

A Proposed U.K. Code of Practice on Taxation for Banks — ‘Spooky Jurisprudence’?

by Adam Blakemore and Oliver Iliffe

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VIEWPOINTS

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HM Revenue & Customs on June 29 published a 24-page consultation document setting out proposals for a Code of Practice on Taxation for Banks.¹ The document outlines a “new and innovative approach”² by the U.K. government and HMRC for combating tax avoidance by banking groups operating in the United Kingdom. By introducing the code, HMRC hopes to initiate and entrench changes in the behavior and attitude of the banking sector toward tax avoidance.

The first paragraph of the proposed code, which is currently in draft form, articulates the U.K. government’s goal:

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 the law, discerning and following the intentions of Parliament.³

The HMRC hopes that the code will engender a new level of transparency in the activities of the U.K. banking sector. While HMRC expects that all banking groups operating in the U.K. will sign up to the code, the sanction for nonadoption will be to attribute direct reputational risk to any that do not.⁴ The code sets out

why the government considers that a code of conduct is required, together with practical aspects of the administration and implementation of the proposed measures.

HMRC has invited comments on the draft code, which are intended to be the starting point in an ongoing dialogue with the banking sector and interested parties. Comments are due by September 25.

Context

The consultation document accompanying the draft code clarifies that the U.K. government believes that “more needs to be done” regarding tax avoidance schemes and transactions. While acknowledging the vital role played by the banking sector in the U.K. economy and its important contribution to tax revenues, the consultation document indicates the government’s view that “it is clear that some banks have been involved in tax avoidance which goes well beyond reasonable tax planning.”⁵

The code refers to the current legislative environment in which part 7 of Finance Act 2004 requires the early disclosure of some tax avoidance schemes, and to the corrective legislation that is regularly enacted to counteract tax avoidance arrangements. Reference is also made to the commitments made in the London summit of G-20 leaders in April regarding the adoption by all jurisdictions of international standards for the exchange of tax information. Nevertheless, the

¹“A Code of Practice on Taxation for Banks,” Consultation Document, HMRC, June 29, 2009 (hereinafter Consultation document).

²*Id.* at para. 4.1.

³*Id.* at Appendix 1, para 1.

⁴Para. 35 of the U.K. government’s document “Building Britain’s Future,” published with the code on June 29, 2009.

⁵Consultation document, *supra* note 1, foreword by the financial secretary to HM Treasury, Rt. Hon. Stephen Timms MP.

code expresses a concern that despite an increasingly tighter legislative framework in which transactions motivated by tax avoidance are heavily targeted by HMRC, banks are uniquely placed to avoid their own tax liabilities or to provide services to their customers “which are sensitive to tax and some of which can be used for tax avoidance.”⁶ HMRC’s stated perception 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”⁷ has therefore led to the code under which HMRC wishes to adopt a new approach to preventing and discouraging tax avoidance.

Reference is also made to an important publication by the OECD and Centre for Tax Policy and Administration in May 2009, “Building Transparent Tax Compliance by Banks.”⁸ Some aspects of this report — particularly the concern regarding the opportunities for tax avoidance that may be present within the banking sector and the importance to revenue authorities of openness and transparency in the tax-related activities of banks — presage some of the proposals made in the consultation document and the draft code.

The code takes the U.K.’s predominantly legislative approach to tax avoidance in a new direction.

The code takes the U.K.’s predominantly legislative approach to tax avoidance in a new direction. The “new and innovative approach” is identified as being “one step further” than the current legislative environment in that it seeks not to counteract transactions but rather to modify behavior and embed a series of responses and attitudes to tax avoidance within the banking sector.

⁶Consultation document, *supra* note 1, para. 2.10.

⁷*Id.* at para. 2.9. It is also noted that the significant financial support offered to some U.K. banks during the recent financial crisis throughout the latter part of 2007 and 2008 appears to be an element behind the proposal of the code. At para. 2.11 of the consultation document, it is noted that in the light of the stabilization of 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.”

⁸OECD Forum on Tax Administration and the Centre for Tax Policy and Administration, “Building Tax Compliance by Banks,” May 2009. Available at <http://www.oecd.org/dataoecd/5/29/42797744.pdf>. HMRC participated in the group of tax administrations assisting the OECD Secretariat in preparing this report.

