HM TREASURY

Bank Levy:

a consultation

July 2010

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ISBN 978-1-84532-763-7
PU1026

Summary information

Subject of this consultation:	Implementation of the Bank Levy announced in the June 2010 Budget.
Scope of this consultation:	This consultation document sets out proposals to develop a framework for implementation, including detailed policy design of the Bank Levy.
Impact Assessment:	The consultation stage impact assessment is attached at annex B.
Who should read this:	The Government would like to hear the views of business, as well as the views of representative bodies and tax advisers, on the proposals set out in this consultation document.
Duration:	The consultation period for this document runs from 13 July to 5 October 2010.
Responses and enquiries:	Responses and enquiries should be sent to: The Bank Levy Team Room 2/E1 HM Treasury 1 Horse Guards Road London, SW1A 2HQ Alternatively, please email: banklevy@hmtreasury.gsi.gov.uk Telephone enquiries: 020 7270 5976
Additional ways to become involved:	Please contact David Ellis on the contact details above if you would like to discuss your response. The Government intends to hold workshops to discuss stakeholder views on the issues raised in this document, before the end of the twelve week consultation process. Please send your expressions of interest to the email address above and indicate your main areas of interest and preferred dates by Friday 30 July.
After the consultation:	It is proposed that draft legislation will be published in the autumn to allow for further comments from stakeholders. Final draft legislation for inclusion in the 2011 Finance Bill will published towards the end of 2010, ahead of implementation of the Levy.
Getting to this stage:	This consultation document reflects joint analysis carried out by HM Treasury and HM Revenue & Customs. Other public bodies have been involved as appropriate.
Previous engagement:	Following the Budget announcement, officials from both HM Treasury and HM Revenue & Customs have met with representatives of both the Association for Financial Markets in Europe (AFME) and the British Bankers' Association (BBA). The material in this consultation document has been informed by those discussions.

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Foreword

Our very recent history shows that when some banks begin to fail, the stability not only of the financial system but also of the whole economy is put at risk. As we emerge from the crisis, we need to rebuild our financial services sector to reduce systemic risk and increase institutional resilience. At the same time we need a banking sector that can support the recovery and promote economic growth.

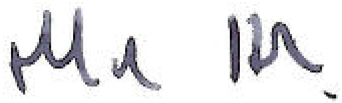
The Government has put forward far-reaching plans for reform. We have already announced an overhaul of financial regulation and the creation of an Independent Banking Commission, and we will continue to press ahead with the implementation of Recovery and Resolution Plans.

The Government also believes that banks should make a fair contribution in respect of the potential risks they pose to the UK financial system and wider economy. Therefore, in the June Budget, the Chancellor announced that we would introduce a Bank Levy from 1 January 2011. The structure of the Levy is intended to encourage the banks to move away from riskier funding models, reducing systemic risk. Once fully in place, we expect the Levy to generate around £2½ billion of annual revenues.

The financial services sector is global in nature; capital flows across national boundaries, firms operate across jurisdictions and risks can spread across national economies. This Government recognises the need for global co-ordination wherever possible. We have already joined with the governments of France and Germany in announcing the introduction of bank levies based on banks' balance sheets, and the UK Levy is based on the IMF's proposals. We will work with our international counterparts to examine concerns about double taxation.

This document takes forward the consultation announced in the Budget on technical aspects of the design and implementation of the Levy. I hope that you take the time to respond fully to this consultation. Your responses will help us to ensure the Levy is designed in a way that best meets its objectives, including ensuring the compliance costs faced by firms are minimised.

The levy is one of a series of reforms which are designed to put the banking sector on a more stable and sustainable basis. We believe that these reforms open the way for banks to play their role in supporting wider economy.



Mark Hoban MP

Financial Secretary to the Treasury

July 2010

1 Introduction

1.1 In the June 2010 Budget, the Chancellor announced that the Government will introduce a Bank Levy (the Levy) from 1 January 2011.

1.2 Following on from the design details announced at Budget, this document sets out the possible and proposed approaches to defining taxable entities and the tax base, as well as other operational issues, and invites responses on these. A consultation stage impact assessment is available at http://www.hm-treasury.gov.uk/d/consult_bank_levy_ia.pdf.

1.3 The consultation is being conducted in line with the principles outlined in the document "Tax policy making- a new approach"[1] published alongside the June Budget. The document sets out three stages for policy development:

- stage 1 - set out objectives and identify options;
- stage 2 - determine the best option and develop a framework for implementation, including detailed policy design; and
- stage 3 - draft legislation to effect the proposed change.

1.4 This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on how best to implement the Levy announced in the June Budget.

1.5 It is proposed that draft legislation will be published in the autumn to allow for further comments from stakeholders. Final draft legislation for inclusion in the 2011 Finance Bill will be published towards the end of 2010, ahead of implementation of the Levy.

1.6 In "Tax policy making- a new approach", the Government also set out an intention to evaluate the effectiveness of tax reforms, to ensure that they are meeting their objectives. Consistent with this, the Government will review the design of the Levy in 2013 to ensure it is operating efficiently.

