PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Seventh Delegated Legislation Committee

DRAFT BANK LEVY (DOUBLE TAXATION RELIEF) (SINGLE RESOLUTION FUND LEVY) REGULATIONS 2016

Thursday 8 December 2016

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not later than

Monday 12 December 2016

The Committee consisted of the following Members:

Chair: Robert Flello

† Aldous, Peter *(Waveney)* (Con)
† Barclay, Stephen *(Lord Commissioner of Her Majesty's Treasury)*
† Caulfield, Maria *(Lewes)* (Con)
† Cleverly, James *(Braintree)* (Con)
Dowd, Jim *(Lewisham West and Penge)* (Lab)
† Dowd, Peter *(Bootle)* (Lab)
† Ellison, Jane *(Financial Secretary to the Treasury)*
† Hoare, Simon *(North Dorset)* (Con)
† Kerevan, George *(East Lothian)* (SNP)
† Liddell-Grainger, Mr Ian *(Bridgwater and West Somerset)* (Con)
McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Mills, Nigel *(Amber Valley)* (Con)
Smith, Mr Andrew *(Oxford East)* (Lab)
Smith, Angela *(Penistone and Stocksbridge)* (Lab)
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Trevelyan, Mrs Anne-Marie *(Berwick-upon-Tweed)* (Con)
† Wragg, William *(Hazel Grove)* (Con)

Joanna Welham, *Committee Clerk*

† attended the Committee

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Thursday 8 December 2016

[Robert Flello *in the Chair*]

Draft Bank Levy (Double Taxation Relief) (Single Resolution Fund Levy) Regulations 2016

11.30 am

The Financial Secretary to the Treasury (Jane Ellison): I beg to move,

That the Committee has considered the draft Bank Levy (Double Taxation Relief) (Single Resolution Fund Levy) Regulations 2016.

The regulations are made under powers available in schedule 19 to the Finance Act 2011 to provide double taxation relief in respect of contributions to the UK bank levy. In particular, the regulations allow double taxation relief when there is a charge under both the UK levy and a new eurozone levy called the single resolution fund.

Since 1 January 2015, all EU member states have been bound by the bank recovery and resolution directive, which requires that member states have a resolution financing mechanism and raise a certain amount of funding on an ex-ante basis from banks authorised in their territory. In the eurozone, banks pay a contribution to the single resolution fund; the UK is satisfying its obligations under the bank recovery and resolution directive by raising contributions through our existing bank levy. In some circumstances, payments made to the single resolution fund overlap with the UK bank levy, giving rise to instances of double taxation.

For other bank levies, such as those of France, Germany and the Netherlands, we have introduced provisions that allow for double taxation relief, but currently no mechanism is in place to give relief for payments made into the single resolution fund. In line with the Government's general policy of avoiding double taxation, it was announced at summer Budget 2015 that relief would be provided against the UK bank levy for payments made to the single resolution fund from 1 January 2015.

I shall explain how the double taxation arises. The UK bank levy is levied on a group basis, whereas the single resolution fund levy is levied on an entity basis, which means that there could be double taxation if there is either an EU subsidiary of a UK-resident entity or a UK permanent establishment of an EU entity. As both bank levies are charged on balance-sheet liability, the regulations will give relief if there is a charge under both the bank levy and the single resolution fund levy in respect of liabilities on the same balance sheet. The regulations set out clear rules for calculating the amount of double tax relief due in the different circumstances in which it could arise. The rules ensure that the regulations provide a clear, consistent and fair outcome for all affected parties.

The Government are continuing their policy of avoiding the double imposition of taxation. Not to do so would risk unfairly burdening certain banks and damaging UK financial sector competitiveness.

Nigel Mills (Amber Valley) (Con): Will the Minister confirm that we will get the first taxing right on UK assets? For a UK permanent establishment of an overseas bank, we should not be crediting overseas tax against our tax so that we end up with no levy on UK assets that we are effectively guaranteeing. Will we credit overseas tax only if that territory is, for example, first in line to be paid any claims if there was a default on the assets?

Jane Ellison: That is a typically erudite question from my hon. Friend, to which I shall attempt to respond during my remarks following the comments of the Opposition Front-Bench spokesman.

I was saying that were the Government not to proceed with this measure, that would risk unfairly burdening certain banks and damaging UK financial sector competitiveness. The regulations address such a risk by supporting UK business and creating a level playing field, so I hope they are approved. I am happy to respond to further questions.