It is considered that the approach set out in the code represents a fresh approach to tax avoidance, at least regarding the method by which HMRC’s aim is to be achieved. The U.K. has no general statutory provision under which tax saving schemes can be voided or re-characterized.⁹ In place of such a general statutory provision, Parliament has enacted antiavoidance legislation targeting specific transactions and arrangements. Further, the English courts have not evolved a jurisprudence under which transactions designed to avoid tax and otherwise lacking in commercial reality can automatically be rendered void or have their legal form disregarded. The courts must consider the purpose of a particular statutory provision and interpret the statutory language in a way that best effects that purpose.¹⁰ There is no explicit basis for courts to tax transactions by reference to economic equivalence rather than their legal form unless the relevant statute expressly permits it.

The innovation of the code is that it seeks to achieve a result through nonstatutory means, which is more normally achieved through legislation. The code would be a nonstatutory and voluntary means to compel, through reputational sanction, certain behavior among banks. HMRC are open about this, stating, “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.”¹¹ However, the code is less open about why HMRC might prefer a nonstatutory approach in this area, and it is difficult to avoid the suspicion that HMRC prefer a nonstatutory approach because it avoids the usual parliamentary process of implementation and will not be subject to interpretation by the courts.

Administrative Law Considerations

Difficult questions are likely to arise during the consultation as to the standing that HMRC will be given in introducing and policing the code.

The consultation document is silent on this point, which may suggest that the government has yet to come to a firm decision. However, HMRC is a public body performing a public function.¹² Accordingly, the

⁹While the U.K. tax statutes contain numerous examples of antiavoidance provisions, frequently based on a tax avoidance “purpose test” or “motive test,” there is no all-embracing single provision equivalent to Part IVA of the Australian Income Tax Assessment Act 1936. While a general antiavoidance rule was contemplated by the U.K. government in the late 1990s, the proposals were not legislated.

¹⁰*IRC v. McGuckian*, [1997] STC 908 at 916; and *Barclays Mercantile Business Finance Ltd. v. Mawson*, [2005] STC 1 at 11.

¹¹Consultation document, *supra* note 1, para. 3.5.

¹²Namely the collection and management of tax under the Taxes Management Act 1970, section 1; the Value Added Tax

(Footnote continued on next page.)

government might, not unreasonably, take the view that the formulation and implementation of the code falls within HMRC's current responsibility for the collection and management of the taxes within its statutory care. HMRC's adoption of this position would indicate its acceptance that any of its decisions regarding breaches of the code would be susceptible to judicial review. This could assist in providing the appropriate safeguards to banks on any occasions when it was alleged that HMRC acted unfairly in reaching a decision that there had been a breach of the code.

Accordingly, HMRC might plausibly be expected to adhere to some minimum standards in assessing whether a breach of the code had occurred, namely that they will:

- apply the same standards of objective assessment to all signatories to the code, whether in the application of internal policies or in the code itself (that is, they will not act arbitrarily);
- correctly ascertain the facts and the applicable law;
- take into account all relevant considerations and ignore all irrelevant considerations;
- not reach decisions that are irrational or unreasonable;
- act proportionately; and
- adopt fair procedures for assessing whether a breach has occurred and adhere to the rules of natural justice in following those procedures.

It would, nonetheless, be surprising if HMRC were not given any additional statutory responsibility or powers to underpin the implementation and management of the code. The absence of such responsibilities and powers might invite a challenge to the effect that HMRC's activities in relation to the code or the aims of the code itself were *ultra vires*.¹³ Much would depend in this context on what HMRC means when it refers to the "spirit" of the law. If, as appears likely, HMRC intends the spirit of the law to be applied in the context of preventing perceived tax avoidance more often than the "letter" of the law (as might be applied by a court), HMRC will have to address a concern that this approach could go further than HMRC's statutory function of the collection and management of tax. This is because HMRC does not have the power or responsibility to raise any more tax than that which is lawfully chargeable. Such considerations also inform what is meant by the statement that taxpayers should

Act 1994, schedule 11, para. 1; the Stamp Duties Management Act 1891, section 1; and the Stamp Duty Reserve Tax Regulations 1986 (SI1986/1711), Regulation 20(3).