Policy context

1.7 It is fair and it is right that banks should make an appropriate contribution, which reflects the many risks they generate. Excessive risk taking in the banking sector was a significant contributory factor in the recent financial crisis. Alongside the wider financial regulatory reform aimed at increasing the resilience of the financial sector, the Levy is intended to encourage banks to move away from riskier funding – problems with risky funding led to serious liquidity problems that played a key role in the financial crisis. The crisis demonstrated the central role that liquidity shocks can play in triggering and propagating systemic banking crises.

1.8 The Levy is intended to ensure that banks make a contribution that reflects the potential risk to the UK financial system and wider economy from bank failures and consequent loss of consumer and investor confidence.

[1] http://www.hm-treasury.gov.uk/d/junebudget_tax_policy_making.pdf

1.9 The Levy is not insurance against failure and liability for the Levy does not indicate that a bank is too big to fail. Systemic risks need to be assessed in light of prevailing circumstances. The wider regulatory reforms underway are aimed at ensuring that no firm is too big to fail and that all firms are resolvable. The contribution to the Exchequer is not intended to fund future intervention but to reflect the wider economic risks posed by the sector. The Government does not propose to establish a resolution fund.

1.10 As set out in the June Budget, the Government expects to raise around £2½ billion each year when the Levy is fully in effect. The Government will therefore consider whether the proposed Levy rates are appropriate once design issues covered in consultation are finalised.

International debate

1.11 The use of levies has also been the subject of international debate.

1.12 At the 2009 Pittsburgh summit, the G-20 leaders asked the International Monetary Fund (IMF) to: "...prepare a report for our next meeting [June 2010] with regard to the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burden associated with government interventions to repair the banking system." The IMF published their report to the G-20 on 27 June.[2]

1.13 The governments of France, the United Kingdom and Germany also issued a joint statement on 22 June stating their intentions to introduce bank levies based on banks' balance sheets. France will present the details of its bank tax in its coming budget. Germany announced a framework for a national bank levy at the end of March and will present draft legislation in the summer. All three levies will aim to ensure that banks make a fair contribution to reflect the risks they pose to the financial system and wider economy, and to encourage banks to adjust their balance sheets to reduce this risk. The specific design of each levy may differ to reflect different domestic circumstances and tax systems, but the level at which each levy is set will take into consideration the need for a level playing field. The Government appreciates the need to avoid double taxation where possible and will urgently take forward discussions on resolving this with other countries that plan to introduce bank balance sheet levies.

Structure of the Levy

1.14 The proposed structure of the Levy was set out in the June 2010 Budget.

1.15 The Levy will apply to:

- the global consolidated balance sheet of UK banking groups and building societies;
- the aggregated UK subsidiary and branch balance sheets of foreign banks and banking groups operating in the UK; and
- the balance sheets of UK banks in non-banking groups.

1.16 These institutions and groups will only be liable for the Levy where their relevant aggregate liabilities, as set out below, amount to £20 billion or more. In calculating branch liabilities and Tier 1 capital, the Government proposes to use the principles applied to the existing capital attribution methodology used for Corporation Tax purposes.

1.17 The Levy will be based on total liabilities and equity excluding:

[2] A Fair and Substantial Contribution by the Financial Sector, Final Report for the G-20, IMF June 2010
http://www.imf.org/external/np/g20/pdf/062710b.pdf

- Tier 1 capital;
- insured retail deposits;
- repos secured on sovereign debt; and
- policyholder liabilities of retail insurance businesses within banking groups.

1.18 The Government proposes that derivative positions will be included on a net liability basis.

1.19 It is proposed that the Levy will be set at 0.07 per cent which is expected to raise around £2½ billion annually. However, there will be a lower rate of 0.04 per cent for 2011. There will also be a reduced rate for longer-maturity funding (i.e. greater than one year remaining to maturity at the operative balance sheet date) to be set at 0.02 rising to 0.035 per cent; half the main rate.

1.20 The Levy will not be deductible for Corporation Tax.

1.21 HM Revenue and Customs will administer the Levy.

1.22 The next three chapters set out the proposed approach to defining taxable entities and the tax base, as well as other operational issues, and invite responses on the appropriateness and practicality of these.

2 Taxable entities

The scope of the Levy

2.1 The Levy will apply to:

- the global consolidated balance sheet of UK banking groups and building societies;
- the aggregated subsidiary and branch balance sheets of foreign banks and banking groups operating in the UK; and
- the balance sheets of UK banks in non-banking groups.

2.2 Institutions and groups listed above will only be liable for the Levy where their relevant aggregate liabilities that are subject to the Levy amount to £20 billion or more.

2.3 For UK banks, the Levy needs to apply to the global balance sheet as that represents the best measure of the potential risk to the UK financial system and wider economy. Building societies also represent the same sort of risk as banks and therefore will be within the scope of the Levy (if they meet the size threshold). Banks in non-bank groups will be within the scope of the tax to the extent of their banking businesses – they represent the same sort of risk as banking groups.

