EXPLANATORY MEMORANDUM TO

THE BANK LEVY (LOSS ABSORBING INSTRUMENTS) REGULATIONS 2020

2020 No. 1188

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Commissioners for Revenue and Customs (HMRC) on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 These regulations provide detailed specifications and conditions for the treatment for the Bank Levy of loss absorbing instruments (such as shares and certain convertible debt) issued by overseas subsidiaries of United Kingdom (UK) resident entities. If these instruments meet certain specified conditions set out in these regulations, they can be deducted from equity and liabilities otherwise chargeable to the Bank Levy. This ensures the new Bank Levy tax rules that take effect from 1 January 2021 work as intended where UK entities hold such instruments. These regulations will apply from 1 January 2021.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 Schedule 9 to the Finance Act 2018 (FA 2018) introduced new rules amending Schedule 19 to the Finance Act 2011(FA 2011). These new rules reduce the scope of the Bank Levy for chargeable periods ending on or after 1 January 2021 so that it is only chargeable on UK balance sheet equity and liabilities.

6.2 Included in these new rules was Step 3 of paragraph 15N(1) of Schedule 19 which provides for a deduction from chargeable equity and liabilities for loss absorbing instruments (see paragraph 6.5 below for a definition) issued by overseas subsidiaries if paragraph 15X of Schedule 19 applies. The purpose of this deduction is to remove from the Bank Levy charge the amount of capital issued by UK entities to meet regulatory requirements for holding loss absorbing instruments issued by those overseas subsidiaries.

6.3 Paragraph 15X provides for assets of a UK group entity representing loss absorbing instruments issued by overseas subsidiaries to be deducted from UK issued loss absorbing liabilities. The deduction will be made against UK liabilities comprising either tier one capital (such as ordinary shares and reserves) or against other loss absorbing instruments, depending correspondingly on which of those two categories the non-UK issued loss absorbing equity and liabilities fall within.

6.4 When FA 2018 was enacted in March 2018, the Bank of England's approach to loss absorbing capacity or recapitalisation (LACR) requirements for loss absorbing instruments had not yet been published. Therefore, provision was made in the Act for regulations to provide detailed specifications and conditions for loss absorbing instruments to come within paragraph 15X. The intention was to use the regulation-making powers once the Bank of England's approach had been decided. The Bank of England's approach to setting such requirements for UK incorporated institutions is set out in section 3A of the Banking Act 2009 and part 9 of the Bank Recovery and Resolution (No. 2) Order 2014 and a Statement of Policy that was issued in June 2018. Requirements are also contained in the Capital Requirements Regulation.

6.5 'Loss absorbing instruments' are defined in paragraph 15V of Schedule 19 as:

a. tier one capital equity and liabilities; and

b. other instruments.

In both cases these must satisfy LACR requirements imposed by a regulator, with paragraph 15V(4)(b) providing that regulations can further specify the meaning of LACR requirements.

6.6 Paragraph 15W of Schedule 19 sets out the conditions regarding which assets can be deducted from liabilities. Such assets are 'qualifying' loss absorbing instruments (QLAIs) issued by overseas subsidiaries that under paragraph 15W(4)(b) meet certain conditions specified by regulations.

6.7 Paragraph 15W(7) also provides that regulations may specify the conditions for the UK entity's liabilities from which such QLAI assets can be deducted.

6.8 These regulations use the powers mentioned at paragraph 15Y to provide details on the relevant specifications and conditions in paragraphs 15V and 15W.

6.9 This is the first use of the powers mentioned in paragraph 15Y of Schedule 19 to FA 2011. Paragraphs 15V, 15W and 15Y were added to Schedule 19 by paragraph 2 of Schedule 9 to FA 2018 with effect for chargeable periods ending on or after 1 January 2021.

7. Policy background

What is being done and why?

7.1 The Bank Levy is a tax on the balance sheet equity and liabilities of banks and banking groups which took effect from 1 January 2011. Its purpose is to ensure banks make a fair tax contribution and to encourage banks to move away from risky funding models that may affect the stability of the financial sector. The charge currently includes the equity and liabilities of non-UK subsidiaries of UK headquartered banking groups and of UK sub-groups of foreign headquartered banks.

7.2 At Summer Budget 2015 the government announced that in line with the evolving regulatory landscape, the Bank Levy would be re-scoped from 1 January 2021 and would be levied solely on the UK balance sheet equity and liabilities of banking groups. The rescope was introduced in FA 2018.

