



**A Code of Practice on Taxation for Banks
Consultation Document 29 June 2009
Response by the Chartered Institute of Taxation**

This is the response of the Chartered Institute of Taxation (CIOT) to the above HMRC consultation document. We start with some general comments about the issues raised by the consultation; then deal with some of the questions that need to be addressed to make the Code of Practice (COP) workable, assuming it is to go ahead; and conclude with further comments, as appropriate, on the specific questions raised in the consultation document. We will comment separately on the draft HMRC guidance on the proposed code: that has been issued too late for us to incorporate meaningful comments in this submission.

Executive summary

The CIOT has considerable concerns about the proposed COP. We have always had a consistent stance of upholding the rule of law in taxation; we do not think wider agendas about the banking industry – on which we are not qualified to comment – should erode that key principle.

We strongly oppose a code that tries to override statute as the governing force of taxation in the UK. We have long objected to ‘tax by law, untaxed by concession’; we similarly oppose a code that seems to attempt to ‘tax by code that which is untaxed by law’. As we discuss below, we believe that taxation by intention of Parliament, in the sense that we understand is meant by HMRC in the COP, is impractical. In addition, the code as proposed is one-sided; at a minimum, there must be comparable obligations on HMRC to operate the tax system in accordance with Parliament’s intentions.

If the code is to be introduced and to be voluntary, there should be no sanctions for non-adoption or for breaches of the code (other than deliberate misleading of HMRC – where existing penalties are available to HMRC). It should be for HMRC to adjust their approach, not penalise.

If the code is to be introduced, we think there are many issues that need to be resolved. We discuss these in the following pages of our comments.

General comments

How are taxes to be imposed?

We are deeply concerned about any move that seems to erode what is one of the cornerstones of the UK's tax system: that taxpayers should be taxed according to the letter of the law. Case law and documents going back to Magna Carta recognise this. In recent years, case law has developed its way of looking at the statute, towards a purposive interpretation of the transactions under consideration. This has been a significant evolution, and one with which taxpayers and HMRC are managing to deal; it seems to deliver a good deal of what HMRC presumably hope to achieve with the current document.

However, any move to tax by the 'spirit' of the law is a major further step. HMRC need to recognise and justify the significance of the change. The ongoing discussion about purposive drafting has highlighted the range of difficulties caused by any such move.

Lord Hoffmann, in his 2004 Goode lecture, set out very clearly the view of the judiciary on any arguments over looking behind the letter of the taxing statute: "The only way that Parliament can express an intention to impose a tax is by a statute which means that such a tax is to be imposed." We wholly support this stance and consider that HMRC have not made a case for departing from it.

If HMRC see this COP as affecting not the taxation of banks and/or bank customers but, rather, their approach to the transactions they do or do not undertake, that needs to be spelt out clearly and, at the same time, the primacy of taxation by the letter of the law acknowledged. If, on the other hand, HMRC see this as a change to taxation by the spirit of the law, or intendment, that needs to be considered by way of a much wider debate.

The operation of the code

The COP is stated to be voluntary. If that is the case, we are unclear why 'sanctions' are needed. If this truly is a voluntary code, then it is for HMRC to inform or adapt their behaviour, presumably through adjusting risk ratings, and not to penalise a non-signatory.

It is also necessary for HMRC to demonstrate how a voluntary code can avoid becoming something that affected taxpayers are pressurised into adopting; that would make it compulsory, and it would be far better for HMRC to be open from the start if that is their objective. Whether it is seen to be truly voluntary or not will be important in determining whether or not the code amounts to unacceptable discrimination.

We do, however, recognise that an organisation that signs up to a COP and then deliberately fails to adhere to it may face consequences; we return to this issue later when commenting on the consultation questions.

The sections of the proposed code

The COP has three broad sections. Looking at the three parts:

- (1) **Governance** – It is surely hard for anyone to argue with the principle that organisations should have proper governance procedures around taxation, and that good governance should include engagement by top levels of management. This is increasingly commensurate with good practice¹ and organisations – not just banks – are adopting it without any need for HMRC to try to impose their requirements.

