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UK Government to Strengthen Code of Practice on Taxation for Banks

On October 11, 2013, the U.K. Government announced three key changes to the Code of Practice on Taxation for Banks (the Code):

- A bank that breaches the Code could be publicly named. However, before concluding whether there is a breach, HM Revenue & Customs (HMRC) must take into account the advice of a new independent reviewer who will consider any potential breaches;
- A bank that enters into a transaction falling within the scope of the recent General Anti-Abuse Rule (GAAR) will be considered in automatic breach of the Code, and could be publicly named; and
- There will be more regular reporting from HMRC on banks' compliance with the Code, including the publication at Autumn Statement 2013 of banks that have newly adopted or re-adopted the strengthened Code. From 2015, HMRC will also publish an annual report on how the Code is operating, which will include names of banks that have breached the Code.

Draft legislation to implement these changes will be included in Finance Bill 2014.

Background

The U.K. government introduced the Code in December 2009 to encourage banks operating in the U.K. to follow the spirit, as well as the letter, of U.K. tax law. Currently, banks that adopt the Code agree to:

- Adopt adequate governance to control the types of transactions they enter into;
- Not undertake tax planning that aims to achieve a tax result that is contrary to the intentions of the U.K. Parliament (this includes an agreement not to engage in tax planning other than that which supports genuine commercial activity); and
- Comply fully with all their tax obligations and maintain a transparent relationship with HMRC.

Adoption of the Code is voluntary (although most commercial and investment banks have agreed to adopt it) and there are no sanctions that can be brought against banks that do not adopt or breach it. To deal with this, HMRC issued on May 31, 2013, a consultation document containing proposals to strengthen the Code. The consultation closed on August 16, 2013, and the U.K. government's announcement is made in light of the responses received.

Observations

Many of the key proposals from May's consultation have survived. Of particular concern is the potential naming of banks that are found to be non-compliant with the Code, which raises serious and legitimate concerns relating to taxpayer confidentiality. However, there are some positive changes to this proposal. HMRC will have to take into account the advice of an independent reviewer (to whom the bank can make

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representations) before concluding whether a bank has breached the Code. HMRC still has the final decision to name a bank as non-compliant, although where it does not agree with the views of the independent reviewer, HMRC must give an explanation of its reasoning to both the bank and the public if it names the bank. Further, HMRC must give a bank at least 30 days' notice of its intention to publish a report naming the bank as non-compliant — this is to allow the bank the opportunity to apply for an injunction preventing HMRC from naming the bank if the bank believes that HMRC has acted unreasonably. If HMRC has disagreed with the views of the independent reviewer, the burden of proof in any such legal action will rest on HMRC to establish that it is acting reasonably.

May's consultation also included the proposal that if HMRC took the view that a transaction was subject to the GAAR and referred the transaction to the GAAR Advisory Panel, the bank could be publicly named as in being breach of the Code. This was concerning, as if a bank entered into a transaction that was referred to the GAAR Advisory Panel by HMRC but was ultimately not subject to the GAAR, it could still be named as being non-compliant with the Code. It has now been confirmed that to trigger the possible naming of the bank as non-compliant in these circumstances, the GAAR Advisory Panel must have issued an opinion that favours the application of the GAAR, and HMRC must have issued a notice that the tax advantage must be counteracted. However, this still means that a bank could be named as non-compliant, even where it is disputing the application of the GAAR in subsequent legal proceedings.

In any event, this proposal could cause banks to take a highly conservative approach to a transaction where there is a risk that it could be caught by the GAAR, as in addition to being subject to GAAR adjustments, the bank could also be subject to the reputational and commercial consequences of negative media and public attention.

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