¹³See, for example, *Laker Airways Ltd v. Department of Trade*, [1977] 2 All ER 182.

pay "their fair share of tax,"¹⁴ which, without further legislation or jurisprudence, can mean only the amount of tax prescribed by the letter of the law construed purposively (as applied by the courts), as opposed to the spirit of the law, when the spirit is said to depart from the letter.

The possible alternative approach to relying on the Crown's prerogative powers as a basis for the code would also raise complex constitutional questions. Further, expecting the code to be adopted by banks (and, by implication, applying different standards to banks) and not all companies must be demonstrably fair and should not amount to "unjustified discrimination."¹⁵ It is anticipated that more color will inevitably be added to the proposed framework of the code in these regards as the consultation progresses.

Private Law Considerations

If the government chooses to avoid underpinning HMRC's role with new legislation a further question arises, the answer to which might serve to undermine the effectiveness of the code. While a lack of a statutory framework might invite a claim that HMRC was acting *ultra vires*,¹⁶ it might also leave HMRC and its officers vulnerable to defamation claims in some situations. Those situations might include a publication in which the HMRC questions the reputation of any bank or makes an allegation of professional misconduct against an employee of a bank if the "publications" (in the context of defamation law) included an untrue statement.

The curious statement that the government intends to "attribute direct reputational risk"¹⁷ to banks, presumably in circumstances when banks fail to comply with, or deliberately breach, the code, raises the question of whether a line can be drawn between attributing reputational risk and attributing reputational damage. In the latter case, if a breach under the code is objectively verifiable,¹⁸ an incorrect decision by HMRC under the code might form the basis for a claim of defamation for publishing an untrue statement.

¹⁴Consultation document, *supra* note 1, paras. 2.1 and 2.11.

¹⁵See *R (on the application of Wilkinson) v. Inland Revenue Commissioners*, [2002] STC 347 at 360, per Moses J. See also *Preston v. IRC*, [1985] STC 282 at 298, per Lord Scarman.

¹⁶However, it might leave the door open to an argument that the implementation and adoption of the code was not a "public function" of HMRC when the costs were funded by the participating banks themselves and not the taxpayer.

¹⁷Para. 35 of "Building Britain's Future," *supra* note 4.

¹⁸It is hard to imagine in this context that HMRC would assert that whether there had been a breach of the code was merely a matter of HMRC's opinion and that it could therefore avail itself of the defense of "fair comment" in the law of defamation.

The question then arises as to whether HMRC and its officers can avail themselves of the defense of absolute privilege.¹⁹ The answer is not clear, and HMRC officers may find themselves in a position analogous to that of the assistant commissioner of the Metropolitan Police Service in *Merricks v. Nott-Bower*,²⁰ with uncertainty as to whether statements published by officers of HMRC are covered by that defense.

Key Components

The draft code states that banks should:

- adopt adequate governance to control the types of transactions they enter into;
- not undertake tax planning that seeks 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 HMRC.

These key components are intended to deliver the principal objective of the code, namely that banking groups will comply with “the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament.”²¹

To follow the code, banks are responsible for discerning the spirit of tax law and the intentions of Parliament. HMRC acknowledges that in some circumstances this process will not be straightforward. HMRC proposes that areas of uncertainty should be discussed with HMRC and notes that “HMRC will be happy to discuss the transaction and its understanding of the intentions of Parliament in relation to the law in question.”²²

To some extent, the focus on the spirit of tax legislation is nothing new. In the context of the code, spirit might be construed as being the purpose that Parliament had in enacting the statute in question. As Lord Hoffman stated in *Norglen Ltd. (in liquidation) v. Reed Rains Prudential Ltd.*:

The question is simply whether, upon its true construction, the statute applies to the transaction. Tax avoidance schemes are perhaps the best example. They either work or they do not. If they do not work, the reason . . . is simply that upon the true construction of the statute, the transac-

tion which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes. There is no need for such spooky jurisprudence.²³

The critical change proposed under the code is that whereas the statute is approved by the legislature (namely Parliament) and then construed where necessary by the judiciary (namely the courts), the executive (acting through HMRC) will be the initial arbiter of whether a bank’s discernment of the spirit of the legislation under the code is correct.

