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Client briefing
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UK Bank levy – revised draft legislation published

Introduction

The UK Government has now published the draft legislation introducing the bank levy for inclusion in the Finance Bill 2011. The legislation is very similar to previously published drafts. The most significant new development is the setting of the rate. The main rate will be 0.075% from 1 January 2012 with an initial main rate of 0.05% applying for the first year. The levy will apply to the global consolidated balance sheets of UK banking groups and the balance sheets of standalone UK banks. In relation to foreign banks and banking groups operating in the UK, the levy will be assessed on their aggregated subsidiary and branch balance sheets.

The levy will be calculated by reference to the total chargeable equity and liabilities on the relevant balance sheet. Certain amounts may be excluded, for example, Tier 1 capital, insured retail deposits and certain liabilities that arise from insurance business undertaken by banking groups. Generally, liabilities are calculated on a gross basis. In limited circumstances, netting of assets against liabilities is permitted. A deduction from chargeable liabilities is also allowed for "high quality liquid assets".

As other jurisdictions are planning separate bank levies, there is clearly a potential for double taxation. The legislation empowers the Treasury to bring into effect by regulation double taxation agreements relating to the levy and also to provide unilateral relief.

For an overview of the operation of the Bank Levy please see our previous briefing by clicking here.

Main new developments

- Main rate set at 0.075% from January 2012 (0.05% in first year starting January 2011).
- Agreement on levy double taxation reached with France – details yet to be published.

Set out below are the main changes from the previously published versions of the legislation.

Detailed changes

Rate of levy - This has now been set. The rate will be 0.075% from 1 January 2012. There will be a lower initial rate for the first year effective from 1 January 2011 of 0.05%. This rate is higher than the version suggested in the

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consultation document (0.07%). In part this is a reflection of the introduction of an allowance for the first £20 billion of chargeable liabilities as opposed to the original proposal of a threshold (where, once the threshold of £20 billion was passed, all chargeable liabilities were subject to the levy). Equity and long-term liabilities are charged at a half rate. From 2012, this rate will be 0.0375% and for the first year 0.025%.

Definition of banking group – In relation to non-UK groups, the provisions consider the nature and activity of certain foreign entities and the grouping rules apply if the non-resident entity is carrying on activities such that, if it were in the UK, it would be a UK resident bank. For these purposes, the non-UK resident entity is deemed to be a UK resident bank if, on the assumption that it were UK resident and carried out its activities in the UK, it would be required to be an authorised person under section 31 of the Financial Services and Markets Act 2000 with the permissions necessary in order to carry out its activities in the UK and as a result would be a UK resident bank. There is a similar rule for entities which are members of a non-UK resident partnership.

Chargeable equity and liabilities

High quality liquid assets – The legislation provides that an entity may reduce its chargeable equity and liabilities by the amount of high quality liquid assets which it holds. This reduction is applied against long term equity and liabilities before short term liabilities. The previous version of the legislation disapplied this offsetting in circumstances where such assets were held to cover excluded equity or liabilities. This provision has been removed.

An additional provision has been included which applies where the assets of the group include a financial asset in respect of an advance made by a member of the group and underlying that asset as collateral is an item owned by the member which would form part of the group's high quality liquid assets, were the collateral rather than the financial asset, an asset of the group. In these circumstances, it is permissible to reduce the amount of chargeable equity and liabilities by the amount of the financial asset, or if lower, an amount equal to the fair value of the collateral. The technical note which accompanies this legislation suggests that this provision is aimed specifically at certain sale and repurchase transactions and total return swaps.

Netting – The legislation provides for certain assets to be netted off against chargeable liabilities and therefore reduce the amount in respect of which the levy is charged. HMRC draft guidance states that "The legislation permits a principles based approach to netting which builds on the regulatory treatment under the Basel II framework and the conditions for netting under US GAAP." The operative provision in the previous legislation only required the netting arrangements to be "legally enforceable". The new legislation requires them to be "legally *effective* and enforceable". It is not clear why this change was thought to be necessary. The new legislation specifically provides that a multilateral agreement may be within the scope of the netting provision, although it remains the position that the liabilities and assets need to be with the same counterparty.

