HM Revenue & Customs

Strengthening the Code of Practice on Taxation for Banks

Summary of Responses
11 October 2013

Contents

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1. Introduction

The consultation process

At Budget 2013 the Government announced that, following consultation, legislation would be introduced in Finance Bill 2014 requiring HMRC to publish an annual report, beginning in 2015, on the operation of the Code of Practice for Taxation of Banks ("the Code").

The consultation formed Stages 2 and 3 of the Tax Consultation Framework.[1] In addition to the questions set out in the Consultation Document, a number of meetings have been held to raise awareness of the consultation proposals and to obtain views from a broad range of interested parties. HMRC ran two "Town Hall" open forum events which attracted approximately 80 attendees, undertook a number of bi-lateral meetings with representative bodies and banks, and participated in a number of externally organised events run by representative bodies and advisers.

The consultation focused on three main issues:

- the HMRC governance process around determining possible non-compliance with the Code,
- the nature of an annual report to be published by HMRC, and
- the processes and criteria by which a decision to name a bank as being non-compliant in the annual report will be made.

It also considered the timescale for banks to adopt or reaffirm their adoption of the Code on the basis of the strengthened features of the Code, and sought comments on the draft legislation giving effect to those features.

Thirty four written responses were received. HMRC would like to thank respondents for taking the time to submit these helpful responses, and for the input of business, representative bodies and advisers at the "Town Hall" events and at meetings set up to consider issues arising from the proposals.

The consultation ran for 11 weeks to allow HMRC time to consider the responses and publish this document as early as practicable to provide banks with as much time as possible to understand the final proposals before choosing whether to readopt or adopt the Code before Autumn Statement 2013.

[1] There are five stages to the development and implementation of tax policy. Stage 2 is determining the best option and developing a framework for implementation including detailed policy design; and stage 3 is drafting legislation to effect the proposed change. Full details are set out in the Government's "Tax Consultation Framework", available at: http://www.hmrc.gov.uk/consultations/tax-consultation-framework.pdf

In addition to summarising the responses received HMRC is also publishing today the amended draft legislation, to be introduced in Finance Bill 2014, and the revised HMRC Governance Protocol. **HMRC welcomes further comments on these documents** (see Chapter 3 “Next Steps”).

Eleven questions were asked as part of the consultation document and HMRC responses to these are set out in Chapter 2.

2. Responses

General responses on the Code

Although the consultation did not include any proposals on the content of the Code itself a substantial number of the respondents questioned the continuing need for the Code, given the improved behaviour of banks towards tax avoidance. Additionally, a small number of respondents suggested that the Government should consider extending the scope of the Code to other sectors, in particular the "shadow banking" sector.

The Government's response

The Government believes that the scope of the Code remains appropriate. Based on the evidence of how the Code has operated and from discussions with banks since its introduction, HMRC are of the opinion that the wording used and the concepts and behaviours required by the Code are generally well understood by banks and practitioners in practice. **The actions to strengthen the Code will ensure that the Code remains as effective as possible in the future.**

The requirement for unconditional adoption of the Code will:

- enable compliant banks to be certain that there is a level playing field in terms of the commitments entered into under the Code by those banks which have adopted the Code;
- ensure that there is full transparency where a bank that has adopted the Code does not comply with it; and
- provide full transparency around the banks which have chosen not to adopt.

HMRC will continue to assess the potential risks to the Exchequer of the activities of "bank like" entities not currently covered by the Code.

The following text summarises the responses to the questions posed in the consultation.

Q.1. We welcome respondents' views on whether requiring smaller banks to only adopt Section 1 of the Code remains a tenable approach under the strengthened Code?

The terms under which the Code was originally issued required smaller banks (including most Building Societies) to adopt only "Section 1" of the Code. It was felt that adoption of all sections of the Code by smaller banks would place an increased level of governance, and hence cost, on smaller banks which was disproportionate to the tax risk that they present.

The practical implementation of this was that those banks and building societies whose tax affairs are dealt with in the HMRC's Large and Complex offices in Local Compliance were treated as "smaller banks". They were asked to demonstrate to HMRC adequate governance and transparency but were not required to have a documented tax strategy: this was considered to be a proportionate approach to the nature and character of transactions such banks and building societies enter into.

Almost all respondents who commented on this question believed the position should not change under the strengthened Code.

> "*The current approach is sensible and practicable*"

The Government's response

Application of Code to smaller banks

The Government agrees that it is right to continue to ask smaller banks to apply an appropriate and proportionate level of governance, thereby limiting costs on such banks, which reflect the risks presented by their tax affairs. Therefore "**smaller banks" will be asked to continue to adopt the concepts contained in Section 1 of the Code only**.

This means that whilst smaller banks and building societies will be asked to adhere to all strands of the Code they will not be expected to have a fully documented tax strategy or need to introduce product approvals committees, unless the nature, size or complexity of products devised or transactions undertaken would warrant it.

Definition of smaller banks

As noted above, since the introduction of the Code, any bank or building society dealt with by Local Compliance (Large & Complex) was classed for Code purposes as a smaller bank.

HMRC feel that a more targeted definition of smaller banks and building societies is needed, taking into account a number of factors that HMRC already considers in its approach to risk within the Large Business Strategy; including size and risk.

HMRC will therefore slightly amend the definition of those entities classified as smaller banks. **From today a smaller bank will, for Code purposes, will be any bank that has not been allocated a Customer Relationship Manager (CRM**). All businesses in the Large Business Service (LBS) and the largest and most complex businesses in Local Compliance are allocated CRMs. Guidance on which customers should have a CRM can be found on the HMRC website at: http://www.hmrc.gov.uk/large-businesses/crm.htm.

