Banking code of practice on taxation – an update

In a follow-up article to their October 2009 analysis of the draft code of practice on taxation for the banking sector, Adam Blakemore and Oliver Iliffe weigh up the implications of recent changes to the scope and content of the code.

Following the publication by HMRC, on 9 December 2009, of a response document and supplementary guidance note in relation to the consultation on the Code of Practice on Taxation for Banks, discussions have now been initiated with banks with a view to implementing the code on a case-by-case basis.

The authors addressed the issues raised by the consultation on the draft code in an article in Issue 8 of *FITAR* (October 2009). The final form of the code, however, has been watered down and the scope of organisations to which the full code will apply has been narrowed. This article considers the scope and effect of the code in its final form, and the revisions that have been made in response to the consultation.

Affected organisations

Originally, the code was intended to apply in its entirety to all banking groups (including their subsidiaries and, where relevant, branches of overseas banks operating in the UK). However, the Government has decided that only those banks, building societies and other organisations providing banking services in the UK whose tax affairs are managed by HMRC's Large Business Services will be expected to adopt and adhere to the entirety of the code.

On HMRC's count, this means 76 banking services organisations will be asked to comply fully with the code. The remainder will only be expected to adopt and adhere to s1 of the code.[1] As HMRC recognise, this latter group comprises several hundred organisations which provide banking services in the UK including at least 180 banks and 49 building societies.

Notwithstanding the creation of this two-tier structure within the code, it appears that the net is still intended to be cast widely, as Answer 1 in the guidance note makes clear. Any 'banking-type activities' of, for example, securities houses, insurance groups, retailers or motor manufacturers may be considered by HMRC to fall within the scope of the code. Those in doubt are invited to discuss their situation with HMRC.

Scope of activities covered

The response document makes clear that the code will not cover 'normal lending and the provision of other banking facilities such as derivatives'. This goes some way in diluting the central prohibition in the code (at s3), which forbids tax planning other than planning that supports genuine commercial activity in relation to the bank's own transactions and in relation to the promotion of arrangements to other parties. However, for transactions outside the scope of normal lending and provision of banking facilities by banks, a bank should 'reasonably believe' that the transaction (or arrangement being promoted) does not give a tax result for the bank (or the parties to whom an arrangement is being promoted) which is contrary to the intentions of Parliament.

In all cases the threshold of tax planning is not to be compared to the level at which a 'scheme' becomes disclosable under the disclosure of tax avoidance schemes rules at Part 7 of Finance Act 2004. As before, the bank needs to form a 'reasonable belief' as to whether the arrangements yield a 'tax result' which is 'contrary to the intentions of Parliament' (discussed further below).

With regard to arrangements promoted to other parties, Answer 6 of the guidance note suggests that this involves an objective assessment by the bank as to whether the anticipated tax results for a third party or customer are 'contrary to the intentions of Parliament'. This might include 'acting in conjunction with a third party promoter' or 'knowingly facilitating others' avoidance schemes'. Care will obviously need to be taken by banks as to the level of knowledge to which they have access. Knowing involvement in a disclosed tax avoidance scheme is likely to result in a breach of the code, although inadvertent involvement through vanilla financing may not. Helpfully, a bank is not required to make any additional enquiries about a client's tax status as a result of the code.

Communication with HMRC

The previous requirement to discuss 'doubt' as to whether a transaction may be contrary to the intentions of Parliament (under paragraphs 4.2 and 4.3 of the draft code), has been dropped. A bank 'may discuss its plans in advance with HMRC', if it wishes, in order to assist the bank in arriving at its 'reasonable belief' or otherwise. The Response Document puts this slightly more strongly by saying that the code 'encourages' disclosure where the bank thinks that the tax result of a transaction 'may' be contrary to the intentions of Parliament.

Accordingly, the revised position appears to be that, provided a bank reaches a 'reasonable belief' that a transaction does not achieve a tax result which is contrary to the intentions of Parliament, then there should not be a breach of the code. The requirement to disclose transactions after they have occurred has also been abandoned, recognising perhaps that a transaction to which no consideration was given by the bank's tax advisers is unlikely to result in a breach of the code where it is otherwise taxed in accordance with the law.

