



House of Commons
Committee of Public Accounts

Management of large business Corporation Tax

Thirtieth Report of Session 2007–08

*Report, together with formal minutes, oral and
written evidence*

*Ordered by The House of Commons
to be printed 2 June 2008*

The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

Current membership

Mr Edward Leigh MP (*Conservative, Gainsborough*) (Chairman)
Mr Richard Bacon MP (*Conservative, South Norfolk*)
Angela Browning MP (*Conservative, Tiverton and Honiton*)
Mr Paul Burstow MP (*Liberal Democrat, Sutton and Cheam*)
Rt Hon David Curry MP (*Conservative, Skipton and Ripon*)
Mr Ian Davidson MP (*Labour, Glasgow South West*)
Mr Philip Dunne MP (*Conservative, Ludlow*)
Angela Eagle MP (*Labour, Wallasey*)
Nigel Griffiths MP (*Labour, Edinburgh South*)
Rt Hon Keith Hill MP (*Labour, Streatham*)
Mr Austin Mitchell MP (*Labour, Great Grimsby*)
Dr John Pugh MP (*Liberal Democrat, Southport*)
Geraldine Smith MP (*Labour, Morecombe and Lunesdale*)
Rt Hon Don Touhig MP (*Labour, Islwyn*)
Rt Hon Alan Williams MP (*Labour, Swansea West*)
Phil Wilson MP (*Labour, Sedgefield*)

The following was also a Member of the Committee during the period of the enquiry:

Annette Brooke MP (*Liberal Democrat, Mid Dorset and Poole North*) and

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Emma Sawyer (Committee Assistant), Pam Morris (Committee Assistant) and Alex Paterson (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee’s email address is pubaccomm@parliament.uk.

Contents

Report	<i>Page</i>
Summary	3
Conclusions and Recommendations	5
1 The level and distribution of Corporation Tax receipts from large businesses	7
2 Performance in managing large business Corporation Tax	10
3 Tackling tax avoidance	13
4 HM Revenue & Customs' skills and training	15
Formal Minutes	17
Witnesses	18
List of written evidence	18
List of Reports from the Committee of Public Accounts 2007–08	19

Summary

In 2006–07, Her Majesty’s Revenue & Customs (the Department) raised a total of £23.8 billion in Corporation Tax from large businesses. There are some 700 of these businesses, and in 2005–06, just 50 of them paid 67% of the large business Corporation Tax, whilst 181 businesses paid none. Two-thirds of the tax comes from the banking, oil and gas and insurance sectors. Businesses pay little or no Corporation Tax because, for example, they have made a loss, or had losses in previous years, or they are using tax reliefs, or engaging in tax avoidance.

In 2006–07, the Department’s large business Corporation Tax enquiry programme raised nearly £2.7 billion. Many of these enquiries were poorly targeted, with nearly 60% producing less than 1% of the additional tax raised. The enquiries also take too long: in January 2008, 42% of its enquiries were over two years old, and 10% over four years old.

In February 2007, based on initial review of tax returns from the previous 12 months, the Department estimated that the potential Corporation Tax at risk was £8.5 billion. It is currently using these estimates to develop a measure of the tax gap—the difference between the amount of tax it collects and the theoretical tax liability if all taxpayers were fully compliant.

Recent legislation requires ‘promoters’ to disclose, and ‘users’ to declare, their tax avoidance schemes. By February 2007, the Department had received 900 disclosures of avoidance schemes, with 350 schemes closed through legislation.

Large businesses are often multinational organisations, whose operations may involve trade and financing across national boundaries. Around half the growth in global trade is from intra-company trade between related companies within large multinationals. These features add to the complexity of their tax assessments, and the Department faces similar issues to tax authorities in other countries in handling their tax affairs.

There has been a widening gap between the skill set of large business tax staff and that of the Large Business Service. The Department is bringing in external recruits, including retired tax advisors, to help to train its staff and to deal with the more complicated technical work.

On the basis of a report by the Comptroller and Auditor General,¹ the Committee examined HM Revenue & Customs on the level and distribution of Corporation Tax receipts, its performance in managing large business Corporation Tax, tackling tax avoidance, and its staff skills and training.

