

# Explanatory Note: draft clause

## Bank Levy

### Summary

1. This clause amends Schedule 19 to the Finance Act (FA) 2011 to make changes to the bank levy. For periods of account ending on or after 1 January 2021, bank levy will be chargeable only on equity and liabilities recognised on the UK balance sheets of banks and building societies. The measure also provides for the amount of UK equity and liabilities subject to the bank levy to be reduced in certain circumstances, for example where a UK bank holds certain types of loss absorbing investments in an overseas subsidiary. Various other changes and administrative updates to the bank levy will apply for periods of account ending on or after 1 January 2018, or from Royal Assent to the Finance Bill which includes this measure. These comprise modifications to the process under which groups nominate a 'responsible member' to meet their bank levy obligations, and to rules governing the shared liability of group members for bank levy amounts.

### Details of the clause and Schedule

2. This clause introduces the Schedule which amends Schedule 19 to FA 2011 (Schedule 19), concerning the calculation and administration of the bank levy.

### Part 1: Chargeable equity and liabilities

3. Paragraph 2 replaces the current paragraphs 15 to 23 of Schedule 19, concerning the equity and liabilities on which the bank levy is charged (chargeable equity and liabilities), with new paragraphs 15 to 15Z4.
4. New paragraph 15 of Schedule 19 sets out how the amount of chargeable equity and liabilities of a bank levy paying group is to be determined for a chargeable period. It provides a single set of rules that will apply for UK banking groups, overseas banking groups and those non-banking groups that include banking entities.
5. New paragraph 15(2)(a) concerns members of a group that are:
  - 'UK sub-groups' (as defined at new paragraph 15B)
  - 'chargeable UK resident entities' (as defined at new paragraph 15C).
6. A group's chargeable equity and liabilities for a period will include the 'UK-based equity and liabilities' of these sub-groups or entities at the end of that period, subject to:
  - the omission of 'excluded' equity and liabilities (as defined at paragraph 28 to 39 of Schedule 19)
  - the adjustments set out at new paragraph 15M.

7. New paragraph 15(2)(b) provides that a group's chargeable equity and liabilities will also include the 'UK allocated equity and liabilities' of any 'relevant foreign banks' (as defined at paragraph 78 of Schedule 19) within the group. The amount of a relevant foreign bank's UK allocated equity and liabilities is to be determined at the end of the chargeable period in accordance with paragraph 24 of Schedule 19.
8. New paragraph 15A sets out how the amount of chargeable equity and liabilities is to be determined for bank levy paying entities that are not members of groups (relevant entities). It provides rules that will apply for relevant foreign banks and other relevant entities.
9. New paragraph 15A(2)(a) concerns the amount of chargeable equity and liabilities of relevant entities that are not relevant foreign banks. This will be the amount of the entity's UK-based equity and liabilities at the end of the chargeable period, subject to:
  - the omission of excluded equity and liabilities (as defined at paragraph 28 to 39 of Schedule 19)
  - the adjustments set out at new paragraph 15M.
10. New paragraph 15A(2)(b) concerns the amount of chargeable equity and liabilities of relevant foreign banks. This will be the amount of the bank's UK allocated equity and liabilities at the end of the chargeable period, determined in accordance with paragraph 24 of Schedule 19.
11. New paragraph 15E sets out how to determine a UK sub-group's UK-based equity and liabilities (as referred to in new paragraph 15(2)(a)), with reference to new paragraphs 15G to 15I. New paragraph 15E(4) permits 'non-UK allocated equity and liabilities' attributable to any foreign permanent establishment to be disregarded from UK-based equity and liabilities. The amount of non-UK allocated equity and liabilities that can be disregarded is to be determined in accordance with new paragraph 15Z.
12. New paragraphs 15G to 15I set out how to determine the assets, equities and liabilities of a UK sub-group, depending upon:
  - whether the sub-group has any non-UK resident members
  - whether any member of the sub-group has a foreign permanent establishment in respect of which the group has elected to disregard non-UK allocated equity and liabilities, under new paragraph 15E(4)
  - whether the group has made an election in relation to its sub-groups under new paragraph 15I.
13. New paragraph 15I provides that, subject to specified conditions, a group may elect to determine its UK sub-groups' assets, equity and liabilities on an entity-by-entity basis.
14. New paragraph 15J sets out arrangements for the making or revocation of an election by a group under new paragraphs 15E or 15I.
15. New paragraph 15K explains how to determine a UK resident entity's UK-based equity and liabilities (as referred to in new paragraphs 15(2)(a) and 15A(2)(a)) with reference to new paragraph 15L. Sub-paragraphs (3) and (4) permit non-UK allocated

