Chartered
Institute of
Taxation
Excellence in Taxation

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2020

MODULE 3.05 – BANKING OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

Under Article 5(5) MTC (2014), OIM would have a PE in France. This is because FS habitually concludes contracts in France on behalf of OIM for the sale of investment products by OIM, and FS does not do so as the capacity of an independent agent.

Under Article 9, the remuneration that OIM pays to PS should be at arm's length, taking into account its functions performed, assets used and risks assumed.

Under Article 7 of the MTC (2014), the profits attributable to the PE of OIM in France would be those which the PE would have derived if it were a separate and independent enterprise performing the activities that FS performs on behalf of OIM.

Under step one of the OECDs authorised approach ("AOA"), the functional and factual analysis would highlight that the sales of investment products to clients in France are concluded by personnel of FS, on behalf of OIM in France. Therefore, the PE is hypothesised to have OIMs rights and obligations arising from the transactions between OIM and the final clients and also from the transaction between OIM and FS.

The first step of the AOA also requires the recognition of an internal dealing between the PE and the head office. In this example the dealing is hypothesised as the sale of the investment products by the head office to the PE.

The functional and factual analysis would also show that the significant people functions relevant to the assumption of inventory risk and to the nature of the inventory are performed by the employees of FS on behalf of OIM in France. Therefore, the PE is hypothesised to be the economic owner of the inventory and the party assuming the inventory risk.

With regard to step two of the AOA, the guidance in the TPG is applied by analogy to establish the arm's length pricing of the internal dealing between the OIMs French resident PE and the UK resident head office. Here, the pricing would equal the amount that OIM would have received if it had sold the products to an unrelated party performing the same or similar activities under the same or similar conditions (e.g. similar risks) that FS performs on behalf of OIM in France.

Part 2

Part 2 of the 2010 OECD report on the attribution of profits to PEs (2010) describes the specific approaches to the capital attribution of PEs of banks under the authorised OECD approach (AOA). Overall approach is to treat the branch as a separate enterprise. The capital allocation approach involves allocating the bank 's genuine free capital in accordance with the attribution of financial assets and risks.

The method for this is completed by attributing assets and risks and then risk-weighting the assets (RWA) of the entity as a whole by following the Basel standardised regulatory rules (the BIS ratio approach).

Here the PE of bank Vega has 15% of the head offices risk-weighted assets, therefore it will have attributed to it 15% of the bank 's free capital. Therefore, the PE would have proportionately the same composition of regulatory capital as the whole bank.

When using the capital allocation approach, required to correctly allocate the total free capital of the bank, and not just the regulatory minimum. The reason for this is that functional analysis has been used to allocate all the assets and all the associated risks of the bank have been attributed to the various parts of the bank, including the head office.

Part 3

The OECD recognised that the majority of jurisdictions adopted measures that affect branches of non-resident banking institutions as compared with subsidiaries of non-resident banking institutions.

In most cases, the report highlighted that it is the supervisory authority has the discretion on requiring whether a non-resident bank needs to establish a subsidiary of a branch, and this is generally on a case-by-case basis, typically when specific conditions have been met.

The OECD report gave several specific country examples. For example, Brazil, Mexico, and Russia do not permit establishment of branches by non-resident banks. Alternately South Africa permits this but only after incorporation.

In addition, other countries do not permit branches of non-resident banks to operate in certain banking services-these were generally deposit taking type functions. Indeed, after the global financial crisis of 2008, the OECD report stated that where the scale of deposit taking is considerable, certain jurisdictions for example, Australia, China and Hong Kong require that non-resident banks establish a subsidiary. Indeed, the Hong Kong regulator can require that a local holding company be formed in order to hold the shares of an existing or proposed authorised institution.

In the EU, a branch can be deemed “significant” depending on the market share or systemic liquidity. A result of being deemed significant is that the payment and settlement activity of the branch will be subject to closer surveillance and disclosure. 1 mark

The UK’s approach to branches of non-resident institutions instead focuses on the home states supervision of the whole organisation, the activity of the branch in the UK together with the and the level of assurance the Prudential Regulatory Authority (PRA) obtains.