11.34 am

Peter Dowd (Bootle) (Lab): It is a pleasure to serve under your stewardship, Mr Flello. This is one of those technical pieces of legislation with which Committees such as this deal daily, but which belie the importance of the provenance of the issue before us. Given that, I want to explore the issue in a little more detail.

I appreciate that we are dealing with regulations that give clarity to an element of the tax position of certain affected banks, as set out in regulation 5(1), while they do business in Europe. However, given the context and history in the background, it would be remiss not to remind ourselves why we are in this position: it is the result of the cataclysmic banking crisis. I say that not to rehash old arguments about the cause of the financial crisis and its dreadful effects on the economy and the lives of so many people, but to ensure that we do not simply wave this legislation through without contextual comment and certain questions being asked. Coincidentally, it also comes the day after the £500 million fine announced by the European Commission in relation to the Euribor case. We owe it to the taxpayers who picked up the bill to look at the context. It is important to do so because of the effect that the financial crisis is still having on people's lives almost a decade later; many people's lives and many businesses have been blighted. We agree that the single resolution fund serves a significant stabilisation purpose in the wake of the bank recovery and resolution directive, which only very few people could object to—for example, those who have been in some sort of political and economic solitary confinement for the past 10 years.

Looking to the future, we are unable to escape the fact that Brexit informs virtually everything we do in economic terms. In that respect, how this will ultimately play out in the light of the Brexit process is moving from delphic to opaque. We hope that, in the not-too-distant future, it will move to somewhere between recondite and abstract. On that note, perhaps the next time the

Financial Secretary chats to the Prime Minister, she can remind her that there are nine flags in the European Union, if I remember correctly, that are red, white and blue, including the French tricolour. I think that is worth a mention over a cup of tea—and a mince pie, at this time of year.

I have to say that I was not inspired in any comforting way about the pathway to a post-EU nirvana by the comments made by some Members in yesterday's debate, but we are where we are. That was clear from yesterday. We live in hope rather than expectation on that one and we need to be grateful for small mercies as things are moving along.

Double tax treaties are a key part of tax law for multinational activities. The simple principle is that no one should be required to pay tax twice in two different jurisdictions in relation to the same asset or profit. Of course, the problem is making sure that some tax is paid somewhere, and that that does not simply become a way of forum shopping, as it has become known, which means picking the jurisdiction with the lower rate of tax or the more benign system. For example, different jurisdictions tax derivatives contracts in different ways, so banks will look to the more benign treatment, which is unsurprising.

The purpose of double taxation treaties or arrangements is to allocate the liability to tax in given situations. As we know, the majority of such treaties follow the OECD model treaty. Such treaties will become a big part of our legal culture post-Brexit—in all situations, not just with tax—so the regulations are very important.

Specifically on the matter before us, at first examination there is little about the regulations that is controversial. That was almost implicit in the statement and the presentation from the Minister. If the aim is to implement EU legislation, there is little to be done. In other words, we must implement its principles, but we do not need to go further than implementing the core provision. However, the Government have some leeway on the precise form of the implementation of EU legislation, so I have some specific points to raise about the regulations, and in so doing I seek reassurances from the Financial Secretary—if not today, then subsequently.

First, we must ensure that no individual treaty permits a bank to direct its profits towards a benign tax regime instead of facing its tax liabilities in the United Kingdom. That raises the question of how the Government propose to deal with potential forum shopping by banks under the regulations, as I mentioned earlier. In addition, what tax avoidance measures are in place beyond what some—although not everybody—consider to be the relatively weak scheme governing the abuse of tax avoidance under the Finance Act 2013?

Secondly, there is good reason to believe that HMRC is underpowered in its personnel, and thus in its ability to investigate the practical implementation of measures of this sort. The Opposition are committed to investing in HMRC to make it fit to represent Britain in the new post-Brexit world. A key part of that will be negotiating bilateral treaties, and it is vital that we can protect our public finances, which means not allowing tax credits or reliefs to allow tax income to go offshore. Given that, how will the Government ensure that HMRC is in appropriate condition to ensure that the regulations are not abused?