equity and liabilities attributable to any foreign permanent establishment of the entity to be disregarded from UK-based equity and liabilities. The amount of non-UK allocated equity and liabilities that can be disregarded is to be determined in accordance with new paragraph 15Z. Sub-paragraph (3) provides for this election in relation to groups, and sub-paragraph (4) applies for UK resident entities that are not members of groups. Sub-paragraph (5) sets out arrangements for the making or revocation of an election.

16. New paragraph 15L sets out how to determine the assets, equity and liabilities of a UK resident entity.
17. New paragraph 15M(1) specifies steps to be taken to adjust the UK-based equity and liabilities of a UK sub-group or entity, in order to calculate how much of this equity and liabilities is chargeable to the bank levy. Of these steps:
  1. Step 1 relates to equity and liability adjustments and netting.
  2. Step 2 introduces a new reduction in the amount chargeable to bank levy for certain loss absorbing instruments that are issued by an overseas subsidiary and held within the relevant group by a UK sub-group or chargeable UK resident entity.
  3. Step 3 mainly reproduces existing provisions in Schedule 19 that allow a reduction in the amount chargeable to bank levy for certain 'high quality liquid assets' (defined in paragraph 70 of Schedule 19) held by the sub-group or entity.

Further detail on these steps are set out at new paragraphs 15N to 15Y.

18. New paragraph 15M(2) concerns the amounts by which equity and liabilities are to be reduced under steps 2 and 3 of paragraph 15M(1). It provides that these amounts will always be equivalent to a reduction in equity and liabilities chargeable at the lower rate of bank levy, which is half of the rate chargeable on short term liabilities.
19. New paragraphs 15N to 15T concern step 1 of the adjustment referred to in paragraph 15M(1), and relate to equity and liability adjustments and netting.
20. New paragraphs 15N and 15O concern entities that are members of groups that do not prepare consolidated accounts ('unconsolidated sub-groups', as defined at paragraph 15N(2)). They provide that equity which would have been eliminated had consolidated accounts been prepared for the unconsolidated sub-group should be left out of the computation of chargeable equity and liabilities. These paragraphs broadly reproduce the effect of provisions currently in operation (see, for example, paragraph 18(3) to (6) of Schedule 19 concerning the chargeable equity and liabilities of foreign banking groups). However, these provisions have been updated (at paragraphs 15N(3)(b) and 15O(3)(b)) to reduce this equity exclusion proportionately, where an election has been made to disregard an entity's non-UK allocated equity and liabilities under paragraph 15E(4) or 15K(3).
21. New paragraph 15P excludes certain liabilities between members of a group from the computation of that group's chargeable equity and liabilities. The various references to 'UK connected liabilities' (as defined in sub-paragraphs (3) to (9)) mean that this paragraph only excludes liabilities that might otherwise be within the chargeable scope of the bank levy. These paragraphs broadly reproduce the effect of provisions currently in operation (see, for example, paragraph 18(7) of Schedule 19 concerning the chargeable equity and liabilities of foreign banking groups).

