



A Code of Practice on Taxation for Banks

Consultation Document
June 29, 2009

Subject of this consultation:	A Code of Practice on Tax for the banking sector.
Scope of this consultation:	The purpose of this consultation is to explore issues arising from the implementation of a Code of Practice on taxation for banks.
Impact Assessment:	There is an impact assessment at Appendix 4 of this consultation document.
Who should read this:	Businesses which operate in the UK banking sector, their advisors and associations.
Duration:	From publication on the 29 th June to 25 th September.
Enquiries:	The review team can be contacted by telephone on 020 7438 7665 or at susan.o'hara@hmrc.gsi.gov.uk
How to respond:	Large Business Service, 22 Kingsway, London, WC2B 6NR or at susan.o'hara@hmrc.gsi.gov.uk
After the consultation:	Following the consultation we will consider any issues that have arisen and subject to Ministerial agreement, the final text of the Code will be published in the Autumn.
Getting to this stage:	This is the first public consultation on this issue.
Previous engagement:	Following the Chancellor's announcement on 16 th March 2009, there have been informal discussions between HM Revenue & Customs and the British Bankers' Association, London Investment Banking Association and a number of other interested parties to help identify the key issues that need to be addressed.

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FOREWORD

For the tax system to be effective, everyone needs to pay their fair share. Tax avoidance damages the ability of the tax system to deliver its objectives, imposes significant costs on society, undermines public confidence in the tax system and shifts a greater burden of tax onto compliant taxpayers.

The Government has consistently tackled tax avoidance since 1997 – making reforms to the tax system, introducing the Disclosure Regime and closing legislative loopholes. We have led international efforts to counter avoidance through sharing of information and intelligence. Avoidance schemes continue to be developed and marketed, so we will not hesitate to take action to close them.

Banks play a vital role in the UK; they are important contributors of tax. Banks, like other businesses, will want to arrange their tax affairs efficiently. However, it is clear that some banks have been involved in tax avoidance that goes well beyond reasonable tax planning. HMRC will continue to challenge this behaviour. The Government has provided significant support to strengthen the financial system. The public rightly expect banks, and financial services firms more generally, to show a high degree of responsibility, the highest standards of corporate governance and to have an open, transparent and professional relationship with HMRC. We need to work constructively with the banks and other stakeholders to achieve this.

Given their access to capital, as well as their range of contacts, banks are uniquely placed to enter into transactions designed to avoid tax, offer transactions of this sort to their customers, or provide the very large amounts of funding and other financial instruments these transactions can require. The Code which we are publishing for consultation seeks to change behaviours and attitudes towards tax avoidance in the banking sector.

This consultation is a starting point in changing the behaviour of banks in relation to tax avoidance. Over the coming months we will be speaking to banks to develop a shared understanding of where we expect them to draw the line, where we want them to raise and resolve issues with HMRC, to ascertain the appropriate level of accountability at a senior level and also what they can expect from HMRC in return. We invite comments from interested parties, but this conversation will continue beyond the conclusion of the formal consultation period.



The Financial Secretary to the Treasury
Rt Hon Stephen Timms MP

1. Introduction

- 1.1 Following the Chancellor of the Exchequer's statement on 16th March, the 2009 Budget announced that HM Revenue & Customs (HMRC) would publish a Code of Practice on tax (the Code) for the banking sector to encourage banks to comply with both the letter and the spirit of the law.
- 1.2 This document explains why the Code is needed (Chapter 2), considers the scope of the Code and explores specific issues relating to the administration of the Code (Chapter 3), and looks at implementation and enforcement (Chapter 4). The consultation questions are reproduced in Chapter 5.
- 1.3 Comments on these issues are welcome.
- comments should be received by **25th September 2009**.
 - comments should be sent by e-mail to: susan.o'hara@hmrc.gsi.gov.uk
 - or by post to: Susan O'Hara, Large Business Service, 22 Kingsway, London, WC2B 6NR
 - or by fax to: 020 7438 7170
 - the document can be accessed from the HMRC Internet site: www.hmrc.gov.uk
- Hard copies are available on request from the above address.
- The Review Team can be contacted by telephone on: 020 7438 7665
- 1.4 Confidentiality: Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).
- 1.5 If you want the information you provide to be treated as confidential please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HMRC.
- 1.6 HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.
- 1.7 The Government's Consultation Code of Practice: This consultation is being conducted in accordance with the Government's Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Appendix 3.