Conclusions and Recommendations

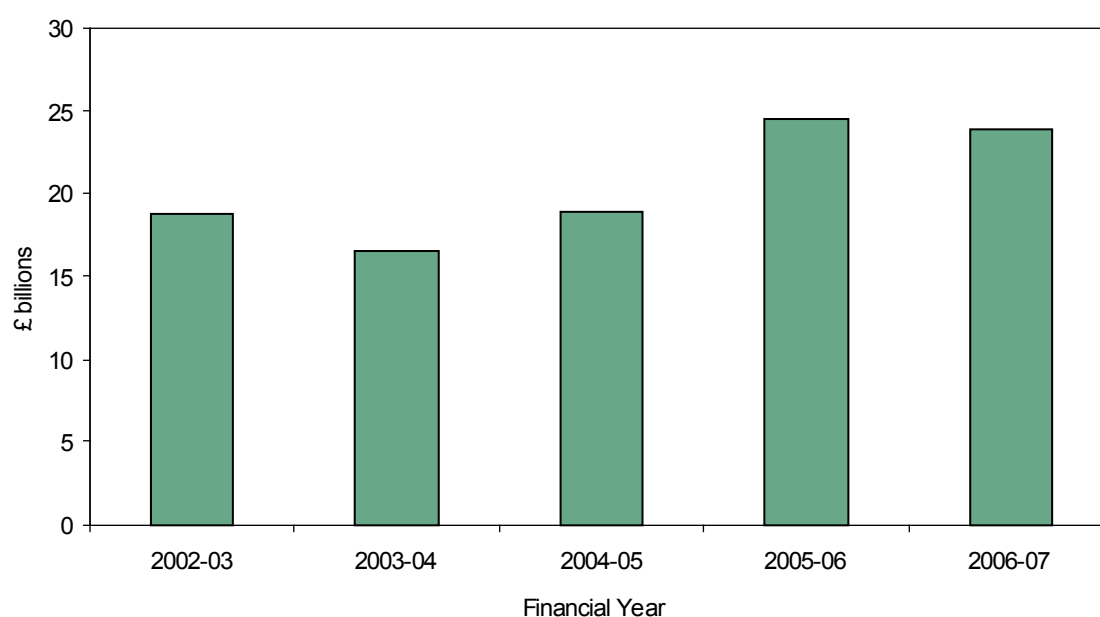
- 1. The Corporation Tax paid by large businesses is heavily skewed towards a small number of businesses. In 2005–06, of the 700 largest businesses in the UK, 50 paid two-thirds of the tax raised, and 181 paid none.** The analysis published in the National Audit Office's report provides transparency on the variations in tax revenue and the contributions from different sectors of the economy. The Department should publish a similar analysis each year with explanations of the trends.
- 2. Businesses in the United Kingdom can legitimately reduce their Corporation Tax payments by claiming a range of reliefs and allowances.** In some cases, the liability may reduce to zero, even though the businesses have made profits. The amount of tax foregone is likely to be substantial, but is not visible. The Department should publish an annual analysis by industry sector of the extent of these reliefs and allowances, as well as their effect on tax revenues.
- 3. Of the £2.7 billion additional tax generated by the Department's Corporation Tax enquiries in 2006–07, 99% came from 40% of the enquiries.** To increase the yield from enquiries and make better use of its staff, the Department should target those businesses that pose the greatest risks of non-compliance. To demonstrate its progress in targeting risks it should publish annually the distribution of its enquiries by value.
- 4. The Department aims to complete enquiries within 18 months, but 42% of enquiries have been running for two years or more.** Because of the delays the companies affected cannot determine their final tax bill, and the Department's staff are diverted from working to resolve current issues. By April 2009, it should aim to achieve this 18 month target for at least 95% of enquiries, and identify the reasons enquiries are not concluded to time.
- 5. The Department has appointed client relationship managers to improve the relationship with large businesses and identify key risks across the different taxes.** To establish whether the client relationship manager role adds value, and improve overall compliance, the Department should undertake an evaluation of their effectiveness by the end of 2009.
- 6. The Department does not have a robust measure of the Corporation Tax gap (the difference between how much tax large businesses pay and their theoretical liability).** It should develop such a measure and publish the results, with separate estimates being produced for large businesses and for small and medium-sized businesses, which are covered by its local offices.
- 7. Around half the growth in global trade currently comes from transactions between subsidiaries of multinational companies.** The Department works through international fora, such as the Organisation for Economic Cooperation and Development, to research and share information on international tax avoidance practices. It should share information and assessments on individual high risk companies with tax authorities in other countries to inform its own risk assessments.

8. **In the United Kingdom, groups of companies are not required to prepare consolidated Company Tax returns so the Department cannot assess the effective Corporation Tax rate across a group of companies.** Tax authorities in Australia and Canada can analyse the effective tax rates across groups of companies to differentiate high and low risk businesses. The Government should consider whether consolidated Company Tax returns would bring greater clarity on the tax position of large conglomerates in the United Kingdom.
9. **As the Department has reduced the use of generic avoidance schemes, tax advisers have developed bespoke schemes to help large businesses reduce their tax liabilities.** In its risk assessments, the Department should consider a number of indicators to large business avoidance activity, such as the cost of professional tax advice, the direct recruitment of staff with expertise in tax avoidance schemes, and the businesses' wider international record.
10. **The Department has introduced a new approach to dealing with large businesses to differentiate its treatment of those it considers high and low risk.** The Department should publicise its new approach and emphasise the likelihood of fewer enquiries for businesses with low risk behaviour. It should also increase the number of penalties for companies engaged in serious avoidance activity, by robustly applying the new penalty regime when it comes into effect.
11. **The Large Business Service faces a loss of skills and industry knowledge as more experienced staff are due to retire.** The Department should assess the number and skills of staff it needs over the next 10 years and how it will recruit them, and develop a linked training programme to enable it to have sufficient expertise for its work.