22. New paragraphs 15Q to 15T set out rules that apply in relation to 'netting', under which, subject to certain conditions, the amount of liabilities chargeable to the bank levy may be reduced. This reduction is available where an entity (M) 'nets':
- its liabilities to another party (N), against
  - assets, in the form of amounts that N (or another entity) owes to M, or to any other member of M's group.
23. The availability of netting is also subject to there being an agreement making provision for 'single net settlement' of the respective parties' (M and N's) liabilities, so that there can be a single net sum payable on the occurrence of a 'netting event'. New paragraph 15Q sets out the netting rules that apply for group members, and new paragraph 15R applies to entities that are not part of a group. Both paragraphs set out similar qualifying conditions for netting. These include requirements concerning:
- the liabilities that can be covered by a netting agreement
  - the recognition of amounts owed by N ('N's liabilities') as assets by M, or another member of M's group where appropriate
  - the conditions to be satisfied by the agreement providing for net settlement.
24. New paragraph 15Q(5) means that group members cannot net liabilities to certain other UK members of the same group. New paragraph 15Q(6)(b) limits the availability of netting where M and N are in the same group and N is a relevant foreign bank with a permanent establishment in the UK.
25. New paragraphs 15Q and 15R also provide definitions of terms such as 'single net settlement' and 'netting event', and make provision for cases in which securities are used as collateral.
26. New paragraph 15T provides general rules for netting, which apply to both groups covered by new paragraph 15Q and non-group entities covered by new paragraph 15R. It allows M's 'net settlement liabilities' to be reduced by M's 'net settlement assets' and defines these terms; as well as making provision that limits the availability of netting in certain cases. Sub-paragraph (6) provides that, where appropriate, long term liabilities and short term liabilities (which are subject to different rates of bank levy) should be netted against M's net settlement assets on a proportionate basis.
27. New paragraphs 15Q to 15T broadly reproduce the effect of provisions currently in operation (see for example paragraph 18(8) to (17) of Schedule 19 concerning the chargeable equity and liabilities of foreign banking groups). However, these provisions are being updated to allow the assets of any group member (and not just M) to be included within netting agreements. In addition, certain requirements (such as those concerning net settlement at paragraphs 15Q(2) to 15Q(4)) have been modified to improve clarity.
28. New paragraphs 15U to 15X concern step 2 of the adjustment referred to in paragraph 15M(1), and apply to bank levy paying groups. The paragraphs provide for a UK sub-group or chargeable UK resident entity to reduce the amount chargeable to the bank levy when all of the following conditions apply:

- that sub-group or entity, or another UK member of the same group (a 'relevant group member'), holds certain 'qualifying loss absorbing instruments' issued by an overseas subsidiary of a UK resident entity within the group
  - these instruments satisfy a 'loss-absorbing capacity requirement' and other conditions to be set out in regulations by HM Treasury
  - the liabilities of the sub-group or entity include 'tier one capital equity and liabilities' or other loss absorbing instruments that satisfy certain conditions.
29. New paragraphs 15U, 15V and 15X set out various definitions, regulation-making powers and conditions to be satisfied in relation to this reduction.
30. New paragraph 15W sets out the amount of the reduction that will be available. It caps this reduction for tier one equity and liabilities and other loss absorbing instruments at the relevant 'liabilities amount' for each type of instrument, as defined at sub-paragraphs (3) and (4). Sub-paragraph (5) excludes from this reduction any assets which have been applied for the purposes of a netting adjustment under step 1 of paragraph 15M(1), and ensures that only one UK sub-group or entity within a group can make a reduction in relation to any qualifying loss absorbing instrument.
31. New paragraph 15Y concerns step 3 of the adjustment referred to in paragraph 15M(1), in relation to high quality liquid assets. It broadly reproduces current provisions of Schedule 19 (see, for example, paragraph 17(7) and (8) concerning foreign banking groups). The paragraph allows for a reduction in the amount chargeable to the bank levy for certain lending transactions involving collateral that, if not used as such, would otherwise form part of a UK sub-group or entity's high quality liquid assets. Sub-paragraph (2) sets out the amount of the reduction that is permitted under this paragraph.
32. New paragraphs 15Z to 15Z3 concern the non-UK allocated equity and liabilities of UK sub-groups or entities. This is the equity and liabilities attributable to foreign permanent establishments of a UK resident entity. A bank levy payer can elect to disregard this non-UK allocated equity and liabilities from its bank levy calculation, as set out in new paragraphs 15E(4), 15K(3) and 15K(4).
33. New paragraph 15Z(3) sets out various steps in the calculation of non-UK allocated equity and liabilities. These steps apply to UK resident entities that are members of UK sub-groups and groups, as well as UK resident entities that are not group members.
1. Steps 1 and 2 establish the proportion (X%) that the assets of a foreign permanent establishment of a UK resident entity bears to the assets of that UK resident entity as a whole, at the end of a chargeable period.
  2. Step 3 requires the amount of UK-based equity and liabilities of the UK resident entity (including non-UK allocated equity and liabilities) to be determined for the chargeable period, and to be adjusted in accordance with new paragraph 15M.