Thirdly, regulation 5(3) relates to the calculation of the levy and its tax credits. There must be concern about the calculation of a bank's equity, which is taken to mean its assets, as opposed to its liabilities, for the purposes of its balance sheet. It should be remembered that in the financial years before it fell into insolvency, Lehman Brothers Inc. was found to have deliberately understated the toxic assets on its balance sheet by entering into the infamous Repo 105 trade, by which it transferred $50 billion off its balance sheet temporarily while being contractually obliged to buy back those assets a few years later. By using such transactions, banks are able to mis-state their equity and liabilities too easily, which is important. Can the Minister guarantee that banks will not be able to do the same thing in relation to these regulations? Moreover, how will we prevent banks from juggling their assets between jurisdictions so as to reduce their liability to tax?

Fourthly, in relation to regulation 7, on determining assets and UK assets, there must be concern that the reference to UK generally accepted accounting principles—so-called GAAP—will permit the sort of fair value or mark-to-market accounting that permitted Enron to overstate its profits by fixing an entirely artificial market value for its derivatives and similar transactions. Can the Minister guarantee that such accounting treatment will not permit banks to understate their liabilities to tax in the United Kingdom?

Fifthly, there is concern that reference to "permanent establishment" in regulation 7(4) could allow a bank to use non-permanent entities to book its activities. One example, Citibank, had more than 2,000 subsidiary entities in 2008, and it is usual practice for banks to have multiple subsidiaries through which they seek to achieve regulatory arbitrage by booking assets in benign jurisdictions. Against that backdrop, is the Minister confident that the regulations will achieve the orderly raising of the levy against the banks? Do we think the regulations will do the job for which they are intended?

Sixthly—Members will be happy that I am coming towards my conclusion—in the brief policy paper from HMRC, the section on the Exchequer impact was blank, with reference to the Office for Budget Responsibility including the impact of the regulations in its autumn forecast. I was unable to find that impact in the OBR's forecast, but I possibly did not look hard enough. Perhaps the Minister could help.

Finally, in relation to the monitoring and evaluation section of the same policy paper, a little more detail on the review mechanism and timetable would be welcome in due course. However, notwithstanding my observations and questions, we support the Government's approach to ensuring that, in effect, relief exists so that double taxation does not put UK companies at a competitive disadvantage where there is imbrication between the bank levy and the single resolution fund levy. The question of ensuring equity or, as the policy paper puts it, a level playing field across borders on taxation for UK companies, and in this case banks and financial services, is self-evident, but the UK taxpayer should not be expected to provide largesse for those who want to have their cake and eat it.

11.43 am

George Kerevan (East Lothian) (SNP): I will not ask for much more, as the hon. Member for Bootle has asked some of the important questions. I have a general point for the Minister that flows from some of them. These regulatory changes have been framed in a period that is about to become redundant. Post-Brexit, we are likely not to be in the single market, and banks will therefore create a whole range of new vehicles and entities with which to conduct business, both from Europe to here and from here to Europe. I press on the Minister the need to keep the regulations under review in the next few years to make sure that there are no loopholes that may be taken advantage of—benignly or otherwise—by the industry, leading to a loss of revenues to the Exchequer. That is important—this is not cut and dried.

Given that the single resolution mechanism will continue in some form or other and that we will have a relationship with it, much in the regulations is premised on use of the existing bank levy. With the bank levy being phased out in favour of the surcharge, will the Minister comment on how that shift in our taxation will affect the regulations?

Thirdly, it is important to underline, without straying too far from the business in hand, that the single resolution mechanism is not, from my point of view or that of many others who have looked at it, fit for purpose. In addition to the setting aside of money for resolution, the main resolution mechanism is bailing in by banks that are in financial trouble. There are clear signs that the bailing-in mechanism by which existing debtors have their debts turned into the bank's shares, and thus have to take some hit in what is owed, is leading to people not lending to banks, and is having a negative impact on the nature of bank capital.

I think we might find that the single resolution mechanism is not fit for purpose if a multitude of banks go into some financial crisis simultaneously. Underlying that is a mechanism that we have created that might not actually work when push comes to shove.

11.46 am

Jane Ellison: This was a thoughtful debate and I thank colleagues for that. I shall address some of the general issues that came up, starting with the question of the balance between ensuring that banks are taxed enough and make a substantial contribution to the economy, and competitiveness.