1 The level and distribution of Corporation Tax receipts from large businesses

1. In 2006–07, Her Majesty’s Revenue & Customs (the Department) raised £23.8 billion in Corporation Tax from large businesses, 54% of the total Corporation Tax raised. This was a fall of £0.5 billion in real terms from 2005–06, which the Department considered largely related to the exceptionally high level of receipts in the previous year (**Figure 1**). These arose from a change in the instalments regime for North Sea taxation, which resulted in collection of an extra quarter’s worth of tax in that year.²

Figure 1: Corporation Tax raised from large businesses from 2002–03 to 2006–07, shown in real terms



Note: Data is shown in real terms, at 2006–07 prices using HM Treasury Gross Domestic Product deflators

Source: C&AG’s Report, HM Revenue & Customs: Management of large business Corporation Tax, HC (Session 2006–07) 612

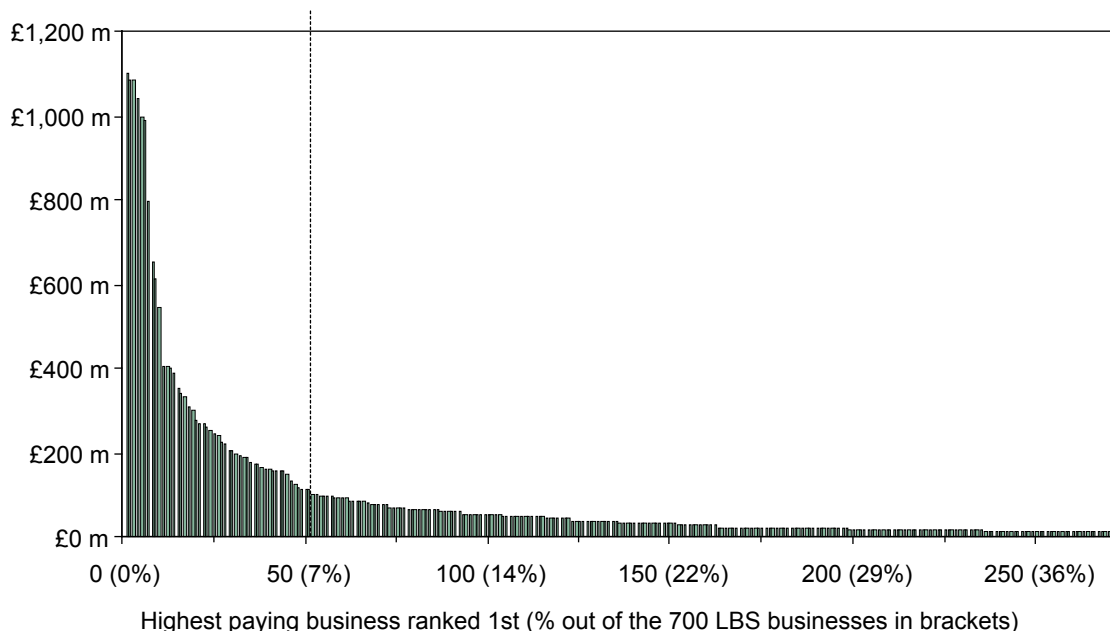
2. Much of the Corporation Tax raised from the 700 large businesses within the Large Business Service (LBS) comes from a small number of businesses (**Figure 2**). In 2005–06, just 50 businesses (7%) paid 67% of the Corporation Tax raised from all large businesses. In the same year, 181 large businesses paid no Corporation Tax. The Department considered that the distribution of corporation tax receipts generally reflected the distribution of market capitalisation among larger UK businesses.³

² Q 121; C&AG’s Report, para 1.11

³ Q 145; C&AG’s Report, para 1.12; Ev 16, para 1

3. Corporation Tax receipts are also heavily skewed by industry sector. In 2005–06, just three of the 17 industry sectors in the Large Business Service (banking, oil and gas, and insurance) raised 67% of all large business Corporation Tax. These sectors accounted for 28% of the businesses managed by the Large Business Service.⁴

Figure 2: The distribution of Corporation Tax payments by large businesses in 2005–06



Source: C&AG's Report, HM Revenue & Customs: Management of large business Corporation Tax, HC (Session 2006–07) 612

4. The Department considered that some large businesses pay little or no Corporation Tax, because, although they have based their headquarters in London as a major financial centre, they have little economic activity in the United Kingdom. Nearly 38% of the activity of United Kingdom quoted groups happens overseas, with much of the profit taxed abroad.⁵

5. Of the 181 businesses that paid no Corporation Tax in 2005–06, 53 did so because of historic tax losses. Some large businesses, particularly in telecommunications and manufacturing, had substantial accumulated losses from the late 1990s, which reduce their current Corporation Tax payments. A further 19 businesses were largely inactive during the period, for example, because they had ceased trading, gone into liquidation or they had reduced their UK presence.⁶

6. Ninety-seven large businesses paid no tax in 2005–06 because of tax losses in that year. Their tax losses were for various reasons including use of reliefs for pension contributions, for research and development expenditure, and for finance costs. The Department acknowledged that the United Kingdom has a relatively generous regime for tax relief on payments of interest on debt. In 12 cases, avoidance activity extinguished all tax liabilities.