Another question is what the phrase “spirit of the legislation” means. The final form of legislation will often reflect compromises and significant digression from what the government originally proposed. In other words, while discerning the government’s intention in proposing the legislation may be relatively easy, discerning the spirit or Parliament’s intention in enacting the final form of the legislation may be less so. Indeed, that is presumably why judges have stressed that the true intention of legislation can be discerned only from its text.²⁴

In any event, it is unlikely that HMRC will be able to oust the jurisdiction of the courts absolutely. It is possible that disputes between banks and HMRC as to whether there has been a breach of the code will be litigated. The resulting jurisprudence will be of great interest, as courts may be expected to determine whether there is any real difference between the intention and the spirit of the law and what, if any, obligations arise on a bank to follow that spirit. The cause of action that might be pursued by a bank is also an open question, as already discussed.

Scope

The consultation document states that the code will apply to all banks operating in the U.K., including foreign banks, together with “similar organisations undertaking banking activities.” There is no clarification of what the phrase “banking activities” includes. The code therefore appears to encompass banking groups, their subsidiaries, “other vehicles,” and banking branches operating in the U.K. The consultation document does not specify only entities that are regulated

¹⁹The defense of qualified privilege is more likely to be available to HMRC but involves the consideration of several factors and the balancing of the public interest and the interests of the bank concerned. It is therefore considered that HMRC is unlikely to rely on this defense in practice.

²⁰*Merricks v. Nott-Bower*, [1964] 1 All ER 717.

²¹Consultation document, *supra* note 1, Appendix 1, “The Code of Practice on Taxation,” para. 1.

²²*Id.* at para. 3.22.

²³*Norglen Ltd. (in liquidation) v. Reed Rains Prudential Ltd.*, [1999] 2 AC 1 at 14, cited as recently as June 25 by the Court of Appeal in *Prudential plc v. Commissioners for HMRC*, [2009] EWCA Civ 622 at para. 13.

²⁴*See, for example*, Lord Hoffman, writing extrajudicially in 2005: “There is only one way to know the intention of Parliament and that is to read the statute” (BTR 2005 2, 197-206 at 204).

by the Financial Services Authority to do banking business. The net being cast by the code might well be wider; therefore, it raises questions for several funds, as well as financial advisory firms that may be regarded as providing banking services.

Governance

The code will require that banks should have a documented strategy and governance process for tax matters encompassed within a formal compliance policy, including a documented strategy for complying with tax obligations. The U.K. board of directors of the banks — or in the case of U.K. branches of overseas banks, a senior accounting person — will be accountable²⁵ for ensuring the bank complies with the code.

The code appears to encompass banking groups, their subsidiaries, 'other vehicles,' and banking branches operating in the U.K.

The only commitment that such a compliance policy is required to contain is “to comply with tax obligations and maintain an open, professional and transparent relationship with HMRC.” The code requires that “the policy must be taken into account in business decision making.” Given that any tax-sensitive transaction will be reviewed by a bank’s internal tax department and subjected to scrutiny through the bank’s internal risk management framework, the circumstances in which a tax policy is not taken into account as a matter of process will probably be limited in practice. It is also likely that banks will already have a detailed strategy for complying with their tax obligations and managing tax risk, with the risk of censure under the code being the least of their concerns if such compliance is not undertaken. Accordingly, the governance requirements appear to be a less controversial aspect of the proposed code.

However, it is anticipated that the code will stimulate further discussion in the function to be occupied by a bank’s internal tax department, which should “play a critical role and its opinion should not be ig-

²⁵Consultation document, *supra* note 1, para. 3.11.

nored by business units.”²⁶ The consultation document therefore supports a role for a bank’s internal tax department as a gatekeeper, acting “independently of the business units, with the tax function having the final say on the tax analysis.”²⁷ Although not expressly set out in the proposed code or the consultation document, it is inferred that when the internal tax department of the bank does not possess the independence, and when a tax department does not have independent authority to reject a transaction with significant tax uncertainty, this could be treated by HMRC as indicative of an internal risk management system that is insufficiently robust, with potential consequences regarding a breach of the code. The implication of the code in this area is that the extent of HMRC engagement with a bank’s internal risk management framework under the code may be greater than is currently the case.²⁸

Tax Planning

The draft code states that a “bank should not engage in tax planning other than that which supports *genuine* commercial activity” (emphasis added). The question arises as to what the word “genuine” adds. The words of Lord Upjohn in *IRC v. Brebner*²⁹ shed some light on how far a bank might go and still be within the bounds of “genuine commercial activity”:

My Lords, I would only conclude my judgment by saying, when the question of carrying out a genuine commercial transaction, as this was, is considered, the fact that there are two ways of carrying it out — one by paying the maximum amount of tax, the other by paying no, or much less, tax — it would be quite wrong as a necessary consequence to draw the inference that in adopting the latter course one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to

²⁶*Id.* at Appendix 1, “The Code of Practice on Taxation,” para. 2.2.

