Banks, tax and policy objectives

The unveiling in the recent pre-Budget report of a bank payroll tax is already proving to be one of the most politically charged pieces of taxation legislation of recent years. In a wide-ranging analysis of the issues, Adam Blakemore and Oliver Iliffe explore both the legal and policy implications of the new measures.

Introduction

Perhaps the most discussed announcement in the Pre-Budget Report 2009 on 9 December 2009 has been the introduction of a new tax, to be known as the 'bank payroll tax' (BPT). The stated rationale of BPT has been identified by HMRC as being to 'encourage change in the remuneration practices that contributed to excessive risk-taking by the banking industry'.[1] In this regard, the policy aspiration for BPT to promote the 'development of sustainable long-term remuneration policies that take greater account of risk and facilitate the build-up of loss-absorbing capital'[2] is distinguishable from many of the announcements in the Pre-Budget Report that aim to raise revenue through the restriction of loopholes and the removal of tax reliefs.

Although BPT is most definitely a tax, the motivation behind it is not primarily financial but lies in the arena of economic and tax policy[3]. In this context, BPT sits alongside other government initiatives such as the introduction of the Financial Services Bill 2010 (which BPT is intended to complement) and the Code of Practice on Taxation for Banks, the latter being another highly visible initiative to mould the behaviour of the UK banking sector.

This article considers BPT and seeks to discuss a number of the more controversial aspects of the tax. The authors will explore changes announced to the Code of Practice on Taxation for Banks in the Pre-Budget Report 2009 in a follow-up article.

Overview

The announcement of the new tax by the Chancellor of the Exchequer in the Pre-Budget Statement was immediately followed by a detailed technical note providing draft legislation to be included in Finance Bill 2010. Subsequently, on 18 December 2009 HMRC published an announcement regarding a number of changes to the draft legislation, together with a document entitled 'BPT – Responses to Some Questions'. On 23 December, HMRC subsequently reissued this document with additional questions and responses ('HMRC Q&As').

Broadly described, the BPT is a 50% tax charge on the amount of any 'chargeable relevant remuneration' to the extent it exceeds £25,000 that is awarded to a 'relevant banking employee' of a 'taxable company'(comprising both banks and certain other financial institutions). The remuneration targeted by the tax is not only bonuses but any form of discretionary remuneration including certain share based benefits and options. The award must be made within a 'chargeable period' from 12.30pm on 9 December 2009 to 5 April 2010,[4] with the tax being due and payable on 31 August 2010. The tax is payable by the 'taxable company', even where this might not be the company actually awarding the remuneration. The taxation treatment of employees receiving such remuneration will not be affected by the remuneration being subject to BPT. The charge is not deductible against corporation tax and may therefore need to be funded by the employer out of taxed income, increasing the cost of payment of the remuneration substantially to the institution providing the remuneration.

Key mechanics

There are a number of key elements in BPT which must be satisfied in order for the tax to be chargeable. Broadly speaking, these are that:

- the institution subject to the tax must be a 'taxable company';
- amounts of 'chargeable relevant remuneration' in excess of £25,000 must be awarded during the chargeable period for BPT; and
- such an award must be made by reason of employment to an employee who is a 'relevant banking employee'.

The following paragraphs consider these requirements in turn.

Identifying a taxable company

The identification of whether an institution is a 'taxable company' for the purposes of BPT is critical. It is important to note that the scope of the tax affects more institutions than simply banks. No distinction is made between financial institutions which might have directly benefited from the UK Bank Recapitalisation Fund or from the operation of the Bank of England Special Liquidity Scheme, on the one hand, and institutions that have only indirectly benefited through government attempts to preserve stability in financial markets since 2008, on the other.[5] Nor is any distinction drawn between investment banking operations and retail banking operations.

Instead, the institutions affected are those that operate as banking institutions or as part of banking groups. The affected institutions fall into five classes: UK resident banks, relevant foreign banks, certain other UK and foreign entities and building societies.

UK resident banks

'UK resident banks' are UK-resident companies that are authorised persons for the purposes of s31 of the Financial Services and Markets Act 2000 and whose activities consist, wholly or mainly, of 'relevant regulated activities' which are:

- two or more of: accepting deposits, dealing in investments as principal, dealing in investments as agent, arranging deals in investments, safeguarding and administering investments, and entering into or administering regulated mortgage contracts; or
- accepting deposits (para 19(1) and 20(1)).