4 C&AG's Report, para 1.13

5 Q 5

6 Ev 16, para 1

In all these cases, the Department was challenging the avoidance schemes through its enquiry work, with possible litigation in three cases.⁷

7 Q 5; Ev 16, para 1

2 Performance in managing large business Corporation Tax

7. In 2006–07, the Department raised additional Corporation Tax of nearly £2.7 billion from its compliance enquiries on large businesses. In April 2006, the Department implemented a new risk assessment approach known as ‘resourcing to risk’. This involves estimating the maximum amount of tax under consideration for each case and then concentrating resources to tackle the highest value, most significant risks first. The approach is designed to enable the Department to differentiate its approach between high-risk and low-risk businesses.⁸

8. At February 2007, 58% of enquiries under way were on cases where the tax under consideration was less than £500,000. Collectively, these were likely to amount to less than 1% of the total intervention yield from all enquiries. Conversely, only 1% of enquiries under way involved tax under consideration of more than £100 million, amounting to 43% of total potential tax yield. There was also no correlation between the resources the Department commits to each enquiry and the amount of Corporation Tax under consideration.⁹

9. The Department acknowledged that it had not been sufficiently rigorous in resourcing to risk and that the proportion of low value enquiries was too high. By January 2008 it had reduced the number of enquiries with a value less than £500,000 by 55%. It had also set a target for 2007–08, to reduce such enquiries by 75%. It had adapted its approach so that decisions on enquiries also take account of the probability of success, as well as the wider significance of the case, for example, if the issue at stake could affect a number of companies, and therefore involve larger amounts of tax at risk.¹⁰

10. The Department’s client relationship managers for each of the large businesses play a key role in assessing and managing the risks that apply to the business and help businesses understand the key risks. The Department considers that these managers have been effective in getting to know the business and in reprioritising work. Its surveys of large business indicate improvements in working relationships, but it does not have firm evidence of their effectiveness in improving compliance.¹¹

11. Under the ‘resourcing to risk’ approach, the Department estimates the maximum amount of tax under consideration for each business. In February 2007, the total estimated tax at risk under consideration was £8.5 billion, based on the tax issues identified in the previous 12 months from initial scrutiny by tax specialists of businesses’ self-assessments. Issues might include, for example, use of a tax avoidance scheme, a claim on capital allowances, or the use of tax reliefs. The Department could not provide an accurate estimate of the total tax under consideration, extending back beyond 12 months. The £8.5

8 C&AG’s Report, paras 2.4, 2.9

9 C&AG’s Report, paras 2.7–2.8

10 Qq 2, 39–40, 66

11 Qq 124–125; C&AG’s Report, paras 2.33–2.34

billion might also overestimate the actual tax at risk since it includes amounts that the Department may decide have been treated properly following further enquiries with the company.¹²

12. In 2005, the Department undertook work on estimating the tax gap for Corporation Tax, but concluded at the time that the results were not sufficiently robust. The tax gap is the difference between the amount the Department collects through routine compliance and the total theoretical tax liability if all taxpayers were fully compliant. It is currently developing a measure based on the estimates of tax at risk, and hopes to generate sufficiently robust figures that it can publish.¹³

13. The Australian Taxation Office has implemented, and the Canadian Revenue Agency is in the process of implementing, a methodology for comparing the effective tax rate of individual businesses to the statutory rate of tax. This methodology is used as a means of differentiating high and low risk businesses. The Department considers there are difficulties in extracting effective tax rate information from accounts that combine United Kingdom and foreign tax and profits. It believes that the challenge in working out what tax is paid, against what profits, is that the United Kingdom does not require a single consolidated tax return for a group of companies that would allow a simple effective tax rate to be undertaken. However, it recognises that a consolidated tax return would be helpful in measuring compliance.¹⁴

14. As at January 2007, 49% of the Department's enquiries underway were over two years old, and 13% were over four years old. Prolonged enquiries prevent businesses from gaining certainty about their Corporation Tax position, tie up the resources of the business and the Department in examining past events where staff may have changed, and restrict their capacity to resolve current issues.¹⁵

