Summary: Intervention & Options

Department /Agency: HM Revenue and Customs	Title: Impact Assessment of the Code of Practice on Taxation for Banks	
Stage: Implementation	Version: 1	Date: 9 December 2009
Related Publications: A Code of Practice on Taxation for Banks consultation document (29 June 2009)		

Available to view or download at:

http://www.hmrc.gov.uk

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What is the problem under consideration? Why is government intervention necessary?

Tax avoidance undermines the ability of the tax system to deliver the Government's objectives, imposes significant costs on society, undermines public confidence in the tax system and creates other unwelcome distortions.

Some banks have engaged in tax avoidance, undertaking transactions that they contend are within the letter of the law, but which are contrary to the spirit of the law.

What are the policy objectives and the intended effects?

The Code

- describes what the Government believes to be good practice for governance and decision-making in banks, including tax planning; it asks banks to have governance around tax, integrated into business decision-making;
- will mean banks should undertake tax planning to support their business operations, but this should not be used to achieve tax results that are contrary to the intentions of Parliament; and
- encourages banks to work with HMRC to build mutually open and transparent relationships.

What policy options have been considered? Please justify any preferred option.

1. Do nothing.

2. A voluntary Code of practice underpinned with a requirement for banks to publish performance against the Code and/or to be audited on their Code performance.

3. A Code of practice which banks adopt and comply with voluntarily. This is the preferred option. It involves the minimum level of intervention needed to be consistent with the policy statement. It also leaves other options open if needed later.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The effectiveness of the Code will be reviewed 12 to 18 months after the operative date, 9 December 2009.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and am satisfied that (a) it represents a fair and reasonable view of the expected cost, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister:

Stephen C. Timms

Date: 4 December 2009

Summary: Analysis & Evidence

Policy Option: 3	Description: A Voluntary Code.

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Banks adopting the Code will incur additional one-off costs undertaking familiarisation with the Code's requirements, procuring external professional advice (if needed), and auditing existing/setting up new governance processes. Ongoing costs will directly relate to the transactions undertaken and the marginal impact these have on the day-to-day relationship with HMRC.
£0.5m	1	
Average Annual Cost (excluding one-off)		
£ Negligible		**Total Cost** (PV) **£ Circa 0.5m**

Other **key non-monetised costs** by 'main affected groups' Some banks raised concerns over the costs associated with additional internal controls and professional advice needed to implement new governance processes. HMRC intends the Code to operate in a way that minimises additional costs.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	No benefits have been quantified.
£ Not Quantified		
Average Annual Benefit (excluding one-off)		
£ Not Quantified		**Total Benefit** (PV) **£ Not Quantified**

Other **key non-monetised benefits** by 'main affected groups' Adopting the Code will complement the building of a more transparent relationship with HMRC. This enhanced relationship should lead to more banks benefitting from a low-risk relationship with HMRC, with the the benefit of reduced formal assurance and compliance activity from HMRC.

Key Assumptions/Sensitivities/Risks Costs will vary by individual bank. HMRC has therefore focussed on clarifying how the Code will be operated so as to minimise additional costs to business.

Price Base Year 2009	Time Period Years	**Net Benefit Range** (NPV) **£ -0.3 to -1.7m**	**NET BENEFIT** (NPV Best estimate) **£ Circa-0.5m**

What is the geographic coverage of the policy/option?				UK
On what date will the policy be implemented?				09 12 2009
Which organisation(s) will enforce the policy?				HMRC
What is the total annual cost of enforcement for these organisations?				£ negligible
Does enforcement comply with Hampton principles?				Yes
Will implementation go beyond minimum EU requirements?				N/A
What is the value of the proposed offsetting measure per year?				£ N/A
What is the value of changes in greenhouse gas emissions?				£ N/A
Will the proposal have a significant impact on competition?				No
Annual cost (£-£) per organisation (excluding one-off)	Micro negligible	Small negligible	Medium negligible	Large negligible
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	**Net Impact** £ 0

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

1. Background

Following the Chancellor of the Exchequer's statement to the House of Commons on 16 March 2009, a consultation document "A Code of Practice on Taxation for Banks" was published on 29 June 2009. It explained why the Code is needed and asked banks, their advisers and other interested parties to consider the scope of the Code, and to explore specific issues relating to the administration and implementation of the Code.