The scope of the definition of 'bank' has given rise to significant concerns within the UK banking sector. 'Bank', as originally defined in the draft legislation, would have included pension fund managers, prime brokerage firms, and independent fund management businesses (principally, hedge and private equity fund managers). In other words, the definition captures institutions that would invariably be required to be registered by the Financial Services Authority for the activities of dealing in investments or arranging deals in investments.

Many of these concerns have been mitigated, if not wholly dissipated, during the course of December 2009. HMRC's admission on 18 December that the 'original definition of a "bank" did not effectively exclude all the groups we intended to exclude'[6] was accompanied by a revised proposal that a non-deposit taker (such as a fund manager) would only fall within the scope of BPT where its activities consist wholly or mainly of 'relevant regulated activities' and where it is a 'full scope BIPRU 730K investment firm'[7] for the purposes of the FSA's capital rules (or would be such a firm if its head office were in the UK).

These proposed changes should leave BPT applicable to larger proprietary trading investment firms, but should substantially exclude most independent fund managers.[8] Nonetheless, some concerns remain, particularly whether a 'full scope BIPRU 730K investment firm' (that does not perform activities which would, on a balanced view, be described as part of a banking trade) will fall within the definition of a 'taxable company'.

Relevant foreign banks

For the purposes of BPT 'relevant foreign banks' are companies that are (a) not resident in the UK but which carry on a trade in the UK through a permanent establishment; and (b) which are an authorised person under the FSMA 2000 and whose activities fall within the same parameters as those for a UK resident bank. The scope of the definition of relevant foreign banks was limited in a similar way to the definition of UK resident banks in the HMRC announcement of 18 December.

Certain UK-resident entities

The definition of a 'taxable company' might also include a UK resident 'investment company' or UK resident 'financial trading company' which is a member of the same group as a UK resident bank or relevant foreign bank, defined respectively as a company whose business consists wholly or mainly of, and the principal part of whose income is derived from, the making of investments (including a savings bank) or a company which carries on a trade consisting wholly or mainly of dealing in shares, unit trust interests and other securities (paras 21, 23 and 24).

Overseas entities

The legislation defines a relevant foreign 'financial trading company' that is a member of the same group as a UK resident bank or relevant foreign bank as a company which carries on a trade through a UK permanent establishment of dealing in shares, unit trust interests or other securities (para 3(b)(ii) and para 24(3)).

Building societies

The legislation also specifies that a building society is a UK building society within the Building Societies Act 1986, or a UK resident investment company or UK resident financial trading company (as defined above) that is a member of the same group as a UK building society.

Institutions that are not operating as companies, such as investment managers established as partnerships, will not be 'taxable companies' and are outside the scope of BPT. A number of other companies were specifically excluded from being 'taxable companies' in the original draft legislation, and this original list was supplemented during the course of December.

The original list of 'excluded companies', such as insurance companies, investment trusts, and open ended investment companies, has now been expanded to include corporate operators of a collective investment scheme, corporate managers of a pension scheme where no other relevant regulated activities are carried on, and prime brokers that are full-scope BIPRU 730K firms.

Further work is ongoing between HMRC and industry bodies to exclude other institutions that might be inadvertently affected by BPT. More generally, HMRC also announced changes to ensure that where a company conducts a banking activity (such as deposit taking) within a predominantly non-banking financial services group, the group should not be classed as a 'banking group' under the BPT.

Casting the net overseas

The scope of BPT does not sit comfortably with the principles of residence and source that usually underpin double tax treaties between jurisdictions. For example, it is possible that overseas branches of UK institutions and non-resident institutions with UK branches subject to BPT will need to consider whether bonus pools held for the purposes of their overseas business can benefit those employees who partly perform their employment duties in the UK. BPT will be assessed on the institution in the UK by reference to the activities of an employee who might be classed as tax resident overseas and who works overseas for a substantial proportion of their time.

Any potential mismatch can mean that an overseas business might suffer UK tax as an economic expense that reduces profits properly taxable only in the overseas territory (assuming a double tax treaty following the OECD model is in place). Not only could this amount, in economic terms, to the assumption by the UK of taxing rights in respect of profits that arise in substance abroad, but there must also be some concern that, under the OECD model double tax treaty, relief or credit for the bank payroll tax suffered might not be available to the overseas branch or non-resident company. This follows generally from the nature of the bank payroll tax, which is not computed by reference to the net income or capital gain of the company being taxed.

