implementation of the Code.

Throughout the consultation period, HMRC has attended meetings with individual banks, advisers, representative bodies and banks collectively, both organised by HMRC and organised by the banks' advisers. HMRC held workshops in London and Edinburgh and attended meetings with:

- the Association of Foreign Banks;
- the British Bankers' Association;
- the Building Societies' Association;
- the Confederation for British Industry; and
- the Association for Financial Markets in Europe (formerly the London Investment Banking Association).

As well as entering into informal discussions with interested parties, 27 formal responses were received from bodies such as the City Law Society, the Chartered Institute of Taxation, the Institute of Chartered Accountants in England and Wales and representative bodies such as the British Bankers' Association and the Association for Financial Markets in Europe (formerly the London Investment Banking Association).

This document summarises the points that were raised in the consultation and sets out how the Government is taking the Code forward. Detailed responses are in Chapter 2 and the way forward (how the Code is intended to operate) is in Chapter 3.

HMRC wishes to thank those who responded to the consultation document. We recognise the time and effort that went into the comments and contributions. A list of respondents and contributors to the consultation can be found at Annex B.

Chapter 2 Responses

This chapter summarises:

- the general comments received in respect of the Code; and
- the responses to the specific questions in the consultation document.

General comments

We received positive comments from the majority of respondents in support of the principles underlying the Code. One respondent said:

“much of the proposed Code, as it relates to governance arrangements and relationships between banks and HMRC, we fully endorse and would regard as existing best practice which should be adopted as appropriate to the circumstances of individual institutions.”

Other comments include:

“we welcome the promotion of closer relationships between HMRC and banks”

“we are strongly in favour of efforts to promote transparency and good governance throughout business.”

We also received comments from the majority of respondents expressing concern that the Code may not be able to achieve its intended objective. Respondents said it is “impractical” and “couched in indefinite and ambiguous language ... concepts such as “the intentions of Parliament” are used without any elaboration as to their meaning”. One respondent said:

“whilst we agree with the principles the Code advocates, we consider that a non-statutory voluntary arrangement ...is, at best, impossible to operate with any degree of consistency”.

These comments are discussed in more detail below.

Responses to the specific questions in the consultation document.

Question 1

What issues are likely to arise in introducing and complying with the Code and how can these issues be overcome?

All respondents (100 per cent) answered this question. Their view is:

- the interpretation of “spirit of the law” and “intention of Parliament” should remain with the courts. HMRC should not become responsible for legal interpretation, as this confers a quasi-legislative and judicial function on them that contravenes the principle of separation of powers;
- the Code discriminates against banks;
- UK banks are at risk of losing business to foreign competitors who are not covered by the Code. UK banks will be in competition with one another if one adopts the Code and the other does not;
- “spirit of the law” and “intention of Parliament” are difficult, if not impossible, to clearly define. This creates uncertainty for taxpayers when undertaking business transactions; and
- more discussions between banks and HMRC are needed to fully determine the impact of the Code, and how issues can be overcome.

HMRC response

The rule of law

We agree that HMRC should not become responsible for legal interpretation. Banks will continue to be taxed in accordance with the law. The Code is not law, but a statement of principles which provide a benchmark for corporate behaviour in relation to governance, tax planning and the relationship with HMRC.

The Code does not, therefore, give HMRC a quasi-legal authority. Further, it does not give HMRC the right to tax the bank in respect of that transaction in accordance with HMRC’s view of the spirit or intention rather than the letter of the law. If the bank enters into the transaction and in due course makes a return on the basis of that transaction, HMRC will still

need to decide how to respond. We may risk assess the transaction and decide to open an enquiry. But the objective of that enquiry will be to establish the correct tax treatment in accordance with the law; the Code will not affect that.

If HMRC and the bank cannot agree the tax treatment of the transaction, the bank will have the right to have its appeal heard by the tax tribunals and the courts; the Code will not affect that.

Discrimination

In announcing the Code would apply only to banks and banking activities, the rationale was that banks have historically promoted tax avoidance on their own account, for clients and for their staff. Their behaviour has been more aggressive than that of other sectors. At a time when banks have received more Government help than other industries, the public expects banks to show a high degree of responsibility and the highest standards of corporate governance. But these standards are no different from those that it is expected other large corporate taxpayers should adopt.

Competition

The Government's intention is that all banks and similar institutions operating in the UK should adopt the Code. This will promote a level playing field across banking. The Government does not agree that adoption of the Code will place UK banks at a competitive disadvantage.

