Tax Representation

TAX FACULTY

TAXREP 50/09

A Code of Practice on Taxation for Banks

Memorandum submitted on 25 September 2009 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation document published on 29 June by HM Revenue & Customs.

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A Code of Practice on Taxation for Banks

INTRODUCTION

1. We welcome the opportunity to respond to the Consultation Document *A Code of Practice on Taxation for Banks* (referred to below as the Code), published on 29 June 2009. The Consultation Document is available at http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_029639 .

2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system are summarised at Annex B.

GENERAL PRINCIPLES

Background

3. We note that Code proposes to adopt an entirely different approach to addressing tax motivated behaviour that the Government wishes to discourage than that which has been hitherto adopted in the UK. The approach adopted is to influence behaviour 'that reflects a shared sense of fair dealing' (see speech by Stephen Timms reported on 21 September 2009) by means of a non-statutory Code. In other words, the Government seeks to influence the operations of Banks in respect of what is considered to be aggressive tax planning and to seek to raise awareness at board level of this issue.

4. We also note that the role of Banks in tax planning is something that has been under consideration at an international level for some time. The 2008 OECD report into the role of tax intermediaries made specific reference to banks and that further work was needed to understand the part it played in tax planning. Since this consultation document was published, the OCED has published (on 13 July 2009) a further report *Building transparent tax compliance by banks*. No doubt the UK approach as set out in the proposed Code has been informed by the thinking and developments that have taken place at the OECD.

5. As chartered accountants, we wholeheartedly support improvements in transparency and a commitment to open and honest dialogue. To that extent, therefore, we understand the Government's intentions. Nevertheless, we have serious reservations about the specific approach that has been adopted which are outlined further below.

Codes of practice

6. In a world of constant change, it is entirely reasonable to set out some underlying principles which seek to inform the standards and behaviours of all those involved in the tax system, including not just taxpayers and tax advisers but Treasury and Revenue officials and those who formulate tax policy. Once established these principles need to be subject to an effective process of review and updating.

7. Such proposals have been suggested in the past, for example in the 2005 ICAEW Tax Faculty Hardman lecture (*If the trust gap widens can the tax gap be narrowed?)* presented by Loughlin Hickey, Global Head of Tax at KPMG, said:

> 'The strategic policy and the process for the drafting of the consequent tax law, including the consultative process, need to be published alongside principles and guidelines against which the tax law can be judged.
>
> There should be formal business representations at the strategic tax policy level in HM Treasury. Communication about controls on the expenditure side would also assist in stimulating taxpayer compliance.
>
> There should be a voluntary code of conduct focussed around behaviours to help set the environment for trust. The conduct could regulate the behaviour of taxpayers, tax collectors and tax advisers and could be devised and regulated by that group.
>
> There should be a forum for training together all of those involved in tax in both the public and private sector where technical and business skills (including business ethics) could be taught.'

The 'spirit of the law' and the 'intentions of Parliament'

8. We set out in our response, TAXREP 48/09, to the earlier consultation document *Working with tax agents* our views on the differences between tax avoidance and evasion. The comments are reproduced in Annex C to the current paper.

9. However, the draft Code proposes that in determining the appropriate behaviours the Banks should comply with 'the spirit as well as the letter of the law' (paragraph 3.6).

10. This is a difficult area, given that tax is levied in accordance with the law as interpreted by the courts rather than the executive. Nevertheless, the courts have increasingly moved towards interpreting the law purposively, in other words that the court in reaching its decision should reflect what Parliament can reasonably have intended when introducing a particular piece of legislation.

11. Loughlin Hickey in his 2005 Hardman lecture also quoted from Lord Hoffman's 2004 Ray Goode lecture in which Lord Hoffman underlined the supremacy of Parliament in formulating the law and stressed the role of the courts as the arbiter of what that law means in practice i.e. the intentions of Parliament:

> 'The only way in which Parliament can express an intention to impose a tax is by a statute which means that such a tax is to be imposed. If that is what Parliament means, the courts should be trusted to give effect to its intention. Any other approach will lead us into dangerous and unpredictable territory.'

12. On this interpretation of the 'intentions of Parliament', section 3 of the Code states that banks must only engage in tax planning which 'supports genuine commercial activity' and does not give a tax result which is 'contrary to the intentions of Parliament'. However, it is not always easy to discern what that intention is, as was highlighted in the House of Lords decision in *BMBF v Mawson* [2004] UKHL 51.