15. The Department is seeking to achieve speedier resolution of its enquiries as part of its response to the Review on Links with Large Businesses, which was published in November 2006. The Department made a commitment to complete enquiries within 18 months. Between January 2007 and January 2008 it had reduced the total number of open enquiries by nearly 40%, and reduced the proportions that were over two and four years old to 42% and 10% respectively (**Figure 3**).¹⁶

Figure 3: The proportion of open enquiries that are over two years old and over four years old

	Percentage of open enquiries over two years old	Percentage of open enquiries over four years old
January 2007	49	13
January 2008	42	10

Source: C&AG's Report, para 2.24 and Q 150

12 Qq 9, 138–139; C&AG's Report, paras 2.10–2.11

13 Qq 7, 103; C&AG's Report, paras 3.8, 3.10

14 Qq 10–17, 79; C&AG's Report, paras 2.14–2.18

15 C&AG's Report, paras 2.24–2.25

16 Qq 150, 152; C&AG's Report, paras 2.24–2.25; Appendix 4

16. While delays had stemmed from insufficient resources being deployed to progress the enquiries, the Department considered that many of the older enquiries tended to be complex cases, involving avoidance schemes and transfer pricing. At times, it faced difficulties in obtaining information from the business and experienced delays because of litigation. On occasions, it met considerable challenge at every stage from the company and its tax advisers.¹⁷

3 Tackling tax avoidance

17. Businesses have the right to plan their tax affairs efficiently to minimise their tax liabilities within the rules and thereby maintain their competitive position compared to other businesses. Companies can also legitimately use tax reliefs and allowances provided for in legislation to reduce their tax liability. However, the Department is keen to reduce the amount of tax lost to the Exchequer through tax avoidance.¹⁸

18. Tax avoidance is not easily definable, but it can involve highly creative ways of using complex tax laws to reduce or defer tax. Interpretations of tax legislation can differ so that businesses may regard their actions as acceptable, while the Department may regard them as in conflict with the rules or intention of the legislation. Businesses often seek help from accounting and law firms, and investment banks in arranging their affairs so as to minimise their liabilities. These advisers may also develop bespoke schemes for their clients to reduce their Corporation Tax.¹⁹

19. In 2006, the Government extended legislation requiring ‘promoters’ of avoidance schemes to disclose, and ‘users’ to declare, their use of schemes. At the end of February 2007, the Department had received nearly 900 disclosures of avoidance schemes and the Government had closed 350 of them with legislation. The Department considered that the majority of marketed schemes had been addressed by legislation or through litigation.²⁰

20. The Department had seen a growth in bespoke schemes to reduce tax liabilities, for example, by transferring intangible assets out of the United Kingdom to low tax countries, and paying the overseas company for use of those assets in the United Kingdom. The Department was seeking to apply its transfer pricing rules (governing the sale of goods between related companies) on such arrangements. The yield from transfer pricing enquiries on large businesses had increased from £118 million in 2003–04 to £473 million in 2006–07. The Department was working with other tax administrations, which faced similar issues on structuring arrangements, through the Organisation for Economic Cooperation and Development.²¹

21. A business’s tax advisers can be a major influence on its tax risk behaviour and compliance with tax legislation. Tax advisers that have devised and sold avoidance schemes may also take measures to slow the Department’s efforts to close the scheme, to defend their investment. The Department has recently led a study into tax intermediaries on behalf of the Organisation for Economic Cooperation and Development. It examined the risks that large firms of tax advisers, which may operate globally, pose for tax systems. The Department places responsibility on the chief finance officers of large businesses for their tax advisers and ensuring compliance. The Department is also a member, along with the tax administrations of the USA, Canada, Australia and Japan, of the Joint International Tax

18 C&AG’s Report, para 2.27

19 C&AG’s Report, para 2.27

20 Qq 6, 105–106; C&AG’s Report, para 2.29

21 Qq 80–81, 105; Ev 16, para 5

Shelter Information Centre based in the USA and the UK. The Centre coordinates intelligence on international avoidance activity.²²

22. The Department is also tackling avoidance through its 'high-risk corporates' programme, in which senior officials of the Department work directly with the management boards of high risk businesses. Its aim is to influence the behaviour of such businesses by warning them of its plans for extensive investigation. On one business, the Department had set up a taskforce of more than 150 officers and outside counsel. The Department had covered around six large businesses in the programme, with collectively several billion pounds of additional tax under consideration. As a result, the Department had resolved significant tax issues, secured additional tax and gained commitments from businesses to change their approach.²³

23. In 2006–07, the Department imposed penalties on large businesses for negligence in their Company Tax returns in only 19 cases, totalling £15 million. Five cases in 2005–06 and one in 2006–07 related to transfer pricing. Currently, there is no statutory basis for the Department to impose penalties where the completed enquiry reveals the business has sought to avoid Corporation Tax, unless there is evidence of negligence, fraud or failure to keep adequate documentation. The Government had introduced a new penalty regime, which will come into force during 2008, and apply to Company Tax returns in 2009. The Department expected these powers to make it easier to obtain a penalty where there has been insufficient care to get matters right, while also not imposing penalties for innocent errors.²⁴