There has also been a slight change to the required netting mechanism provision in order for the rules to apply. There needs to be in place an agreement between the relevant parties which makes provision for there to be a single net settlement of all liabilities of the parties to each other (as far as covered by the provision) if a netting event occurs. A netting event occurs if the insolvency or bankruptcy of either of the counterparties gives rise to a termination of the arrangement. The "*netting event occurs*" language is a change from the previous draft which made reference to the trigger event being the termination of any arrangements under which any liability covered by the provision arose, or a default under any such arrangements.

Where netting is permitted under these arrangements, but the liabilities exceed the assets, a provision has been introduced to apportion the netted liabilities between long-term and short-term liabilities (broadly on a *pro rata* basis of the liabilities which are subject to the netting).

Chargeable equity and liabilities of a foreign banking group – In relation to foreign banking groups, there is a *de minimis* provision which applies where the liabilities of an entity are less than £50 million. Such amounts, subject to an overall cap, may be ignored. There have been some slight changes to the operation of this provision.

Excluded equity and liabilities – The definition of Tier 1 capital equity and liabilities has been amended. The definition now refers to equity and liabilities that are Tier 1 capital *before deductions* for the purposes of the FSA Handbook.

A new excluded category has been introduced for sovereign repo liabilities. These are excluded to the extent that the underlying debt securities would qualify as a high quality liquid asset and are debt securities issued by a designated multi-lateral development bank, a government or a central bank.

There has been a slight change to the definition of relevant insurance liabilities. These liabilities now include liabilities to policyholders under contracts of general insurance.

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Supplementary

A new supplementary provision has been added to make express provision for determining the chargeable periods of entities that do not prepare accounts for a period.

Residence - The definition of residence for the purposes of the rules has been changed. The position for corporate entities remains the same. For partnerships, the rule now provides that the territory in which a partnership is resident is the territory in which the control and management of the partnership's trade and investment activities takes place.

Collection and management **-** These provisions are little changed from the previous draft of the legislation, subject to there now being a specific carve-out from the definition of responsible member for a company which is a securitisation company.

Consequential amendments - There is a new power for the Treasury to make consequential amendments to these provisions by a statutory instrument where such changes are required as a result of certain regulatory/accounting changes.

Anti-avoidance

The operative wording of the anti-avoidance provision has been expanded so that it now applies in relation to arrangements which have a levy avoidance motive or any *part* of such arrangements.

The carve-out from the application of this provision in relation to arrangements designed to "improve" the bank's funding profile is no longer subjected to satisfying an officer of HMRC as to the effect of the arrangements. This provision has been replaced by more objective carve-outs from the operation of the anti-avoidance provision intended to reflect situations which "improve" the funding profile of the relevant entity; for example, there is a carve-out from the anti-avoidance provisions for arrangements which increase, on an on-going basis, the excluded equity and liabilities of the relevant group or the relevant entity. This would apply if an entity increased the amount of its Tier 1 capital.

Comment

The most significant new announcement on 9 December was the fixing of the main rate at 0.075%. As HM Treasury appeared to have a fairly specific revenue target for the Bank Levy, an increased rate from that proposed in the original consultation is not surprising – given the move to an allowance for the first £20 billion of chargeable equity and liabilities. The overall effect of this is to shift the burden to larger banks.

In relation to the revised anti-avoidance provisions, the removal of the subjective rule which provided that the overrides were dependent upon HMRC being satisfied certain conditions were met is welcome.

A more general point is that it is somewhat unsatisfactory that the levy will enter into force with minimal detail of the arrangements for double taxation relief where entities are subject to a similar levy in more than one country. We understand that an agreement on levy double taxation has been reached with France, but no details of this have been published.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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