2. Why is a Code needed?

- 2.1 The Government believes that for the tax system to be effective it must be seen to operate fairly and everyone should pay their fair share of tax. Tax avoidance undermines the ability of the tax system to deliver the Government's objectives and creates other unwelcome distortions.
- 2.2 Tax avoidance takes many forms. It can, for example, involve exploiting loopholes in legislation, artificially creating the conditions for tax relief, or using different parts of the tax code together to get a result which was never intended by the legislation.
- 2.3 The Government has a good record on tackling tax avoidance. Over the last 12 years, the Government has sought to change the economics of tax avoidance and make it less attractive.
- 2.4 The Government has legislated to make the law more robust against avoidance. The introduction of the 2004 Disclosure of Tax Avoidance Schemes legislation has helped bring more transparency to certain types of arrangement, highlighting areas of weakness in the legislation and enabling the Government to act quickly to close loopholes. The Government looks to ensure the quality and robustness of new legislation both through active consultation and by using a range of avoidance-proofing techniques.
- 2.5 HMRC's operational response to avoidance has also been robust and vigorous. This has a number of elements, including:
- improved engagement with business, especially large business, following the *2006 Review of Links with Large Business* (<http://www.hmrc.gov.uk/budget2007/large-business-plan07.pdf>) and the 2008 *OECD Study into the Role of Tax Intermediaries* (www.oecd.org/document/28/34/39882938.pdf) which have led to improvement in HMRC's commercial understanding;
 - using the disclosure regime to obtain information about who is engaged in avoidance schemes; and
 - focusing HMRC's resources on areas of risk, including project working of avoidance cases to improve consistency of outcome.
- 2.6 Tax and financial regulation are matters of general concern for governments worldwide. The London Summit of G20 leaders in April 2009 addressed the need to strengthen financial supervisory and regulatory regimes both nationally and internationally. It agreed a range of measures on international banking supervision, called on all countries to adopt the international standard for exchange of tax information and made clear that the G20 stands ready to take agreed action against those jurisdictions which do not meet international standards in relation to tax transparency.
- 2.7 But more needs to be done. Tax avoidance is sophisticated and those that seek to design schemes or undertake avoidance can often move quickly into new schemes or devise new products and the Government continually has to refresh its approach to dealing with such activity. The disclosure regime provides the Government with more real-time information about tax avoidance schemes. The proposed Code takes this one step further and seeks to change behaviours from the outset.
- 2.8 The world economy was hit by a global credit shock in mid-2007. Since then the resulting economic crisis has had an impact on avoidance in the financial services sector as highly complex tax avoidance transactions (examples are in Appendix 2) have become somewhat less prevalent in markets that currently need simplicity and transparency. Nevertheless, some banks are still engaged in various forms of avoidance, as external changes create new opportunities. While some banks have reduced or withdrawn from avoidance activity, there remains a risk that this may be only temporary pending changes in the financial markets.
- 2.9 The Government expects all businesses and individuals to manage their tax affairs in a responsible way. However, it believes that the unique position of the banking sector imposes a particular responsibility on them to comply with the spirit as well as the letter of the law and to do so in a way that

is transparent and open. It has therefore decided to introduce the Code to set out the principles and behaviours the Government expects with regard to tax compliance in the banking sector.

2.10 Tax avoidance is not exclusive to banks, but banks are uniquely placed in that they:

- can seek to avoid their own tax liabilities, whether this involves increasing the recovery of VAT incurred on their transactions, reducing their profits liable to corporation tax or minimising their and their employees' income tax and national insurance contributions;
- provide financial services to customers, many of which services are sensitive to tax and some of which can be used for tax avoidance; and
- have access to large amounts of capital which they can use to facilitate avoidance schemes designed and implemented by others, for example by providing loans of tens of billions of pounds for periods sometimes as short as a few hours.

2.11 The Government believes that, in the light of the significant taxpayer support provided to stabilise the banking system, taxpayers are entitled to expect that banks, important taxpayers in their own right, and their customers pay their fair share of tax.