Chargeable relevant remuneration

BPT is charged on the award of 'chargeable relevant remuneration' in excess of £25,000. Perhaps unsurprisingly, the legislation encompasses a very wide class of remuneration and proceeds to exclude certain routine awards of remuneration, rather than seeking to define what a 'bonus' is for the purposes of the tax.

The remuneration potentially within BPT is:

- 'earnings' falling within s62 of Income Tax (Earnings and Pensions) Act 2003 in relation to an employment (including salary, wages, benefits and anything else constituting an emolument of the employment); and
- any other benefit not being 'earnings', which is provided by reason of the employment (para 4).

Other forms of remuneration are expressly included within the scope of BPT and include:

- loans made to an employee in order to avoid a liability for BPT, other taxes or NIC (para 12);
- payments made to individuals who perform banking services for a taxable company through certain intermediaries (para 10); and
- arrangements made on or prior to 5 April 2010 for remuneration to be provided after 6 April 2010 (para 11(b)).

The draft legislation includes a definition of when remuneration is 'awarded', namely being when a contractual obligation (itself a defined term) to pay or provide remuneration arises in the chargeable period, or when the remuneration is simply paid without an obligation arising in the chargeable period. Difficult questions arise regarding the situation where an employee is informed on or before 5 April 2010 that remuneration will be provided after 5 April 2010, but subject to some condition (for example, that a remuneration committee will not cancel the award). Although HMRC Q&A 3 explores this situation, the answer provided is less than comprehensive and difficulties can be foreseen in this area.

The wide scope of 'relevant remuneration' in para 4 is limited by certain 'excluded remuneration' that is not treated as relevant remuneration (paras 4(3) and 5). Excluded remuneration includes:

- regular salary, wages or a regular benefit, with 'regular' connoting an inability to vary salary according to the performance of the business of the taxable company or the employee receiving the remuneration or 'any similar considerations';
- any remuneration in respect of which a 'contractual obligation' to pay or provide the remuneration arose before 12.30pm on 9 December 2009 (a contractual obligation only arises when the amount of remuneration or the amount of a bonus pool is either fixed, or capable of being fixed, without the exercise of a discretion by any person (para 5(3) and HMRC Q&A 1)); and

- share options awarded under an approved share incentive plan (under s488 ITEPA), or a share option under an SAYE option scheme within s516 ITEPA.

HMRC's Q&As clarify a number of areas regarding 'excluded remuneration', including the view that warehousing profits with a view to funding potential future remuneration is not intended to be within the scope of BPT (HMRC Q&A 19).

No distinction is drawn by the draft legislation between the circumstances under which remuneration is awarded. Non-discriminatory remuneration awarded for the most aggressive risk-taking transactions is treated in exactly the same manner as bonuses earned for long-term prudential investment or, indeed, for high performance by an administrative, compliance or legal officer within an institution. A bonus earned for restructuring and revitalising an industrial concern with socially beneficial consequences in a deprived region of the UK would be subject to BPT in the same way as a bonus earned for a repackaging of sub-prime asset-backed securities.

Furthermore, BPT is chargeable on the full amount of the relevant remuneration, with no apportionment by reference to remuneration that is payable for work undertaken by the employee outside the UK. The operation of BPT in this manner reinforces the perception of the tax as a blunt tool of tax and economic policy that aims to prevent the depletion of an institution's capital reserves through deterring bonuses completely, as opposed to a more sophisticated mechanism for rewarding prudential investment and punishing short-term risk taking.

The policy based origins of BPT are also evident when the detail of the draft legislation is examined. For example, there is no symmetry between BPT and a number of income tax provisions. The award of a share option to an employee during the chargeable period by reason of employment is, where not 'excluded remuneration' under para 5, subject to BPT on the higher of money's worth or market value when the relevant remuneration is awarded.

The draft legislation contains no equivalent to s475(1) ITEPA 2003 to eliminate a charge on the acquisition of the option. In the event that restricted shares are awarded to an employee in the chargeable period and where those restrictions are subsequently lifted, the restriction is ignored in determining the liability to BPT,[9] a situation different to the income tax position.