¹ See, for example, work by Hendersons and PricewaterhouseCoopers' Tax Transparency Framework.

The issue is how governance should be demonstrated; the requirements imposed by FA 2009 section 93 (Senior Accounting Officers) have raised great concerns among affected companies in terms of the extra effort that is required to document what are already satisfactory procedures, to no real benefit. This COP must avoid adding unnecessarily to burdens, and needs to justify its requirements in terms of a real impact on tax revenues.

- (2) **Tax planning** – This is clearly the hub of the COP. Its requirements need to be certain to ensure fairness to all affected taxpayers. We discuss the concerns we have with its terms below under ‘Areas for clarification’.
- (3) **Relationship between the bank and HMRC** – Again, it is hard to argue with the sentiments here of aiming for a "... transparent and constructive relationship, based on mutual trust ...". However, we consider this is already being achieved in practice, with credit due to HMRC for their part in the improved relationships. But we would stress that this must be a two way process. The banks deserve the trust of HMRC unless there is a reason for that to be forfeited. The new HMRC Charter is important in this regard.

We note that parts 1 and 3 of the COP reflect the recent OECD report on banks: although that report did not have an equivalent tax planning section, which we regard as significant in view of the problems that arise from its inclusion.

Intention of Parliament

Both parts 1 and 3 of the draft COP talk about the ‘Intentions of Parliament’. This may be easy for the tax layman to accept, but tax professionals know that the intention of Parliament is often difficult to discern. It is rarely clearly expressed, except in very broad terms, in whatever documents accompany new legislation. In any event, many disputes about tax planning that is alleged to flout the intentions of Parliament arise over the interaction of two or more areas where Parliament never considered any question of intention. How are such questions to be resolved?

The code is, presumably, deliberately vague and broad in terms of ‘intention’. That puts considerable onus on the bank to evaluate its proposed action, with the risk that too much time will be spent on clarifying and confirming transactions that are acceptable but which have some features that raise concerns. (These might be ‘light grey’ ones in the terminology used by HMRC in workshops on the code.) If action is needed, it would surely be more efficient all round to focus it on the ‘black’ transactions: ones clearly against the principles or aim of the legislation.

We have had it suggested that HMRC want the test to be in terms of whether Ministers would object to the planning when they see it, rather than any attempt to discern the intention of the legislation at the time it was enacted. That approach would be of even greater concern; it would take the operation of the tax system completely away from the statute and into the realms of opinion of the taxing authority. If there is a delay between the transaction and considering action against it, this also raises major concerns about judging through hindsight, rather than on the basis of practice at the time the transaction was undertaken.

Another area of concern is if the perceived intention is in conflict with the wording of the legislation. If the latter is clear, why should the bank be expected to follow another route - and, presumably, risk HMRC applying the letter of the law?

Is the code discriminatory – or even-handed?

The proposed code places obligations on banks. Fairness surely requires this to be an even-handed approach. Accordingly, we would expect HMRC to adopt an obligation to operate the tax system fairly and give a taxpayer a better result than the letter of the law suggests, if that better result is in line with what Parliament seemed to intend when passing the law in question.²

There is a major question over the obligations of this COP applying just to banking activities. Whilst we note that a key reason for this is stated to be the Government's support of the banking system, we have to question whether it amounts to a form of discrimination. Have HMRC satisfied themselves that there is no issue under EU law in this regard? We also need clear statements that there is no intention of extending this COP to other taxpayers, nor to other Government departments, using this COP as a precedent.

A better route

If there is a need to restrict or control certain banking activities in some way, we would have preferred that an extension to the existing FA 2004 disclosure regime (DOTAS) were used. We would have thought that adding some further hallmarks, targeted at these, would give HMRC the protection that they need in a known framework and by way of legislation rather than a COP. We would like to understand why this route has not been followed.