3. The Code

- 3.1 The Code draws on two themes in the Government's approach to encourage large businesses to develop their relationships with HMRC. These are:
- the benefits of transparency; and
 - the importance of good governance and senior-level accountability for tax matters.
- 3.2 The Government has encouraged transparency for several years: it is the principle that underpinned the introduction of the tax avoidance disclosure regime in 2004; it is a key theme of the Large Business Service Operating Model and the Review of Links with Large Business; and it gained broad international consensus through the OECD *Study into the Role of Tax Intermediaries*. Transparency is important because it improves understanding between the bank and HMRC and allows HMRC to efficiently allocate its resources to manage risk more effectively.
- 3.3 The Government has also encouraged businesses to adopt good governance practices. From its inception, the Large Business Service (LBS) expected that boards would be involved in setting tax strategy and taking the final decision on major transactions; it has been and remains a significant element in the LBS Risk Framework; and it also featured in the 2008 OECD *Study into the Role of Tax Intermediaries* and was prominent in the discussions on the 2009 OECD study *Building Transparent Tax Compliance by Banks* (<http://www.oecd.org/dataoecd/5/29/42797744.pdf>).
- 3.4 So the main principles upon which the Code is based are already well established and understood by banks. The Government expects banks to be able to apply these principles voluntarily in relation to all their tax affairs but does recognise that regulatory or commercial issues will arise for some businesses introducing the Code into their existing governance processes. **We would welcome views on what issues are likely to arise in introducing and complying with the Code, and how these issues could be overcome.**
- 3.5 The Code does not replace any existing approach to tax avoidance and does not mean that the Government will not act quickly to shut down avoidance activity at the earliest opportunity. The Code builds on the established best-practice principles of transparency and compliance. The Government recognises that the banking sector does raise complex tax issues and that uncertainty will arise from time to time over the tax treatment of complex commercial deals and therefore the Code encourages an early dialogue and discussion between the bank and HMRC when such uncertainties arise. **We would welcome views on how uncertainties about tax issues could be resolved under the Code.**
- 3.6 The Code is set out in Appendix 1. It sets out the principles and behaviours which the Government expects banks to adopt with regard to all taxes and how the Government expects banks to comply with the spirit as well as the letter of the law.
- 3.7 The Code is made up of four sections:
- Section 1. Overview
 - Section 2. Governance
 - Section 3. Tax planning
 - Section 4. Relationship between the bank and HMRC.

Section 1: Overview

- 3.8 The overview sets out a purposive introduction of what behaviours the Code seeks to embed in the banking sector.
- 3.9 The Government intends that the Code should be adopted by all banks operating in the UK, and by any similar organisations undertaking banking activities. The Code should be signed by a senior officer of the organisation, preferably at board level. These businesses and other institutions should apply the Code in all their dealings, throughout their commercial operations, including in their subsidiaries and other vehicles.
- 3.10 The remainder of the Code deals with specific issues on implementation and describes how the Government wants the Code to be applied in practice.

Section 2: Governance

- 3.11 Banks should have a documented strategy and governance process for taxation matters encompassed within a formal compliance policy. This policy should include a documented strategy to comply with tax obligations and to maintain an open, professional and transparent relationship with HMRC. The responsibility and accountability for the governance process will rest with boards of directors or equivalent senior officers in the bank. This reflects views expressed in the consultation between the financial sector and HMRC undertaken when conducting the OECD study *Building Transparent Tax Compliance by Banks*.
- 3.12 Good governance requires boards of directors (or other senior leadership of the business) to exercise strategic oversight of tax matters. They must take accountability for tax and ensure that there is a strategy describing the bank's approach to tax and the process for implementation. While the Code does not determine what the strategy or the governance process should be – these are matters for the business to decide – it promotes a commitment to adopt a responsible approach to tax planning, as well as encouraging the development of an open, transparent and professional relationship with HMRC.
- 3.13 In paragraph 2.2, the Code focuses on processes. In the course of the OECD study, banks explained how their internal processes operate. Banks regard product approval and other committees as standard practice enabling them to manage the risks they carry. Tax is one of these risks. Managing it should mean the tax analysis of any proposed transaction is signed off by the group tax function independently of the business units, with the tax function having the final say on the tax analysis. The only exception to this is that major business decisions can be taken by boards despite the tax risks.

Section 3: Tax Planning

- 3.14 Section three is intended to assist boards in determining where to draw the line on tax planning. It provides reference points by which boards may benchmark their behaviours and form a view on whether or not to undertake certain activities that have a tax consequence.
- 3.15 The Government recognises that tax is an important factor in many business decisions. In banking, where the margins between profit and loss can be very narrow, an unplanned tax liability can be very unwelcome, so tax planning in support of commercial transactions is normal and appropriate. But the Government does not condone tax planning which goes beyond support for genuine commercial activities. For example, exploiting loopholes in the legislation, or combining the use of parts of the tax code that were never intended to be used together, go beyond what is acceptable.
- 3.16 The rest of the tax planning section of the Code identifies three different capacities in which banks may operate:
- where the bank is a principal participating in a transaction - this will cover all the transactions and structures a business puts in place for its own activities as well as many where it is providing financial services to customers (e.g. lending);