3. Step 4 requires the equity and liabilities at step 3 to be attributed to the foreign permanent establishment (as non-UK allocated equity and liabilities) in the same proportion (X%) as was established at step 1 and 2 above.
  4. Step 5 requires identification of the proportion of the UK resident entity's UK-based equity and liabilities (as determined at step 3) that are long term equity and liabilities.
  5. Step 6 disregards the UK resident entity's non-UK allocated equity and liabilities.
  6. Step 7 applies the UK resident entity's long term UK equity and liabilities, and UK short term liabilities, to paragraph 6(2) of Schedule 19. This paragraph sets out steps for determining the amount of bank levy that is chargeable.
34. New paragraph 15Z1 provides details of how the amount of assets of a foreign permanent establishment is to be determined for step 2 of the calculation at new paragraph 15Z(3), including by applying certain provisions of corporation tax legislation. The paragraph also provides that the assets of a foreign permanent establishment representing an 'excluded' loan relationship (as defined at sub-paragraph (6)) are to be left out of this calculation.
35. New paragraphs 15Z2 and 15Z3 provide netting rules for steps 1 and 2 of the calculation at new paragraph 15Z(3), concerning the assets of a UK resident entity (E) and any foreign permanent establishments of that entity.
36. New paragraph 15Z2 includes requirements concerning:
- the liabilities that can be covered by a netting agreement ('E' and 'N's liabilities)
  - the recognition of amounts owed by N ('N's liabilities') as assets by the UK resident entity (E)
  - the conditions to be satisfied by the agreement providing for net settlement.
37. It also includes definitions of terms such as net settlement provision, single net settlement and netting event, and makes provision for cases in which securities are used as collateral. New paragraph 15Z2(5) means that group members cannot net liabilities to certain other UK members of the same group. New paragraph 15Z2(6)(b) limits the availability of netting where E and N are in the same group and N is a relevant foreign bank with a permanent establishment in the UK.
38. New paragraph 15Z3 provides, at sub-paragraph (1), for the net settlement assets of a UK resident entity (E) to be reduced by that entity's net settlement liabilities, for the purposes of step 1 of the calculation at new paragraph 15Z(3). Sub-paragraphs (4) to (7) provide definitions and limit the availability of netting where E's assets include the liabilities of a relevant foreign bank within the same group.
39. Sub-paragraphs (2) and (3) explain how netting applies to the assets of a foreign permanent establishment of E. As set out at sub-paragraph (8), the net settlement assets of the permanent establishment are those assets which qualified for netting at entity (E) level, under sub-paragraph (1). For the purposes of step 2 of the calculation

at new paragraph 15Z(3), these assets of the permanent establishment are to be reduced by the same proportion (Z%) as E's net settlement assets were reduced under sub-paragraph (1).

40. New paragraph 15Z4 provides an exclusion from the bank levy charge for:
- a group member that has UK-based equity and liabilities of less than £50 million at the end of the chargeable period
  - a relevant foreign bank that has UK allocated equity and liabilities of less than £50 million at the end of the chargeable period.

This is subject to a £200 million cap on the total equity and liabilities can be excluded by a group.

41. Paragraph 3 of the Schedule amends paragraph 25 of Schedule 19, which sets out netting rules that apply when calculating a relevant foreign bank's UK allocated equity and liabilities under paragraph 24(1) of Schedule 19. These amendments are largely consequential and will, where appropriate, make the netting rules in paragraph 25 consistent with those elsewhere within Schedule 19.
42. Paragraphs 3(7) and 3(9) of the Schedule omit provisions that apply the netting rules in paragraph 25 to step 3 of the calculation at paragraph 24(1) of Schedule 19 (concerning a relevant foreign bank's chargeable equity and liabilities). The netting rules that will apply for the purposes of step 3 are set out in new paragraphs 27A to 27D, as introduced by paragraph 6 of the Schedule.
43. New paragraphs 27A to 27D set out the netting rules that will apply for the purposes of paragraph 27, and for step 3 of the calculation at paragraph 24(1)(concerning a relevant foreign bank's chargeable equity and liabilities). New paragraph 27A provides rules that will apply where the relevant foreign bank is part of a group, and new paragraph 27B will apply where the bank is not part of a group. These netting rules are modelled on those in new paragraphs 15Q to 15T, as introduced by paragraph 2 of this Schedule.
44. The effect of the changes set out in paragraphs 3 and 6 of the Schedule is that:
- the netting rules at paragraph 25 will apply to the calculation of the assets of a relevant foreign bank and its UK permanent establishments, for the purposes of step 1 and 2 of paragraph 24(1)
  - the netting rules at new paragraphs 27A to 27D will apply for the purposes of determining the amount of chargeable equity and liabilities of the relevant foreign bank, for the purposes of step 3 of paragraph 24(1).
45. The netting rules at new paragraph 27A to 27D differ from those at paragraph 25 of Schedule 19 in that they allow the assets of any group member (and not just the relevant foreign bank) to be included within netting agreements. By contrast, paragraph 25 requires assets to be recognised by the relevant foreign bank in question if they are to form part of a netting agreement.
46. Paragraphs 4, 5 and 7 to 13 of the Schedule update Schedule 19, consequential to other changes in this Schedule.