2. Policy objectives and intended effects

The Government intends that banks should comply with the spirit as well as the letter of the law. The aim of the Code is to achieve this. It asks banks to ensure that they follow good practice by:

- having proper governance around tax, integrated into business decision-making;
- establishing an appropriate relationship with HMRC, following the principles set out in the Review of Links with Large Business; and
- undertaking tax planning only to support their business operations, not to achieve unintended and unexpected tax advantages (i.e. tax results that are contrary to the intentions of Parliament).

3. The options

<u>3.1. Do nothing</u>

This option is not recommended as some banks will continue to design, promote, undertake and facilitate tax avoidance and not adopt adequate governance to control this type of transaction. Doing nothing will not address this.

<u>3.2 A voluntary Code with a requirement that banks publish their compliance with it.</u>

This option was considered but HMRC does not think that banks' publishing compliance with the Code should be a requirement of adopting the Code at this time. Publishing compliance with the Code and/or being audited on performance against the Code would be a more burdensome reporting mechanism than our preferred option. This option is not therefore recommended. Banks are however free to publish their compliance with the Code if they wish.

<u>3.3. A voluntary Code with no requirement that banks publish their compliance with it.</u>

This is the preferred option. Given the voluntary nature of adoption HMRC will be happy to discuss with banks, or their representative bodies, the key issues for them in deciding whether to adopt the Code. HMRC will confirm in writing to a bank, if asked, their understanding of the implications for the bank in implementing the Code. This will deliver the criteria set out in section 4 of the Code and establish a two-way, open and transparent relationship between a bank and HMRC.

4. Who will the Code apply to?

The Code will apply to all banks, building societies and organisations undertaking banking activities in the UK. The Code therefore applies to the following:

I) Groups that undertake banking-type activities, including:

- firms listed as banks by the Financial Services Authority;

- UK subsidiaries of overseas banking groups;
- UK branches of overseas banking companies;
- securities houses; and
- building societies as defined by s119 Building Societies Act 1986.

II) Banks owned by, and banking-type activities of predominantly non-banking groups, including, but not restricted to,

- insurance groups;
- retailers; and
- motor manufacturers.

4.1 How will HMRC manage those affected by the Code?

The management of banks' taxation affairs within HMRC is split between two HMRC operating units:

- the Large Business Service (LBS) which manages the largest and most complex of HMRC's business customers; and
- Local Compliance (LC) which manages other business customers.

The banks and organisations are currently distributed as follows:

- 76 are managed within the (LBS); and
- the remainder (including 180 banks and 49 building societies) are managed within LC.

All banks within the LBS and 16 within LC have a Customer Relationship Manager (CRM) as a dedicated point of contact.

Banks managed within the LBS

The Government expects all banks within the LBS to adopt all aspects of the Code.

Reporting compliance with the Code will be part of the existing regular contact with a bank's CRM. As such, there will be no additional formal written returns or equivalent administrative burden in reporting adherence to the Code.

Banks managed within LC

All banks not currently within the LBS will be expected to comply with only the summary requirements in section 1 of the Code. That is:

- adopt adequate governance to control the types of transactions they enter into;
- not undertake tax planning that aims to achieve a tax result that is contrary to the intentions of Parliament;
- comply fully with all their tax obligations; and
- maintain a transparent relationship with HMRC.

These businesses may decide to adopt all aspects of the Code if it fits with their governance structure. However, by applying a minimum requirement HMRC believes that this approach provides the right level of assurance for HMRC without requiring these banks to incur additional costs.