- where the bank is not a principal - this covers all situations where the business is providing a facilitation service to customers without participating in transactions (e.g. introducing them to another party); and
 - in relation to the bank as an employer.
- 3.17 In the first situation, the Code expects the tax results to be consistent with the underlying economic consequences - both for the business itself and for any counterparty. This is the broad approach UK tax law follows.
- 3.18 There are some situations where UK tax law departs from the underlying economics: where the law does not tax a profit (or relieve a loss), e.g. substantial shareholdings exemption; where UK tax law disallows an expenditure, e.g. entertaining; or where the mechanism for relieving expenditure departs from the economics in its timing, e.g. capital allowances. As there is no ready rule of thumb in these circumstances, the Code requires the tax results should not be contrary to the intentions of Parliament.
- 3.19 In the second situation, when providing a service to customers, the Code requires that the business will not promote arrangements that would give a result contrary to the intentions of Parliament. This will include undertaking not to promote avoidance schemes, whether or not such schemes would fall within the disclosure provisions of Finance Act 2004, or any other arrangements that the bank believes would produce a result that would not accord with the Code. This paragraph does not prevent banks facilitating transactions as long as they are not promoting them.
- 3.20 In the third situation, the Code reflects Government policy that all employers and employees pay the proper amount of tax and National Insurance Contributions (NICs) on the rewards of employment. In the past there have been many examples of arrangements whereby employees received reward in ways which were intended to escape tax and NICs. These often involved payments by way of assets. Although legislation has been put in place to tackle such avoidance, the Code makes it clear that this type of arrangement would not be acceptable under the Code.
- 3.21 Examples of avoidance are given in Appendix 2. Avoidance transactions can have common features, or “signposts”, which have been identified as indicators of types of transaction that are unacceptable. These are not exhaustive, but include:
- transactions that have little or no economic substance;
 - transactions bearing little or no pre-tax profit which rely on anticipated tax reduction for significant post-tax profit;
 - transactions that rely on a mismatch such as: between legal form or the accounting treatment and the economic substance; or between the tax treatment for different parties or entities; or between the tax treatment in different jurisdictions;
 - transactions involving contrived, artificial, transitory, pre-ordained or commercially unnecessary steps. For example, a combination of options designed to generate a tax loss without any economic loss; and
 - transactions or arrangements where income, gains, expenditure or losses are not proportionate to the economic activity taking place or the value added in the UK. This can involve the transfer of ownership of an income stream from a company in the UK to an associated offshore vehicle in a low-tax or no-tax jurisdiction.
- 3.22 In order to adhere to the Code, banks will need to discern the intentions of Parliament. In many cases this will be obvious; it is usually self-evident that a tax result is contrary to the intention. Nevertheless, the Government recognises that there will be some circumstances where the appropriate way to apply the law is not straightforward and that the bank cannot easily discern the intentions of Parliament. In these circumstances, Section 4 (see below) sets out that businesses should discuss their proposed transactions with HMRC (by contacting their Customer Relationship Manager (CRM) or other normal point of contact). HMRC will be happy to discuss the transaction and its understanding of the intentions of Parliament in relation to the law in question. But the decision on whether or how to proceed with the transaction will remain with the bank, which should be prepared to explain its decision. **We would**

welcome views on what support banks should expect from HMRC to help them implement and abide by the Code.

Section 4: Relationship between the Bank and HMRC

3.23 Banks' relationship with HMRC should be transparent and constructive, based on mutual trust wherever possible. This section mainly reflects the relationships that the HMRC Review of Links with Large Business, Large Business Service Operating Model and Organisation for Economic Co-operation and Development (OECD) *Study into the Role of Tax Intermediaries* describe. Many relationships between HMRC and banks have already achieved this degree of maturity, and with others the relationship is developing along these lines. This section of the Code also makes clear that, where it is important to understand the intentions of Parliament, the banks should initiate dialogue with HMRC.

3.24 Key aspects of the desired relationship are that:

- the business fully discloses issues that HMRC would want to know about and might want to discuss;
- both the business and HMRC focus on significant issues, using resources where there is risk;
- discussions often occur in real time;
- the tone of the relationship is positive and professional; and
- the business and HMRC work together to resolve any issues quickly.

Typically, this will encourage mutual trust to develop between the business and the CRM team.