2.4 UK branches and subsidiaries of foreign banks are within the scope of the measure – their business represents the same sort of systemic risk whether it is carried on in a branch or a subsidiary, and they are in direct competition with banks headquartered in the UK. The contribution to the Exchequer is not to fund future interventions, but to reflect the wider economic risks posed by the sector, and the same risks are posed by UK branches and subsidiaries of foreign banks as UK banks.

2.5 For foreign bank groups the Levy needs to apply to aggregated liabilities of the UK business and their subsidiaries to ensure that a fair measure of the UK's exposure to that group can be determined and to provide a consistent basis with UK banks.

Definition of banks and banking groups

2.6 he Government proposes to define a "bank" for the purposes of the Levy as per the Bank Payroll Tax provisions at paragraph 43 Schedule 3 Finance Act 2010.[1] This legislation provides a familiar basis for the definition of a "UK resident bank" and "relevant foreign bank". It should be noted that in the case of a foreign-headed banking group there will be a liability to the Levy only where there is a UK resident bank or a relevant foreign bank that is a member of the foreign banking group (see below for how such membership will be determined).

2.7 The Government also proposes to use the "banking group" definition in paragraph 45 Schedule 3 Finance Act 2010, but with necessary modifications to reflect the fact that the Levy will be based upon accounting group concepts rather than the tax group definitions used for Bank Payroll Tax.

[1] "Building Society" will be as defined in the Building Societies Act 1986.

2.8 The taxable balance sheet of UK-headed banking groups would thus be the global consolidated balance sheet prepared under IFRS.

2.9 A company will be treated as a member of a banking group if its financial statements are included (in whole or part) in the consolidated financial statements of a banking group. For these purposes the intention is to look at consolidated banking group financial statements prepared under either IFRS[2] or US GAAP.

Aggregation

2.10 Where all the UK businesses results that are consolidated into global bank group accounts are also included in the UK sub-group consolidated accounts then the balance sheet of those sub-group accounts will be the taxable balance sheet for the purposes of the Levy.

2.11 Where there is a UK company (or a foreign company operating in the UK through a branch) which is a member of a foreign banking group but is not included in the UK sub-group consolidation of that banking group (for instance where there is a UK branch and a separate UK sub-group), or where there is no UK sub-consolidation, it is intended that legislation will require an aggregation of the liabilities and equity of those interests.

2.12 This process will require an aggregation of the liabilities and equity extracted from relevant balance sheets prepared under IFRS or UK GAAP[3] of:

- UK sub-group consolidated accounts;
- any other UK entity accounts not included in such a consolidation (and their subsidiaries); and
- UK branch accounts (based upon the capital attribution methodology used for Corporation Tax).

2.13 The calculation would be subject to the adjustment for those items which would normally be adjusted for in a consolidation under UK GAAP or IFRS (such as elimination of UK inter-company balances).

Table 2.A: Example

Bank A has a UK sub-group (which prepares consolidated accounts), and a UK branch. Under the proposals the calculation would require:

- The calculation by the bank of the aggregate of the liabilities and equity in the sub-group consolidated balance sheet and the branch accounts;
- If the sub-group had received a loan from the branch, then the aggregate liabilities and equity would be reduced by the amount of this loan recognised in the consolidated accounts.

The aggregation must be prepared on a basis coterminous with the period of account of the global consolidated balance sheet of the banking group.

2.14 Where the only UK presence of a foreign banking group is a UK resident bank or relevant foreign bank (with no subsidiaries) then the taxable balance sheet will be the entity or branch balance sheet (see below) prepared under IFRS or UK GAAP.

[2] References to IFRS in this document are to EU adopted IFRS.
[3] References to UK GAAP in this document are to UK GAAP including FRS 26)

2.15 Where there is a UK resident bank or a relevant foreign bank in a non banking group the taxable balance sheet will be the entity balance sheet or the sub-consolidated balance sheet of the banking sub-group, as appropriate, again prepared under IFRS or UK GAAP.

Questions

- Does the proposed aggregation present any practical difficulties which could create an excessive compliance burden? If so, how could it be improved?
- Is there a more effective way of determining the amount chargeable to the Levy for those who do not produce a UK consolidated balance sheet which includes all UK interests and their subsidiaries?
- Are there any other ways of defining banks and banking groups bearing in mind the policy objective that the Levy applies to retail and investment banks and banking groups with relevant taxable liabilities?
- Given the proposed scope of the Levy, are there are other issues in relation to the definition of taxable entities?

Calculation of branch liabilities

2.16 As outlined above, for the purposes of the Levy, a UK branch of a foreign bank will be required to determine its share of the entity liabilities and Tier 1 capital. For Corporation Tax purposes, branches already use a method that is tried and tested and has OECD approval, to calculate the amount of interest that may be deducted in computing the taxable profits of the branch. This involves determination of the amount of assets and capital that branches are required to hold. The Government proposes that this capital attribution tax adjustment (CATA) method will form the basis for determining the branch taxable liabilities.