²⁷*Id.* at para. 3.13.

²⁸Comparisons with the current position as set out in Chapter 2 of the HMRC *Tax Compliance Risk Management Process* internal guidance manual, which contains guidance for HMRC Large Business Service staff in performing “business risk reviews,” are instructive. While consideration of tax governance and underlying risk management frameworks and systems are a component of the business risk review performed by HMRC for a large business, including a banking institution, the current published guidelines stop short of attempting to govern the precise framework and reporting processes to be established by the commercial organization in question. *See, for example*, HMRC, *Tax Compliance Risk Management Process*, Internal Guidance Manual TCRM11000, “Annex I: Actions Plans.”

²⁹*IRC v. Brebner*, (1966) 43 TC 705, at 718-719.

carry out commercial transactions except upon the footing of paying the smallest amount of tax involved.

In a *Brebner* sense, “tax planning . . . which supports genuine commercial activity” (which would be permitted by the code) arguably encompasses tax planning that seeks to eliminate any tax from applying to a genuine commercial activity. In other words, there must be something other than tax that motivated the transaction, and the tax planning must come second. If “genuine commercial activity” can be viewed in this light, the code may permit tax planning in a wide range of circumstances.

The draft code provides that a 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.” A similar expression is used both regarding when the bank acts as principal and when it acts as the provider or facilitator of transactions by third parties. Banks acting prudently, rationally, and properly are unlikely to have a reasonable belief that their actions are contrary to Parliament’s intentions (the discernment of which is considered above). The difference regarding the code is that it is the government (through HMRC) that wants to be the arbiter of what Parliament intended, as opposed to leaving that determination to the courts, where dispute arises.

There is also a reference to the bank acting as employer and the prevailing government policy that all employees and employers should pay the “right amount of tax and national insurance” on employment remuneration and rewards. The government’s position in this regard seems similar to statements by the paymaster general in December 2004 regarding tax planning in relation to employee remuneration. The examples of tax avoidance in this area include “payments by way of assets” (potentially a reference to a number of exotic and, in many cases, long-extinct methods of remunerating key employees with commodities outside the scope of the tax legislation, such as with platinum sponge and oriental carpets).

In this regard, the code includes examples of what tax avoidance “can involve,” by using subjective concepts, namely by:

- exploiting *loopholes* in tax law;
- juxtaposing two unrelated provisions in tax law in a way *never intended or envisaged* when the provisions were enacted; or
- *artificially* creating the conditions for a tax relief or deferral.

Several hallmarks of avoidance are also listed in the code, including the use of offshore vehicles, arbitrage between tax jurisdictions using hybrid entities and instruments, and “other arrangements, the purposes of

which are to achieve a tax advantage.”³⁰ These hallmarks are supported by a number of specific examples of aggressive avoidance. The body of the consultation document also lists further “signposts” of avoidance, including transactions bearing little or no pretax profit, transactions that rely on mismatches (such as between legal and accounting form), and transactions between the tax treatment of parties or entities in different tax jurisdictions. Many transactions bearing these signposts have been considered in the English courts, but without the signposts being universally identified indicating tax avoidance.³¹

There is ample scope for disagreement between the government and banks on which legislative misalignments amount to loopholes, what was intended or envisaged by tax legislation, or what constitutes “contrived, artificial, transitory, pre-ordained or commercially unnecessary steps” in a transaction.³² Both the hallmarks and signposts identified in the consultation document and the proposed code are indicative and not definitive. This leaves unanswered the question as to how the government and banks will discover that they disagree on the concepts. The answer, presumably, is the concept of transparency, which the code implies is the solution to this problem, as discussed below.