The Code is not intended to put UK banks at a disadvantage over their foreign competitors. The Code does not alter the fact that responsibility for business decisions rests with the bank. Where there is any doubt of the tax treatment of a transaction, the bank should discuss the proposed transaction with HMRC in advance and HMRC will give the bank our view. This will be HMRC's opinion of whether the tax result is contrary to the "intentions of Parliament".

It remains the bank's decision whether to undertake the transaction or not. The bank must decide whether it reasonably believes the tax result is contrary to the "intentions of Parliament". The Code gives a bank that thinks a transaction it wants to undertake may not be within the "intentions of Parliament", and too good to be true, an opportunity to seek HMRC's views.

The bank must still decide whether to enter into the transaction; it is a commercial decision for the bank. The Code does not give HMRC the right to prevent the bank from entering into the transaction.

Definition issues

Some banks have told us they may find it difficult to decide whether transactions are, or may be, contrary to the “intentions of Parliament”. There was significant debate in the consultation period about the meaning of “intentions of Parliament”.

The Code is not a legal document and the phrase should not be construed as if it were a statutory provision/legislation. It refers to the broad objective at the time the relevant legislation was enacted.

Through a technical note, which HMRC has drafted in consultation with banks and their advisers, we will suggest banks answer the question of whether the transaction is contrary to the “intentions of Parliament” in practice by asking whether the tax consequences of a proposed transaction are too good to be true, so that the tax consequences would be a surprise to HMRC. This is because a tax result contrary to the “intentions of Parliament” would not be what HMRC would expect.

The technical note will also explain that the Code applies to banks’ own avoidance schemes, (i.e., those they enter into themselves), and schemes they design and plan to sell to their customers. The Code will not cover normal lending and the provision of other banking facilities such as derivatives. This is because HMRC accepts it would be operationally impossible for banks, when they are involved in someone else’s transaction, to identify whether the tax consequences of that transaction are, or may be, contrary to the “intentions of Parliament”.

Summary

The Code is about behaviour and not about legal relationships. It is intended to encourage banks to think carefully about the transactions they want to enter into, and to lead to better dialogue between HMRC and the bank before transactions take place, supplementing the information HMRC receives under the statutory disclosure rules.

The Code expects that banks will enter into open and transparent dialogue with HMRC in real time, that is, as questions about transactions emerge. This is already the case with many banks, following the implementation of the Review of Links with Large Business.

Question 2

How can uncertainties about tax issues be resolved?

14 respondents answered this question (52 per cent). Their views were:

- banks should be encouraged to initiate dialogue with their Customer Relationship Manager (CRM) if there is uncertainty;
- the circumstances when a bank should or should not consult with HMRC must be clearly defined;
- HMRC must engage promptly with banks and be prepared to discuss hypothetical situations. A clearance procedure is needed to give early certainty;
- there should be a process for independent review where a bank disagrees with HMRC's view; and
- the wording at paragraph 4.2 of the draft Code is a concern as it added a "compulsion" to a voluntary Code.

HMRC response

Dialogue with, and when to consult, the CRM

The Government recognises that there will always be some areas of uncertainty among banks and their advisers about how the law applies to specific business transactions. Section 4 of the Code encourages the business to disclose to HMRC any proposed transaction where, on the bank's legal analysis, the tax consequences may be contrary to the "intentions of Parliament", (i.e. the tax result could be seen as too good to be true). The bank can choose to discuss the proposed transaction with its CRM before the transaction takes place. This is a change to the draft Code, published in June, which the Government has made, reflecting discussions held with banks.

For all other transactions, including those where the bank believes that HMRC may disagree with the bank's legal analysis or there are other significant uncertainties in relation to tax

matters, disclosure should take place as soon as is reasonable after the transaction has been implemented. The responsibility for initiating this discussion rests with the bank.

Engagement with HMRC

Where banks are uncertain about a transaction, the Code encourages banks to engage with HMRC. HMRC recognises there may be commercial timing pressures, and will respond within them as far as possible. HMRC may need more time for complex issues. But however complex, HMRC will commit to work with the bank within a reasonable timeframe that recognises the commercial pressures. The bank should make reasonable efforts to give HMRC sufficient time to comment, but banks do not need permission from HMRC before undertaking a transaction, and are under no obligation to await a response where commercial considerations require an earlier business decision.

It is for the bank to decide what transactions to undertake, not HMRC, based on its own internal governance procedures, the commercial considerations and the aims of the Code.

Independent review

As banks do not need to abide by HMRC's views, no special dispute resolution procedure is needed. Any disagreements arising under the Code will be dealt with using existing processes.