2.17 A full explanation of the CATA process is provided in the HMRC International Tax manual.[4]

2.18 The first step in the CATA process is to attribute assets to the branch using the Key Entrepreneurial Risk Taking principles. This gives the branch's total assets for the purposes of the branch balance sheet.

2.19 The next step in the CATA process is to risk weight those assets and then establish the amount of branch capital necessary to support the risk assumed This, therefore, provides the amount of total capital, both Tier 1 and Tier 2, which is attributable to the branch. (Further details on establishing the amount of total capital and split between Tier 1 and Tier 2 can be found in the HMRC International Tax manual as mentioned above.)

2.20 In computing the interest deduction due to the branch, the Tier 1 and Tier 2 capital first displaces any interest free funds provided by head office and then an appropriate mix of interest-bearing funds held by the branch, so that the relevant amount of interest deduction is then disallowed.

2.21 For the purposes of the Levy, the key steps of the CATA process could be adopted to attribute to the branch as required its total assets, risk weighted assets, Tier 1 capital and liabilities net of Tier 1 capital. Two alternatives are considered below.

2.22 The first method works on the basis of the appropriate mix of interest-bearing liabilities held in the branch. It should be noted that for CATA purposes, it is not necessary to correlate

[4] http://home.inrev.gov.uk/intmanual/INTM267700.htm

the appropriate mix of interest-bearing funds held by the branch with the composition of the funding of the bank overall.

Table 2.B: Attribution on basis of the interest bearing liabilities held in the branch

Assume the branch had been attributed no capital but held 50 million in long term loans and 50 million in retail deposits.
Under the CATA process it is attributed 40 million capital, total Tier 1 and Tier 2.
The capital might displace 20 million long term loans and 20 million retail deposits.
The bank as a whole, however, may have liabilities composed Tier 1, 390 million, Tier 2, 150 million, long term loans 1000 million, retail deposits 2000 million.
Thus, the appropriate mix of interest-bearing liabilities held in the branch and adopted for CATA purposes may not reflect the mix of liabilities of the bank as a whole.

2.23 If the amount of Tier 1 to be deducted from liabilities is to be the amount computed under the CATA process, which reflects the risk inherent in the branch, then the liabilities to be attributed to the branch would be those considered the appropriate mix for a branch of that profile.

2.24 The problem with this approach is that it takes no account of the fact that in a liquidity crisis the branch would have recourse to the funding of the entity as a whole and not just to the liabilities held at branch-level. Furthermore some of the "liabilities" of the branch might in fact be intra-entity funding from head office. Adopting this method would require such funding to be included in the levy base.

2.25 The alternative course in attributing liabilities and equity to the branch is to apportion the total liabilities (including Tier 1 capital) of the entity of which the branch is a part in the same proportions that the branch assets computed under the CATA bear to the total assets of the entity.

2.26 Those liabilities will have the same profile as the entity liabilities

Table 2.C: Attribution on basis of total liabilities of the entity

Bank entity has Tier 1 capital of 20 and liabilities excluding Tier 1 capital of 100 (50 short-term, 30 long-term and 20 insured retail deposits).
UK branch is attributed 50 per cent of entity assets under CATA.
Branch liabilities will thus be 25 short-term, 15 long-term, 10 insured retail deposits. Branch Tier 1 capital will be 10.

2.27 A further point to consider then is the basis for attribution of liabilities: should it be according to risk weighted assets or total assets? Attribution in the ratio of branch risk weighted assets to total assets may have the advantage of more accurately reflecting the risk located in the branch, but the use of total assets better reflects the policy aim of the Levy which is focussed on the funding profile of the business and what this says about the likely systemic risk the business poses in a liquidity crisis, rather than on the asset mix of the business.

2.28 If the liabilities are attributed on the basis of the proportion of risk weighted assets then the Tier 1 capital attributable to the branch as computed under the CATA can then be deducted.

2.29 If the liabilities are attributed on the basis of total assets it would seem more appropriate to deduct Tier 1 capital at the entity level from total liabilities and equity before attributing the net liabilities to the branch.

2.30 Under the latter method it would also be appropriate to undertake any netting of derivatives at the entity-level and only attribute net derivative liabilities to the branch.

Questions

- Does the proposed use of CATA as a basis of calculation represent a suitable means of identifying the liabilities of a UK branch of a foreign bank?
- Should liabilities be attributed to the branch on the same basis as under the CATA or in the ratio of liabilities held by the bank as a whole?
- If the latter, should liabilities be attributed on the ratio of branch risk weighted assets to total risk weighted assets or total assets of the branch to the total assets of the bank as a whole?
- Do any of the suggested calculation methodologies present any practical difficulties which could create an excessive compliance burden?

Threshold

2.31 It is right that the levy should be proportionate. The proposed threshold therefore balances the probability that the failure of a bank could pose a systemic risk against the relative burden imposed in order to gather additional revenue at the margin. However, in discussions held and correspondence received since the Budget announcement, a number of institutions have argued that an allowance rather than a threshold should be applied (which to generate the same yield would imply a higher rate of Levy).