Financial requirements on branches has been discussed above, the OECD study also focused on the governance of branches, although they noted that overall since the 2008 financial crisis most jurisdictions that have branches of non-resident banks have increased their governance process. Indeed, every country that had governance requirements on branches applied a fit and proper test.

Additionally, some countries required a risk management and/or audit function in the branch, with half of countries in the OECDs study, with 50% of the countries in the study requiring the establishment of a board of directors/management board.

As a result of the governance requirements on branches, that are often now equivalent to domestic banks to, the report highlighted that this may diminish the attractiveness of branches in the future.

Despite branching being a widely available option, due to the financial and governance requirements that are now being imposed, while the same or equivalent to domestic banks, may limit the attractiveness of branching going forward.

Question 2

Part 1

The five conditions provided apply as follows:

An acquisition for consideration

Acquisition means the purchase, including by exercising an option or forward purchase which has previously been defined in a contract, the exchange or allotment, in consideration for contributions of equity securities.

From this it can be seen that the "acquisition includes by subscription, albeit this is subject to a separate exemption. Acquisition must also be for value therefore acquisition and allotment of bonus shares are not included within the scope.

Acquisition also expressly includes:

- Exercise of a derivative that results in a transfer of ownership of the underlying securities; and
- Acquisition of equity securities by subscribing for shares/ units in CIV schemes and paying for them with these securities.

Resulting in a transfer of ownership

A transfer of ownership arises when the securities are posted to the account of the buyer, which in accordance with the Monetary and Financial Codes is the effective settlement date i.e. when the securities are delivered to the custody account-keeper by a book entry to the account held directly or indirectly with the central depositary.

As a consequence of the definition, a purchase with a subsequent failure to deliver the securities will not lead to the application of FFTT as the custody account-keeper does not recognise the transfer of ownership.

A purchase and sale on the same date of the same security giving rise to a transfer of ownership of the net balance will only result in the net balance being subject to FFTT.

Of shares or equivalent securities

This includes equity securities i.e. shares and other securities issued by joint-stock companies that give or could give access to capital or voting rights. The scope also includes all equivalent instruments or rights representing a financial investment in an entity and issued under foreign law.

The definition of other securities that could give rise to capital includes Warrants and Bonds that may give access to shares but excludes warrants that give pre-emptive share rights. Depositary receipts including ADR's representing equity securities of an in-scope issuing company are subject to the provisions of the FFTT regulations.

Admitted to a regulated market

Any regulated market of the EU as published by the Commission of the EU plus foreign markets recognised by the AMF. The recognition of the respective market is not related to the nature of the transaction undertaken i.e. it can be made on or off market.

Issued by a French company with a market capitalisation of more than Eur 1 Billion

The company must have a registered office in France i.e. the listing of the entity on or off Euronext Paris has no bearing. Market capitalisation is determined on 1 December in the year prior to the tax year based on the valuation of the security on its primary listing market.

Part 2

Considering the application of FFTT in respect of the following transaction:

Hedge Fund > lends under an SBL to > Bank Alpha (ISP)

Bank Alpha > OTC transfer to affiliate > Bank Beta

Bank Beta > TRS > Bank Delta (ISP)

Bank Delta > hedges pre-existing financial contract via a basket of securities > Client

Considering the application of the regulations this sequence of trades constitutes an acquisition for consideration resulting in a transfer of ownership of shares admitted to a regulated market issued by a French company with a market capitalisation of greater than Euro 1 Billion

This determination that the transfer is in scope for the FFTT assumes the following:

1. The French company has a registered office in France.

2. The equity shares are admitted to a regulated market.

In determining which if any of the transfers result in an application of FFTT it is necessary to consider the application of the available exemptions.

Hedge fund lends under an SBL to Bank Alpha

As this is a stock lend which is a temporary transfer of ownership for guarantee purposes evidenced by an agreement, it falls within the 'Securities Financing Transaction' exemption and is not subject to FFTT.

Bank Alpha transfers ownership to an affiliate Bank Beta

As this is a transfer to an affiliate it will follow within the 'Intra-group Exemption'.

3. That the affiliate is a member of a group where the group controls at least 40% of the voting rights or are under common ownership at least 95% owned.