Other provisions appear, on the surface, potentially unfair when viewed from the perspective of employee remuneration; there is no provision for refunding tax paid where a deferred bonus is subject to a future clawback.[10] The identification of asymmetries and perceived unfairness highlights, however, that BPT is a taxing measure driven by a policy initiative. As considered further below, the aspiration behind the BPT is the sterilisation of bank 'bonus culture', an aim that is not necessarily synonymous with the implementation of progressive and equitable employment taxation.

Relevant banking employee

For BPT to be charged on an award by a taxable company of relevant remuneration, that award must be made by reason of employment to an employee who is a 'relevant banking employee' of a taxable company. An employee will be a 'relevant banking employee' where:

- the employee's employment is a 'banking employment', broadly being any employment wholly or mainly concerned (whether directly or indirectly) with activities consisting of the lending of money or certain regulated activities (being the activities that would result in a financial institution falling within the definition of a 'UK resident bank', a 'relevant foreign bank', a building society, or some other company carrying on activities which are not 'relevant regulated activities' but which consist of lending money); and
- the employee is either UK tax resident in the tax year 2009-2010 or performs the duties of their banking employment in the UK for more than 60 days in the tax year 2009-2010.[11] The 60-day limit operates as a cliff-edge. There is no proportionate reduction in BPT by reference to the precise time spent by an employee in the UK; a bonus to a visiting employee spending only 70 days in the UK is treated in the same way as a bonus to a UK resident employee.

Individuals who are not 'relevant banking employees' but who 'perform banking services' for an institution through an intermediary can be treated as though they were such a relevant banking employee. These provisions are comparable, albeit in a much abbreviated form, to the provisions relating to managed service companies in Chapter 9 of Part 2 of ITEPA 2003.

The breadth of the definition of 'relevant banking employee' means that BPT will be payable by banks in respect of bonuses paid to not only (for example) front desk traders responsible for managing risk and proprietary trading by an institution, but also to employees such as support personnel and management staff who might have only a peripheral, if any, interaction, with any 'excessive risk-taking' by that institution.

Anti avoidance

While several media commentators speculated at the time of the Pre-Budget Report on potential schemes and routes for avoidance of BPT, mitigation of BPT is difficult and is likely to be achieved only with material non-tax consequences. Unsurprisingly, the draft legislation contains anti-avoidance provisions, with the main anti-avoidance provision being couched in language familiar to tax professionals.

Paragraph 13 counteracts 'relevant arrangements' where the main purpose, or one of the main purposes, of any person in entering into the arrangement is the reduction or elimination of BPT. 'Relevant arrangements' are further defined as being arrangements that: (i) involve the making of remuneration 'otherwise than during the chargeable period'; or (ii) are in a form that is not relevant remuneration but which equates to relevant remuneration. Simply deferring a bonus until after 5 April 2010[12] or seeking an economic equivalent to remuneration are therefore unlikely, by themselves, to constitute effective tax planning.

Additional anti-avoidance provisions are present in the draft legislation and set out to prevent the avoidance of BPT through provision of loans that are, in substance, earnings as well as the channelling of a bonus through an employee benefit trust or similar intermediary.

Planning to avoid BPT might still be possible, but is likely to involve substantial non-tax consequences. Owing to 'regular salary' falling outside the scope of BPT, increasing salary rather than paying discriminatory remuneration would be a viable way of mitigating BPT costs. On the other hand, any such a move is permanent, lacks the flexibility of bonus-form remuneration and is unlikely to accord with the wider remuneration strategy of institutions.

Similarly, the migration of UK based bank employees, while regularly reported or threatened in the UK media, is not a straightforward route to avoid BPT. The migration required would probably need to be of both the employee (physically) and his or her employment (to an overseas employer). This is a significant change and would necessitate a detailed review of the employment laws in the jurisdiction of migration alongside any consequential changes to the employee's contract of employment.

In addition, migration would only be likely to have the effect of avoiding BPT in specific circumstances: for example, where any bonus paid by the new foreign employer relates to work undertaken after the migration. Although migration remains a potential route to limit the cost of BPT (owing to the mechanical provisions within the draft legislation that tax remuneration without reference to the specific work projects undertaken by the employee), it is far from a simple mitigation solution. Moreover, it has the added disadvantage of potentially attracting unwelcome scrutiny from HMRC.

International dimensions

Ultimately, whether BPT results in a mass migration of banking services from the UK to other leading world financial centres will have to be judged against the context of the legislative and regulatory responses of other jurisdictions to the financial crisis. French and US developments in this field appear to be most advanced, but it remains to be seen whether, in the future, a more robust regulatory environment (perhaps taking the form of taxation inducement for prudential risk taking by banking institutions) will become universal among the G20 nations.