3.25 As set out above, there will be instances where it will be necessary to discuss transactions where there is doubt about the intentions of Parliament, and the Code clarifies that these should take place in advance of entering the transaction.

4. Implementation and Enforcement

Introduction

- 4.1 The introduction of a voluntary Code of practice on taxation for banks is a new and innovative approach to addressing and changing behaviours and attitudes towards tax avoidance. However the emphasis on transparency and good governance builds upon the approach the Government has been promoting and is in line with the best practice many companies have already adopted. The Government is consulting on the implementation of the Code so that the banking industry, and its advisors, have the opportunity to work with HM Revenue & Customs (HMRC) to make the Code work. The objective is to agree arrangements which are robust and practicable for the banks and HMRC to implement.
- 4.2 Resolving issues of implementation will require dialogue between banks and HMRC. There are already very well established lines of communication, both at sectoral level through regular discussions with the main banking organisations and at individual bank level where the introduction of Customer Relationship Managers (CRMs) has enabled strong relationships to be created.
- 4.3 This dialogue has helped HMRC to improve its understanding of business but banks will always know their own business better than HMRC and this Code recognises that. The Code places responsibility for governance and behaviours on the board (or other senior party) and it will be for the board to form a view and take decisions for which they will be accountable.

Implementation

- 4.4 During the consultation period, HMRC will meet with banks individually to discuss the Code. This dialogue will continue after the Code has been adopted and HMRC will use the Code as an integral part of its risk assessment and relationship management with each of the banks.
- 4.5 In 2007 HMRC published guidance on how the Large Business Service (LBS) will prioritise the allocation of its resources to work which carries the greatest risk. A risk review considers seven aspects of tax risk. The adoption of the Code by a business, and its implementation after adoption, will be additional factors HMRC will take into account when considering risk.
- 4.6 HMRC is in regular contact with the larger customers in the banking sector each of which has a CRM. The CRM will monitor implementation of the Code as part of the risk review process.

Enforcement

- 4.7 As noted above, LBS uses a transparent process – as part of HMRC’s compliance strategy – to inform decisions on use of its resources. Part of this process is the annual risk review. When conducting this review the CRM will examine whether the bank has complied with the Code. The CRM will discuss with the bank the issues that arose and how they were resolved. In particular the CRM will wish to test whether any significant uncertainties were raised with HMRC at the appropriate time so that the CRM can be satisfied that the required degree of transparency and disclosure is being applied. Those not adopting the Code can expect greater scrutiny from HMRC.
- 4.8 The Government expects banks who adopt the code to comply with it. Where banks do not comply, or where HMRC has concerns about compliance with the Code, HMRC will raise the issue with the board of the bank. Where appropriate, HMRC will raise their concerns with the senior non-executive. Where non-compliance is 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. **We welcome views on this approach to enforcement.**
- 4.9 For many banks already following best practice, complying with the Code should entail no additional administrative cost or burden, apart from those incurred in the initial implementation which should be minimal. **We are keen to know the views of banks on what they think the administrative costs of complying with the Code will be, both initially and going forward.**

- 4.10 The Government will monitor the effectiveness of the Code at achieving its aims in practice and HMRC will be responsible for ensuring compliance with the Code. If there are concerns about whether a bank is complying with the Code HMRC will seek to resolve these concerns through dialogue with the bank's board or appropriate senior officer. The Government believes that its objectives can be achieved through this direct engagement, but if inappropriate behaviours by banks persists, the Government will consider further steps to reinforce the Code. This could include, for example:
- requiring banks to disclose in their accounts the extent to which they have complied with the Code; and /or
 - requiring an audit of a bank's compliance with the Code.
- 4.11 The Government wants to ensure that Parliament and the public are provided with information on compliance with the Code. This needs to be consistent with the important principle of taxpayer confidentiality. The Government will therefore update Parliament annually on the operation of the Code across the sector. This will summarise how many banks have signed up to the Code, whether HMRC is satisfied the Code is generally being complied with, and the steps HMRC is taking to address non-compliance. **We welcome views on this proposal and how we could provide this information without undermining taxpayer confidentiality.**
- 4.12 A consultation stage Impact Assessment is published along with this consultation document and **we also welcome comments on the assumptions made in this.**

5. Questions for consultation

1. What issues are likely to arise in introducing and complying with the Code and how can these issues be overcome? (3.4)
2. How can uncertainties about tax issues be resolved? (3.5)
3. What support should banks expect from HMRC to help them implement and abide by the Code? (3.22)
4. What other sanctions should be considered where non-compliance is found to be deliberate? (4.8)
5. What do banks think the administrative costs of complying with the Code will be both initially and going forward? (4.9)
6. How should the public and Parliament be updated on compliance with the Code? (4.11)
7. We welcome comments on the assumptions made in the Impact Assessment (4.12)

Appendix 1: The Code of Practice on taxation

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 Where the bank is principal, transactions should not be structured in a way that will have tax results 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 which is not contrary to the intentions of Parliament.
- 3.2 Where the bank is not principal, but is providing or facilitating transactions undertaken by other parties, there should be no promotion of arrangements unless the bank reasonably believes that the tax result of those arrangements is not contrary to the intentions of Parliament.