The Government have been clear that banks should make a fair contribution, to reflect the risk that they pose to the economy. The shadow Minister, the hon. Member for Bootle, revisited some of the reasons for that, which are very well known. Since 2010 we have introduced a number of measures to ensure that that happens: the bank levy, a tax on banks' balance sheets introduced in 2011, which has raised £12 billion; an 8% corporation tax surcharge introduced in January and forecast to raise £7.1 billion in the next five years; restrictions on the amount of profit that can be offset by historic—that is pre-April 2015—banking losses resulting from the financial crisis and misconduct scandals, which are expected to raise an additional £5.5 billion by 2021; and restrictions on the amount of tax relief available for compensation payments associated with misconduct and mis-selling. Those were forecast to increase banks' tax payments by about £1 billion across the period 2015 to 2020, but we expect that actually they will raise more.

At the same time as we ask banks to contribute to reflect the risk that they pose to the economy and to make a fair contribution we are always focused—even more so in the light of the decision to leave the EU—on making sure that all sectors of the UK economy retain their competitiveness. We feel that the banking sector does that: the regime is sustainable and fair and constitutes a competitive long-term plan for taxing the sector. By 2021 banking firms will pay 25% tax on profit—that is still the lowest among G7 nations—alongside a 0.1% levy on UK balance sheet liabilities.

Of course, banks consider a number of factors in deciding where to locate. The UK is the world's leading financial centre. Colleagues may be interested to know that last year alone we exported £63.7 billion in financial services, insurance and pensions. Of course, we enjoy other advantages here, such as strong regulations, strong and independent regulators, and a very skilled workforce. We are trying for balance, and double taxation is at the heart of the issue of balance. We believe that people should be taxed fairly, but not taxed twice for the same thing.

I want, in general terms, to assure the Committee that the UK intends to retain its world-leading position on international taxation matters. The Prime Minister reiterated that at a recent G20. We were at the forefront of the OECD's base erosion and profit shifting project, looking more generally at the issue of large multinational corporations, and, since 2015, 30 measures have been brought in or are coming in to deal with avoidance and evasion. As a country, we have stepped up on this issue and taken an international leadership position. We do not intend to relent on that.

A point was made about HMRC, and this comes up a lot. It is true that HMRC is going through a significant transformation—for example, some of the customer service aspects of what it does are being centralised from well over 100 different offices around the country to 13 regional centres. However, the upskilling and the investment in compliance and enforcement have been significant. For example, another £800 million was put into this at summer Budget 2015. I am meeting the senior HMRC director this afternoon to talk about it; we have regular meetings, and there is a laser-like focus on the issue. It is worth noting that HMRC has done a really good job in bearing down on this. The UK has one of the smallest and certainly one of the most transparent tax gaps in the world, and that is in no small measure owing to the work that we do on that at the same time as maintaining a position of international competitiveness.

I hope that what I have said gives the Committee a general assurance that we are trying to strike a balance. Basically, our mantra is that taxes should be competitive and fair, but paid. If people stick to that mantra, we cannot go too far wrong.

Let me deal with one or two specific questions. It is worth stating for the record that the measure that we are debating is not about implementing EU legislation. This relief is not required by the EU. The bank levy is a UK tax, and the Government announced in 2015 the decision to provide double tax relief, because it delivers on our policy against the double imposition of taxation

in general and in respect of the bank levy in particular. This is a UK decision. It was not forced on us; it is a response to the European measure. Allowing relief for instances of double taxation risks will ensure that certain banks are not unfairly burdened and will avoid creating competitive distortions in the market. I hope that that explanation clarifies the situation.

My hon. Friend the Member for Amber Valley asked for confirmation that the UK would retain primary taxing rights over UK assets. The short answer to his question is yes. Double taxation relief is being given only in the case of non-UK entities and their liabilities. I hope that that gives him some reassurance.

The shadow Minister mentioned forum shopping. I have made some general comments to show that we remain focused on ensuring that we do not go in that direction, but as further reassurance let me say that I hope that any tax relief under this measure is strictly limited to charges that are paid on the same balance sheet. If overseas charges apply to a smaller proportion of the balance sheet or a charge at a lower rate, any relief will be correspondingly reduced. This is just a proportionate response to the levies that are being imposed through the European scheme.

In closing, I want to take up the point made by the hon. Member for East Lothian. Of course, over the next few years we will keep this matter under review. Clearly, as we exit the EU some aspects will change. We will keep that under careful review and consider the implications. I come back to the first principle that we have applied across a whole range of relationships around double taxation. That will always be our guiding way through on these matters, but clearly there will be implications as we leave the EU, and we will deal with those in due course.

Question put and agreed to.

11.54 am

Committee rose.