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New UK Bank Payroll Tax – a partial response by the UK government to "excessive risk-taking" by the banking industry

As part of the 2009 Pre-Budget Report, the UK government announced the introduction of a new tax known as the Bank Payroll Tax ("BPT") and published draft legislation. BPT is to be levied on banks and certain other financial institutions that pay bonuses or provide certain other remuneration to particular categories of employees in excess of £25,000. The UK government considers such a move to be necessary to tackle the remuneration practices that – it believes – contributed to "excessive risk-taking" by the banking industry. The UK government further believes that the introduction of BPT will form part of helping to ensure that the UK financial services sector's development is sustainable and supports long-term economic growth.

Overview

Broadly, BPT will be payable by a financial institution (see "Who is liable to BPT?" below for details) which awards a bonus or other relevant remuneration to an individual employee in excess of £25,000 between 12.30 pm on 9 December 2009 and 5 April 2010. BPT is to be levied at the rate of 50 per cent. of the amount by which the remuneration in question exceeds £25,000, and will be payable on 31 August 2010. Subject to certain exceptions (see "What remuneration gives rise to BPT?" below for details) BPT is payable on any remuneration, whether in the form of a cash bonus or in a different form (including shares). As BPT is payable by the relevant financial institution providing the remuneration, rather than the employee receiving it, BPT will not affect the employee's individual UK income tax liability or the financial institution's liability for social security contributions.

Who is liable to BPT?

It is important to note that BPT is payable by a wider range of financial institutions than simply banks. Specifically, BPT will potentially be payable by the following companies:

- Any "UK resident bank". This broadly means a UK tax-resident trading company that is authorised under the UK regulatory regime to carry out certain activities, where the company's activities either (a) include accepting deposits or (b) wholly or mainly consist of accepting deposits, dealing in investments as principal, dealing in investments as agent, arranging deals in investments, safeguarding and administering investments, and regulated mortgage contracts. It includes a UK tax-resident company that is a member of a trading partnership that carries out such activities;
- Any "relevant foreign bank". This broadly means a non-UK tax resident company that is authorised

as above and that, trading through a UK permanent establishment, undertakes similar activities to those mentioned above. It includes a non-UK tax resident company that is a member of a trading partnership that carries out such activities;

- Any "UK resident investment company" (being, broadly, a company whose business consists of making investments, including savings banks) and any "UK resident financial trading company" (being, broadly, a company that deals in shares and other securities) that, in either case, is a member of the same group as a UK resident bank or a relevant foreign bank;
- Any "relevant foreign financial trading company" (being, broadly, a non-UK tax resident company that deals in shares and other securities through a UK permanent establishment) that is a member of the same group as a UK resident bank or a relevant foreign bank;
- Any UK building society; and
- Any UK resident investment company and any UK resident financial trading company that, in either case, is a member of the same group as a UK building society.

Certain companies – such as insurance companies, investment trusts and open-ended investment companies – are specifically excluded from liability under the BPT regime.

What remuneration gives rise to BPT?

It should be noted that the draft legislation relating to BPT does not make any reference to a "bonus" triggering the tax. Instead, the draft legislation basically works by including in the calculation of the tax all cash and non-cash remuneration, and then specifically excluding certain types of "standard" remuneration (such as non-variable salary and certain UK tax-approved share ownership plans).

Therefore, a BPT liability – in principle – arises by reference to the excess over £25,000 of the following amounts, where the amounts are awarded to or in respect of a "relevant banking employee" (see "Whose remuneration gives rise to BPT?" below for details) by reason of that person's employment as such:

- Any earnings (meaning, broadly, any salary, wages, fees and other incidental benefits) in relation to such an employment; and
- Any other benefit provided by reason of such an employment.

However, a BPT liability will not arise in relation to the following:

- Any "regular" salary or wages or a "regular" benefit (meaning, broadly, that the amount in question cannot vary according to any performance indicator, whether of the business or the individual);
- Any remuneration paid or provided under a contractual obligation that arose prior to 12.30pm on 9 December 2009 and the amount was fixed, or capable of becoming fixed, without the exercise of any discretion (or the bonus pool was so fixed or capable of becoming fixed); or
- Shares or share options awarded under certain UK tax-approved share incentive or share option plans.

There are specific provisions to cover the following situations:

- Where an employee has multiple employments with the same company or has separate employments with two or more companies in the same group;
- Individuals who provide relevant services through an intermediary;
- Arrangements that are entered into prior to 5 April 2010 for remuneration to be provided after 5 April 2010; and
- Where a loan is provided (instead of remuneration being paid) in order to avoid BPT or other taxes.

Whose remuneration gives rise to BPT?

A liability to BPT only arises in connection with remuneration awarded to or in respect of "relevant banking employees". This means employees, directors and other officers of a relevant financial institution (or certain individuals who provide services through an intermediary):

- Who are tax-resident in the United Kingdom in the tax year ending 5 April 2010, or who perform their relevant employment duties wholly or partly in the United Kingdom at any time in that tax year; and
- Whose employment duties wholly or mainly (and whether directly or indirectly) are concerned with either those activities that would make the employer financial institution a UK resident bank or a relevant foreign bank or activity that otherwise consists of the lending of money.