Question 3

What support should banks expect from HMRC to help them implement and abide by the Code?

20 respondents answered this question (74 per cent). Their views were:

- HMRC must manage enquiries in real time and respond satisfactorily to the commercial time pressures on transactions. They must be sensible and pragmatic;
- HMRC should state how consistency of treatment in applying the Code to banks will be achieved;
- more clear guidance will be necessary, especially details of HMRC's role and obligations in their relationships with banks.
- more meetings with industry bodies will be required; and

- for banks to behave in the way the Government wants, the Government needs to reciprocate.

HMRC response

Managing enquiries

As above, HMRC recognises transactions often need to take place quickly to achieve commercial objectives. HMRC will respond within the bank's timescales as far as possible. But as it is for the bank to decide whether to undertake the transaction, it does not have to wait for HMRC to respond.

Consistency

There are several hundred banks, building societies and organisations providing banking services in the UK. The management of banks' taxation affairs within HMRC is split between two different HMRC operating units:

- the Large Business Service (LBS) which manages the relationship with the largest and most complex of HMRC's business customers; and
- Local Compliance (LC) which manages the tax affairs of other business customers.

The banks and organisations are currently distributed as follows:

- 76 are managed within the LBS; and
- the remainder (including 180 banks and 49 building societies) are managed within LC.

All banks within the LBS, and 16 within LC, have a CRM as a dedicated point of contact. LBS and LC will work together to deliver the consistent service the banks require.

Meetings with industry bodies

During the consultation period, HMRC held several meetings with industry representative bodies to discuss the issues when banks adopt the Code; this included what guidance banks will need to help them comply with the Code. These discussions have continued after the end of the consultation period, and the technical note has been shared with the banks' representative bodies, to ensure that it is fit for purpose.

Question 4

What other sanctions should be considered where non-compliance is found to be deliberate?

11 respondents answered this question (41 per cent).

- eight respondents said there should be no sanctions for a voluntary code. If compliance with a voluntary code is enforced, that Code becomes compulsory.
- three agreed sanctions would be appropriate for non-compliance and suggested.
 - withdrawing state funding (1 respondent);
 - “naming and shaming” (2 respondents); and
 - greater scrutiny from HMRC (1 respondent).
- two respondents were in support of paragraph 4.8 of the consultation document:
- “where non-compliance (with the Code) was found to be deliberate and the officer of the bank who signed up to the Code is a member of a professional body, HMRC will consider making a report to that body”.
- the other nine respondents thought this would be disproportionate and ineffective, saying non-compliance with a voluntary code is not allied with professional misconduct.

HMRC response

The Code is voluntary. HMRC would consider making a report to a professional body where there had been a serious breach of its rules, for example where a tax adviser or a person authorised by the FSA had acted dishonestly. HMRC expects these will be exceptional circumstances. Simply taking a commercial decision HMRC or the Government did not like would not be sufficient to require such a response.

Question 5

What do banks think the administrative costs of complying with the Code will be both initially and going forward?

10 respondents answered this question (37 per cent). Their views were:

- there will be costly internal controls to implement and external costs will rise, for example due diligence and professional adviser fees, as banks will face increased

uncertainty. These costs and burdens will not be “one-off” for smaller banks and building societies with no existing in-house tax function;

- there will be very substantial and unnecessary administrative burdens; and
- one respondent did not foresee compliance with the Code as costly.

HMRC response

Costs

HMRC think three key factors will broadly influence the impact on individual banks of adopting and complying with the Code. These are:

- the size of business – and thus the volume & complexity of transactions undertaken;
- the existence (or otherwise) of appropriate governance procedures; and
- whether the bank is managed within LBS or LC. This determines how HMRC expects a bank to adopt and comply with the Code.

One-off Costs

HMRC expects that, in adopting the code, banks could incur one-off costs in the following areas:

- familiarisation (reading and understanding the Code and associated technical note);
- auditing existing processes (identifying where the weaknesses/gaps in existing processes are);
- seeking professional advice (particularly smaller banks and building societies);
- setting up additional internal controls/procedures if they do not already exist; or
- managerial oversight and/or approval of a) any decision to adopt the Code and b) any governance changes made in order to comply with the Code.

On-going Costs

The responses to the consultation suggested that banks could incur on-going costs in the following areas:

- seeking professional advice and/or making enquiries to HMRC on transactions where the bank is uncertain (particularly smaller banks and societies);
- transactions not undertaken as a result of implementing the Code; and
- internal controls and reporting processes.