To date, the French governmental proposals appear to be a reasonably close echo of BPT, essentially constituting a levy on bonuses paid out by banks operating on French territory. Reports relating to the French tax are suggestive of a narrower scope than BPT, being imposed on market operators and traders who take risks on behalf of their respective banks, and not administrative staff or employees working in, say, an M&A department of a bank. The French tax which is charged at a rate of 50%, would apply to those traders whose 2009 bonuses exceed €27,500 in cash, deferred payments or stock options. It appears that the French government's current intention is that the tax will only apply to 2009 bonuses that are paid out in 2010.

US proposals are at an earlier stage of development, although President Obama proposed a 'fiscal crisis responsibility fee' on 14 January 2010 to be raised from around twenty of the largest financial institutions doing business in America. The fee, to be in place for at least 10 years, might be based on the size of an institution's assets, less insured bank deposits and tier 1 capital.

The fee might, therefore, place a higher burden on investment banks than retail banks which use significant retail deposits to finance their balance sheets. The US Administration in proposing this initiative appears, like the UK and France, to be looking to taxation legislation to encourage a modification in banking behaviour through actively promoting stable sources of funding (retail deposit taking) in preference to ostensibly less stable investment banking and broker-dealing.

EC Treaty considerations

A further question relating to the introduction of BPT arises in relation to the compatibility of the tax with the fundamental freedoms of the European Community, in particular the freedom of establishment under art 43 of the EC treaty. When a purely domestic situation in the form of, say, a UK bank with no overseas branches or affiliates, is compared with an EC bank that is either non-resident with a UK branch, or which is UK resident with branches in other EC member states, the imposition of BPT is potentially more onerous for the banks with cross-border operations.

This is because BPT is taxed by reference to its employees, wherever they might be based. A UK bank with no overseas operations will pay BPT on bonuses to its employees who work in the UK generating profits that are exclusively taxed in the UK. A non-UK, EC bank with a UK branch will pay BPT in respect of all employees who spend more than 60 days working at the UK branch.

There is no recognition under the draft BPT legislation that the majority of an employee's time might be spent earning profits for the bank in its home state. This means that it is disproportionately expensive for non-resident banks to maintain a UK branch or for UK banks to maintain overseas branches where there is likely to be a significant degree of travel by employees between branches.

The point is highlighted, if crudely, by imagining an EC where all states enact BPT in the UK form. In an extreme example, a bank with cross border operations might have to pay BPT six times over for an employee who spent 61 days at branches in six different member states (an effective rate of tax of 300% on the excess bonus taxed). On the other hand, a bank operating in a single member state would only pay BPT once in relation to bonuses awarded to each of its employees (at 50%). On this basis, it might be argued that BPT indirectly discriminates against banks with cross-border operations.

One must assume that the government has considered this point, although it is unclear, at the time of writing, what view it has taken. If it has been accepted that there is indirect discrimination, the 'rule of reason' test[13] will need to be satisfied.

This poses two problems. First, the objectives of BPT need to be identified; a single clear objective is perhaps less than transparently clear from the HMRC Technical Note. The rule of reason requires that BPT must be appropriate to obtain these objectives and, in this context, assuming one objective is to discourage the award of bonuses, it appears that many banks have already indicated that they will award bonuses despite the imposition of BPT.

Second, the imposition of BPT arguably lacks proportionality in relation to those employees who spend only part of their time in the UK. Such residual uncertainty does little to reinforce the position of those advocating the tax.

In summary, therefore, there is a possibility that BPT breaches EC law, which begs the question whether an argument along these lines might be pursued before the Courts at a later date. Given the high cost of the tax and how it is likely to deter the payment of substantial bonuses to potentially aggrieved employees, there may be plenty of incentive to do so.

Tax policy objectives and potential asymmetries

As noted above, the government's stated rationale for introducing BPT was to encourage change in the UK banking sector regarding remuneration.[14] Although the introduction of tax legislation to modify taxpayer behaviour certainly is not new, BPT is novel in that it seeks to prevent the very circumstances (the award of non-discriminatory remuneration, already subject to income tax and national insurance) that in fact give rise to a liability to BPT in the first place. In this regard, BPT is not a windfall tax.