Question

- What would be the impacts of setting an allowance rather than a threshold?

3 Tax base

The Levy Base

3.1 The Levy will be based on total liabilities and equity as reported in the relevant accounts, excluding:

- Tier 1 capital;
- insured retail deposits;
- repos secured on sovereign debt; and
- policyholder liabilities of retail insurance businesses within banking groups.

These exclusions are based on the broad balance sheet levy recommended by the International Monetary Fund in their report to the G20. Definitions of each exclusion are discussed further below.

3.2 It is intended that the main Levy rate will be set at 0.04 per cent in 2011 and 0.07 per cent from 2012, but longer-maturity funding – greater than one year remaining to maturity at the operative balance sheet date – will be subject to half the main rate (i.e. 0.02 percent in 2011 rising to 0.035 per cent).

3.3 In the case of intra-group liabilities of the UK part of a foreign group with its parent or other overseas entities, for the purposes of the Levy, this funding will be treated as short-term unless it can be demonstrated by the group that it is backed by external long-term funding.

3.4 It is also proposed that net derivative liabilities should be used for calculation of the Levy. This is discussed further below.

Tier 1 Capital

3.5 The Levy base excludes Tier 1 capital in order not to discourage capital accumulation. This follows the IMF recommendations and complements the wider regulatory reform agenda, including moves to strengthen capital requirements. The Government proposes that the definition of Tier 1 capital will therefore follow the Basel and EU capital requirements.

Insured Retail Deposits

3.6 The exclusion of insured, retail deposits reflects two factors:

- the general stability, or 'stickiness' of retail funding for banks, particularly where these are covered by some form of guarantee or insurance; and
- the desirability of avoiding 'double imposition', as suggested in the IMF Report, in respect of liabilities for which banks may be required to make contributions to a guarantee or insurance scheme.

3.7 There is also no generally accepted definition of retail deposits, so coverage by a statutory or State-run guarantee or insurance scheme is intended to provide an objectively verifiable basis for exclusion of liabilities from the Levy base.

3.8 It is proposed that insured retail deposits should include retail deposits that are subject to an explicit State guarantee.

Questions

- Aside from those discussed in this document, are there any other, robust definitions of retail funding that could achieve the objectives of excluding only relatively stable retail funding and avoiding double imposition?
- Are there any other forms of deposit insurance or guarantee, or other equivalent measures in other jurisdictions that could and should be covered by this exclusion?

Sovereign repos

3.9 The exclusion for repo liabilities secured against sovereign and supranational debt is intended to reflect the relatively low risk associated with those instruments and the deep markets for the collateral. For these purposes the Government could adopt a relatively simple approach and exclude repos of all sovereign and supranational debt instruments issued directly by national governments, government-guaranteed entities and central banks without any further discrimination on the basis of underlying risk.

3.10 An alternative approach which would better reflect the intention behind this exclusion might be to base the range of acceptable collateral on the definition of high quality assets which are currently permitted by the FSA to be included in a bank's liquid assets buffer.[1] Thus the exclusion would cover repos of:

- high quality debt securities issued by a government or central bank of an EEA State, Australia, Canada, Japan, Switzerland or the United States of America and which met the criteria for credit rating and currency denomination specified in the FSA Handbook; and
- securities issued by a designated multilateral development bank or supranational institution.

Questions

- Should the repo exclusion be framed in terms of the current FSA requirements for liquid asset buffers, rather than just those secured against sovereign debt?
- Are there other types of repo where the collateral has similar risk and liquidity characteristics that we should also consider excluding?

Policyholder liabilities

3.11 Excessive risk taking in the banking sector was a significant contributory factor in the recent financial crisis and the Levy is intended to reflect this risk. Where UK banking groups include retail insurance businesses, policyholder liabilities are excluded from the Levy calculation as it is recognised that those banks are required to contribute as necessary to policyholder protection schemes that provide cover for these liabilities in the event of failure.

3.12 This exclusion applies to life and non-life insurance business.

[1] FSA Prudential Handbook for Banks, Building Societies and Investment Firms (BIPRU), section 12.7.
http://fsahandbook.info/FSA/html/handbook/BIPRU/12/7

Questions

- Does excluding retail insurance policyholder liabilities as they appear in the balance sheet correctly capture those liabilities that are covered by the protection schemes?
- Are there other liabilities that are also covered by protection schemes to which banks are required to contribute?

Netting derivatives

3.13 In determining the liability base for the Levy, we need a consistent and broadly applicable basis for determining what the overall liability should be in respect of derivative contracts. This is made more difficult by the significant divergence here between the accounting practices adopted in the EU and the US.

3.14 Under IFRS and UK GAAP offsetting of any financial asset and financial liability requires a legally enforceable right of set-off plus an intention either to settle on a net basis, or to realise the asset and settle the liability simultaneously. In practice this results in relatively little netting of derivatives. US GAAP on the other hand currently allows net exposures to be included in the accounts where the exposures are with the same counterparty and subject to a master netting arrangement, even where there is no intention to settle net.