Therefore those few entities within Local Compliance with a CRM that currently adopt only Section 1 of the Code will in future be required to adopt the Code in full. HMRC will contact these customers to inform them of this new requirement.

Some banks are subsidiaries of larger non-banking groups which are dealt with by Large Business Service, which would therefore have a CRM. The Government has considered representations made regarding these entities and these banking groups can adopt only Section 1 of the Code, unless, when viewed alone it (the bank or banking sub group) would itself meet the criteria to have a CRM. In those circumstances the bank would need to adopt the full Code. Again HMRC will contact these customers to inform them of this new requirement.

Q.2. Views are welcomed from respondents on the proposed timetable for adoption/re-adoption.

The Government set out at Budget 2013 that banks would be asked to re-adopt or adopt the Code by Autumn Statement 2013. HMRC held a large number of meetings during the consultation to raise awareness of the proposals for strengthening the Code with the aim of providing banks with sufficient information and allow banks adequate time to fully understand the proposals as they developed.

During these meetings most banks have said they were comfortable with the proposed timetable, however these banks preferred to discuss this issue in bi-laterals rather than send in formal responses.

A few respondents felt that further consultation was necessary and that adoption should be put back to Budget 2014. There were other requests to delay adoption for 3 or 4 months after the publication of the response document to allow any banks who wanted to have confirmation from HMRC whether they

are currently conducting their affairs in a way which could be viewed as a breach of the Code to receive a response and that the timetable should allow for such discussions to take place and be concluded.

The Government's response

The wording and commitments under the strengthened Code remain unchanged and HMRC's conversations with banks confirm that the concepts and behaviours required by the Code are generally well understood by banks and practitioners. As such, the Government feels that by publishing the final proposals contained in this document today, there is sufficient time for banks to consider whether to adopt or re-adopt the Code by Autumn Statement 2013,

Q.3. HMRC welcomes comments and views on the proposed approach set out to revise the Governance Protocol on Code compliance and whether the proposals provide the necessary assurance safeguards around the naming of non-compliant banks, and

Q.5. We also welcome views on whether any other enhancements should be considered at this time to the Governance Protocol.

The consultation set out that HMRC would introduce stronger governance processes around the Code, in particular incorporating an additional oversight role for the Tax Assurance Commissioner in the process of naming a bank as not complying with its Code commitments.

These questions were the main focus of responses received: both with regard to whether there was a breach of the Code; and in particular whether HMRC should subsequently name a bank as failing to meet its Code commitments.

These responses broadly fell into the following categories.

(i) External scrutiny

All respondents expressed varying degrees of concern that there were insufficient safeguards for banks in the proposed process, particularly given the potential reputational risks to a bank of being named in an HMRC report.

Some suggestions to address this issue were provided, and were mostly in terms of introducing a form of independent oversight into the "naming" process. Some respondents felt that incorporating something similar to the GAAR[2] Advisory Panel within the governance process should be considered with the suggested role for such a panel to be to accept or reject an HMRC decision

[2] General Anti Abuse Rule - Part 5 Section 206 Finance Act 2013

before publication of a bank in the annual report. Other responses suggested that, as there was no right of appeal, before the naming of a bank by HMRC a taxpayer should be able to make representations before an independent Tribunal judge or someone similarly qualified.

(ii) Voluntary nature of the Code

Most respondents felt the naming of a bank for being non compliant questioned the voluntary nature of the Code, with a small number of these respondents also drawing comparisons with the OECD[3] *Framework for a Voluntary Code of conduct for Banks and Revenue Bodies*[4]*,* suggesting that the proposals on the Code seemed to mark a move away from that framework.

(iii) Legal recourse

In response to early questions, HMRC set out that a bank would in all cases be able to seek a Judicial Review of any HMRC decision to name that bank as non-compliant. However, most respondents who commented on this issue felt that any Judicial Review would occur only after a bank had been named, and any reputational damage had already been done. Some respondents added that such a review would only look to see if HMRC correctly followed procedures, not whether HMRC's conclusion that a bank should be named was correct in itself.

Some respondents had more fundamental concerns about the interaction with the legal process, suggesting that the naming of non-compliant banks taken in advance of any litigation (if appropriate) and judgement by a court could impact on the legal process more widely.

(iv) Right of appeal

Notwithstanding the proposal that the Tax Assurance Commissioner would take the final decision on whether to name a bank as non-compliant, a number of respondents felt that the decision would have such fundamental reputational and commercial consequences for the bank in question that there should be a formal right of appeal against any decision by HMRC.

Some respondents developed this theme further, suggesting that the voluntary nature of the Code does not remove the requirement for a right of appeal, since this is a statutory measure which provides an exception to the statutory duty of confidentiality to the taxpayer.

[3] The Organisation for Economic Co-operation and Development

[4] http://www.oecd.org/tax/administration/45989171.pdf

In a joint response the banking and building societies representative bodies[5] summarised their concerns on this point as follows;

> *If the proposal to 'name and shame' is not withdrawn, it is vital that there be both an independent assessment of any decision by HMRC that an institution is not complying with the Code or should be publicly named as such, and a proper appeals process. An independent review and a proper appeals process are required to maintain the rule of law and the integrity of the tax system, thereby ensuring the continued attractiveness of the UK for inward investors and also managing the risk that serious damage could be wrongfully caused.*

(v) Role of HMRC

A number of respondents felt that the proposals placed HMRC in the position of final arbiter in imposing a potentially serious reputational penalty and that this was inconsistent with HMRC's role in the tax system. Some respondents felt that the proposals created the potential for reputational damage to be caused to a bank or building society simply because HMRC considered that transactions had been undertaken which resulted in an application of existing tax law that was in HMRC's view inconsistent with the 'intentions of Parliament'. This could be the case even where it is ultimately shown that the transactions were not abusive as the GAAR did not apply to them.