13. We understand that the aim is for the 'intentions of Parliament' to be interpreted as the intention if Parliament was asked now. We are concerned that on this basis, too much power is being given to HMRC to determine what Parliament may, or may not, have intended. While it is reasonable for HMRC to have its own views, there is a danger that the Code gives considerable scope to HMRC to substitute its own view of what Parliament may have intended. The interpretation of the meaning of the law should be a matter for the courts, and subject to a transparent appeals process, not a matter for officials to decide in consultation with Ministers. We think Parliament should, and would want, to retain oversight of the Code and the way it is implemented and developed so as to ensure that it does not usurp the role properly attributable to Parliament, and the interpretive role of the courts.

14. We are also concerned that although the Code was put out for consultation it is looking unlikely that any of the wording will be significantly changed and instead there will be a fall-back onto guidance to try and clarify the meaning of the Code. This does not appear to us to be a productive way to arrive at a pragmatic Code and is likely to lead to interpretation problems as the guidance and Code may well end up saying slightly different things. We are concerned that disagreements about the meaning of the Code may have no obvious route to resolution, creating confusion and delays that may be commercially sensitive.

Will it work?

15. As noted above, we understand the rationale for the proposed approach but are concerned as to whether it will work.

16. The Code is voluntary, although we understand it is expected that Banks who signed up to receiving taxpayer support will be required to sign up to the Code. We do not know whether most other banks will sign up to it, but would expect those with significant offshore operations to be less willing to sign up to the Code, especially those who are used to operating a system of formal rulings with fiscal authorities to settle disagreements about particular circumstances.

17. We are concerned that the Code may merely drive those who wish to engage in the activity that the Government is trying to discourage towards those who do not sign up to the Code. This might both defeat its object and drive a range of bone fide banking services offshore, thus making the UK less competitive. Whilst the proposal ***may*** (our emphasis) make it easier to identify those taxpayers and Banks who wish to engage in such activity, in practice we suspect that little extra intelligence will be gained over and above that which is known already to HMRC.

18. Banks may choose for a variety of reasons not to sign up to the Code but that will not automatically mean they are engaging in the types of behaviour the Code is targeting. It would be a waste of taxpayers' money if HMRC then put resources into targeting them as high risk when a proper risk analysis showed that the opposite was true. HMRC will need to adopt a pragmatic and flexible approach to dealing with those who do not sign up based on all of the evidence at its disposal.

19. The effect of the Code will need to be monitored closely and there should be regular independent reports on its effectiveness as compared to compliance costs and the effect on UK competitiveness. The Impact Assessment states that it will be reviewed after the first year. If the Code is introduced, we suggest that it is reviewed on an annual basis.

The future

20. As noted above, the effect of the Code will need to be monitored closely and there should be regular independent reports on its effectiveness as compared to compliance costs and the effect on UK competitiveness.

21. Whilst the principles of transparency and openness are of course ones to which we emphatically subscribe and which should be encouraged, we do not think that the Code is a suitable model for more general application. If the Government believes that further measures are necessary across the wider taxpaying community, we would be happy to discuss the advantages and disadvantages of other possible approaches to addressing this issue.

DETAILED COMMENTS

Guidance

22. At the time of finalising this draft we have been sent a copy of the draft guidance, which we understand was discussed earlier with the Banks although not with professional bodies or other interested parties. We have not yet had the opportunity to consider the draft guidance in detail. We welcome the opportunity to consider and comment upon the guidance before it is finalised.

Enforcement

23. Paragraphs 4.7 to 4.12 deal with enforcement of the voluntary Code of Practice.

24. Paragraph 4.8 states:

'Where non-compliance is found to be deliberate and the officer of the bank who signed up to the Code is a member of a professional body, HMRC will consider making a report to that body. We welcome views on this approach to enforcement.'

25. We do not believe that reporting, for example, a member of the ICAEW to the ICAEW disciplinary board is likely to be very practical way to enforce the Code.

26. Let us presume that the Code of Practice was put in place as currently envisaged. In due course HMRC reports an ICAEW member as the signatory to a document whereby XYZ Bank has signed up to the Code and is believed by HMRC to be in departure from it.