Bank Beta executes a TRS for the shares with Bank Delta which is included as a basket hedge for a financial contract sold to a client

These two trades must be seen together as the sale of the financial contract by Bank delta to the client is partially hedged with a derivative purchased from Bank Beta, another entity which also hedges its risk with the underlying equity which is within scope of FFTT. The combined transactions falls within the 'Hedge' exemption to the FFTT regulations (subject to assumption (iv) holding). For the exemption to apply the hedge must relate to an established client need i.e. it cannot be in anticipation this will be evidenced by the facts and circumstances of the trade.

4. The security when included in the basket of securities maintained by Bank Delta provides an economic hedge to the financial contract.

PART B

Question 3

The pertinent facts are:

Entity	QI	QDD	FATCA Status
Theta Bank	QI	QDD	FFI Model 1
Theta Jersey	QI	QDD	FFI Model 1
Paris Branch	Branch of QI	QDD	FFI Model 1
Lisbon Branch	Branch of QI	N/A	FFI Model 1

Theta Bank borrows US Treasury's (UST) and US Equity securities from client positions held in pooled accounts (subject to segregated reporting) at its branches and subsidiary; the securities are held over Record Date.

In considering this fact pattern the following assumptions have been made:

- As the securities are held over Record Date the clients will receive manufactured dividends and manufactured interest;
- The US Equities are in respect of entities incorporated in the US and the stock lending arrangement is a potential section 871(m) transaction;
- The transfers under the stock lending arrangements are not subject to fees or other payments (other than economic payments); and
- The clients of all the entities are not US Persons as defined in the US Tax Code.

Given these assumptions the following Withholding and Recipient outcomes apply:

US Treasury

Client Position Booked in	Interest Equivalent Payment from	Interest Equivalent Recipient for 1042-S Purposes Line 13	Withheld Y/N and by Whom
Lisbon Branch	Theta Bank	Client	No – Portfolio Relief applies
Paris Branch	Theta Bank	Client	No – Portfolio Relief applies
Theta Bank Jersey	Theta Bank	Theta Jersey	No – Portfolio Relief applies
	Theta Jersey	Client	No – Portfolio Relief applies

US Equities

Client Position Booked in	Manufactured Dividend Payment from	Manufactured Dividend Recipient for 1042-S Purposes	Withheld Y/N and by Whom
Lisbon Branch	Theta Bank	Client	Yes – Theta Bank
Paris Branch	Theta Bank	Paris Branch	No – paid gross (Paris Branch is a QDD)
	Paris Branch	Client	Yes – Paris Branch
Theta Jersey	Theta Bank	Theta Jersey	No – paid gross (Theta Jersey is a QDD)
	Theta Jersey	Client	Yes – Theta Jersey

Question 4

Part 1

Needs to be criminal tax evasion under UK law or alternately foreign law.

The tax evasion must be enabled by the business' employee, agent or those performing services to the business.

The business must have failed to prevent that person from enabling the crime.

Part 2

Under s.46 of the criminal finances act, where the financial institution has a UK connection, failure to prevent the facilitation of non-UK tax evasion would be an offence under.

However, an offence is only committed where it meets a requirement of dual criminality, therefore recognising that different countries approach the criminalisation of taxpayer non-compliance differently.

The offence is a criminal offence in the country where it is committed (s.46(5)(a)), but also the offense would be considered as the fraudulent evasion of tax in the UK (s.46(5)(c)).

Additionally, the facilitation offence must be a criminal offence in the jurisdiction where it is committed (s.46(6)(a)) and would, if the foreign tax evasion offence were a UK tax evasion offence, also be a tax evasion facilitation offence in the UK (s.46(6)(c)).

HMRC has provided details of how a company or partnership can 'self-report' any acts of criminal facilitation that it has identified.

In order to self-report, there is an online facility for authorised representatives to file a report via the government gateway to tell HMRC on behalf of a company or partnership that they have failed to prevent a representative from criminally facilitating UK tax evasion, and that they could be guilty of a corporate failure to prevent offence under Part 3 of the Criminal Finances Act 2017. Before February 2019 this was done by email.