5. Costs and Benefits.

The costs and benefits discussed below focus on the preferred option, a Code of Practice that banks adopt and comply with voluntarily. The focus of this Impact Assessment is on the marginal costs and benefits generated by the Code, that is the costs and benefits which are generated in addition to any existing governance processes undertaken by companies to meet their tax obligations.

In the following section, references to "banks" is for brevity; the phrase refers to all banks, building societies and organisations undertaking banking activities in the UK (as explained in section 4 above).

Given the requirements of the Code summarised above in section 4.1, three key factors will broadly influence the impact on individual banks of adopting and implementing the Code. These are:

- the size of business – and thus the volume and complexity of transactions undertaken;
- the existence (or otherwise) of appropriate governance procedures;
- whether the bank is managed within LBS or LC. This determines how HMRC expects a bank to adopt and comply with the Code.

5.1 Costs as reported in the consultation.

Respondents to the consultation commented on a number of areas where they considered adopting the Code would generate costs. No respondents were able to specifically quantify or place a value on their expected costs but responses made the point that costs would vary by organisation and would thus be very bank-specific.

Several respondents to the consultation indicated there would be an increase in both internal and external costs, and administrative burdens.

Banks said they would find it difficult to decide whether the tax result of a transaction is, or may be, contrary to the intentions of Parliament. In terms of external costs, this means there would be greater due diligence carried out and an associated increase in professional fees. In terms of internal costs, this means there would be reviews of internal controls and procedures to ensure compliance with the Code and, if required, improvements to these. This would lead to increased reporting, both internally and externally.

For smaller banks and building societies without an in-house tax function, there will be both one-off and continuing costs in implementing the Code. For example, costs of professional advisers if banks are unsure the tax results of transactions are in compliance with the Code.

5.2. One-off Costs.

The consultation process indicated that, in adopting the Code, banks could incur additional one-off costs in the following areas:

- familiarisation (reading and understanding the Code and associated guidance);
- auditing existing processes (identifying where the weaknesses / gaps in existing processes are);
- seeking professional advice (particularly smaller banks and building societies);
- setting up additional internal controls / procedures if they do not already exist; and
- managerial oversight and/or approval of (a) any decision to adopt the Code and (b) any governance changes made in order to comply with the Code.

One-off Cost Estimates

HMRC estimates that the total additional one-off cost of adopting the Code will be £540,000. A "lower" and "upper" range to that estimate is £0.3 million to £1.7 million.

If expressed on an average "per bank" basis, the additional one-off cost of adopting the Code will be £1,770. A "lower" and "upper" range to that estimate is £945 to £5,473.

We estimate that the costs may be lower than the central estimate of £1,770 for smaller banks but may be higher than this central estimate for larger banks.

The banks managed within LC will need to assess what they need to do in order to comply with section 1 of the Code. Many of these organisations will not have in-house tax functions and may need to obtain advice from professional advisers.

The Code requires that banks have proper governance around tax. The largest banks, those managed within LBS, should have established corporate governance procedures, where tax is an integrated part of a bank's decision-making processes. There may be some large banks without existing formal governance procedures. However, HMRC would expect that decision-making and other processes are already in existence, and that these could readily be adapted so that a bank is able to comply with the Code without incurring additional costs.

Assumptions

The above estimates were derived by estimating the time different banks might spend on each of the main five areas listed above. Wage data drawn from the HMRC Standard Cost Model was used to apply a value to these time estimates.

HMRC is assuming that all banks will adopt the Code, so the central estimate of £0.5 million can be considered a conservative estimate.

Sensitivity analysis was undertaken in that the lower (upper) ranges were estimated by halving (doubling) key assumptions.

Familiarisation:
- HMRC assumed that key employees within the banks would spend five hours reading PBR publications and understanding the finalised format of the Code;

Auditing Existing Procedures:
- A central assumption was that banks would commission a member of staff to audit and review their existing processes to see what, if anything, was needed in addition to pre-existing governance procedures;
- HMRC assumed that an employee in a larger bank would spend at least one week carrying out this review, with smaller banks taking half that time.