A windfall tax might be identified as a one-off tax that is driven by exceptional circumstances but which is usually raised retrospectively on historic transactions or profits. Examples would include the special tax on banking deposits imposed in Finance Act 1981 that targeted potential windfall profits by banks on non-interest bearing accounts at a time of high interest rates. Another example would be the windfall tax on privatised utilities in 1997.

Unlike such retrospective windfall taxes, and despite elements of retrospectivity being clearly present in BPT owing to the unusual legislative process relating to its introduction (see below), BPT actively seeks to modify current and future behaviour in the UK banking sector. Unusually for a tax, BPT might be adjudged a success even if it collects very little revenue. In this case, the success of BPT would be evidenced by an absence of bonuses being paid.

Given these policy objectives, it is unsurprising that the legislation is a fairly blunt tool. The Government has chosen to include all bonuses paid by the affected institutions. No distinctions are drawn regarding either the impact of particular remuneration on the capital reserves of the institution concerned, or on the degree to which the remuneration was earned through the successful navigation of financial risk.

The counter-argument might well be (with some justification) that the introduction of a tax based on granular factors comprising the determination of remuneration would be impractical given the timing of the introduction of BPT. Nevertheless, the broad based scope of BPT sits slightly uneasily with some other stated policy objectives of governmental organisations. For example, the interaction between the draft legislation on BPT and the approaches of the regulatory authorities to remuneration structures (as described in The Turner Review)[15] remains particularly opaque.

Moreover, the end of the chargeable period for BPT is expected to coincide with the enactment of the Financial Services Bill being introduced in the 2009-10 session of Parliament. Given the synchronisation of the two legislative initiatives, it might have been expected that a shared policy objective would be apparent from a review of both legislative initiatives. However, the provisions in the Financial Services Bill are significantly more prescriptive than BPT when viewed in the context of the reform of the UK banking sector.

The draft legislation for the Financial Services Bill specifies that a regulated institution should prepare an executives' remuneration report disclosing 'anything connected with the remuneration of relevant executives' within the institution.[16] In addition to the reporting obligation, the FSA will be required to introduce rules requiring authorised institutions to act in accordance with a 'remuneration policy', with such policy to be consistent with the effective management of risks.[17]

Under these provisions, the FSA will be able to prohibit specifically prescribed remuneration, provide that certain agreements providing such remuneration are legally void and provide for the recovery of such prohibited remuneration. The legislation therefore permits the FSA to address any failure of an authorised firm to comply with the FSA's rules on remuneration policies, as set out in the FSA's Remuneration Code.[18]

The inference to be drawn from these measures, and from scrutiny of the FSA's Remuneration Code, is that Government policy in modifying the remuneration practices of the UK banking sector is increasingly sophisticated following the financial crisis, perceiving certain forms of remuneration as undesirable, and looking towards sustainable remuneration in the context of effectively managing risks.

Such sophistication is arguably absent from the draft legislation on BPT. The draft legislation on BPT does not distinguish between the nature of the risks and performance being remunerated. While BPT is not designed to seek reparation for the costs of the financial crisis, it fits uneasily into a suite of regulatory legislation which actively attempts to orientate remuneration policy within that sector towards goals which are perceived by the Government to be economically beneficial.

In this regard, a reasonable criticism of BPT might be that it falls between two stools. When set beside the detailed regulatory provisions and rules governing remuneration policies and arrangements in the banking sector, concerns are inevitable regarding how smoothly BPT augments a coherent Governmental response to the financial crisis.

Legislative process concerns

Aside from policy considerations, some of the unease with BPT originates from the *de facto* application of the tax, despite only being in draft form and despite remaining subject to scrutiny and enactment by Parliament. Given the perceived need to deter the substantial bonuses in the UK banking sector that are usually paid on or around the end of the calendar year, this was probably understandable. The notion, however, of an executive being able to influence important economic behaviour in this way without the approval of the legislature is unattractive. Furthermore, unless a truncated Finance Bill is to be placed before Parliament before the UK general election in 2010, the introduction of the final form legislation on BPT will follow the end of the chargeable period of the tax on 5 April 2010.

Some of these concerns would be ameliorated were it evident that BPT was in final form when announced in the pre-Budget report. However, it is clear from their announcements on 18 December that HMRC was reacting to a number of representations from industry groups and tax practitioners to the application of the legislation in complex or unforeseen situations.

