Consultation On Strengthening The Code Of Practice On Taxation For Banks

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Background

On May 31, 2013, HMRC published a consultation document entitled "Strengthening the Code of Practice on Taxation for Banks," with a closing date for comments of August 16, 2013 (the **"Consultation Document"**).

The Code of Practice for Taxation of Banks (the **"Code"**) was introduced in 2009 with the objective of changing "*the attitudes and behavior of banks towards avoidance given their unique position as potential users, promoters and funders of tax avoidance.*" Banks (including building societies and organizations providing banking services operating in the UK) were asked to sign up to the Code on a voluntary basis, although it was only by the end of November 2010 that the designated "top 15" banks had adopted it. The Code has been adopted by 262 banks to date.

The Code sets out an expected approach with regard to banks' governance, tax planning and engagement with HMRC. As an overarching principle (set out in the opening paragraph of the Code), banks should "*comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament.*"

In turn, banks should:

- adopt adequate governance to control the types of transactions entered into;
- refrain from tax planning that aims to achieve a tax result that is contrary to the intentions of Parliament;
- comply fully with all tax obligations; and
- maintain a transparent relationship with HMRC.

Since its inception, despite the fact that a large number of institutions have signed up to it, the Code has been the subject of varying degrees of criticism, primarily on the grounds that it contributes to an erosion of the rule of law: those subject to the Code are required to discern Parliament's intention (without any real guidance on how to do so) and are expected to adhere to "obligations" on a non-legislative basis, notwithstanding that it is a fundamental constitutional principle that governmental authority should be exercised pursuant to clear and freely accessible written legislation, adopted and enforced in accordance with due process.

Nevertheless, HMRC's view – as stated in the Consultation Document – is that thanks to the Code, "*HMRC has seen a positive response by banks in relation to their tax planning and transparency*" and that the Code has been a "*significant factor*" in changing the attitudes of banks towards tax avoidance.

The Consultation Document

HMRC states in the Consultation Document that it considers the Code to be "*generally operating well,*" but two main issues have been identified:

- The Code lacks "*public transparency*" and
- There are no obvious downsides for banks from not adopting the Code and no codified consequences for non-compliance.

The Consultation Document does not contain any proposals to alter the content of the Code, but puts forward the following measures to address the points above:

- a requirement for any "bank" (meaning any entity that is chargeable to the bank levy) that wishes to be subject to the Code to unconditionally confirm or re-confirm their commitment, in writing and on an unconditional basis, to the "obligations" set out in the Code before the 2013 Autumn Statement;
- the publication by HMRC at Autumn Statement 2013 of a list of all banks that have newly adopted or re-adopted the Code; and
- from 2015 onwards, the publication of an annual report on the operation of the Code, which may include the naming of any bank that, in HMRC's opinion, is not complying with the Code.

Legislation enacting the above is to be included in Finance Bill 2014.

HMRC is keen to stress in the Consultation Document that the Code will remain "voluntary." There is evidently an expectation on HMRC's part that all institutions within the scope of the Code will affirm or re-affirm their commitment to it, as HMRC apparently sees no circularity in the argument that the Code remains "voluntary" despite the proposal to "name and shame" (and potentially cause significant reputational damage to) non-compliant banks.

On the proposal to name non-compliant banks, the Consultation Document announces the following:

- Whether actions will be considered compliant (or not) with the Code will depend on "*the nature or severity of the actions undertaken and be assessed on a case by case basis.*" A single transaction within the scope of the General Anti Abuse Rule (or "GAAR") may, on its own, be sufficient to lead to a conclusion of non-compliance with the Code, or a pattern of behavior may lead to such a conclusion.
- An assessment as to whether a bank is compliant with the Code may be reached by looking at transactions undertaken by a bank before Autumn Statement 2013 (where that bank had previously adopted the Code) as well as after. However, in deciding whether to name a bank that is not complying with the Code, HMRC will only look at actions undertaken after re-adoption or adoption at or after Autumn Statement 2013.
- HMRC will follow the communication and escalation procedures set out in its "Governance

Protocol" on compliance with the Code of Practice on Taxation for Banks (published on March 26, 2012) in forming the decision to name a non-compliant bank. HMRC concedes that it will need to "*set out much more explicitly*" how this will apply in practice, but it also acknowledges that a conclusion that a bank is non-compliant will not automatically lead to the bank being named as non-compliant: the naming of a non-compliant bank will be a discretionary power rather than a mandatory requirement.

- Three Commissioners will make the initial assessment of whether a bank is complying with its Code commitments, but the Tax Assurance Commissioner will have the ultimate decision on whether or not to publish the name of a non-compliant bank in the annual report.
- The Consultation Document alludes to the fact that banks will be given the opportunity to respond to HMRC's conclusions of non-compliance with the Code before the naming of the bank is made public. So, if following HMRC's communication to a bank's board of its opinion that the bank is not complying with the Code, the bank takes actions that convince HMRC that the bank is committed to complying with the Code in the future, HMRC may decide not to name that bank where "*no further purpose would be served by publicly naming that bank.*"
- Finally, HMRC accepts that banks will have "*the normal rights of legal recourse in relation to any decision by HMRC to publish the bank's name, for instance through Judicial Review,*" but crucially, there will be no statutory right of appeal against HMRC's decision to name a bank which it deems to be non-compliant – because the Code will remain "voluntary."

Reaction

The prospective "naming and shaming" of banks which, "*in HMRC's opinion,*" are not complying with the Code has done little to ease concerns about the constitutionality of the Code.

It should be noted that HMRC has incorporated elements of procedural fairness into the "strengthened" Code – for example, the process requiring deliberation by three Commissioners and a final decision by the Tax Assurance Commissioner before publicly naming a non-compliant bank, the apparent ability to discuss informally with HMRC and take corrective action before the decision to "name and shame" is made public, and the requirement for HMRC to have regard to any guidance that it has published on the Code as well as to its "Governance Protocol" in deciding to name a non-compliant bank.

However, the fact that there is no formal right of appeal against HMRC's conclusion that a bank is non-compliant with the Code, when that conclusion is itself an expression of HMRC's *opinion*, is obviously problematic. The prospect of HMRC acting as "judge, jury and executioner," without any statutory foundation or independent checks and balances (for example, an independent body providing an oversight function like the GAAR Advisory Panel) – and quite possibly before any judicial

determination of the correct tax treatment of a given transaction – is, for many, a troubling development.

Whilst HMRC considers that judicial review may be available in the event of abuse of its discretion to name a non-compliant bank, this radically underplays the complexity and expense of the judicial review process. Furthermore, HMRC has indicated that a claim of defamation may be brought in the case of the wrongful "naming and shaming" of a bank, but again this ignores to a large extent the reality of a defamation claim: firstly, there may be difficulties for a bank in establishing the exact quantum of its loss and, secondly, HMRC may have defences against such claims in some cases (for example, qualified privilege).

So, although the Code itself may be said to have worthy aspirations, such as improving the relationship between banks and HMRC and aligning tax planning more closely with genuine commercial activity, it would not be surprising if the proposed "strengthening" of the Code, as set out in the Consultation Document, were to leave institutions within its scope questioning whether (re-)committing to the Code actually serves their best interests.