27. The first problem is that in the absence of an admission by the Bank concerned that it had transgressed the Code, who is to determine whether the Code has been departed from? In the absence of a clear disciplinary issue it would not be possible to use the normal channels.

28. Moving the example on, let us presume that there had been an admission by the bank (either expressed or tacit) of a breach of the Code or that the facts are unequivocal. We then come to the principle of remoteness. Unless the member had personally been given special responsibility by the bank to police observance of the Code, he or she can plead that the signature was given in good faith but it was the bank's responsibility to introduce and police systems to ensure compliance. The fact that unbeknownst to him or her, elsewhere in the

organisation someone had departed from the Code did not bring discredit on him or her personally.

29. If the individual had been given special responsibility for policing the Code, then the disciplinary route might be easier to follow but if he or she had not been disciplined by his employers it might be difficult to establish that he or she had discharged the duties of employment incompetently or inefficiently to such an extent or on such a number of occasions as to bring discredit on him or her, the Institute or the profession of accountancy, which is the criterion within the Disciplinary byelaws which must be satisfied for misconduct to be proved.

Appendix 1 – the draft Code of Practice on Taxation for Banks

30. We note that the heading is The Code of Practice on taxation. If the Code is intended solely for the Banks then the title should clearly reflect that fact.

Tax Planning

31. There is currently uncertainty about the meaning of paragraphs 3.1 and 3.2.

32. The natural reading of paragraph 3.1 (acting as principal) would appear to relate to the Banks' own tax affairs whereas paragraph 3.2 (providing or facilitating transactions undertaken by other parties) would appear to be in relation to customers. But we understand from informal discussions that is not the case.

33. Paragraph 3.1 may be read as acting as principal by making a loan to a customer; and on this basis the same criteria have to be applied to the customer's tax affairs by the Bank as to their own. In practical terms this does not appear to us to be practicable and we understand discussions are ongoing to at least restrict this interpretation to cases where the Bank is providing some form of tailored rather than off the peg service and hence where the Bank might reasonably be expected to have some better knowledge of what the customer is doing.

Relationship between the Bank and HMRC

34. The relationship that is described in section 4 is very much like that which is being put in place following the Varney Review and the Links with Large Business and also reflect the 'good practice' recommendations in the OECD report of June 2009 Building Transparent Tax Compliance by Banks.

35. We do note that there is a requirement in paragraph 4.2 that 'where the bank believes its proposed transaction may be contrary to the intentions of Parliament' then the bank is required to 'explain its plans in advance with HMRC'.

36. To the extent that the particular plans would match a hallmark under the Disclosure of Tax Avoidance Schemes (DOTAS) then the banking Code of Practice would require the transactions to be reported before it takes place whereas under DOTAS the disclosure is only required within 5 days of the scheme details being made available to the taxpayer by the promoter. In the absence of a promoter notification is generally required within 30 days of the relevant transactions being entered into.

37. In effect, this aspect of the Code could be seen as enhancing further the principle of transparency and an extension of the existing DOTAS rules as they apply to

Banks. If disclosure is made at an earlier stage under the Code, then we think it would be reasonable to provide that any such disclosure would satisfy any requirements required under the DOTAS provisions. We therefore question whether amending the DOTAS legislation might not be a better and more certain way of dealing with HMRC's evident desire for more timely information.

DETAILED QUESTIONS

What questions are likely to arise in introducing and complying with the Code and how can these issues be overcome? (3.4)

38. As we have highlighted above, the biggest difficulty would appear to be for the Banks to be able to discern what might be the 'intention of Parliament' in relation to the tax implications of any proposed future course of action by the Banks. Although it is recommended that in cases of doubt the Banks will need to consider the implications with their appointed CRM, what happens when the CRM does not know (and as the role is one of ringmaster rather than technical specialist, this seems likely to be the norm), or cannot give an answer within a commercial timeframe?

How can uncertainties about tax issues be resolved? (3.5)

39. As in the previous paragraph we believe that some uncertainties can be resolved in discussion with the particular Bank's CRM but it is likely that there could be very different opinions available and it is important to the perception of fair dealing openly espoused by Stephen Timms (above) that a Bank is not penalised for taking a reasonable view even if that differs from the CRM or HMRC in general. Using previous case law as examples, there are many situations when the courts have disagreed with the HMRC view:

What support should banks expect from HMRC to help them implement and abide by the Code? (3.22)

40. The guidance must provide greater clarity about the meaning of parts of the Code of Practice where there is any uncertainty. We will be commenting on the draft guidance in due course. Well chosen guidance will aid a better understanding of the Code of Practice.