Areas for clarification

Assuming the COP is to go ahead, we see various areas needing work.

Banking activities

This term governs the scope of the code and needs to be carefully defined. Questions that arise include:

- To what extent are insurance groups included?
- Are hedge funds, investment trusts and asset management operations included?
- Are MNCs with group finance/treasury operations covered? and
- Can you confirm that oil companies, which typically carry out significant trading and financing operations, are not included?

Overseas aspects

Clearly, a multinational bank with operations in the UK is within the scope of the code. However, issues that need clarification include:

² Two examples would be:

- (a) The operation of the Option to Tax for VAT purposes, intended to mitigate the adverse consequences of the ECJ's decision regarding the VAT status of commercial property. When banks and others entered into sale and leaseback transactions intended to amortise the VAT cost, it was subsequently claimed that this was not intended, and the law was changed to prevent them so doing.
- (b) When independent taxation of husbands and wives was introduced, it was clear from statements by Ministers that movement of assets between spouses to improve their tax position was anticipated. However, HMRC pursued the Arctic Systems case against such 'income shifting'.

- Are the worldwide operations of a UK-based bank included? (We assume they are, but only insofar as they relate to UK activities: which may, of course, raise questions of definition and management.)
- For a foreign-based bank with UK operations, is the code only applicable to its UK operations? (We assume this is the intention.)
- What if the UK operations are modest compared with the rest of the group, with the UK unlikely to be able to influence significantly the conduct of the business? Does the code apply?
- What if the UK operations are not actually within the definition of banking operations, although the overseas aspects are certainly 'banking operations'?
- Is a non-UK bank with no UK presence that transacts business with a UK customer from outside the UK within the scope of the Code? If it is, how is the Code to be applied? If it is not, does that not give an unlevel playing field? and
- Does the foreign-based multinational have to appoint a UK-based person to be responsible for the code?

The signatory

We can understand that one of the objectives of the code is that responsibility for taxation matters should be clearly established at a high level within the bank. However, this raises questions, including:

- Do HMRC expect an individual to take personal responsibility for the banking code, with the individual's name disclosed to HMRC? and
- If this is HMRC's intention, why cannot HMRC accept a corporate signatory, which would be acceptable on most commercial undertakings?

There are also overseas aspects, as noted already.

Timing of judgments

There is a need for HMRC to operate quickly in relation to questions raised by banks if the code is not to hamper normal commerce, but there is also an important issue in terms of how HMRC form their views. It has been suggested that the test to be applied is one of 'Would action be likely to be taken against the scheme?' or 'Would the Minister object to the scheme?' These are dangerous; they seem to point towards a foregone conclusion on almost any planning. Does this approach mean that no new planning is allowable?

As we commented above, if HMRC come to look at a bank's actions some years after the event - ie a transaction that has not been brought to their attention under the code - then they must not judge with hindsight. They need to bear in mind that life may have moved on and that the transaction was reasonable when undertaken, even if it would raise concerns now.

Dividing lines

As already noted, we see section 3 of the code as the main section. This makes it particularly important to make sure paragraphs 3.1 and 3.2 are properly defined and understood.

The natural reading of COP paragraph 3.1 (acting as principal) is in relation to the bank's own tax affairs and 3.2 (otherwise facilitating) as being in relation to customers. However, it is possible to read 3.1 as acting as principal by making a loan to a customer and this, per condoc 3.16, appears to be the approach being taken by HMRC; on this basis, the same criteria have to be applied to the customer's tax affairs by the bank as to its own. If this is

the case, it would be impossible to manage; at a minimum, COP paragraph 3.1 needs to be restricted to cases where the bank is providing some form of tailored, rather than off the peg, service and, hence, where the bank might reasonably be expected to have some better knowledge of what the customer is doing.