The acknowledgement of HMRC that 'the original definition of a bank did not effectively exclude all the groups we intended to exclude' is welcome and refreshingly honest, but less than optimal in legislation that was intended to modify behaviour of the UK banking sector at each point in the chargeable period from 12.30pm on 9 December 2009 to 5 April 2010.

Refinements in complex taxing statutes are not unusual, but there remains the suggestion with BPT that fundamental elements of the tax are either not set in stone or are malleable depending on special unforeseen circumstances. An example would be the cryptic statement by HMRC of the possibility of extending the legislation to employees of partnerships (where a partnership and not a corporate financial institution carries out banking activities).[19]

Deprived of Parliamentary scrutiny and legislative process, the chargeable period of BPT will have ended without the subjects of the tax, the financial institutions concerned, being certain of the parameters of their liability. It is believed that this uncertainty might, at least as much as any desire to mitigate the taxation liability under BPT, be responsible for both the unease in the banking sector and the rumours of banking operations being migrated to other jurisdictions.

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Endnotes

1. All paragraph references in this article are to the draft legislation on BPT contained in Chapter 2 of 'HMRC Bank Payroll Tax: Technical Note, Draft Legislation and Explanatory Notes' (published 9 December 2009) ('HMRC Technical Note'). The quotation is located in chapter 1, paragraph 2 of the Technical Note.
2. HMRC Technical Note, chapter 1.
3. BPT has been estimated as raising only £550m, compared with the £1bn increase each month resulting from the increase in the rate of UK VAT to 17.5%.
4. Paragraph 14 states that the chargeable period closes on 5 April 2010 ('ending with 5 April 2010'). No specific time is given, although midnight on 5 April 2010 seems logical.
5. One of the oddities of BPT is that the Bank of England, as a 'taxable company' is not prevented from being subject to BPT. The situation was different in respect of the special tax on banking deposits introduced in 1981, where the Bank of England was exempt from the special tax (s134(5) Finance Act 1981).
6. Paragraph 2 of the note entitled 'The bank payroll tax announced at PBR 2009', published on the HMRC website on 18 December 2009.
7. A 'full scope BIPRU 730K investment firm' holds a base capital of €730,000, carries on activities effectively consisting wholly or mainly of 'regulated activities' and which regularly deal on their own account or underwrite issues of financial instruments on a firm commitment basis characteristic of investment banks.
8. In addition, the HMRC Q&As provided additional comfort to third party fund managers within a banking group that dealing and arranging deals as agent as part of the discretionary management of assets of external clients would not be an activity which, by itself, results in an individual carrying on a 'banking employment' (see HMRC Q&A 23 and also below).
9. HMRC Q&A 7.
10. HMRC Q&A 8.
11. See para 8(b)(ii) and the revised legislative scope at HMRC Q&A 27. 'Tax year' is defined as beginning on 6 April and ending the following 5 April (para 25(1) and s989 Income Tax Act 2007).
12. The increase of the highest rate of income tax to 50% after 6 April 2010 is an incremental disadvantage for institutions, and employees, considering mitigating BPT through bonus deferral.
13. Developed from judgment in *Rewe Zentrale AG v Bundesmonopolverwaltung für Branntwein* (Case 120/78), perhaps better known as the *Cassis de Dijon* case, under which a restrictive national measure might be acceptable if, inter alia, it protects a legitimate public interest and is proportionate in any restriction.
14. 'Reforming Financial Services', Chapter 3 of the pre-Budget report and paragraphs 2 and 3 of Chapter 1 of the Technical Note.
15. 'The Turner Review: A Regulatory Response to the Global Financial Crisis' (March 2009, pp79-81).
16. Section 9(2)((b) Financial Services Bill 2010. By contrast, the draft legislation on BPT requires a report of all bonuses over £25,000 in the chargeable period (irrespective of whether BPT applies to them), but the requirement seems to fall short of the proposed requirements regarding executive's remuneration reports in s9 of the Financial Services Bill 2010.
17. Section 11 Financial Services Bill 2010, introducing new s139A of the FSMA 2000.
18. The FSA Remuneration Code applies to 26 large banks and broker dealers and came into force on 1 January 2010.
19. HMRC Technical Note page 5. The reference is particularly surprising owing to the usual structuring precaution of ensuring that individual partners are not employees in order to prevent them falling inadvertently into the restricted securities legislation in Chapter 2 of part 7 of ITEPA 2003.