7.3 The rescope required more than a simple narrowing of the tax base to include only the equity and liabilities of UK entities. This was because UK balance sheets may include funding raised externally by UK entities to fund overseas subsidiaries. In particular, regulators require banking groups to issue loss absorbing instruments on behalf of both their domestic and overseas activities, to help facilitate more orderly resolution in the event of crisis. It would not be in line with the aims of the rescope if the Bank Levy applied to the totality of a UK bank's balance sheet liabilities without taking account of the fact that some of that balance sheet may relate to funding overseas activities. To address this issue, Schedule 9 to FA 2018 introduced a deduction from equity and liabilities otherwise chargeable to the Bank Levy for certain loss absorbing instruments issued by an overseas subsidiary of a UK resident group member.

7.4 Many countries have a regulatory authority responsible for orderly resolution of its banks in the event of a bank's failure. For the UK, this is the Bank of England. The regulatory authority is responsible for imposing a requirement to issue loss absorbing instruments and for defining which instruments will be eligible and other conditions regarding their issuance and ownership. The Bank of England had not published its requirements when FA 2018 was enacted, so powers were included in paragraph 15Y of Schedule 19 to FA 2011 to provide specifications and conditions for loss absorbing instruments in secondary legislation.

7.5 The Bank of England's regulatory requirements have now been finalised and the purpose of these regulations is to provide the specifications and conditions for loss absorbing instruments, so that the deduction introduced by FA 2018 and contained in paragraph 15X of Schedule 19 can be effective from 1 January 2021.

7.6 The regulations introduce specifications for the definition of a 'loss absorbing capacity and recapitalisation' requirement, which are based on regulatory requirements that are comparable to the UK's LACR requirements imposed by the Bank of England.

7.7 The instrument specifies that if equity and liabilities would have been tier one capital equity and liabilities but for deductions made under certain regulatory capital requirements then those equities and liabilities are specified as tier one capital for the purpose of calculating this deduction.

7.8 This instrument also introduces a requirement that QLAIs issued by an overseas subsidiary must be held by a UK entity for the purpose of satisfying LACR requirements imposed by a UK or non-UK regulator. LACR requirements can arise in more than one territory as the authorities setting the requirements may regulate the group, the parent or any of its subsidiaries and these may reside in different jurisdictions.

7.9 This instrument also introduces a requirement concerning the UK entity's liabilities from which QLAI assets can be deducted. The regulations require that such liabilities are in issuance for the purpose of satisfying LACR requirements of a relevant regulator.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 There are no plans to consolidate the legislation.

10. Consultation outcome

10.1 The draft regulations were published for a four week consultation beginning 13 July 2020. Meetings were held and responses received from a small number of accountancy firms, representative bodies and banks affected by the rules. The instrument has been updated to reflect technical comments received.

11. Guidance

11.1 Draft guidance on these regulations is available online at https://www.gov.uk/government/consultations/draft-regulations-amendment-to-the-bank-levy-rules-on-deductions-for-certain-loss-absorbing-instruments.

12. Impact

12.1 The impact on business, charities or voluntary bodies is limited to around 30 banking groups in scope of the Bank Levy who may hold loss absorbing instruments issued by an overseas subsidiary. These regulations ensure that Paragraphs 15V and 15W of Schedule 19 to FA 2011 operate as intended. The small number of businesses impacted by these regulations will incur insignificant one-off costs of familiarisation with the conditions set out in the regulations. There are not expected to be any ongoing costs to those businesses from the regulations. There is no, or no significant, impact on charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 A Tax Information and Impact Note covering this instrument will be published on the website at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 HMRC will monitor the impact of the regulations through information collected on tax returns and through communications with affected taxpayer groups

14.2 The regulations do not include a statutory review clause. They amend United Kingdom tax legislation and therefore fall within the exceptions at section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

15. Contact

15.1 Sam Louks (Telephone: 03000 530 709 or email: samuel.louks@hmrc.gov.uk) or Andrew Martel (Telephone: 03000 517 495 or email: andrew.martel@hmrc.gov.uk) at HMRC can be contacted with any queries regarding the instrument.

15.2 Richard Thomas, Deputy Director for Financial Products and Services, at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glen, Economic Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.