Other questions that arise include:

- A bank acting on general wealth management for high net worth individuals will usually involve a good deal of planning for capital growth and results rather than income results. To what extent is this caught by the code? and
- Tax return services are often offered by banks; what is the position when a bank becomes aware that a customer is undertaking tax planning that might fall foul of the code, but has not otherwise been involved in the arrangements?

As for paragraph 3.3, the question that arises is how the 'rewards of employment' are to be defined. We have no problem with the wording of 3.3 on the surface: that if a bank employee (or indeed any other employee) is remunerated, then tax and NIC should be properly calculated and paid over in accordance with the law. However, we do have a real concern if this means that a valid arrangement which gives the bank employee a share in the growth of the business has to be regarded as an income reward rather than a capital reward. Is the code trying to put an end to share incentive plans?

Consistent guidance/application

The draft code and subsequent discussions point to a system that will depend very much on the bank working with its CRM. That has some merit; it also has dangers, in terms of how consistency can be ensured. It would not be acceptable to find that banks are treated differently purely according to who is their CRM.

Consultation questions

We have already touched on most of the issues raised by the consultation questions. Our further comments are as follows:

1. What issues are likely to arise in introducing and complying with the Code and how can these issues be overcome? (3.4)

The key issues are interpretation and consistency, as discussed above. The challenge in operating a code that is dependent on terms such as 'intention of Parliament' is to give taxpayers the certainty they need for their commercial operations. This extends to making sure that the UK is not disadvantaged. Banking is a very international business; if the UK comes to be seen as an uncertain jurisdiction, prone to change its tax rules and so lacking certainty for businesses, business will leave the UK.

2. How can uncertainties about tax issues be resolved? (3.5)

HMRC have to be willing and ready to engage promptly with banks, debate issues and give clear and firm answers/rulings on proposed transactions. They must be prepared to discuss hypothetical situations; banks will, not unreasonably, want to know what the tax implications of undertaking a course of action are before they commit to it. HMRC's traditional approach of not commenting on something that has not been undertaken will not do. Equally, HMRC will need to accept that transactions will be changed and refined – mostly not for tax reasons – so necessitating further discussions about tax treatments.

3. What support should banks expect from HMRC to help them implement and abide by the Code? (3.22)

This is, in essence, the resources necessary to deliver the sort of commercially-orientated relationship outlined in our response to the previous question. The decision of the CRM is clearly important, but should not be the final arbiter on such important issues. An appeal, or least internal review, process should be available.

4. What other sanctions should be considered where non-compliance is found to be deliberate? (4.8)

While disagreeing with the availability to HMRC of sanctions, the steps outlined in paragraph 4.8 seem reasonable. Whilst this is a voluntary code, it is reasonable for HMRC to discuss non-compliance with the bank, including with senior officers; if HMRC believe they have been deliberately misled by an officer of the bank, they should use their existing powers, including reporting the individual to their professional body, if appropriate. However, we would stress that such action would only be appropriate for deliberate misleading of HMRC – not for some operational failure to operate a voluntary code. Nor would it be appropriate for HMRC to take (or threaten) action against an individual for what, in reality, is a difference of opinion over the classification of a transaction.

5. What do banks think the administrative costs of complying with the Code will be both initially and going forward? (4.9)

We are not in a position to comment on this with authority, but would observe that the main cost will be the increased uncertainty that the bank will face in its operations: a cost that is, by nature, unquantifiable. The impact assessment needs to identify the costs and net benefits involved before any decision is taken to proceed.

6. How should the public and Parliament be updated on compliance with the Code? (4.11)

The proposed report suggested at paragraph 4.11 seems appropriate. Maintaining taxpayer confidentiality is paramount and so only aggregate data can be publicised.

7. We welcome comments on the assumptions made in the Impact Assessment (4.12)

This is disappointingly thin. In particular, there seems to be no real exploration of extending the existing disclosure regime, which would seem to be a preferable route, with lower costs and less uncertainty.

The Chartered Institute of Taxation
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The Chartered Institute of Taxation

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