What other sanctions should be considered where non-compliance is found to be deliberate? (4.8)

41. We would be very surprised if Banks, having signed up to what is a voluntary Code of Practice, then deliberately did not abide by its terms. For the reasons we have set out above, we are not convinced that reporting Bank officials to their professional body is a workable proposition in that it will not discourage what may be considered undesirable behaviour as the professional bodies will not be able to apply any form of sanctions.

What do banks think the administrative costs of complying with the Code will be both initially and going forward? (4.9)

42. We are not in a position to answer this question. We presume that the Banks which respond to the consultation will provide estimates of the costs that they believe they will incur in complying with the Code of Practice.

How should the public and Parliament be updated on compliance with the Code? (4.11)

43. We believe that there should be a specific account each year on the working of the Code of Practice with recommendations for any changes or improvements. This could be incorporated in the Annual HMRC report or in a separate joint or independent review.

We welcome comments on the assumptions in the Impact Assessment? (4.12)

44. The two key assumptions of the Impact Assessment are that its impact on tax receipts cannot be predicted and that in relation to costings 'no special mechanism is required to indicate adoption of the Code'. This statement is disappointing. Without details of any predicted revenues and associated costs, the assessment adds little if anything to the information already provided in the consultation document. We would be very surprised if Banks do not have to incur costs in order to implement the Code as inevitably compliance will involve changes to monitoring and reporting procedures and processes even if a Bank is already operating within the terms of the Code. Much more work is needed, in consultation with the Banks, to determine the likely costs that Banks will incur to comply with the Code.

IKY/FJH
23 September 2009

ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.

4. To find our more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

ANNEX B

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see http://www.icaew.co.uk/index.cfm?route=128518.

ANNEX C

Extract from TAXREP 48/09 Working with tax agents

Acceptable and unacceptable tax avoidance

30. Taxpayers have the right to organise their affairs to minimise legitimately their tax liabilities. For many years the tax profession, taxpayers and the tax authority have struggled with drawing clear lines about what is acceptable tax planning and what is not, especially in cases where the primary legislation is open to interpretation. There is no accepted definition of tax avoidance. The ICAEW's professional conduct rules do advise members to be cautious in recommending any tax avoidance schemes to clients. However, much will depend upon the particular taxpayer's appetite for risk and the specific facts of the case.

31. It is right that HMRC should ask Parliament to change rules that promote behaviours that it considers contrary to policy. We have stated consistently that the right approach to counter tax avoidance that is considered unacceptable is through targeted anti-avoidance legislation and perhaps some future help could be provided by using purposive legislation that is clear in its intent.

32. In recent years the Government introduced the Disclosure of Tax Avoidance Scheme (DOTAS) rules. These rules provide HMRC with an early warning of tax avoidance schemes and an opportunity to determine quickly if action is needed. We worked closely with HMRC to ensure that the disclosure rules work as intended but do not impose too great a burden on taxpayers. We believe that these rules have been successful and that they have helped to reduce the incidence of aggressive tax avoidance schemes. We have also offered help in the ongoing consultation on how to enhance the DOTAS rules and we believe that this route may provide a better solution to some of HMRC's concerns in this area.

Tax evasion

33. Tax evasion is illegal. It is contrary to the ICAEW's ethical principles and rules and our members should not become involved in it. If they do so, then they are likely to be subject to our disciplinary proceedings and if found guilty face punishment, which is likely to include a fine and exclusion from membership. We will support any reasonable steps taken to counter tax evasion. The ICAEW has 132,000 members (although the number engaged in practice is considerably lower at around 30,000) and it is entirely possible that a very small number of our members may knowingly become involved in evasion. We do not want such people as our members and we will support HMRC to help ensure that any such members are identified and dealt with appropriately. However, it is important to recognise that some members and firms may inadvertently become involved in assisting tax evasion. Where it is inadvertent, such members and firms may require help and assistance to make sure it does not recur rather than face possible disciplinary action.