22 Qq 78, 107, 128–129; C&AG's Report, para 2.35

23 Qq 3, 98; C&AG's Report, para 2.31

24 Qq 85–86, 147; Ev 16, para 6, C&AG's Report, para 2.5

4 HM Revenue & Customs' skills and training

24. Large businesses are often multinational organisations whose operations may involve international commercial transactions, intra-company trade across national boundaries and cross border-financing arrangements. Around half of the growth in global trade is from intra-company trade between related companies within large multinationals. These features and other factors such as controlled foreign companies' legislation and double taxation reliefs contribute to the complexity of the tax assessments for large businesses. In this environment, the Department needs to have the requisite skills and industry knowledge to deal effectively with such issues.²⁵

25. Six hundred staff in the Large Business Service work on Corporation Tax. A quarter of these staff are due to retire over the next 10 years. Departmental staff and large businesses consider that those staff with the greatest experience and industry knowledge tended to be those approaching retirement. To address this loss of knowledge and skills, the Department had recently increased the numbers of recently qualified tax inspectors it was deploying to the Large Business Service, whom it will train and develop. It was also recruiting people who have retired from the major accountancy and law firms to undertake more complicated technical work and help with staff development.²⁶

26. The Department had found that recruiting people who had experience of working in the large firms had been helpful in bringing a commercial understanding and perspective, and sometimes knowledge and expertise about approaches to avoidance. Eight staff had left the Large Business Service in 2007 to join the major firms. Where this happens, the Department examined the reasons why. The Department considered that maintaining a flow of staff in both directions between the Department and the private sector was healthy. It also seconded staff to learn how businesses work.²⁷

27. In its own survey of staff, a third of the Department's tax specialists and client relationship managers did not feel the training they received was sufficient to give them confidence in their role. Large businesses also consider that there has been a widening gap between the skill set of their own tax staff and that of the Large Business Service. The Department's initial training of its specialists in tax administration is held in high regard internally and externally. But it had reduced the additional training it provides to enhance the skills and knowledge of front line specialists. For example, it had halted its international training courses, which covered transfer pricing issues, and cut back on a number of technical update courses.²⁸

28. The Department considered that on the job training provided a better approach to training on international tax issues, working alongside permanent staff who had developed

25 Q 77; C&AG's Report, para 4.8

26 Qq 41, 54, 148; C&AG's Report, paras 4.2, 4.16

27 Qq 41, 92-94, 148; Ev 16, para 7

28 Q 63; C&AG's Report, para 4.9

expertise and external recruits. The Department was also creating more specialist roles, and provided training packages to support these roles. It had built up a group of international specialists who worked solely on those issues within the Large Business Service. It had also recently created 16 new specialist posts in transfer pricing, which it planned to fill in the first half of 2008. By so doing, the Department expected to fulfil its commitment to shorten the time it takes to complete transfer pricing enquiries. Since 2005–06, it had recruited 14 avoidance consultants and the Department's Anti-Avoidance Group was currently running a further external recruitment exercise.²⁹

29 Qq 43–44, 59–63, 92

Formal Minutes

Monday 2 June 2008

Members present:

Mr Edward Leigh, in the Chair.

Mr Richard Bacon

Mr Austin Mitchell

Mr Paul Burstow

Mr Don Touhig

Mr Philip Dunne

Phil Wilson

Mr Nigel Griffiths

Draft Report (*Management of large business Corporation Tax*), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 28 read and agreed to.

Resolved, That the Report be the Thirtieth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 4 June at 3.30 pm.]

Witnesses

Monday 28 January 2008

Page

Mr Dave Hartnett CB, Acting Chairman, **Ms Melanie Dawes**, Acting Director, General Business, and **Ms Freda Chaloner**, Acting Director, Large Business Service, HM Revenue and Customs