- 3.3 Remuneration packages for bank employees, including senior executives, should be structured so 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 believes its proposed transactions may be contrary to the intentions of Parliament, the bank will explain its plans in advance with HMRC.
- 4.3 If, exceptionally, the bank discovers a transaction or arrangement has taken place where the tax result may be contrary to the intentions of Parliament, it will disclose the circumstances to HMRC at the earliest available opportunity, without waiting for the relevant tax filing date.

APPENDIX 2: Tax Avoidance

1. No country has found an agreed or enforceable definition of tax avoidance, but it can involve:
 - exploiting loopholes in tax law;
 - juxtaposing two unrelated provisions in tax law in a way never intended or envisaged at the time the provisions were enacted; or
 - artificially creating the conditions for a tax relief or deferral;and schemes, arrangements or transactions may:
 - use offshore vehicles in tax havens or elsewhere;
 - require arbitrage between UK and other countries' laws, often involving hybrid instruments or entities; or
 - take the form of other arrangements, the purpose of which is to achieve a tax advantage.
2. Specific examples of avoidance HMRC has seen include:
 - in the construction of a new building, a bank set up a series of artificial arrangements between subsidiary companies, the only purpose of which was to benefit from a higher rate of recovery of VAT than would be possible otherwise. It is clear what the rules were intended to achieve; the artificial arrangements were entered into solely to circumvent these rules.
 - a scheme known as “dividend strips” involved artificial arrangements whereby a bank would acquire and subsequently sell the rights to receive dividends on shares. This was designed to exploit a weakness in the relevant legislation. It had the potential to wipe out a year’s Corporation Tax liabilities for the banking sector.
 - arrangements known as the “gilt-strips” scheme involved the deliberate generation of losses on the purchase and re-sale of strips of Government gilts (i.e. the coupons were stripped from the right to receive the capital), matched by non-taxable gains. The objective was artificially to create the conditions for relief from capital gains tax on gilts and thereby reduce or even extinguish the income tax liabilities of wealthy individuals.
3. In its *Study into the Role of Tax Intermediaries*, the OECD identified two areas of concern which summarise the above bullets:
 - “Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences”; and
 - “Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law”.
4. Whether or not a particular scheme or arrangement is effective in achieving its objective of securing a tax advantage is a legal question which taxpayers and their advisors may need to debate with HMRC, and which the courts ultimately need to resolve in a few cases. Paragraphs 1 and 2 above illustrate situations where, despite the correct application of the letter of the law, the intended outcome of the tax planning goes beyond the “spirit of the law”, in the sense that the law was clearly not written with the objective of allowing these outcomes. HMRC has published ‘Signposts’ of tax avoidance. These are available at (<http://www.hmrc.gov.uk/avoidance/aag-risk-assessing.htm>).

Appendix 3: The Government's consultation Code of Practice

ABOUT THE CONSULTATION PROCESS

This consultation is being conducted in accordance with the Government's Consultation Code of Practice. If you wish to access the full version of the Code, you can obtain it online at:

<http://www.berr.gov.uk/files/file47158.pdf>

THE CONSULTATION CRITERIA

- 1. When to consult** - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
- 2. Duration of consultation exercises** - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- 3. Clarity of scope and impact** - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- 4. Accessibility of consultation exercise** - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- 5. The burden of consultation** - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- 6. Responsiveness of consultation exercises** - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- 7. Capacity to consult** - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints about the process, please contact:

Richard Bowyer, Better Regulation Unit
020 7147 0062 or richard.bowyer@hmrc.gsi.gov.uk

Summary: Intervention & Options

Department /Agency: HMRC	Title: Impact Assessment of Code of practice on taxation for banks	
Stage: Consultation	Version: 1	Date: 29 th June 2009
Related Publications: Code of practice on taxation for banks – Consultation document (29 June 2009)		

Available to view or download at:

<http://www.hmrc.gov.uk>

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What is the problem under consideration? Why is government intervention necessary?