A full analysis of the costs and benefits is in the implementation Impact Assessment at www.hmrc.gov.uk

HMRC has explained in meetings it is not the Government's intention the Code should be intrusive. The Government's intention is, that by adopting and implementing the Code, banks and HMRC will establish and maintain appropriate relationships. HMRC has listened to the responses received through the consultation process and, while the main tenets and policy rationale of the Code remain unchanged, HMRC has agreed to change some wording of the Code to clarify the responsibilities and behaviours expected. In particular the Government has decided that banks not currently within the LBS will be expected to comply with only the summary requirements in section 1 of the Code.

Question 6

How should the public and Parliament be updated on compliance with the Code?

Eight respondents answered this question (30 per cent).

- two respondents agree with the wording of paragraph 4.11 of the consultation document.

Others sought to add further detail as follows:

- a report should be made of the number of transactions considered not to accord with the intention of Parliament before and after the introduction of the Code;
- details of who has signed the Code posted on the HMRC website;
- the Chancellor to make an announcement at Budget;
- changes before and after the introduction of the Code in the tax take and banks' behaviour;
- update on legislative changes made or cases brought to court as a result of the Code;
- league tables; and
- information on how many banks have signed and the identity of non-compliers revealed.

HMRC response

HMRC will publish annual details of progress in implementing the Code, split into the

following categories:

- the top 15 banks;
- the rest of the banks in the LBS; and
- banks in LC.

Question 7

We welcome comments on the assumptions made in the Consultation Impact Assessment.

Seven respondents answered this question (26 per cent). Most thought it difficult to comment at all.

Specific comments were:

- there will be no cost savings, nor extra revenue; and
- banks will incur extra costs.

HMRC response

An Implementation Impact Assessment has been published and can be found at www.hmrc.gov.uk.

Chapter 3 Way forward

The Government continues to believe the Code is necessary and accepts the Code should be voluntary. The aim of the Code is to promote good practice for governance and decision making in banks, and to build open and transparent relationships between banks and HMRC, so that banks undertake tax planning to support their business operations but not achieve tax results that are contrary to the “intentions of Parliament”.

The Government is grateful for suggestions from those consulted that the Code should be amended in three ways with the objective of achieving this aim. An updated version of the Code is at Annex A. The changes in the Code are:

- (i) as noted above, paragraph 4.2 no longer demands that banks initiate dialogue with HMRC if they are in doubt whether the tax result of a proposed transaction is contrary to the “intentions of Parliament”. Instead, the bank may choose to do so. This is not expected to make a difference to the level of transparency but it clarifies the tone of the discussion between the bank and HMRC. In particular, it recognises that a relationship cannot be built on coercion;
- (ii) paragraphs 3.1 and 3.2 set out more clearly the Government’s expectations in relation to tax planning. Paragraph 3.1 applies where the tax results of the transaction concern the bank; paragraph 3.2 applies where they concern the bank’s client or other parties. In some circumstances, both paragraphs may apply in relation to the same transaction; and
- (iii) changes to paragraph 3.3 and 4.2 make it explicit that the test is the reasonable belief of the bank. This was implicit in the original wording.

The Government has also decided to make two other changes to the way the Code operates.

- (i) respondents pointed out that some of the detail of the Code, especially in section 2, will not apply to the smaller banks. For example, a small bank may not have a tax department. The Government has therefore decided that banks not managed within the LBS should adopt only section 1 of the Code. They will need:
 - adequate governance;

- not to undertake tax planning that aims to achieve a tax result contrary to the “intentions of Parliament”;
 - to comply with tax obligations; and
 - a transparent relationship with HMRC
- (ii) the Government has accepted a suggestion that the means of adoption of the Code should be for the bank to take a corporate decision, following its own governance, and to communicate this to HMRC through its existing dialogue. This is a minor change to the process set out in the Consultation Document.

The amended Code asks banks to ensure that they:

- have proper governance around tax, integrated into business decision-making;
- establish an appropriate relationship with HMRC, following the principles set out in the Review of Links with Large Business; and
- undertake tax planning only to support their business operations, not to achieve unintended and unexpected tax advantages (i.e. tax results that are contrary to the “intentions of Parliament”).

The Code does not take responsibility for business decisions away from the business. Most banks should know when they are achieving a tax result contrary to the “intentions of Parliament”. Where there is any doubt, the bank can choose to discuss the proposed transaction with HMRC in advance; HMRC will advise the bank if we believe the tax result is too good to be true and contrary to the “intentions of Parliament”. But it remains the bank’s decision whether to undertake the transaction or not. The bank must decide whether it reasonably believes the tax result is contrary to the “intentions of Parliament”, if it does, it is expected not to proceed with the transaction in the way it proposed.