A few respondents felt that prior to naming of a bank as non-compliant HMRC should also consult the Prudential Regulatory Authority and Financial Conduct Authority, as there could be circumstances in which such an action could undermine the stability of the bank in question or even the broader financial system.

The Government's response

External Scrutiny

The Government acknowledges the concerns raised about the lack of independent scrutiny, and has introduced a role for an "Independent Reviewer" within the decision making process. Before deciding whether a bank has breached the Code and, if so, whether they should be named within HMRC's annual report HMRC Commissioners will be required to consider the advice of the "Independent Reviewer", who will be an independent person of appropriate standing. The Government believes this will provide a significant safeguard to banks.

[5] British Bankers Association, Building Societies Association and Association of Foreign Banks.

To reinforce this safeguard, however, the Government has introduced a statutory requirement for HMRC Commissioners, where their decision does not accord with the views of the Independent Reviewer, to set out to the bank the reasons why they have reached a different view and also to set those reasons out in the annual report.

The Governance Protocol and draft legislation published today sets out the role of the Independent Reviewer.

The revised Protocol sets out:

- how the HMRC governance process will operate taking into account the roles of the HMRC Tax Disputes Resolution Board (TDRB) an appointed "Independent Reviewer" and the HMRC Commissioners;
- indicative timelines for banks to make representations;
- a bank's ability to make representations to both HMRC and to the "Independent Reviewer" as part of the decision making process; and
- matters that HMRC Commissioners will need to, and may, consider when making a decision whether to name a bank as non-compliant.

Voluntary nature of the Code

The Code remains voluntary, and it will remain a decision for each bank whether or not to adopt. However, publication of the banks which have adopted should provide those banks with a reputational upside as a result of the additional transparency surrounding the Code. The Government is affording banks reputational benefits; in that they will be able to point to their names in HMRC's initial report on the operation of the Code as having adopted the commitments. Additionally the bank will be able to highlight the lack of 'naming' in later reports as being a clear indicator of their continued compliance with their Code commitments. Introducing consequences for not complying with the Code ensures that other banks can be reassured that there will be full transparency where competitors are not adhering to their Code commitments.

The OECD paper referred to on page 9 above discusses a framework for transparency and open relationships between large business and tax authorities. The Government believes the Code continues to fit with these principles. Transactions that have been entered into will continue to be taxed in accordance with the law unless the bank amends their return to negate the tax advantage and the Code remains voluntary.

Legal recourse

As noted above, an "Independent Reviewer" has been introduced into the governance process to ensure that an external party considers representations from both HMRC and the bank before a bank is named.

The “Independent Reviewer” would not only consider whether or not HMRC followed the correct procedures, but also whether in their opinion a bank has not complied with its commitments under the Code.

In addition, the Government is introducing a legal requirement that HMRC cannot publish a report naming a bank as breaching the Code less than 30 days after the bank has been notified of the decision by HMRC Commissioners. This will give the bank an opportunity to consider bringing legal proceedings seeking an injunction preventing Commissioners from naming in any case where they believe HMRC has acted unreasonably.

The Government has also specified in the draft legislation that the burden of proof in any legal action where the bank is named will rest with HMRC to demonstrate that their conclusion is reasonable in any case where HMRC Commissioners have reached a different conclusion to the “Independent Reviewer”.

Right of appeal and Role of HMRC

The Code is about a bank’s behaviours, so it follows that any decision on whether a bank should be named as not complying with its Code obligations should be made close to the events. The inclusion of a formal appeals process could mean a decision would not be published until years after the event and would be counter to the behavioural change objectives of the Code.

The revised protocol will give a bank a series of opportunities to make representations to HMRC and one to an “Independent Reviewer” before any decision is made that they should be named; therefore there will be in effect an inbuilt appeals process.

The Government considers that it is right that HMRC Commissioners remain the final arbiter under the Protocol on whether a bank has breached its commitments to HMRC under the Code

The Government believes that the additional safeguards – introduction of the ‘Independent Reviewer’ role and the opportunity to commence legal proceedings before the naming of a bank in the annual report – should provide assurance to banks that any decision to name a bank will be subject to appropriate levels of external scrutiny.

Q.4. Do these proposals offer sufficient transparency for the public around how the rules will operate?

Since the introduction of the Code, HMRC has seen a positive response by banks in relation to their tax planning and transparency in their relationship with HMRC. However, as set out in the consultation document, the Code lacks public transparency, and there are no codified consequences for non-compliance with a bank's Code commitments. In the longer–term, there is a risk that banks will lose their current commitment to the Code if they conclude it provides no reputational benefit.

Generally, respondents felt that the proposals did not offer more transparency about how the Code rules operate, other than to outline some more of HMRC's governance procedure. Some responses queried whether there needed to be any increased transparency at all, as the press and public have always been able to ask banks whether they had adopted the Code.

It was suggested by some respondents that non-adoption of the Code will be equated by the public to non-compliance and that HMRC should publicly state the Code is voluntary, and that no negative inferences should be drawn from a bank's choosing not to adopt.

The Government's response

Strengthening of the Code will ensure we have greater transparency and maintain a level playing field for all banks – reinforced by introducing an unconditional re-adoption or new adoption by banks to the Code commitments.