Ev 1

List of written evidence

HM Revenue and Customs

Ev 16

List of Reports from the Committee of Public Accounts 2007–08

First Report	Department for International Development: Tackling rural poverty in developing countries	HC 172 (Cm 7323)
Second Report	Department of Health: Prescribing costs in primary care	HC 173 (Cm 7323)
Third Report	Building for the future: Sustainable construction and refurbishment on the government estate	HC 174 (Cm 7323)
Fourth Report	Environment Agency: Building and maintaining river and coastal flood defences in England	HC 175 (Cm 7323)
Fifth Report	Evasion of Vehicle Excise Duty	HC 227
Sixth Report	Department of Health: Improving Services and Support for People with Dementia	HC 228 (Cm 7323)
Seventh Report	Excess Votes 2006–07	HC 299
Eighth Report	Tax Credits and PAYE	HC 300 (Cm 7365)
Ninth Report	Helping people from workless households into work	HC 301 (Cm 7364)
Tenth Report	Staying the course: the retention of students on higher education courses	HC 322 (Cm 7364)
Eleventh Report	The compensation scheme for former Icelandic water trawlermen	HC 71 (Cm 7364)
Twelfth Report	Coal Health Compensation Schemes	HC 305 (Cm 7364)
Thirteenth Report	Sustainable employment: supporting people to stay in work and advance	HC 131 (Cm 7364)
Fourteenth Report	The budget for the London 2012 Olympic and Paralympic Games	HC 85 (Cm 7365)
Fifteenth Report	The Pensions Regulator: Progress in establishing its new regulatory arrangements	HC 122 (Cm 7365)
Sixteenth Report	Government on the Internet: Progress in delivering information and services online	HC 143 (Cm 7366)
Seventeenth Report	Foreign and Commonwealth Office: Managing Risk in the Overseas Territories	HC 176 (Cm 7366)
Eighteenth Report	Improving corporate functions using shared services	HC 190 (Cm 7366)
Nineteenth Report	BBC Procurement	HC 221 (Cm 7366)
Twentieth Report	HM Revenue & Customs: Helping individuals understand and complete their tax forms	HC 47 (Cm 7366)
Twenty-first Report	The Carbon Trust: Accelerating the move to a low carbon economy	HC 157 (Cm 7366)
Twenty-second Report	Improving the efficiency of central government's use of office property	HC 229 (Cm 7366)
Twenty-third Report	Report on the NHS Summarised Accounts, 2006–07: Achieving financial balance	HC 267
Twenty-fourth Report	The privatisation of QinetiQ	HC 151
Twenty-fifth Report	The cancellation of Bicester Accommodation Centre	HC 316
Twenty-sixth Report	Caring for Vulnerable Babies: The reorganisation of neonatal services in England	HC 390
Twenty-seventh Report	DFID: Providing budget support to developing countries	HC 395
Twenty-eighth Report	Government preparations for digital switchover	HC 416
Twenty-ninth Report	A progress update in resolving the difficulties in administering the single payment scheme in England	HC 285
Thirtieth Report	Management of large business Corporation Tax	HC 302
Thirty-first Report	Progress in Tackling Benefit Fraud	HC 323
Thirty-second Report	Reducing the cost of complying with regulations: The delivery of the Administrative Burdens Reduction Programme, 2007	HC 363
Thirty-third Report	Ministry of Defence: Major Projects Report 2007	HC 433
Thirty-fourth Report	Increasing employment rates for ethnic minorities	HC 472
Thirty-fifth Report	Housing Market Renewal: Pathfinders	HC 106
Thirty-sixth Report	HM Treasury: Making Changes in Operational PFI Projects	HC 332
Thirty-seventh Report	Leaving the Services	HC 351
Thirty-eighth Report	Nuclear Decommissioning Authority—Taking forward decommissioning	HC 370

Thirty-ninth Report	Preparing to deliver the 14–19 education reforms in England	HC 413
Fortieth Report	DEFRA: Management of Expenditure	HC 447
Forty-first Report	NHS Pay Modernisations: New contracts for General Practice services in England	HC 463
Forty-second Report	Preparing for sporting success at the London 2012 Olympic and Paralympic Games and beyond	HC 477
Forty-third Report	Managing financial resources to deliver better public services	HC 519
Forty-fourth Report	The roll-out of the Jobcentre Plus office network	HC 532
First Special Report	The BBC's management of risk	HC 518 (Cm 7366)
Second Special Report	Evasion of Vehicle Excise Duty	HC 557 (Cm 7366)

Oral evidence

Taken before the Committee of Public Accounts

on Monday 28 January 2008

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Angela Browning
Mr Philip Dunne
Nigel Griffiths

Keith Hill
Mr Austin Mitchell
Dr John Pugh
Mr Don Touhig

Sir John Bourn KCB, Comptroller and Auditor General, National Audit Office, gave evidence.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, gave evidence.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

MANAGEMENT OF LARGE BUSINESS CORPORATION TAX (HC 614)

Witnesses: **Mr Dave Hartnett CB**, Acting Chairman, **Ms Melanie Dawes**, Acting Director, General Business, and **Ms Freda Chaloner**, Acting Director Large Business Service, HM Revenue and Customs, gave evidence.

Q1 Chairman: Good afternoon. Welcome to the Committee of Public Accounts. Today we are considering the Comptroller and Auditor General's Report *HM Revenue and Customs—Management of Large Business Corporation Tax*. Welcome back, Dave Hartnett, who is Acting Chief Executive of HM Revenue and Customs. Would you like to introduce your colleagues?

Mr Hartnett: Yes, Chairman. Good afternoon to you as well. To my left is Melanie Dawes, a member of our Executive Committee who leads on business issues generally and, to my right, Freda Chaloner, who leads the Large Business Service.