Self-reporting is voluntary, indeed HMRC's guidance states that the individual and the company or partnership they are acting on behalf of have a right to remain silent. HMRC guidance states that the authorised person must not encourage anyone to commit a crime or continue committing a crime to obtain more information.

The report must contain the following information:

- Name of the authorised representative making the filing and their role in the company/partnership;
- Country where tax being evaded;
- Details of the relevant company/partnership e.g. company number, UTR, and authorised person contact details;
- Details of any regulatory bodies the company is a member of;
- Previous disclosures made;

- A description of the offence including dates and amounts;
- A description of the prevention procedures in place to prevent persons from criminally facilitating tax evasion.

If the authorised representative self-reports their company in a timely manner, this could be used as part of the company or partnership's 'reasonable procedures' defense if they are charged with an offence, and potentially be reflected in any penalties if convicted.

Once the report has been made, a submission reference will be issued. HMRC could share the report with other tax authorities if they are legally permitted to do so.

HMRC guidance states that where there are concerns over money laundering or terrorist financing self-reporters, where the company or partnership that they are acting for are regulated, they may have to submit a suspicious activity report (SAR) to the National Crime Agency. This should be completed before self-reporting tales place.

Part 3

DAC6 applies to cross-border tax arrangements, which meet one or more specified characteristics -hallmarks, and which concern either more than one EU country or an EU country and a non-EU country. The relevant hallmarks are as follows.

Generic hallmarks linked to the main benefit test. These are arrangements that give rise to performance fees or involve mass-marketed schemes.

Specific hallmarks linked to the main benefit test. This includes certain tax planning features, for example arrangements aimed at converting income into capital in order to obtain a tax benefit.

Specific hallmarks related to cross-border transactions with some of these hallmarks also being subject to the main benefit test. For example, deductible cross-border payments between associated enterprises where the recipient of the payment is essentially subject to no tax, zero or almost zero tax.

Specific hallmarks regarding the automatic exchange of information (AEOI) and beneficial ownership. Indeed, an arrangement is reportable if it has the effect of undermining the rules, or the absence thereof, on beneficial ownership or Directive 2014/107/EU or any other equivalent agreement on AEOI.

Specific hallmarks concerning transfer pricing. For example, the use of unilateral safe harbours, the transfer of hard-to-value intangible assets when no reliable comparables exist, and the forecasting of future cash flows or income are extremely uncertain.

PART C

Question 5

Section 19(1) of Hk Stamp Ordinance (CAP 117), provides that contract notes in respect of the sale and purchase of HK stock will be stamped not later than 2 days after the sale or purchase is effected or not more than 30 days If not effected in Hong Kong, and that the contract notes will be endorsed to the effect that stamp duty has been paid on the contract note in accordance with the applicable head.

Section 19(11) provides an exemption to this obligation in respect of a stock borrowing or a stock return where a stock borrowing means borrowing Hong Kong stock from a lender under a stock borrowing agreement, either on or off exchange where HK Stock means stock the transfer of which is required to be registered in Hong Kong.

A stock borrowing agreement is an agreement which provides for stock to be obtained from another person whereby the agreement requires that the same stock and quantity must be returned or a reasonable equivalent provided or an alternative payment made which does not reduce the risk of loss or gain in respect of the stock.

Where the borrower is no longer obliged to return the stock or its reasonable equivalent or is no longer used for a specified purpose the stock borrowing is subject to HK Stamp on both the sale and purchase with effect from the either the date the obligation to return is no longer applied or with effect from the date of the stock borrow where the specified purpose no longer applies.

For the exemption to apply the executed copy of stock borrowing and lending agreement together with a fee of HKD 270 must be provided to the Collector within 30 days after any stock borrowing is effected under the agreement and a record of stock borrowings and lendings made under the agreement must be retained and a copy provided to the Collector on a 6 monthly basis.

Question 6

To: Tom, Head of Banking Operations
From: Jonathan, Head of Tax Advisory

Tom, I wanted to summarise our recent conversation on the determination of Controlling Persons (CP) for the purposes of the Common Reporting Standard (CRS).

In accordance with CRS Competent Authorities are required to report all CP's of Passive Non Financial Entities (PNFEs) who are resident in a reportable jurisdiction. However as all our booking entities are located in jurisdictions which have elected to follow the "wider approach", this requires that we must identify and report to the Competent Authority all CPs of PNFEEs who are natural persons resident in a jurisdiction different to the booking location regardless of whether this is a reportable jurisdiction.