3.15 Basing the treatment of derivatives on the accounting convention of the home State would therefore give rise to a competitive distortion. Imposing one or other accounting treatment could impose additional compliance costs on those banks that did not report according to that standard.

3.16 However, the Basel II standard for calculating the credit exposure potentially provides a common base for the treatment of netting derivative exposures. This provides for netting in a wider range of circumstances than is permitted under IFRS. The Basel II treatment is intended to reflect the balance sheet exposure in the event of default, which seems an appropriate measure to use for the purposes of the Levy.

3.17 The Basel II treatment allows a bank to net derivative exposure provided that:

- it has a well founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction regardless of whether the counterparty is insolvent or bankrupt; and that
- it is able at any time to determine assets and liabilities with the same counterparty that are subject to the netting agreement and monitors the relevant exposures on a net basis.

Questions

- Which method of calculating the aggregate derivative liability represents the best approach in order to achieve an appropriate balance in terms of common treatment and minimising compliance costs?
- Are there methodologies other than those noted in this document that might alternatively be used to calculate the aggregate derivative liability?

Further issues

3.18 In correspondence received since the June Budget announcement, a number of institutions have suggested, given the rationale of the Levy, there may be other items contained within the liabilities side of the balance sheet that would merit exclusion from the Levy base. Trade bodies have also noted that there may also be other impacts on banks operations raised by the design of the Levy, and we would be keen to understand further any potential issues.

Question

- Given the rationale of the Levy base, are there are other issues in relation to the definition of the base?

4 Operation

4.1 There are a number of operational issues relating to the application of the Levy:

- the administrative process;
- operation of anti avoidance rules; and
- issues around potential double taxation.

Administrative process

4.2 Responsibility for processing and administration of the Levy will rest with HMRC.

"Responsible company"

4.3 In order to minimise the administrative burdens on banking groups and to streamline the administration of the Levy, a single UK company group member will be responsible for the return of the liability and payment of the Levy on behalf of the banking group. Obviously where the Levy is based on only one company's balance sheet (or the branch of one company) the responsibility (and liability) will rest with that company. The responsible company will be responsible for:

- making the return of the Levy on behalf of the banking group through its company tax return;
- submitting the financial statements;
- submitting the tax computations; and
- the payment of the Levy.

4.4 The existing Corporation Tax Self Assessment (CTSA) system will be used to report and collect the Levy (legislation will be required to achieve this) – see below.

4.5 As the responsible company will be responsible for all administrative aspects of the Levy the default position will be that this company will be:

- for UK banking groups' the ultimate parent company; and
- for foreign banks' the intermediate UK parent company that holds the UK banking group.

4.6 In situations where the Levy is based upon aggregated liabilities, or where, for whatever reason, it is inappropriate, or impracticable for the responsibility for paying the Levy to rest with the relevant default company outlined above, then the group may nominate another UK company which, if HMRC agrees, will become the responsible company for Levy purposes.

4.7 HMRC will not agree to a nominated company being the responsible company where it has a different period of account to the period of account of the taxable balance sheet, or where the company in question has no obvious means of paying the Levy out of its own resources.

4.8 The responsible company will be required to submit the following relevant financial statement:

- where it is a member of a UK banking group: the global group consolidated balance sheet for the period;
- where it is a member of a UK sub-group of a foreign banking group that produces a consolidated balance sheet at UK-level and there are no UK businesses outside that consolidation, those consolidated accounts for the period;
- UK subsidiaries and branches of foreign banking groups not covered by the above bullet, a computation of aggregated liabilities, equity and Tier 1 capital for the UK businesses and their subsidiaries;
- UK banks operating in non banking groups: a balance sheet for the banking business for the period.

Tax computation

4.9 In addition a computation will also be required showing how the liability arising under the Levy is calculated from the figures within the balance sheet (or aggregation computation) including any adjustments made to those figures with respect to any departures from the balance sheet figures permitted or required as set out in the legislation.

4.10 In the normal way companies will be required to retain for at least six years from the end of the relevant accounting period any supporting documents that are necessary to determine the liability arising from the Levy and which may be required for the purpose of checking the return made.

Return of the Levy

4.11 As noted above new legislation will be introduced requiring the financial statements and supporting documents referred to above to be submitted as part of the responsible company's company tax return for the relevant accounting period. The new legislation will allow the filing date for those financial statements to be determined in accordance with Para 14 of Schedule 18, FA 1998.

4.12 The responsible company will return the amount of Levy for its group within its own company tax return. Supplementary page CT600B will be amended to include a new box into which the amount of bank Levy due will be entered. This sum will then be included in a total that is carried through to the company's main CT600 return.

4.13 The Levy will be included within the company's tax return self assessment, and enquiries and any other related matters will also fall within the provisions outlined within Schedule 18, FA 1998.

Payment of the Levy

4.14 It is intended that the provisions of the Corporation Tax (Instalment Payments) Regulations will apply to the responsible company, which will pay the Levy (and its CT if any due) via Quarterly Instalment Payments (QIPS).