There is a reputational benefit to the bank and they can point to adoption if there is any external public scrutiny. Previously under the Code there had been nothing to stop a bank staying silent on adoption, and allowing the external assumption that they had been applying the Code, thus creating an unintentional "halo effect". The increased transparency ensures a level playing field.

The Code remains voluntary. Any bank not adopting would be free to publically explain the reasons for this.

Q.6. We would welcome views from respondents on whether the examples set out below provide a sufficient degree of guidance of the types of transactions, or patterns of transactions or other behaviours that would lead to HMRC concluding that a bank is not complying with its Code commitments? and

Q.7. Do respondents consider this to be an appropriate descriptor for transactions within the ambit of the GAAR?

The consultation set out some straightforward examples of transactions and patterns of behaviours to assist banks understanding of how HMRC operate the Code.

Respondents generally felt that the examples were helpful, but that there should be further examples outlining situations where a bank would be able to take corrective action, so that it is would not be named. In addition, respondents also requested more clarity on the opportunities that a bank would have to make its representations.

Some respondents pointed out that there can be a “reasonable difference of opinion” over the key concepts of “intentions of Parliament” or “spirit of the law” and felt that further guidance on HMRC views on these would help, and in particular assist the overseas Boards of non UK banks that may not understand these concepts.

With regard to the intentions of Parliament, respondents pointed out that in some circumstances the transaction or arrangements being entered into and their tax treatment could never realistically have been considered by Parliament at the time the applicable legislation was enacted. As such, HMRC needed to make clear their view when considering whether the interaction of different parts of the tax code together produces a result which was never intended by Parliament.

A small number of respondents felt that the examples could be read as implying that all transactions must be raised with HMRC before execution, even if the bank reasonably considers a transaction to be Code compliant, and that therefore the examples could be viewed as changing the scope of Code.

A majority of respondents felt that further examples were needed to provide greater clarity around the interaction of the GAAR and the Code. In particular, HMRC should clarify that a bank would not be classified as non compliant until after the GAAR Panel had issued their opinion that the relevant arrangements entered into were not a reasonable course of action.

The Government’s response

The Government agrees that it is appropriate that a bank should not automatically be classified as non compliant purely due to undertaking or promoting a single transaction or arrangement, except in cases where the GAAR Advisory Panel has concluded the arrangements entered into are not a reasonable course of action and a designated officer of HMRC has given a notice stating that the tax advantage under the arrangements should be counteracted. The draft legislation and Code Governance Protocol have been amended to reflect this.

HMRC will consider providing further examples for publication at Autumn Statement.

Q.8. Do respondents agree that this definition will result in appropriate coverage by the Code?

The consultation proposed that, to ensure consistency between HMRC tax regimes, the scope of the Code should be slightly amended to align with the scope of the Bank Levy.

While some respondents had no objections to this proposal, a small number of others raised a concern that the Code only applies to banks, and as such unfairly discriminates against banks compared with other commercial enterprises in the UK. A few respondents made a specific request that the Code should be extended to the "shadow banking" sector.

Other respondents concentrated on the detail of the proposal and felt that the change may cause issues as the bank levy definition follows the accounting definition of a group. Therefore securitisation companies and many other SPVs consolidated into banking groups for accounting purposes would be brought within the scope of the Code and that the parent group would not necessarily have the power to ensure that those entities are Code-compliant. A small number identified that the bank levy definition includes a £100m capital resources condition (assessed on an aggregate basis for groups) which could effectively exclude some smaller banks from the scope of the Code.

Other respondents requested that, as the change may include some non-banks who are not currently considered to be within the ambit of the Code, HMRC should notify these taxpayers of this change.

The Government's response

The Code is one element of the Government's anti avoidance strategy and is designed to change the attitudes and behaviour of banks towards avoidance given their unique position as potential users, promoters and funders of tax avoidance. HMRC is aware of the growth in "shadow banking" and is evaluating the potential risks arising from entities which are able to offer similar services to the banking sector.

The draft legislation has been amended to ensure that the provisions apply to all banks.

Q.9. Do respondents agree that the legislation as drafted covers the issues set out in this Consultation Document appropriately?

Most respondents did not provide a response to this question.

Those that did felt that further thought should be given to addressing the question of confidentiality. One respondent commented that although the draft legislation has the effect of removing the right to taxpayer confidentiality from banks, this is not the case for any third parties which may be a party to a non-compliant transaction with the bank.

One respondent felt that as Clause 1(3) of the draft legislation stated that the annual report will give "details" of non-compliance, it would be helpful if the legislation or guidance could indicate the nature of or the typical details that would be publically disclosed or perhaps whether the annual report would solely indicate under which Section of the Code the non-compliance has occurred (i.e. Governance, Tax Planning or Relationship between the bank and HMRC).

The Government's response

The draft legislation has been amended where appropriate and the Governance Protocol will clarify what will be included in the Annual Report.

Q.10. Are there any other matters that respondents would like to see covered in the legislation? And

Q.11. HMRC would also be grateful for any detailed drafting points that respondents might have on the draft clauses

Most responses to this question focused on the need for greater safeguards and whether a process can be developed for an independent review, mirroring the comments in response to Questions 3 and 5.

Respondents also suggested that if named, a bank should be permitted to publish its own representations in any annual report in which it is named. In addition HMRC's obligations under the Code should be enshrined in legislation to demonstrate HMRC's commitment to the Code.

The Government's response

As detailed elsewhere in this response document, the Government has listened to concerns and has now introduced an independent review into HMRC's governance process. As part of this, if HMRC's Commissioners disagree with the Independent Reviewer's advice, then they must set out and explain the reasons for the difference of opinion when notifying the bank and in the relevant

Annual Report of their decision to name the bank. In addition, the draft legislation provides a minimum time period between the bank being notified of HMRC's decision and the naming of a bank to allow a bank to seek injunction against naming in any case where they believe HMRC has acted unreasonably.