For this purpose a CP is effectively the beneficial owner of the account and is determined in accordance with AML / KYC procedures as determined by Recommendation 10 of the FATF and the related Interpretative Note.

For an account holder that is a legal person the CP is the natural person that exercises control over the entity which can be in the form of a controlling interest in the entity. Although there is no prescribed level at which an interest becomes controlling and this is a risk based judgement, depending upon the ownership structure of the legal entity a threshold of 25% is often used. Where there is no natural person exercising control through an ownership interest, we must look to the natural person who exercises control through other means and if this requirement cannot be satisfied we will look to the position of the senior managing official.

In respect of a trust, the FATF guidance provides that the CPs will always include the settlor(s), trustee(s), protector(s) the beneficiary(ies) or classes of beneficiary(ies) and in addition any other natural person exercising ultimate effective control. Where the CP is a settlor which is an entity, it is the natural person that is the controlling person of the entity.

Where the beneficiary is a class or is a group with defined characteristics, it is necessary to obtain sufficient information such that the class or group can be identified at the time of pay-out or when the rights vest. In the case of a discretionary beneficiary they will be deemed a beneficiary only when the trust pays-out or when the beneficiary receives an indirect benefit. It should be noted that in a year where the discretionary beneficiary is not in receipt of a distribution this does not constitute an account closure.

Where the legal arrangement is other than a trust then CP means natural persons who are in an equivalent position to the COPs of a trust. In the case of a usufruct both the bare-owner and the usufructuary may be considered as CPs of a trust.

For a pre-existing entity account with an aggregate account balance or value of less than I Million USD, where we only hold the name of the CP's and were not required under AML/ KYC to obtain/ retain other information at the time that the account was opened we do not have an obligation to document or report the CP.

Question 7

Introduction
AtoZ would not be entitled to reclaim the full amount of VAT that they incur on costs because they are partly exempt for VAT purposes.

In simple terms, if the service provided is taxable, the costs attributable to the service are usually fully recoverable. However, the VAT costs attributable to an exempt service are likely to be irrecoverable. The exception is where an exempt service is provided to clients established outside the EU.

Additional compliance requirements

AtoZ will receive exempt income from services that it performs such as M&A activity, debt restructuring, divestments, IPOs or debt and equity private placements.

A consequence of this is that an annual adjustment must be carried out at the end of each VAT year. This requires AtoZ to apply the normal VAT recovery method using annual data, rather than on a quarter-by-quarter basis. The difference between what can be reclaimed on an annual basis, versus what was claimable in the individual VAT return periods, forms the annual adjustment which may be in favour to AtoZ ie an amount can be reclaimed from HMRC.

It should be noted that a modest error, e.g. processing a supply as zero rated, when it should have been exempt (leading to an over recovery of VAT) will have knock on effects on the groups VAT recovery and the annual adjustment figures. This could result in a significant amount of VAT being at risk, especially if the errors occur consistently over time. This is because HMRC can raise an assessment going back 4 years.

As AtoZ is a partially exempt business, an extra adjustment required for the VAT recovery claimed on expenditure on capital assets, including any commercial property purchase and/or refurbishment that costs over £250,000. Therefore, there would be an extra adjustment for the property refurbishment (based on cost of £3,250,000). This is dependent on the change in the annual adjustment recovery rate, i.e. from the rate applied to the original year of purchase and use of the asset to the rate calculated in each subsequent adjustment year for 10 years. If disposed of before 10 years, the remaining periods need to be treated based on the VAT treatment applied to the disposal.

How to apply for PSEM with HMRC

For AtoZ, where their services provided includes both taxable and exempt supplies, VAT recovery must be determined using an appropriate partial exemption method.

Conventionally HMRC has expected financial services businesses to use a partial exemption “special method” to determine VAT recovery. Such a method is bespoke to their individual business model but must be agreed with HMRC in advance. If the special method is not used a method based on turnover must be applied.