Seeking external professional advice:
- Respondents to the consultation made it clear that banks without in-house tax functions (e.g. smaller banks and building societies) may need to procure external professional advice in order to comply with the Code;
- HMRC assumed that 50 per cent of the banks managed within LC would need to procure one day of external professional advice;
- HMRC assumed that a much smaller percentage (10 per cent) of larger banks would need to procure one day of external professional advice.

Setting up additional internal controls:
- A central assumption was that banks would commission staff to set up any new governance processes;
- HMRC assumed that an employee in a larger bank would spend at least one week setting up new internal controls. HMRC assumed that it would take less time (one day) for smaller banks that are only adopting section 1 of the Code.

5.3 On-Going Costs.

The responses to the consultation suggested that banks could incur on-going costs in the following areas:

- seeking professional advice and/or making enquiries to HMRC on transactions where the bank is uncertain (particularly smaller banks and societies);
- transactions not undertaken as a result of implementing the Code; and
- internal controls and reporting processes.

Banks managed within LC

The impact for smaller banks and building societies that do not have an in-house tax function will be greater if they adopt section 2 of the Code. For this reason, banks managed in LC will be expected to comply with only the summary requirements in section 1 of the Code.

Internal costs

Many of the organisations managed within LC do not have need for regular contact with HMRC, but may have queries about the Code and how it affects them. This could be a burden on smaller banks that do not currently routinely need to contact HMRC.

HMRC will continue to discuss with the representative bodies for the smaller banks and building societies, including the Building Societies' Association and the Association of Foreign Banks the most cost-effective way smaller banks can raise their queries about the Code.

Banks managed within the LBS

HMRC does not think extra costs will be incurred by banks as a result of implementing the Code.

If, for example, banks are uncertain about the tax result of a transaction, HMRC considers that there is a reasonable test which banks should be able to apply in practice: they should ask whether the tax consequences of a proposed transaction are too good to be true, so that the tax consequences would be a surprise to HMRC.

Section 4 of the Code encourages banks to seek clarification from HMRC if doubt remains. A bank can obtain, in advance of undertaking a transaction, HMRC's view regarding whether, on the bank's analysis of the transaction, the tax consequences are contrary to the intentions of Parliament.

HMRC is aware there may be commercial timing pressures and HMRC will respond within the timeframes set out to them as far as possible. If a response cannot be provided in time, it remains the bank's decision whether to undertake a particular transaction.

Internal costs

For many large banks, HMRC does not think extra internal costs will be incurred in ensuring compliance with the published Code. HMRC believes the existing internal controls for many large banks will already be tested and proved as robust; any costs incurred in improving these is a result of a business decision and not from implementing the Code.

The consultation document indicated that a senior officer of the organisation, "preferably at board level", should sign the Code to indicate adoption. It was suggested this requirement could have resulted in additional internal compliance costs. Ministers have decided that banks do not have to formally sign a document to show adoption of the Code; instead banks can take a corporate decision on whether to adopt and implement the Code, following their own governance to determine how the decision is taken. The bank should notify HMRC of this decision.

Following adoption of the Code by a bank, HMRC will wish to discuss with that bank how they are implementing it. This will become an aspect of HMRC's existing risk assessment process. HMRC's approach will differ between:

- banks that adopt and implement the Code; and
- banks that do not.

HMRC will want to discuss with banks that do not adopt and/or implement the Code why this decision has been taken.

Summary.

The Government's intention is, that by adopting and implementing the Code, banks and HMRC will establish and maintain appropriate relationships. HMRC has listened to the responses received through the consultation process and, while the main tenets and policy rationale of the Code remain unchanged, the Government has agreed to change some wording of the Code to clarify the responsibilities and behaviours expected. In particular, the Government has decided that banks not currently within the LBS will be expected to comply with only the summary requirements in section 1 of the Code.