3. Next steps

Re-adoption and adoption of the Code

As set out in Chapters 1 and 2, the Code is unchanged and the Government confirms its Budget commitment to ask HMRC to publish a list at Autumn Statement 2013 of those banks which have unconditionally adopted or readopted the Code.

Banks wishing to adopt or readopt should provide notice in written form (including in electronic form) to HMRC no later than 5PM on the day before Autumn Statement 2013.

Notice should be sent to either:

- the consultation mailbox bankcode.consultation@hmrc.gsi.gov.uk
- Alan Taylor at: HMRC, Large Business Service, 7th Floor, South West Wing, Bush House, Strand, London WC2B 4RD, or
- your CRM or customer coordinator.

Revised governance Protocol and draft legislation

HMRC originally published its Governance Protocol on a Bank's Compliance with the Code of Practice on Taxation for Banks ("the Protocol") on 26 March 2012. The Protocol sets out HMRC's communication and escalation procedures in any case where HMRC has concerns about a bank's compliance with its commitments under the Code.

In light of the measures being introduced to strengthen the Code set out in this document, HMRC has similarly amended the Protocol. The revised Protocol is attached at Annex B.

Any future changes to the Governance Protocol, will before being introduced be subject to consultation with relevant stakeholders.

Draft Finance Bill 2014 legislation to enact these measures was published with the consultation document. The draft legislation has been revised to reflect the policy decisions set out in this document and is being published today by HMRC.

HMRC would welcome comments on the draft legislation.

Annex A: List of stakeholders consulted

Alverez & Marsal Tax & LLP
Association for Financial Markets in Europe "AFME"
Association of Accounting Technicians "AAT"
Association of Foreign Banks "AFB"
Bank J. Safra Sarasin (Gibraltar) Ltd
Barclays
BDO
British Bankers Association "BBA"
Building Societies Association "BSA"
C Hoare & Co
CBI
Chartered Institute of Taxation "CIOT"
Charities Aid Foundation - CAF Bank
Clifford Chance LLP
Coventry Building Society
Credit Agricole
Darlington Building Society
Deloitte
Ernst & Young LLP
Freshfields Bruckhaus Deringer
Grant Thornton
Joint Rep Bodies response (AFB, AFME, BBA, BSA)
KPMG LLP
Linklaters
Mansfield Building Society
Nacional Financiera
Norton Rose Fulbright LLP
Pinsent Mason LLP
Pricewaterhousecoopers "PWC"
Stafford Railway Building Society
The City of London Law Society
The Institute of Chartered Accountants in England and Wales tax Faculty "ICAEW"
The Law Society
The Tax Law Review Committee

Annex B: The Governance Protocol

Introduction - Establishing HMRC's View on a Bank's Compliance with the Code of Practice on Taxation for Banks

1. The Code of Practice on Taxation for Banks ("the Code") was introduced in 2009 and applies to bank and Building Society groups, banks in non banking groups and single bank or Building Society entities.
2. HMRC first published its Governance Protocol on a Bank's Compliance with the Code of Practice on Taxation for Banks" on 26 March 2012.
3. The Governance Protocol set out HMRC's communication and escalation procedures in any case where HMRC has concerns about a bank's compliance with its commitments under the Code.
4. **This version of the Governance Protocol ("the Protocol") published on 11 October 2013 replaces the 26 March 2012 version and is to be read as the current Protocol by banks and their advisers and for the purposes of the draft Finance Bill 2014 legislation.**
5. The Protocol covers "participating groups and entities". These terms are defined in Section 2 of the draft legislation published alongside the formal Consultation Response Document *"Strengthening the Code of Practice on Taxation for Banks"*.

   Participating groups and entities are banks and building societies which have notified HMRC Commissioners, in writing, that they have unconditionally committed to complying with the Code on or after 31 May 2013. Such institutions are hereafter referred to as "participating banks".
6. In accordance with Clause 4 of the draft "Code of Practice on Taxation for Banks: HMRC to publish reports" Finance Bill 2014 legislation any future changes to the Protocol will be subject to consultation before being introduced.
7. Not all banks are required to fully adopt the Code. Some smaller banks[6] are only required to adopt Part 1 of the Code. This provides these institutions with a more flexible and appropriate approach to documenting and governing their strategy towards tax and is proportionate to, and consistent with, HMRC's risk strategy.
8. However, the principles underpinning that strategy should be the same as that for larger banks that adopt the Code in its entirety, and it should be noted that the considerations and processes set out in the Protocol will apply equally to both smaller and larger banks.

[6] See Smaller Banks and Building Societies document for definition

Background

9. HMRC issued a consultation *"Strengthening the Code of Practice on Taxation for Banks"* on 31 May 2013. The consultation focussed on:
    - The HMRC governance procedure by which it determines a bank's non-compliance;
    - The processes and criteria by which a decision to name a bank as non-compliant will be made; and
    - The nature of the annual report to be published by HMRC.
10. HMRC issued a new draft Governance Protocol, as part of the consultation document, and to reflect the proposals set out in the consultation document for a new strengthened Code. In the light of consultation responses and discussions with stakeholders the Government has revised and refined some of the proposals. This updated Protocol reflects the Government's final policy position.
11. It sets out in detail how the HMRC governance process will operate taking into account the roles of the HMRC Tax Disputes Resolution Board (TDRB), an appointed "independent reviewer" and the HMRC Commissioners. In addition it provides indicative timescales for banks to make representations and is updated to reflect further points and requests for clarification raised during the consultation.
12. The following sections sets out the three main areas of the Code that HMRC would consider under its Protocol and includes a draft of the revised Protocol.