Tax avoidance undermines the ability of the tax system to deliver the Government's objectives, imposes significant costs on society, undermines public confidence in the tax system and creates other unwelcome distortions.

The Government is providing significant levels of support for the banking sector. Some banks continue to engage in tax avoidance, undertaking transactions that they contend are within the letter of the law, but which are contrary to the spirit of the law.

What are the policy objectives and the intended effects?

For all banks 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 of practice describes the expected approach by banks to governance, tax planning and engagement with Her Majesty's Revenue & Customs (HMRC). This should introduce more transparency and lead to a behavioural change in banks that have been engaging in tax avoidance.

What policy options have been considered? Please justify any preferred option.

1. Do nothing.
2. A Code of practice which banks adopt and comply with voluntarily. This is the preferred option. It involves the minimum level of intervention needed to be consistent with the Policy statement. It also leaves other options open if needed later.
3. A Code of practice underpinned with a requirement for banks to publish performance against the Code and / or to be audited on their Code performance.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The effectiveness of the Code will be reviewed after twelve months. We will consider factors such as the level of take-up and the degree of compliance.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



.....Date: 28th June 2009

Summary: Analysis & Evidence

Policy Option: 1	Description: Introduce a Code of Practice
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' The Code will affect all banks.			
	One-off (Transition) Yrs				
	£ To be quantified				
	Average Annual Cost (excluding one-off)				
	£ To be quantified		Total Cost (PV)	£ To be quantified	
Other key non-monetised costs by 'main affected groups' Banks will incur one-off costs understanding the impact this Code has on their business. Banks may also incur costs if they need to set up additional governance and/or reporting procedures in order to comply with the Code. This consultation will seek to clarify the existence and scale of such additional costs.					

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' The Code will affect all banks. The consultation asks banks to identify any costs savings the Code will generate.			
	One-off Yrs				
	£ To be quantified				
	Average Annual Benefit (excluding one-off)				
	£ To be quantified		Total Benefit (PV)	£ To be quantified	
Other key non-monetised benefits by 'main affected groups' We expect the Code to increase the level of transparency with regards to the banking sector's tax affairs.					

Key Assumptions/Sensitivities/Risks We cannot predict the impact this Code will specifically have on tax receipts as many other factors will also influence tax receipts from the banking sector. Costings should be provided on the assumption that no special mechanism is required to indicate adoption of the Code.

Price Base Year 2009	Time Period Years TBC	Net Benefit Range (NPV) £ To be quantified	NET BENEFIT (NPV Best estimate) £ To be quantified
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What is the geographic coverage of the policy/option?	Nationwide			
On what date will the policy be implemented?	TBC			
Which organisation(s) will enforce the policy?	Banks in the UK			
What is the total annual cost of enforcement for these organisations?	£			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ N/A			
What is the value of changes in greenhouse gas emissions?	£ N/A			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro TBC	Small TBC	Medium TBC	Large TBC
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ TBC	Decrease of	£ TBC
		Net Impact	£ TBC

Key: Annual costs and benefits: (Net) Present

Evidence Base

Background

Some banks have engaged in tax avoidance whether on their own account or as providers of avoidance schemes and structured finance to their customers and counterparties. Tax avoidance has the potential to undermine public confidence in the tax system.

The Chancellor announced on 16 March 2009 that he had asked HM Revenue and Customs to introduce a Code of practice on taxation for the banking sector. *“We expect banks to fully comply with their tax obligations. So I can tell the House that I have asked HM Revenue and Customs to publish shortly a Code of practice on taxation for the banking sector - so that banks will comply not just with the letter but the spirit of the law.”* All banks will be expected to sign up to this.

Objective

The Code of practice sets out how the Government expects banks to comply with the spirit as well as the letter of the law, under three headings:

1. **Governance**; Banks should have a documented strategy and governance process for taxation matters encompassed within a formal compliance policy. This policy should include a documented strategy to comply with tax obligations and to maintain an open, professional and transparent relationship with HMRC. The responsibility and accountability for the governance process will rest with boards of directors or equivalent senior officers in the bank.
2. **Tax Planning**; Banks will only engage in tax planning to support genuine commercial activity. For example, transactions will not be structured in a way that achieves tax results that are inconsistent with their economic consequences. There are circumstances where legislation deliberately departs from the economic consequences of a transaction (e.g. substantial shareholding exemption). Here, the tax results should not be contrary to the intentions of Parliament. The focus on the tax outcome and structuring reflects the aim of the Code, which is to deter tax avoidance. Avoidance transactions generally use the same building blocks as normal commercial transactions, but construct them in a way that aims to achieve an unintended tax result.
3. **Relationship**; Banks' relationship with HMRC should be transparent and constructive, based on mutual trust wherever possible. This section mainly reflects the relationships that the HMRC *Review of Links with Large Business, Large Business Service Operating Model* and Organisation for Economic Co-operation and Development (OECD) *Study into the Role of Tax Intermediaries* describe. Many relationships between HMRC and banks have already achieved this degree of maturity, and with others the relationship is developing along these lines. This section of the Code also makes clear that, where it is important to understand the intentions of Parliament, the banks should initiate dialogue with HMRC.

Options

1. The do nothing option is not recommended. Since the introduction of the disclosure rules in 2004, all “promoters” of tax avoidance have been required to disclose certain tax avoidance transactions, usually within five days of the “relevant date”. This has had a significant impact on the level of avoidance, but some banks have continued to design, promote, undertake and facilitate transactions that the disclosure rules have not, so far, been able to deter. Banks are, often uniquely, able to undertake a wide range of transactions; they have a large amount of capital when this is needed and they are used to finding creative solutions to financial problems. These features mean they can have opportunities to exploit tax avoidance opportunities. Doing nothing would not address these issues.

2. A Code of practice which banks adopt voluntarily. They will also need to take steps to implement and comply with the Code. This is the preferred option as it achieves the Government's objective in the least intrusive way with minimal additional burdens. It is consistent with the existing way in which large businesses are taxed. This option leaves open to the Government the option to augment, or strengthen, the Code of practice later, if this proves necessary, by invoking one of the further options below.

3. The remaining options would require additional audit and reporting measures. These would underpin adoption and implementation of the Code.

Issues

1. Definitional issues

These include “spirit of the law” and “intention of Parliament”. There are examples in Appendix 2 of the consultation document setting out arrangements, which would generally be accepted as beyond the spirit of the law. HMRC acknowledges this is a difficult issue and the Code sets out the importance of banks’ initiating a dialogue with HMRC where there is uncertainty.

2. Competition issues

The Government does not intend to generate competition issues for those banks who sign the Code. The consultation should highlight any areas of concern.

3. Consultation

Through informal pre-consultation with several banks and their representative bodies, the British Bankers’ Association (BBA) and the London Investment Banking Association (LIBA), we confirmed our internal analysis of the issues in relation to the Code. These issues are described in the consultation document and views are sought on them. The results of the consultation may require an updated impact assessment to be published.

4. Business sectors affected

The Code will directly affect all banking and similar businesses, their subsidiaries and their branches, operating in the UK.

5. Benefits

By adopting and implementing the Code, banks will be able to demonstrate their commitment to paying a fair amount of tax.

6. Costs

The administrative cost of establishing the governance and other processes the Code of practice requires should be minimal. If banks feel that this assumption is wrong we would welcome information that explains why (see section 7).

7. Administrative burdens

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular: the administration burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the ‘Standard Cost Model’, an activity-based costing model which identifies what activities a business has to do to comply with HMRC’s obligations, and which estimates the cost of these activities, including agent fees and software costs.

The administrative burden of complying with the Code is one of the issues for consultation. As no special mechanism is currently anticipated for firms to indicate their adoption of the Code, we expect there to be a negligible impact on admin burdens. It is likely banks will be able to indicate adoption of the Code in the normal course of their dialogue with HMRC. Banks should provide information if they consider that a substantial administrative burden will be incurred adopting the Code.

8. Assumptions

None

9. Equity and fairness

It is not expected any groups will be disproportionately affected by the introduction of the Code of practice.

10. Implementation plan, monitoring and evaluation

The impact of the Code will be reviewed twelve months after implementation.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Banks Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Annexes

Specific Impact Tests: Results

Competition Assessment

The change does not directly or indirectly limit the range of banks, or limit the ability of banks to compete. It also does not limit banks' incentives to compete vigorously.

Small Banks Impact Test

If the Code is voluntary small banks would, by definition, not have to conform to it. But small banks may well want to sign up to the Code to demonstrate their commitment to it.

The Code has been tested against the following other impacts:

Legal Aid

Sustainable Development

Carbon Assessment

Other Environment

Health Impact Assessment

Race Equality

Disability Equality

Gender Equality

Human Rights

Rural proofing

and we conclude that there is no impact