5.4 HMRC costs.

HMRC does not expect an increase in monetary costs as a result of the Code. The main cost will be in terms of the resources required to handle enquiries from banks following their adoption and implementation of the Code.

HMRC expects that enquiries may increase initially as banks, building societies and organisations undertaking banking activities in the UK clarify their obligations in adopting the Code and/or seeking HMRC's views on proposed transactions.

5.5 Benefits.

The Government expects the Code to reduce the amount of tax avoidance by banks. Adopting the Code should also complement the building of a more transparent relationship between banks and HMRC. HMRC considers that this enhanced relationship will lead to more banks in LBS benefitting from a low-risk relationship with HMRC. The benefit of a low-risk relationship is reduced formal assurance and compliance activity from HMRC.

6. Competition.

The Government does not intend to generate competition issues for those banks that adopt the Code. Some respondents indicated the Code would put them at a disadvantage over their foreign competitors and UK banks that did not adopt the Code. HMRC does not accept that the adoption of the Code places any banks operating in the UK at a competitive disadvantage. Many global banks operating successfully in the UK already adopt comparable documented strategy and governance processes and have constructive and transparent relationships with HMRC.

HMRC is taking steps to ensure all banks feel able to adopt the Code. HMRC is producing guidance for the Code and is continuing to talk to banks and their representatives about any areas that remain unclear.

7. Small Firms Impact Test.

The Code will apply to the banks, building societies and organisations undertaking banking activities in the UK. Some of these businesses do employ fewer than 20 people, for example the smaller building societies and UK branches of overseas banks.

This Code can be adopted in full by these small banks. As part of the consultation, HMRC received responses from organisations representing the smaller banks, in particular the Building Societies' Association and the Association of Foreign Banks. These organisations identified several concerns for their members; in particular, they identified the fact that smaller banks would face on-going costs in seeking external professional advice where they have no in-house tax functions.

To mitigate these costs, all banks not currently within LBS will, as a minimum, be expected to comply only with the summary requirements in section 1 of the Code.

8. Administrative burden.

8.1 Definition and explanation of coverage.

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular, the administrative burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model' (SCM), an activity-based costing model which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.

The SCM, and the administrative burdens it estimates, is only one element of the total compliance costs a business may face when HMRC introduces a new measure.

The SCM does not therefore consider:
a) costs which a business would have incurred anyway had the relevant HMRC obligation not existed; and
b) the wider compliance cost issues, such as the costs of business uncertainty, cash flow costs, or the costs of deciding whether or not to do something.

The SCM does consider the costs which apply to a normally efficient business and the costs to businesses which comply.

8.2 Implications of the Code.

Implementation of the Code does not directly change any of the forms and returns which banks are required to submit to HMRC in order to comply with HMRC's obligations beyond the Code. A business implementing the Code will not face any additional administrative burden. Reporting compliance with the Code will also not involve any formal written return.

9. Implementation plan.

All banks will be expected to adopt and implement the Code with effect from the announcement on 9 December 2009. HMRC will invite the banks to discuss any matters that arise on implementation.

10. Consultation.

HMRC has undertaken a very extensive consultation involving meetings with individual banks, advisers, representative bodies and banks collectively (both organised by HMRC and organised by their advisers).

The consultation period closed on 25 September 2009. HMRC received 27 formal responses as well as a wealth of informal discussions containing a range of comments. A summary of the responses has been published at www.hrmc.gov.uk

11. Impact tests.

Other Specific Impact Tests

HMRC has considered whether the policy options would have any impact on the following:

- Legal Aid
- Sustainable Development
- Carbon Assessment
- Other Environment
- Health Impact assessment
- Race Equality
- Disability Equality
- Gender Equality
- Human Rights
- Rural Proofing

and we conclude there is no impact.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

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