Whether or not the bank discusses transactions in advance, the Code expects that banks will enter into open and transparent dialogue with HMRC in real time, i.e. as questions emerge, as is already the case with many large businesses, and as set out in the procedures following the implementation of the Review of Links with Large Business.

The transactions actually entered into, whether as discussed or varied in some way, will still be taxed in accordance with the law, not the Code.

A bank's decision on adoption of the Code, and its success in implementing it, will not affect the bank's relationship with HMRC; HMRC's objective is to establish open and transparent relationships with all large business customers. But HMRC will wish to discuss with banks that adopt the Code how they are complying with it and will evaluate this as part of the normal risk-assessment process, seeking to understand both the bank's overall implementation of the Code, and the reasons behind particular decisions.

Annex A

Code of Practice on Taxation for Banks

OVERVIEW

1. The Government expects that banking groups, their subsidiaries, and their branches operating in the UK, will comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament.
 - 1.1 This means that banks should:
 - adopt adequate governance to control the types of transactions they enter into;
 - not undertake tax planning that aims to achieve a tax result that is contrary to the intentions of Parliament;
 - comply fully with all their tax obligations; and
 - maintain a transparent relationship with HM Revenue & Customs (HMRC).

GOVERNANCE

2. The bank should have a documented strategy and governance process for taxation matters encompassed within a formal policy. Accountability for this policy should rest with the UK board of directors or, for foreign banks, a senior accountable person in the UK.
 - 2.1 This policy should include a commitment to comply with tax obligations and to maintain an open, professional, and transparent relationship with HMRC.
 - 2.2 Appropriate processes should be maintained, by use of product approval committees or other means, to ensure the tax policy is taken into account in business decision-making. The bank's tax department should play a critical role and its opinion should not be ignored by business units. There may be a documented appeals process to senior management for occasions when the tax department and business unit disagree.

TAX PLANNING

3. The bank should not engage in tax planning other than that which supports genuine commercial activity.
 - 3.1 Transactions should not be structured in a way that will have tax results for the bank that are inconsistent with the underlying economic consequences unless there exists specific legislation designed to give that result. In that case, the bank should reasonably believe that the transaction is structured in a way that gives a tax result for the bank which is not contrary to the intentions of Parliament
 - 3.2 There should be no promotion of arrangements to other parties unless the bank reasonably believes that the tax result of those arrangements for the other parties is not contrary to the intentions of Parliament.

- 3.3 Remuneration packages for bank employees, including senior executives, should be structured so that the bank reasonably believes that the proper amounts of tax and national insurance contributions are paid on the rewards of employment.

RELATIONSHIP BETWEEN THE BANK AND HMRC

4. Relationships with HMRC should be transparent and constructive, based on mutual trust wherever possible.
- 4.1 The features of this relationship should include:
- disclosing fully the significant uncertainties in relation to tax matters;
 - focusing on significant issues;
 - seeking to resolve issues before returns are filed whenever practicable;
 - engaging in a co-operative, supportive and professional manner in all interactions;
 - working collaboratively to achieve early resolution and hence certainty.
- 4.2 Where the bank is in doubt whether the tax result of a proposed transaction is contrary to the intentions of Parliament, to help the bank form its reasonable belief under section 3, it may discuss its plans in advance with HMRC.

Annex B

List of Respondents

Allen and Overy LLP
The Association of Foreign Banks
The Association for Financial Markets in Europe (formerly the London Investment Banking Association)
Barclays Bank
BDO Stoy Hayward
Berwin, Leighton Paisner
BNP Paribas
The British Bankers' Association
The Buiding Societies' Association
The Chartered Institute of Taxation
The City of London Law Society
Clifford Chance LLP
Credit Suisse
The Confederation for British Industry
Deloitte LLP
Deutsche Bank
Ernst & Young LLP
The Financial Markets Law Committee
The Financial Services Authority
Freshfields Bruckhaus Deringer LLP
HSBC
The Institute of Chartered Accountants in England and Wales (Tax Faculty)
The Institute of Chartered Accountant's of Scotland
The Institute of Directors
The International Securities Lending Association
J P Morgan
KPMG LLP
The Law Society
Linklaters LLP
Lloyds TSB
The Low Incomes Tax Reform Group
Maurice Turner Gardner LLP
Merrill Lynch
PricewaterhouseCoopers LLP
The Public and Commercial Services Union
Royal Bank of Scotland
The Society of Trust and Estate Practitioners

3 individuals also provided responses