## Part 2: Miscellaneous amendments

47. Paragraph 15 of the Schedule omits paragraphs 43 and 44 of Schedule 19, concerning joint ventures. These paragraphs are no longer required following changes to the relevant accounting provisions.
48. Paragraph 17 of the Schedule inserts new paragraph 53A of Schedule 19. From 1 January 2019, the largest UK banks will be required to separate core retail banking from investment banking, under ring-fencing requirements applied by the Prudential Regulation Authority. New paragraph 53A limits the joint and several liability of any 'ring-fenced entity' that is not the responsible member for a group (as defined at paragraph 54 of Schedule 19). The effect is that these ring-fenced entities will not be liable for bank levy amounts arising in respect of non ring-fenced entities within the group.
49. Paragraphs 18 and 19 of the Schedule concern the nomination of a 'responsible member' in relation to a group's bank levy. It updates provisions requiring annual nomination of a responsible member to permit the automatic renewal of an entity's responsible member status. This is subject to 'renewal conditions' set out in new paragraph 54(3A) of Schedule 19 (introduced by paragraph 18(4)) and other conditions specified in new paragraph 55A of Schedule 19 (introduced by paragraph 19).
50. Paragraph 18(5) of the Schedule updates paragraph 54 of Schedule 19 by adding new sub-paragraphs (6A) and (6B). These provide a new option that applies if HM Revenue and Customs (HMRC) rejects a group's nomination of an entity to be its responsible member. In such cases, these sub-paragraphs permit HMRC and the group's parent entity (or another entity acting on behalf of the parent) to agree, within a specified period, that a different entity should be the group's responsible member. Where such an agreement is made, the default arrangements set out in paragraphs 54(4) and (5), which would otherwise determine who is the responsible member for the group, will not apply.
51. Paragraphs 20 to 32 of the Schedule remove various references to UK GAAP (UK generally accepted accounting practice) and US GAAP (United States Generally Accepted Accounting Principles) throughout Schedule 19. For the affected provisions, it is anticipated that a reference to 'international accounting standards' will achieve the appropriate outcome.

## Part 3: Commencement

52. Part 3 of the Schedule sets out commencement provisions for these amendments.

## Background note

53. The bank levy was introduced in 2011. Its purpose is to ensure that banks and building societies make a fair contribution, reflecting the risks they pose to the financial system and the wider UK economy. The bank levy also creates appropriate incentives to encourage banks to move away from riskier funding models.
54. The Summer Budget 2015 set out a long-term plan for taxation of the UK's financial services industry. This balanced the need to ensure that the financial sector remains robust, highly competitive and open for business against the ongoing need for banks and building societies to make an appropriate tax contribution that reflects their



unique risks to the UK financial system and wider economy. The plan included the introduction of a new 8% corporation tax surcharge on banking sector profits from 1 January 2016 and a phased reduction of the bank levy rate between 2015 and 2021.

55. In addition, to reflect significant changes in international regulation and resolution planning that are reducing the risk of overseas banking operations to the UK, a change in the scope of the bank levy was announced. This measure gives effect to this change, so that bank levy will only be chargeable on UK balance sheet equity and liabilities for periods of account ending on or after 1 January 2021.
56. This measure is part of a wider package of changes designed to provide a sustainable basis for raising revenue from banking sector in the long-term, while recognising developments in the regulatory and resolution regime for banks. The measure also includes changes to simplify the administration of the bank levy.
57. If you have any questions about this change, or comments on the legislation, please contact Steven Tovey on 03000 542532 (email: [steven.tovey@hmrc.gsi.gov.uk](mailto:steven.tovey@hmrc.gsi.gov.uk)).