4.15 Legislation will be enacted to enable the responsible company to be deemed to be a large company (where this is not already the case) for the purposes of the Corporation Tax (Instalment Payments) Regulations 1998.

4.16 Although the responsible company will be responsible for paying the Levy the Levy will be the joint and several liability of all the UK resident companies and any non-resident companies within a banking group with UK branches.

Commencement date and transition

4.17 Banking groups that do not prepare their group accounts for a period coterminous with the calendar year will have periods of account that straddle the commencement date for the Levy (1 January 2011).

4.18 The responsible company for such groups will be required to make a return of the Levy for its accounting period that is coterminous with the straddling period. The liability for that balance sheet date will be computed as normal based upon the taxable liabilities at the balance sheet date, but will be reduced by reference to the proportion of the period of account that falls before 1 January 2011.

4.19 Payment of the Levy liability in the commencement period (calendar year 2011) will be required only on QIPs payment dates for the relevant accounting period of the responsible company falling on or after Royal Assent of Finance Act 2011 with the potential Levy liability apportioned across the relevant number of QIPs payments. Where all QIPS payment due dates for a responsible company fall before the date of Royal Assent then the legislation will provide for the payment of the Levy for that period 30 days after Royal Assent.

Table 4.A: example payment schedule

A banking group has a 12 month period of account ending on 31 March 2011.

At the balance sheet date the taxable liabilities are £200bn short-term and £100bn long-term.

If the whole balance sheet period fell after 1 January 2011 the Levy liability would be £200bn at0.04% (£80m) and £100bn at 0.02% (£20m) = £100m. As only 3/12 of the balance sheet period falls after 31 January 2010, the actual liability for the period will be £25m.

Its UK responsible company will be required to account for, and pay any amounts due under, the Levy. The earliest date on which the Levy will be due is the earliest QIP date (if any) falling after Royal Assent. If Royal Assent occurs on the 10 July 2011 then its QIPS payments would be as follows:

QIP 1 – due 14 October 2010 (CT only)
QIP 2 – due 14 January 2011 (CT only)
QIP 3 – due 14 April 2011 (CT only)
Final QIP – due 14 July 2011 (CT plus the Levy liability of £25m)

Anti avoidance

4.20 To ensure that banks pay the correct amount of the Levy commensurate with their funding profile the Government intends to introduce targeted anti-avoidance measures and welcomes the opportunity to engage with the banking industry to ensure that these measures are as targeted as possible to keep banks' compliance burden to a minimum, whilst being effective in preventing avoidance of the Levy.

4.21 It is proposed that the targeted anti-avoidance rule would ignore, for the purposes of determining a liability for the Levy, any transactions, arrangements, understanding etc. one of whose main purposes was or would be to reduce or eliminate a group's liability for the Levy. This will be designed to, for example, prevent groups from entering into transactions around the balance sheet date designed to disguise the group's true funding profile.

4.22 Transactions undertaken with the motivation of reducing the Levy liability, but which reflect a real change in the funding profile of the group to longer term or zero rated liabilities would not be considered avoidance (as this would be in line with the underlying policy intentions of the Levy).

4.23 It is also proposed that the Levy will be treated as a "tax" for the purposes of the "tax advantage" definition in section 1139 CTA 2010 so that, for example, any debits on loan relationships or derivative contracts entered into with a main purpose of avoiding the Levy would be subject to disallowance for CT purposes under the unallowable purpose rules.

4.24 We also propose to include the Levy in the list of taxes (in section 318 FA 2004) subject to the Disclosure of Tax Avoidance Schemes (DOTAS) regime. This will give the Treasury the power to make regulations prescribing descriptions of avoidance schemes required to be disclosed to HMRC by scheme promoters or users. DOTAS provides early information about avoidance schemes and their users, informing both anti-avoidance legislation and HMRC's operational interventions.

Double taxation

4.25 The United Kingdom's tax treaty network generally provides double taxation relief where income or gains are taxed in both the country where they arise and the country where the recipient is resident.

4.26 However, liabilities arising under the Levy are not covered by our existing treaties. So, for example, a foreign country would not be required to give relief under an existing treaty for the UK Levy suffered by a UK branch of that country's bank. Similarly, if that country's levy is not on income or gains, the UK would not be required to give relief for the levy suffered by a foreign branch of a UK bank under the relevant treaty.

4.27 The Government appreciates the need to avoid double taxation where possible and acknowledges that where foreign countries also introduce levies, there could be double taxation on foreign subsidiaries and branches of UK banks and the UK subsidiaries and branches of foreign banks. The Government is considering the impacts and need for mechanisms to alleviate double taxation and will urgently take forward such discussions with other countries that plan to introduce bank balance sheet levies.

Impact assessment

4.28 The consultation stage impact assessment is available at http://www.hm-treasury.gov.uk/d/consult_bank_levy_ia.pdf. As part of the consultation exercise, the Government is keen to understand better the likely compliance impacts on firms covered by the Levy.