HMRC Operation of the Code

13. In most cases HMRC expects that it will not have cause for concern about a bank's compliance with the Code.
14. However, where HMRC does have concerns over whether a bank has met its undertakings under the Code, in relation to;
    - the bank's governance process (under Part 2 of the Code)
    - the bank's tax planning (under Part 3 of the Code), or,
    - the relationship between the bank and HMRC (under Part 4 of the Code)

    the Protocol sets out how those concerns will be addressed.

Governance

15. These situations would arise where HMRC had concerns over
    - the bank's strategy for, and governance of, risk management for taxation matters;
    - whether the strategy is understood and operated within the bank; or
    - the bank's attitude towards the openness, transparency and professionalism of its relationship with HMRC.

16. Reasons HMRC may be concerned over the bank's strategy or governance could include:

    (1) a lack of policy for proper tax risk management containing a documented strategy and governance process for taxation matters except where the bank's approach to avoiding tax risk is sufficiently clear for it to be unnecessary for the bank to have such a formal written policy,

    (2) failure to let the CRM or equivalent officer see any such policy on request,

    (3) evidence that the strategy, and compliance with it, is not considered at an adequately senior level consistent with the scale of risks being managed,

    (4) failure to give the CRM, on request, an understanding of the processes adopted over the period concerned to ensure that the policy is taken account of in business decisions,

    (5) failure by the bank to review its actions over time to ensure that it believes it is properly implementing its governance obligations under the code,

    (6) evidence of systemic failures in implementation revealed by the bank's own review or for other reasons,

    (7) failure to provide any required certificate under schedule 46 FA 2009,

    (8) evidence that the tax department is not involved in, does not fully understand, or has little power to influence transactions undertaken which may present tax risk,

    (9) a recent pattern of mistakes in completing tax returns,

    (10) significant arrears in filing returns or paying tax, or

    (11) failure to disclose transactions which may present a significant tax risk.

Tax Planning

17. Those concerns would arise where the bank has failed to:

    - adhere to the tax planning strategy envisaged by the Code in its formal operations and policy, where it has one
    - adopt the tax planning strategy approach envisaged by the Code in practice; including failure to provide adequate guidance to the bank's operating staff on how the strategy operates

- review, prior to implementation, all potentially contentious transactions for compliance with the tax planning strategy, involving an appropriate level of tax expertise and challenge, and documenting the review appropriately
- prevent implementation of, or the facilitation or promotion of, transactions where the tax management function was not satisfied that:
  (1) they supported genuine commercial activity,
  (2) they produced tax results for the bank that are consistent with the underlying economics of the arrangements; or if not,
  (3) the tax results they produced were not contrary to the intentions of Parliament, taking into account both a purposive construction of legislation and whether Parliament could realistically have intended the result, given a track record of acting to close loopholes to prevent transactions that are “too good to be true”.
- take reasonable views in coming to decisions under points (1) to (3) in the above bullet point, where the failure to do so amounts to failing systematically or wilfully to implement its undertakings about tax planning.

18. Evidence of possible systematic or wilful failure may include one or more of the following:

    (1) a pattern of executed transactions which are followed by legislative changes intended to clarify or correct tax law to prevent the intended tax results of such transactions,

    (2) a deliberate or continuing failure by the bank’s management to undertake a proper review of proposed transactions; to ensure that it is sufficiently well informed about the transactions and the legislative context for it to take reasonable decisions; or to challenge proposals that are inconsistent with the code, or

    (3) an approach to the Code which ignores its overall intent of constraining destabilising tax avoidance transactions that are likely to trigger a need for Parliament to consider legislative change.

Relationship between the Bank and HMRC

19. HMRC may express concerns whether a bank has met its undertakings under code paragraphs 4 to 4.2 where the concerns are

    (1) over the bank’s delivery of these undertakings over the period concerned; or

    (2) about the bank’s commitment to the undertakings, or to a shared plan to resolve the delivery concerns.

20. Reasons why HMRC might indicate concern to the bank about delivery of or commitment to these undertakings could include:

    (1) a failure to disclose significant potentially contentious transactions at the earliest reasonable date,

    (2) a failure to provide adequate information for HMRC to understand potentially contentious transactions,

    (3) a failure to work with HMRC to agree reasonable timelines for enquiries or potential disputes to be brought to decision point, or

    (4) a failure to discuss in advance transactions when the bank is unsure whether they are contrary to the intentions of parliament, if it is reasonable to assume a primary reason for that is to leave Parliament uninformed about the impact of the transaction until completed.

21. The draft Protocol on the following pages sets out;

- The way in which HMRC will interact with a bank where either it has concluded that a bank has met its commitments under the Code or where it has concerns or has identified that a bank may not have met its Code commitments, and
- The escalation route where HMRC suspects that a bank may not have met its commitments under the Code, and
- The role that the TDRB, the Commissioners and the independent reviewer will play in the Commissioner's decision that a bank should be named in an annual report as not complying with the Code, and
- How the escalation route interacts with the arrangements that are being referred to the GAAR advisory panel.