Relationship Between Banks and HMRC

The draft code is said to be voluntary. Signing up to the code will bring certain obligations, one of which is that “relationships with HMRC should be transparent and constructive, based on mutual trust wherever possible.”³³ The expectation in the code is that when a

³⁰It is interesting that the consultation document invariably construes tax arbitrage between jurisdictions in a pejorative context and without benefit to the United Kingdom. There is no consideration of transactions that might be initiated by, and generate economic returns for, U.K. banks, except when the tax avoidance is the avoidance of the tax charged by a foreign jurisdiction, such as through foreign tax credit utilization structures.

³¹For example, the Privy Council did not determine that the film financing arrangements in *Peterson v. CIR*, [2005] STC 448, were motivated by tax avoidance (which was proscribed by the relevant New Zealand antiavoidance legislation) despite the pre-tax negative result of the arrangements and the circularity of the film funding arrangements. The words of Lord Wilberforce in *IRC v. Holmden*, [1968] AC 685, at 712, are interesting in the context of loopholes:

There is a presumption in taxing law that two sections, however complementary they appear, are exhaustive: There may always be a no man’s land between them that the subject does not have to define but on which he can take his stand.

³²Consultation document, *supra* note 1, at para. 3.21.

³³*Id.* at para. 3.23.

bank “believes its proposed transaction may be contrary to the intentions of Parliament, the bank will explain its plans in advance with HMRC.” There is no conditionality regarding this requirement: A bank signing up to the code will therefore be required to engage in discussions with HMRC. The threshold of this requirement is deliberately set low, being based on the bank’s subjective belief that a risk exists. It is anticipated that considerable discussion will almost inevitably take place in the consultation process relating to the proposed code regarding the nature of such a belief and regarding the evidence that will be necessary to demonstrate that such a belief does or does not exist.

Of the four parts of the proposed code, it is considered that the proposal for the management of the relationship between HMRC and the banks may produce the greatest uncertainty, particularly the focus on transparency as a key component of the relationship.³⁴ It is understood that no tax planning or transactions should be entered into if they depend in any way on nondisclosure of information to HMRC. However, the code also anticipates the banks “disclosing fully the significant uncertainties in relation to tax matters” and disclosing “issues that HMRC would want to know about and might want to discuss.”³⁵ The proposed onus on the banks of disclosing not only difficulties of interpretation that they have expressed but also issues that HMRC “might want to discuss” places a materially greater obligation on that bank than the routine self-assessment of their own tax liabilities. The disclosure requirement under the code of these matters appears to be without regard to how likely it is that the transactions in question will take place. Amending the proposed code in this regard must be made to prevent time being wasted; a code that requires the disclosure of sensitive issues regarding a transaction that is unlikely to take place stands little chance of being workable in practice.

This onus on transparent disclosure also falls on a defined individual within each bank. The consultation document proposes that the code should be signed by a board member of the bank or a senior officer of the banking organization. HMRC proposes raising any concerns over noncompliance by the bank with the signing board member or senior officer. There is also the proposal that if a bank deliberately fails to comply with the code, HMRC may make a report to any professional body of which that signing director or senior officer is a member. This focus on individual respon-

sibility for corporate action is another new feature of the proposed code, although comparable changes are proposed in Finance Bill 2009 regarding senior accounting officers of large companies.³⁶ Despite many banking organizations following best practice in their relationship with HMRC, this imposition of personal responsibility for the bank’s tax compliance arrangements is unlikely to be welcome.

For banks that are unwilling to sign the code, the consultation document makes it clear that they will receive greater scrutiny from HMRC.

For banks that are unwilling to sign the code, or that sign and then deliberately breach the code, the consultation document makes it clear that they will receive greater scrutiny from HMRC. While HMRC states in the impact assessment accompanying the consultation document that “all banks will be expected to sign up to this,” a refusal to sign the code will not, in itself, directly result in any additional tax liability. Nevertheless, the inference to be drawn from the consultation document and draft code is that “direct reputational risk”³⁷ could be occasioned by such a refusal. It is not clear from the consultation document what form this direct reputational risk would take. It is not impossible that this could involve either the publication of the names of banks that have signed the code (thereby leading to a process of deduction regarding which banks have not yet signed) or the more straightforward publication of the names of banks not yet having signed the code despite being invited to do so (although any such suggestion would be highly controversial given the right each taxpayer bank has to confidentiality in tax affairs). Either method of publication has the capacity to engender uncertainty in the market, potentially accompanied by the adverse effect that such a publication could have on the share prices of any banks not yet signing up to the code.

