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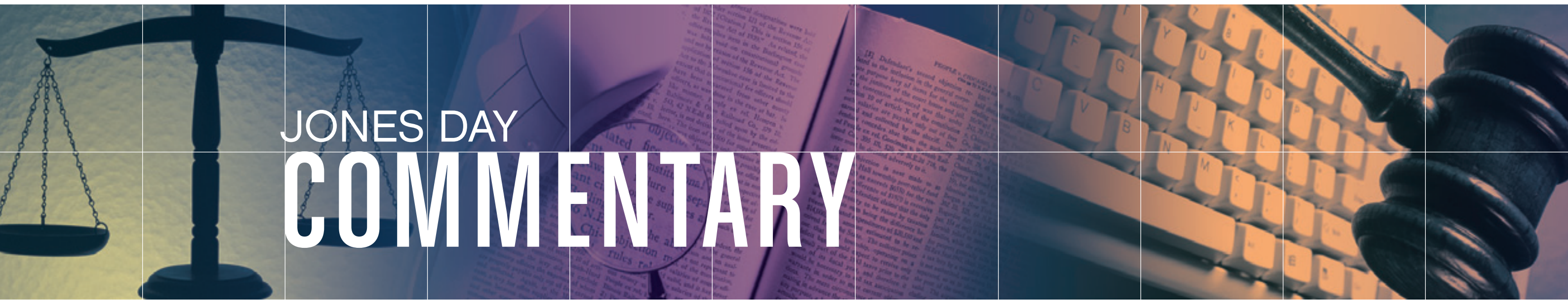

CODE OF PRACTICE ON TAXATION FOR BANKS

In Alastair Darling's budget speech on 16 March 2009, he announced that Her Majesty's Revenue & Customs ("HMRC") would publish a Code of Practice on Taxation for Banks (the "Code") to encourage banks to comply with the spirit as well as the letter of the law. A consultation document duly followed (29 June 2009) which contained a draft Code and after the consultation period was over, a slightly revised Code was published (9 December 2009).

HMRC has a long-held concern that banks have the opportunity to enter into transactions whereby they can seek to reduce their own tax liabilities or those of their customers. The Government also feels that banks and their customers should pay their "fair share" of tax, particularly as the banking system has had to be stabilised with taxpayers' money.

The Code does not extend just to banks listed as such by the Financial Services Authority but also includes groups that undertake banking-type activities, such as UK subsidiaries of overseas banking groups, UK branches of overseas banking companies, securities houses and building societies (as defined by Section 119 of the Building Societies Act 1986). It also extends to banks owned by, and banking-type activities of, predominantly non-banking groups, including insurance groups, retailers and motor manufacturers. For those predominantly non-banking groups, the Code applies only to the banking activities of the group, whichever entity within the group carries them out.

The Code was introduced on 9 December 2009. HMRC acknowledges that banks may require time to consider the implications of Code, but banks should aim to adopt and implement the Code as soon as possible thereafter.

HMRC accepts that the Code does not override the law but sees it as a "statement of principles which provide a benchmark for corporate behaviour in relation to governance, tax planning and the relationship with HMRC".

The Code is relatively concise and is divided into four sections: Overview; Governance; Tax Planning; and Relationship between the bank and HMRC.

SECTION 1–OVERVIEW

The Overview states that "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". This statement is then explained:

"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)."

SECTION 2–GOVERNANCE

The next section of the Code relates to governance by which is meant the bank's internal governance of tax matters. The Code decrees that the bank should have "a documented strategy and governance process for taxation matters encompassed within a formal policy". The Code goes on to state that accountability for this policy should rest with the UK board of directors or, for non-UK banks, a senior accountable person in the UK. The Code requires that the bank's tax department should "play a critical role and its opinion should not be ignored by business units".