The scope of these provisions is, accordingly, very wide. For example, remuneration paid to employees, such as operations staff and others whose principal role is to support the primary trading activities, may nevertheless give rise to BPT. Further, remuneration paid to an employee may give rise to BPT if that employee was only a temporary employee or the employee's activities only related to the United Kingdom to a very small degree; this could be a particular issue in relation to employees of financial institutions who principally work at a non-UK branch or permanent establishment of a UK entity.

Other issues

Various anti-avoidance measures are to be included. One particular measure includes a typical UK "main purpose" anti-avoidance test. It provides that, broadly, BPT will nevertheless be imposed if arrangements are entered into before 6 April 2010 to provide a reward after 5 April 2010 (or to provide a reward in a form that would not be subject to BPT) where the main purpose, or one of the main purposes, of entering into the arrangements is to avoid a charge to BPT.

It should be noted that payments of BPT will ***not*** be deductible by the financial institution for UK corporation tax purposes. This, in effect, means that BPT will need to be funded out of taxed income. Financial institutions that are subject to tax in other jurisdictions will need to consider, where relevant, whether they will be able to obtain credit for the BPT against their domestic tax liability.

While it is expected that BPT will apply with respect to remuneration awarded up to and including 5 April 2010, the UK government has stated that it will consider extending the period of charge beyond this date so that BPT remains in place until the relevant measures of the recently announced Financial Services Bill come into force. It is proposed that the Financial Services Bill will introduce two measures aimed at changing the executive remuneration procedures of firms authorised by the Financial Services Authority ("FSA"). Under the first measure, FSA-authorised firms could be required to produce a report and disclose almost any information about officers', employees' and service consultants' remuneration; the FSA will be entitled to publish these reports. Under the second measure, the FSA will be required to introduce rules providing that FSA-authorised firms must have, and act in accordance with, a "remuneration policy". More importantly, the FSA would be given statutory powers to prohibit certain types of bonuses, invalidate agreements which provide for a prohibited type of bonus and provide for the recovery of any sum or property paid (even retrospectively) pursuant to such a prohibited type of bonus. The Financial Services Bill is still in its early stages and may not be passed before 5 April 2010 or the next UK general election (which is likely to be held in May 2010). It is also worth noting that the FSA's Remuneration Code comes into force on 1 January 2010, further to which certain financial institutions must establish remuneration policies and procedures that are "consistent with and promote effective risk-management".

Comparison with measures in other jurisdictions

The use of a specific tax as a means by government to control remuneration practices and risk-taking in the banking industry is currently unique to the United Kingdom. No similar measure has yet been introduced in other major financial jurisdictions. In the United States, rather than any specific windfall taxes on bonuses, as of this writing the emphasis on controlling remuneration and risk-taking has been implemented by placing tight restrictions on the remuneration policies of those institutions seeking government assistance through the Troubled Assets

Relief Program as well as introducing broad principles for remuneration of all US public companies. Equally in France, there has until now been no suggestion that controls would be implemented through similar taxes. Controls on bonuses in the banking sector in France have been mooted by measures such as required deferrals of bonuses, imposition of long-term performance criteria as conditions for payment, requiring that part of bonuses must be paid in the form of shares and also making government contracts dependent on compliance with remuneration guidelines.

The UK's introduction of BPT may nevertheless be the precedent for other major jurisdictions to follow suit. For example, one day after the UK government's announcement of its intention to implement BPT, the French government announced that it would be introducing a similar 50 per cent. tax on bonuses above €27,000. Subsequently, the German government has also signalled its support for the UK proposal (although it remains to be seen whether Germany will actually implement such a tax). It would not be surprising if other major global financial centres announce that they too will adopt such an approach in due course.

Comment

As will be evident, BPT is likely to become an unwelcome additional (and hefty) cost for relevant financial institutions that reward their employees with anything other than basic salary. Although the draft legislation is relatively short, it is very broad in scope; prior to making bonus payments, financial institutions are likely to need to consider carefully whether the new BPT regime will apply to them and, if so, to what extent.

There is a strong element of retrospective taxation in this new measure; the legislation is only in draft form (it will likely need to be included in the next UK Finance Bill, which would not be enacted until April 2010 or so) and most bonuses are awarded in the financial services industry at, or near to, the end of the calendar year. The draft legislation contains precious few details of the compliance obligations to which financial institutions will be subject with respect to BPT. As a result, there is a potentially significant extent to which financial institutions will be leaping into the unknown when they make discretionary bonus awards.

Given the recent furore over risk-taking and the "bonus culture", however, as well as the need to raise and collect revenue, it is unlikely that BPT will not be implemented by the UK government. It will be necessary to ensure, however, that areas of doubt – such as the territorial scope of the tax with respect to employees working principally at a non-UK branch or permanent establishment of a UK entity, and the compliance obligations – are clarified as soon as practically possible.

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