HMRC Governance Protocol on a Bank's Compliance with the Code of Practice on Taxation for Banks ("the Code")

General

- The Protocol applies to bank or Building Society groups, banks in non banking group and single bank or Building Society entities. Where one of these groups or entities has notified the Commissioners in writing that it is unconditionally committed to complying with the Code on or after 31 May 2013 the draft Finance Bill 2014 legislation at Clause 2 provides that these institutions are termed "participating groups or entities". Participating groups or entities will for the purposes of this Protocol be referred to collectively as "participating banks".
- HMRC will engage with participating banks in a co-operative, supportive and professional manner and in return expects those banks to comply with their commitments under the Code.
- HMRC may at any time have one of the following views about a participating banks' compliance with the Code:
    I. it considers the bank to be compliant with its Code commitments
    II. it has initial concerns over the bank's compliance with the Code,
    III. it has an interim view that the bank has breached the Code; or
    IV. it has reached a final opinion that the bank has breached the Code.
- In each case HMRC will notify the bank of its view and where HMRC has concerns over compliance with the Code will as appropriate enter into a dialogue with the bank.
- Equally where HMRC is satisfied that a bank is fully complying with its Code commitments, the Customer Relationship Manager (CRM) or equivalent HMRC Officer[7] (hereafter referred to collectively as CRM) will notify the bank of this view as part of the annual risk review process or on another appropriate occasion.
- Under the Protocol the final decision on whether a bank has breached the Code will be made by the HMRC Commissioners.
- The following sections set out the process which HMRC will follow to determine whether a bank has breached the Code and also, from 2015, whether a bank should be named in the HMRC Annual Report.
- Annex I provides a diagrammatic representation of the Protocol stages.

[7] http://intranet.active.hmrci/lbs_lc_portal/guidance/l_c/cc_guidebook.htm

HMRC has concerns about a bank's compliance with the Code

- If the team with operational responsibility for the bank has a concern about an element of the bank's behaviour by reference to its commitments under the Code then initially the CRM will raise this with the bank at the earliest opportunity; setting out the reasons for the concern. As part of this process the bank will be asked to make its representations on the issue. There is no fixed or indicative timeframe in which HMRC would expect these conversations to be concluded. However HMRC would expect an open collaborative conversation to take place: in line with Part 4 of the Code.
- Where the concern relates to whether a transaction or transactions that the bank has undertaken, or promoted, include tax planning that may give a tax result that is contrary to the intentions of Parliament, the CRM must discuss their concerns with the technical and policy specialist(s) with responsibility for the relevant legislative area(s) once the bank has set out its position.
- If following the HMRC technical and policy specialists' review there is still a concern, then the CRM must obtain the agreement of an HMRC Officer at or above Deputy-Director grade in the Large Business Service and CTISA before sharing their concerns with the bank. Equally where the concerns relate to other elements of a bank's behaviour or governance no firm views of those concerns will be relayed to the bank until approval has been jointly given by the relevant HMRC Officers.
- If, after subsequent conversations between the CRM and the bank, concerns remain then, HMRC (typically at or above, Director level and hereafter referred to as the "HMRC Director") will seek to discuss the issue with the bank's board (typically the Chief Financial Officer). In the case of a single transaction undertaken or promoted by a bank where HMRC is concerned that it includes tax planning which gives a tax result that is contrary to the intentions of Parliament, unless the transaction is part of an emerging pattern of behaviour by the bank or it is a potential GAAR transaction, then normally a reference to the HMRC Director will not be required. The bank will be provided with **28 days** in which to make any further representations following the discussion between the HMRC Director and its board.
- If following this period and any subsequent related discussions with the bank's board HMRC's concerns still remain unresolved, then the case will be referred by the HMRC Director to the HMRC Tax Disputes Resolution Board (TDRB) for the TDRB to consider whether, in their view, those unresolved concerns constitute a breach of the Code.
- The HMRC Director will inform the bank of the reference to TDRB as soon as possible.

Role of the TDRB

- The TDRB reviews all significant tax disputes before they are referred to the Commissioners with a recommendation. This process, and the detail of the cases that should be referred to TDRB, is laid out in the Code of Governance for settling tax disputes http://hocan.inrev.gov.uk/cpolnew/downloads/code_of_governance.pdf
- Firstly, the TDRB will come to an interim conclusion as to whether a bank has breached its commitments under the Code.
- The TDRB will be required to take into account any representations made by the bank. The bank will be invited to make these representations in writing within **28 days** from the date the HMRC Director notified it of the referral.
- In reaching its interim conclusions as to whether there has been a breach of the Code the TDRB may not take into consideration actions undertaken by the bank prior to Autumn Statement 2013. However the TDRB may take into account any actions undertaken after Autumn Statement 2013 or, if later, the date from which the bank becomes a participating bank.
- The HMRC Director will notify the bank's board of the TDRB's decision as soon as possible.
- Secondly, where the interim conclusion is that the bank has breached the code the HMRC Director will, when notifying the bank on behalf of the TDRB, ask the bank to set out any remedial or mitigating action or any exceptional circumstances that should be taken into account in determining whether the bank should be named. The bank will have **28 days** to respond to this request.
- If the bank does respond within the time limit then any evidence or arguments that the bank provides will be referred back to TDRB. An interim conclusion will then be reached as to whether, if the Commissioners conclude that the bank has breached the Code, any mitigating or remedial action undertaken by the bank, or exceptional circumstances are such that, the bank should not be named in the annual report. The bank will be informed of TDRB's interim conclusion on this point with its reasons.
- The matter will be referred to the independent reviewer once the bank is notified of TDRB's interim conclusion.
- If the bank has not responded in the 28 day period mentioned above, at the end of that earlier period, the matter will be referred to the independent reviewer.