- Can you provide information on (i) the time involved with each stage of the proposed process for calculating the liability and paying of the Levy, (ii) the levels of seniority of the staff expected to be involved with this, and (iii) whether any changes to IT systems are needed?
- Do you have any comments on the issues raised in the consultation stage impact assessment?

5 Summary of questions

5.1 The Government welcomes views from groups of companies and their representatives, in addition to the views of professional advisers, on the questions asked in this consultation document.

Taxable entities

Definition of banks and banking groups

5.2 Does the proposed aggregation present any practical difficulties which could create an excessive compliance burden? If so, how could it be improved?

5.3 Is there a more effective way of determining the amount chargeable to the Levy for those who do not produce a UK consolidated balance sheet which includes all UK interests and their subsidiaries?

5.4 Are there any other ways of defining banks and banking groups bearing in mind the policy objective that the Levy applies to retail and investment banks and banking groups with relevant taxable liabilities?

5.5 Given the proposed scope of the Levy, are there are other issues in relation to the definition of taxable entities?

Calculation of branch liabilities

5.6 Does the proposed user of CATA as a basis of calculation represent a suitable means of identifying the liabilities of a UK branch of a foreign bank?

5.7 Should liabilities be attributed to the branch on the same basis as under the CATA or in the ratio of liabilities held by the bank as a whole?

5.8 If the latter, should liabilities be attributed on the ratio of branch risk weighted assets to total risk weighted assets or total assets of the branch to the total assets of the bank as a whole?

5.9 Do any of the suggested calculation methodologies present any practical difficulties which could create an excessive compliance burden?

Threshold

5.10 What would be the impacts of setting an allowance rather than a threshold?

Tax base

Retail deposits

5.11 Aside from those discussed in this document, are there any other, robust definitions of retail funding that could achieve the objectives of excluding only relatively stable retail funding and avoiding double imposition?

5.12 Are there any other forms of deposit insurance or guarantee, or other equivalent measures in other jurisdictions that could and should be covered by this exclusion?

Sovereign repos

5.13 Should the repo exclusion be framed in terms of the current FSA requirements for liquid asset buffers, rather than just those secured against sovereign debt?

5.14 Are there other types of repo where the collateral has similar risk and liquidity characteristics that we should also consider excluding?

Policyholder liabilities

5.15 Does excluding retail insurance policyholder liabilities as they appear in the balance sheet correctly capture those liabilities that are covered by the protection schemes?

5.16 Are there other liabilities that are also covered by protection schemes to which banks are required to contribute?

Netting derivatives

5.17 Which method of calculating the aggregate derivative liability represents the best approach in order to achieve an appropriate balance in terms of common treatment and minimising compliance costs?

Other

5.18 Given the rationale of the Levy base, are there are other issues in relation to the definition of the base?

Operation

Impact assessment

5.19 Can you provide information on (i) the time involved with each stage of the proposed process for calculating the liability and paying of the Levy, (ii) the levels of seniority of the staff expected to be involved with this, and (iii) whether any changes to IT systems are needed?

5.20 Do you have any comments on the issues raised in the consultation stage impact assessment?

6 Next steps

How to respond

6.1 The Government welcomes answers to the questions listed in Chapter 6 and any wider comments on the proposals in this consultation document. Responses should be sent to:

The Bank Levy Team
Room 2/E1
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

Alternatively, please email: banklevy@hmtreasury.gsi.gov.uk

Telephone enquiries: 020 7270 5976

6.2 Comments should be received by 5 October 2010.

Proposed workshops

6.3 The Government intends to hold workshops to discuss stakeholder views on the issues raised in this document, before the end of the twelve week consultation process. Please send your expressions of interest to the email address above and indicate your main areas of interest and preferred dates by Friday 30 July. You will receive a reply by email on when and where the workshops will be held.

Confidentiality disclosure

6.4 Information provided in response to this discussion document, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

6.5 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury or HM Revenue & Customs (HMRC).

6.6 HM Treasury and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Code of practice on consultation

About the consultation process

A.1 The consultation is being conducted in line with the principles outlined in the document "Tax policy making- a new approach"[1] published alongside the Emergency Budget. The document sets out three stages for policy development:

- stage 1 - set out objectives and identify options;
- stage 2 - determine the best option and develop a framework for implementation, including detailed policy design; and
- stage 3 - draft legislation to effect the proposed change.

A.2 This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on how best to implement the Bank Levy announced in the June Budget.

The consultation criteria

1. When to consult - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
2. Duration of consultation exercises - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Clarity of scope and impact - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Accessibility of consultation exercise - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. The burden of consultation - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Responsiveness of consultation exercises - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Capacity to consult - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

[1] http://www.hm-treasury.gov.uk/d/junebudget_tax_policy_making.pdf

A.3 If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Richard Bowyer, Better Regulation Unit
Email: richard.bowyer@hmrc.gsi.gov.uk
Telephone: 020 7147 0062

HM Treasury contacts

This document can be found in full on our website at:
hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

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ISBN 978-1-84532-763-7

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