The method used to determine the VAT recovery can have a significant impact on the amount of VAT recoverable. AtoZ has a partial special exemption method in place special method already in place, however it is always worth reviewing whether it is still reasonable for the business as this was agreed with HMRC in November 2009 after which business operations and product lines undoubtably would have changed.

AtoZ could seek to apply a more beneficial method can be based on the number of projects or transactions being worked on or based on a sectorised approach with different methods for VAT recovery in each part of the business. Although it can be time consuming to agree the method the benefits can be significant.

It is crucial for AtoZ to keep on top of their VAT position, with regular annual reviews. Indeed, regular reviewing of the groups VAT position also demonstrates, if any errors do arise, that "reasonable care" is being taken by AtoZ, which will help alleviate and reduce any penalties that HMRC may seek to apply.

Additionally, AtoZ supplies financial instruments in the form of shares and bonds. Section 7 of HMRCs partial exemption toolkit (2014) confirms that such supplies should be ring-fenced, and a separate partial exemption computation is required for the recovery of input VAT. This would represent an additional compliance burden for AtoZ.

Penalties for non-VAT compliance

With regard to the implications for non-compliance, HMRC will seek to charge penalties and interest, this is regardless if the noncompliance is international or not. The penalty amount from HMRC will range from 15% to 30% of the VAT owed for a "careless" error. In contrast, a deliberate or concealed error will attract higher penalties. Additionally, the actual penalty amount is subject to an assessment by HMRC HMRC's as to whether the business took "reasonable care" or failed to take reasonable care in making the error.

The rules governing VAT are continually changing due to new legislation, updates in HMRC's guidance, and various case law precedents released over time. It is a complex process. There have been numerous tribunal cases often motivated by the specific requirements of the appellant, but which do provide fundamental background into the thinking of the European Courts and HMRC.

Question 8

Part 1

The legislation contained within 66(1)(a) of schedule 19 refers to double taxation relief being possible in where ‘equivalent foreign levy’ has been paid.

Sub paragraph 66(2) of schedule 19 confirms that this means any tax imposed by the law of a foreign territory that corresponds to the bank levy.

To correspond, the non-UK levy must broadly follow the proposals for the design of bank levies in the IMF report “a fair and substantial contribution by the financial sector” (2010).

Additionally, the non-UK levy must be based upon a balance sheet (on assets or liability) and must be similar in scope to the UK levy.

If the non-UK levy is based on a tax on Income, or alternately profits or gains it would not be deemed equivalent to the UK bank levy.

Under the home state primacy principle, the state of residence of the bank subsidiary or permanent establishment (PE) will give double tax relief for any equivalent levy charged by the state of residence by the parent, or head office in the case of a PE. So, by way of example, if a French bank has a PE in the UK, the UK will give relief against the UK bank levy for the French bank levy charged upon the UK PE.

Part 2

Paragraph 47 of Schedule 19 contains the UK bank levy’s anti-avoidance measures. The aim of such measures being to eliminate the ability of banks to avoid and/or reduce a UK bank levy liability through avoidance techniques.

With regard to the territorial scope of the legislation, the anti-avoidance legislation refers throughout to the ‘relevant group’ and ‘relevant entity’. Indeed paragraph 47(13) states that ‘group’ comprises foreign banking groups and relevant non-banking groups.

The avoidance legislation details a two-step test. Firstly, one or more entities must have entered into arrangements. It is intended that ‘arrangements’ will be interpreted widely, therefore including any arrangements whether or not legally enforceable. These could include a single transaction or alternately a set of transactions.

Secondly, the main purpose, or one of the main purposes of any entity, in entering into the arrangements or any part of the arrangements, is to avoid or reduce a charge or assessment to the UK bank levy.

For an anti-avoidance rule to apply both steps above must have been satisfied. If the two-step test is met, the bank levy is charged or assessed. This may include, for example, assessing a charge to the bank levy that would otherwise be avoided, alternately increasing a charge or assessment that would otherwise be reduced.

The bank levy legislation does encourage banking groups to implement lower risk funding strategies. For this reason, the anti-avoidance rules do not apply to arrangements where their objective was to comply with the policy aim of lower risk funding strategies. As a result, the legislation includes exemptions for arrangements to the extent that they have this specified effect.