Role of the "Independent Reviewer"

- Clause 3 of the draft Code of Practice legislation to be included in Finance Bill 2014 sets out the role of an independent reviewer.
- The independent reviewer will be appointed by the HMRC Commissioners but must be a person independent of both the Commissioners and the bank in question.
- The final decision on whether a bank has breached the Code will be made by the HMRC Commissioners. But before they consider whether a bank has breached the Code and, if so, whether to name the bank they must commission the independent reviewer to compile a report on
    - whether in the independent reviewer's opinion there has been a breach of the Code, and if so,
    - whether or not, in the independent reviewer's opinion, having regard to any remedial or mitigating actions undertaken by the bank or any exceptional circumstances, HMRC Commissioners should publish the name of a bank as having breached the Code in the HMRC annual report.
- The independent reviewer must give the bank **at least 28 days** from the receipt of HMRC's report setting out TDRB's interim conclusions to make its representations. It is for the independent reviewer to decide whether the representations are to be oral or written (or both).
- In compiling their report the independent reviewer must have regard to;
    - TDRB's report setting out the rationale for its interim conclusions that the bank has breached the Code and its interim conclusion on whether the bank should be named in an annual report on the operation of the Code,
    - any representations made by the bank,
    - any action taken by the bank to remedy or otherwise mitigate the alleged breach of the Code, or any exceptional circumstances that might justify not naming the bank,
    - this Governance Protocol insofar as it is relevant to their functions,

  and may take account of:

    - any other matters they consider relevant to the consideration of whether the bank has breached the Code, and
    - any actions by the bank after Autumn Statement 2013, but may not take into account any actions before that date or if later before the bank became a participating group or entity.
- HMRC must provide the independent reviewer with access to the information held by HMRC in relation to the issue, or issues, under consideration.
- The independent reviewer's report must be completed within **60 days** of receipt of TDRB's report.

- Once completed the independent reviewer's report must be provided to both the bank and the Commissioners.

HMRC Commissioners' role

- Once the independent reviewer has delivered their report to HMRC Commissioners, the bank has **28 days** in which to make written representations on the report to the Commissioners.
- It is expected that Commissioners will consider the case 28 days after the end of that period (i.e. 56 days after the report of the independent reviewer is given to Commissioners).
- Any document containing internal briefing on the independent reviewer's report that is given to the Commissioners for the purpose of their consideration will be given to the bank at the same time.
- In reaching their final decision on whether a bank has breached the Code the HMRC Commissioners must have regard to:
    - the report made by the independent reviewer; and
    - any representations made by the bank,

  and may take into consideration
    - any actions by the bank after Autumn Statement 2013, but may not take account of any actions before that date or if later, before the bank became a participating bank.
- In reaching their final decision on whether a bank should be named, the HMRC Commissioners must have regard to any remedial or mitigating action undertaken by the bank or exceptional circumstances which might justify not naming the bank in the annual report.
- Once the Commissioners have reached their decisions the Commissioners will inform the bank's board of their decisions **within five working days**.
- If the Commissioners form a different opinion from that of the independent reviewer the HMRC report must, when informing the bank of their decisions, set out, and explain, the reasons for the difference of opinion.
- Where the Commissioners have decided that a bank has breached the Code and that the bank should be named in an annual report then there must be a delay of at least 30 days before the relevant annual report is published.

The HMRC Annual Report

- The Code is one element of the Government's anti avoidance strategy and is designed to change the attitudes and behaviours of banks towards tax avoidance. The annual report, which will set out details of the operation of the Code in the year or period in question, provides transparency around the operation of the Code in two ways by:
    - Providing full transparency where a bank has adopted the Code but does not comply with it, and
    - Providing full transparency around the banks which have chosen to, and those that have chosen not to, adopt the Code.
- Where a bank has unconditionally committed to the obligations under the Code but, after having followed this Protocol, HMRC Commissioners have concluded a bank has breached the Code, the Commissioners may publish the name of a bank as breaching the Code in an annual report on the operation of the Code.
- Normally the relevant annual report will be the one for the year or period in which the breach of the Code was determined to have occurred. However Clause 1(3) of the draft legislation provides that where, it is not practicable for the bank to be named in report for the period in which the breach arises, the bank will be named in the next annual report where it is possible to do so.
- If the Commissioners form a different opinion from that of an independent reviewer on whether a bank has breached the Code or over the naming of a bank the annual report for the relevant reporting period must set out the reasons for the difference of opinion.

Interaction with the GAAR

Where there is a unanimous or majority agreement amongst the GAAR Advisory Panel that arrangements entered into, or promoted by, a bank are not a reasonable course of action and HMRC has concluded that it would be appropriate to seek to apply the GAAR to the arrangements concerned and a notice has been given under paragraph 12 of Schedule 43 to FA 2013 stating that a tax advantage is to be counteracted, then—

- The action by the bank in entering into or promoting these arrangements will constitute a breach of the Code and accordingly:
- the role of the independent reviewer and thereafter the Commissioners is limited to considering whether the bank should be named in the HMRC annual report.

In all other cases where arrangements entered into or promoted by a bank have been referred to the GAAR Advisory Panel in accordance with Schedule 43 to FA 2013, whether or not the bank has breached the Code will depend on all the facts and surrounding circumstances which could include for example whether the arrangements form part of a pattern of behaviour. If following discussions between the bank and HMRC in accordance with the

escalation routes set out in the Protocol, HMRC concludes that the bank has breached the Code and should be named in an annual report it would be required to commission a report from the independent reviewer and have regard to that report in the normal manner before reaching its conclusions.

Annex 1

Outline of Code Governance Protocol

HMRC Escalation processes

HMRC & Bank Conversation/representations

Messaging of decision – agreed Code compliant