It is suggested that a documented appeals process to senior management should be implemented for occasions when the tax department and business unit disagree. This requirement no doubt stems from HMRC's observations that at times banks' internal tax departments are at odds with the business transactors when it comes to implementing tax advantaged structures. The Code states that "the bank's tax department should play a critical role and its opinion should not be ignored by business units". It is surprising that the Government should seek to dictate how an internal department of a bank operates within its own organisation. However, this internal governance requirement is consistent with the Government's desire to regulate the internal tax functions of companies. The Finance Act 2009 introduced legislation requiring that the "senior accounting officer of a qualifying company must take reasonable steps to ensure that the company establishes and maintains appropriate tax accounting arrangements" (Section 93 of and Schedule 46 to the Finance Act 2009).

Generally, however, the governance part of the Code is not seen as particularly controversial and many banks already had similar policies in place.

SECTION 3–TAX PLANNING

The meat of the Code, so far as HMRC is concerned, is contained in this part. It opens with the statement that "the bank should not engage in tax planning other than that which supports genuine commercial activity". If the UK tax treatment is consistent with the underlying economic consequences of the transaction, then that tax treatment should be acceptable. In contrast, where specific legislation applies to give a tax treatment that is different from simply following the accounts, the bank must decide whether it reasonably believes that the application of this tax treatment to the transaction concerned is "not contrary to the intentions of Parliament". Exploitation by a bank of perceived loopholes in rules which have been introduced to counteract particular structures, in order to implement such a structure, will undoubtedly be regarded as "contrary to the intentions of Parliament".

The Code seeks to deter banks from entering into tax aggressive transactions in the first place, presumably with the aim that such transactions will not be tested before the Courts. The Courts will then not need to decide whether such transactions fall within the statutory construction which the bank and its advisers contend applies. In the House of Lords' decision in *Barclays Mercantile Business Finance Ltd v Mawson [2004] UKHL51* it was confirmed that "the paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case". Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] HKCFA48*, "The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically". In construing a statutory provision purposively, the intention of Parliament is of paramount importance. HRMC, it seems, is asking the banks to perform this purposive construction themselves under the Code, as an initial step, before the bank needs even to consider whether it should disclose the scheme under the disclosure of tax avoidance schemes regime (DOTAS) or appeal the scheme before the Courts. Whilst HMRC acknowledges that the Code is not law, it is seeking to prevent the law from having to be applied by introducing a vetting procedure to be undertaken by the banks themselves, at a far earlier stage.

The tax planning which must not be "contrary to the intentions of Parliament" extends under the Code not only to transactions which the bank enters into but also to those which its customers enter into: "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". Also included are remuneration packages for bank employees. These should structured so that the "bank reasonably believes that the proper amounts of tax and national insurance contributions are paid on the rewards of employment".

In determining whether a proposed arrangement is contrary to the intentions of Parliament, HMRC suggests that the bank ask itself the question of whether the result is too good to be true.

SECTION 4–RELATIONSHIP BETWEEN THE BANK AND HMRC

The Code encourages relationships with HMRC to be "transparent and constructive, based on mutual trust wherever possible".

The relationship should include:

- disclosing 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.

The suggestion is that where a bank is in doubt whether the tax result of a proposed transaction is contrary to the intentions of Parliament in order to have a reasonable belief under Section 3 (Tax Planning), it should discuss its plans in advance with HMRC. This is therefore encouraging voluntary disclosure earlier than that required under the DOTAS regime.

ADOPTION OF THE CODE

Banks which are not managed within the Large Business Service of HMRC need only adopt Section 1 of the Code. This relaxation is in response to representations made in response to the first draft of the Code that it would be inappropriate for smaller banks to comply with the Code. It does not seem likely that this concession will make any practical difference since Section 1 is a summary of the other three sections of the Code. HMRC has stated that if a bank does not adopt the Code or fails to comply with it, having adopted it, the bank will not be considered low risk and is likely to face additional scrutiny from HMRC.

HMRC will not publish a list of banks that have signed up to the Code but it will reveal how many banks have adopted it and how the Code is operating in practice. No such information is available, however, at the date of writing this *Commentary*.

LAWYER CONTACT

For further information, please contact your principal Firm representative or the lawyer listed below. General email messages may be sent using our "Contact us" form, which can be found at www.jonesday.com.

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