The question of whether to initiate discussion with HMRC is likely to remain, however, a key pressure point in the code. The consequences of making a disclosure to HMRC are that the law could be changed and, where the bank and HMRC fail to agree, a risk assessment will be conducted which may result in an enquiry being opened in relation to the bank's tax return.[2] Banks are, therefore, unlikely to make disclosures to HMRC until they have exhaustively analysed a transaction to the extent that they feel unable to reach a reasonable belief that the tax results of the transaction are not contrary to the intentions of Parliament.

The intentions of Parliament

The principal remaining difficulty faced by banks is how they propose to interpret the main threshold of the code, namely 'a tax result' being 'contrary to the intentions of Parliament'.

According to the guidance note, a 'tax result' is one that must have a 'significant impact upon the bank's own tax position'.[3] This opens up the possibility of a bank deciding that the impact of a transaction on its tax position is de minimis or simply 'not significant'. Although not made express by the guidance note, when a bank is forming an objective belief regarding the tax result for a client or a third party, it might be fair to say that the same principle ought to apply (there being no suggestion to the contrary).

There is likely to be greater confusion, however, and it will be interesting to see how differing views between banks and HMRC are resolved in this regard when it comes to assessing what might be 'contrary to the intentions of Parliament'. The code is clear that it is for the bank to make the initial determination on this point. However, there might be consequences where HMRC later disagrees with the bank's determination; in a way, this illustrates the manner in which the bank should interpret this phrase.

HMRC has equated, in a number of places, the phrase 'contrary to the intentions of Parliament' with the phrase 'too good to be true'.[4] On one level this is understandable. The 'truth' in a tax law context is the final determination by a court of the intentions of Parliament as determined upon a 'true' construction of the legislation.[5] However, the response document makes it clear that it is HMRC's view of the intentions of Parliament or the 'truth' that are relevant here.

At page 9, the response document states that HMRC 'will suggest that 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'. It ultimately appears to be the case, therefore, that the correct threshold under the code is whether a bank believes that its analysis would 'surprise' HMRC.

Conclusion

Notwithstanding the uncertainties that remain and the competition concerns (which were rejected by HMRC in the response document), it should be noted that adoption of the code is voluntary and, further, that the code is not considered by HMRC to be a legal document. However, organisations that provide banking services and which do not adopt the code do face some practical consequences.

It is possible that they could be identified by omission, because HMRC will publish details regarding the progress of implementation of the code annually and it is currently unclear whether this will identify those banks that have adopted the code or whether these details will be anonymised. HMRC also says that a non-compliant bank 'will not be regarded as low risk'.[6] This might result in a reassessment of the bank's risk profile, presumably in accordance with HMRC's Tax Compliance Risk Management Process Manual, which could, in turn, result in a greater level of scrutiny from HMRC.

Those banks that do adopt the code may, assuming a finite level of HMRC resources, enjoy the consequences of greater HMRC scrutiny being directed at their non-compliant competitors. However, the code undoubtedly comes with real costs in terms of one-off and ongoing compliance and, although the code is not expressed to be a legal document, individuals who sign the code on behalf of the banks are making a commitment that must be assumed to be honestly held. In this context, the threat of HMRC to report professional individuals to their governing bodies where dishonesty is suspected by HMRC will not be taken lightly. Indeed it is perhaps within the minds of these individuals that HMRC might be hoping for behavioural change to begin.

Adam Blakemore (Adam.Blakemore@cwt.com) is a tax partner in the London office of Cadwalader, Wickersham & Taft LLP, and Oliver Iliffe (Oliver.Iliffe@cwt.com) is a tax associate in the same office.

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Endnotes

1. See page 15 of the response document.
2. See Answers 14 and 21 of the Guidance Note.
3. See Answer 5 of the guidance note.
4. See, for example, Answer 3 of the guidance note, 'The question of whether the tax results are contrary to the intentions of Parliament can be answered in practice by asking whether the tax consequences of the proposed transaction are too good to be true'.
5. See *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2004] UKHL 51, para 32, 'But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found'.
6. See Answer 25 of the guidance note.