Conclusion

As mentioned above, HMRC appears to consider that some key components of the draft code, in their focus on adherence to the spirit of the law, might be

³⁴The theme of openness and transparency is also featured prominently in “Building Tax Compliance by Banks,” *supra* note 8. See, in particular, paras. 4.19 to 4.25.

³⁵Consultation document, *supra* note 1, para. 3.24. The proposal that “any significant uncertainties” should be disclosed also appears, at least at first sight, being almost incapable of objective verification.

³⁶Clause 92 and Schedule 46, Finance Bill 2009 (as published on Apr. 30, 2009).

³⁷*Supra* note 4.

seen as slightly restating existing canons of statutory construction as applicable to tax law. (Less charitable readers of the draft code may fear that HMRC's construction of the spirit of the law may diverge from that of the House of Lords.) It is clear that the code will also remain voluntary. Accordingly, and setting aside the expansion of information that HMRC anticipates should be disclosed as part of a transparent relationship, it is clear that HMRC anticipates that banks with good relationships with HMRC might notice little additional burden (apart from the initial implementation).³⁸ In this light, it must be asked whether the draft code would have any real effect other than the "moral censure" of those banks that chose not to sign up. The answer may lie in the government's own perception. If the government perceives that inappropriate behavior persists, it states that it may introduce reporting or auditing requirements that examine a bank's compliance with the code and, it might be inferred, that it may require the mandatory adoption of the code by banks.³⁹

Far greater may be the U.K. banking sector's likely concern over the intended change in attitudes and behaviors toward avoidance, which is the goal of the government under the code since changes in this area may increase the competitive advantages of banks not following the code. Ignoring the possibility of U.K. banks not signing up to the code and thereby deriving competitive advantages, there remains the possibility that foreign banks not lending from their U.K. branches (but rather, say, from elsewhere in the European Economic Area) could stand at a competitive advantage in offering cheaper financing to U.K. corporations and

businesses; that cheaper financing would be enhanced through aggressive tax planning outside the United Kingdom. Given the disparity of tax regimes even within the EU and the mobility of financing in the current markets, the code's possible creation of such competitive disadvantages may be a significant concern in the U.K. banking sector.

The real question is likely to be whether the government, as the executive, believes it can go any further without resorting to legislation as an agent of tax policy. In this regard, the government should keep the words of Lord Wilberforce from *Black-Clawson International Ltd. v. Papierwerke Waldhof-Aschaffenburg AG*⁴⁰ in mind:

Legislation in England is passed by Parliament, and put in the form of written words. This legislation is given legal effect on subjects by virtue of judicial decision, and it is the function of the courts to say what the application of words to particular cases or particular individuals is. This power, which has been devolved on the judges from the earliest times, is an essential part of the constitutional process by which subjects are brought under the rule of law — as distinct from the rule of the King or the rule of Parliament; and it would be a degradation of that process if the courts were to be merely a reflecting mirror of what some other interpretation agency might say.

It may be that the government would accept that the imposition of more wide-ranging obligations on banks and other taxpayers than is envisaged by the code would be a degradation of the constitutional process or simply unworkable in practice. However, the concern must be that the code presages the type of penumbral spirit or spooky jurisprudence that Lord Hoffman objected to in *Reeds Rain Prudential* referred to above, albeit through extralegal initiatives. ◆

³⁸Consultation document, *supra* note 1, para. 4.9.

³⁹*Id.* at para. 4.10 and p. 22. Any mandatory requirement for the U.K. banking sector to accede to the code, or a similar accord, would, however, not seem to be in keeping with the goals of developing an "enhanced relationship based on mutual trust" in which a revenue authority and a bank have complementary and reciprocal responsibilities and obligations. See "Building Tax Compliance by Banks," *supra* note 8, at para. 4.19.

⁴⁰*Black-Clawson International Ltd. v. Papierwerke Waldhof-Aschaffenburg AG*, [1975] AC 591, at 629F-G.