Funding the Future

Lo and behold - the banks say there's a spirit to tax l...

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Citywire carries a fascinating report this morning, which I fear I will quite at length, but it's important. It says:

Rival investment banks have decided against following Barclays into creating tax-free structured products for wealthy clients for fear that HM Revenue & Customs (HMRC) could take a dim view on them.

Barclays has been selling tax-free structured products to high net worth clients for more than a year via its Barclays Wealth division.It is understood Citigroup has also begun looking at similar structures for its private banking clients and is now operating in this space.

However, several rival investment banks have told Citywire they deem these products to be â€šÃ„Ã²too aggressive' and although they are legal, the banks fear that HMRC might ultimately take a negative view on the tax treatment of the products.

It is understood the products are simple structures, such as auto-calls. The client undertakes the credit risk of Barclays, and the return is based on the performance of an index, such as the FTSE 100. However, the twist is that the investment bank uses gilt options for structuring and any profits on maturity of the product are delivered as gilts, meaning payments would not be liable to income or capital gains tax. At present, gilt options — unlike other types of options — are tax-free.

Allen & Overy — the global law firm that is actively involved in assessing the tax treatment of structured products — is understood to have reassured rival investment banks that there is a high probability these products would be deemed tax-free by HMRC.

This it should be noted is standard aggressive tax avoidance behaviour. The rate of tax for the highest-paid in the UK was recently increased to 50% and as a result this type of product has been created to assist those faced with such a tax charge to avoid their obligation to society. Those to whom the product is sold are offered the reassurance that a major firm of lawyers has given assurance that the scheme is legal, an assurance for which the purchaser or the bank selling the product will have paid dearly, but which is deemed to be a price worth paying because this then means that if the scheme is subsequently challenged by H M Revenue & Customs those who used it can claim that they took reasonable steps to ensure its legality and as a result will not suffer, in most circumstances, a tax penalty for the additional tax charge that will then arise.   note that this contrasts sharply with the arrangement for most ordinary taxpayers who cannot afford such assurance. They pay penalties even if they make honest mistakes on their tax returns which are subsequently discovered by them or the Revenue. The adage that there is one tax law for the rich and one for the rest is undoubtedly true.

That though is not the key point in this case. What is really interesting is that Citywire goes on to note that:

However, one head of structured products at a major investment bank said: â€šÃ„Ã²[We believe it is] against the spirit of the tax rules. We just backed off completely. It’s one of those things where the reputational risk is just so great.’

A director at another rival investment bank said: â€šÃ„Ã²If you go into technical [details], it does work, but that doesn’t mean it is in the spirit [of the law]. I think it’s too aggressive,’ while a senior director at a third investment bank, added: â€šÃ„Ã²A lot of clients [who bank with Barclays Wealth] showed us this, but we took the view that it was too aggressive and that if the Revenue saw this, they would say so.’

HMRC declined to comment specifically on individual structured products with gilt options, citing tax-payer confidentiality. However, it said: â€šÃ„Ã²HMRC has a responsibility to ensure everyone pays the right amount of tax due.

â€šÃ„Ã²Where someone seeks to reduce their tax liability through the use of tax avoidance schemes, HMRC would be very keen to make sure that any scheme met both the letter, and the spirit, of the tax law. To that end, the government has made an additional £900 million available to HMRC to ensure the tax rules are respected across the board.’

Citigroup and Allen & Overy both declined to comment, and Barclays was unavailable for comment.

Note what these other advisers are saying. They are saying there is a spirit to tax law, and that they recognise it, and that they are, in this extreme circumstance, trying to comply with it even though, as they note, the scheme is technically legal. What is more, they are advising their clients to comply with it.

In other words, they are saying that tax avoidance may be legal, but unacceptable.

Some of us have, of course been saying this for a long time but it's good to see that bankers agree. Barclays excepted, of course, or so it seems.