Q2 Chairman: Thank you. Perhaps we could start by looking at how good you are at raising this. If we look at paragraph 2.7 which relates to figure five, I was quite surprised to read, Mr Hartnett, that 58% of open inquiries involve cases where the tax under consideration is less than £500,000. So you have got 58% of your inquiries generating only 1% additional Corporation Tax. Do you really have a grip on this tax?

Mr Hartnett: I think we do, Chairman. We were very conscious that figure was too high. We have been reducing it as we have switched our resource to bigger risks. We have looked at these smaller risks and have closed a great number of them down. I will just ask Melanie if she can give you a number to give you a feel for it.

Ms Dawes: Since February, when the Report was written and that figure was produced, we have cut the number of issues for less than £500,000 by 55%. What we have also done is introduce a more rounded measure of a small issue that takes into account not just the monetary amount but also looks at the probability of success and the impact on the wider tax system. We have set ourselves a target for that in

this financial year of cutting those small issues by 75% and so far we have achieved a 70% reduction in the nine months to the end of December.

Q3 Chairman: So it would not be a fair criticism to say you are concentrating on the small fry and letting the big fish get away?

Mr Hartnett: Absolutely not, Chairman. Some of the big fish are very big indeed. We have applied a lot more resource to those, taking a taskforce approach to the biggest risks, recently applying more than 150 of our officers, plus outside counsel and others, on just one case.

Q4 Chairman: You see, what surprises me is that many people will be as astonished by this as I was. If we look at 1.12 what we see there is a third of large businesses pay no Corporation Tax at all. That is extraordinary. Do you think that members of the public, if they were watching this, would find that very strange?

Mr Hartnett: I think members of the public would be interested to know why that is.

Q5 Chairman: I think they would be, so you are now going to tell us.

Mr Hartnett: If we were to explain it to them I think they would begin to understand why it is like that. London, as a financial centre, attracts the headquarters of many corporates but not the economic activity behind it, so there are many large businesses which have very little economic activity to be taxed in the UK. Nearly 38% of the activity of UK quoted groups happens abroad and much of the profit will be taxed abroad. Some great UK corporations have very substantial accumulated losses. Some industries in particular have a lot of losses brought forward from the late 1990s, and I am thinking of telecoms and manufacturing. The UK is regarded as having a relatively generous regime for

 HM Revenue and Customs

interest relief as well. Then, of course, there are pension contributions. And it would be remiss of me not to say that tax avoidance plays a part in this and we bear down on that.

Q6 Chairman: That is what worries me. Let us look at paragraph 4.9, and you have mentioned tax avoidance: “Our consultation with large businesses indicated that they felt there was a widening gap between the skill set of their tax department staff and that of the Large Business Service.” Could it be that you are simply, not to mince words, being taken for a ride by some big companies?

Mr Hartnett: I do not think so, Chairman. I really do not believe that is a serious proposition. With the introduction of tax disclosure rules in 2004 and with Government having closed a great number of tax avoidance schemes, what we are learning from both business and their advisers is that marketed schemes are substantially in the past, although clearly not entirely. We are seeing fewer disclosed and we test to make sure disclosure is made. I think we have been very effective in countering avoidance. Am I complacent, of course not I think there is scope for us to do more.

Q7 Chairman: Do you think you really have a proper measure of the gap between what companies are supposed to pay and what they do pay? The technical term is tax gap but, to put it in a way that ordinary people understand, do you actually know whether people are paying the right amount of Corporation Tax?

Mr Hartnett: I think we can be confident in absolute terms that there is a tax gap. What we are less confident about is how to measure it but there are broadly two approaches. We can have a bottom-up approach through random inquiries, a tried and tested method that we used for direct taxes with small business, but which works much less well with big business, and we can have a top-down approach through our estimates of tax risk. I think we are getting better and better at estimating the tax risk.

Q8 Chairman: You saying you are getting better and better, but if we look at paragraph 2.11 we see that Corporation Tax at risk is now at £8.5 billion. That is a lot of money, is it not?

Mr Hartnett: It is a lot of money.

Q9 Chairman: So compliance amongst large business is a very serious problem, is it not?

Mr Hartnett: Securing compliance is something we are tackling vigorously, but a lot of the £8.5 billion is tax at risk which may be on technical issues, may be cross-border issues. I am afraid I cannot tell you sat here at the moment how much of that is tax avoidance but some will undoubtedly be.

Q10 Chairman: Putting it in simple terms the public might understand, would it not be helpful if these large companies had to publish in their accounts what profits they are making and what tax they are paying?

Mr Hartnett: I think that would—

Q11 Chairman: It would add transparency, would it not, and reassure the public?

Mr Hartnett: It would certainly add transparency but, Chairman, it is there for many of them already.

Q12 Chairman: It is there, is it?

Mr Hartnett: It is there for many of them.

Q13 Chairman: Sorry?

Mr Hartnett: It is there for many of them already. You can deduce that, and best practice for some—

Q14 Chairman: What do you mean “you can deduce that”?

Mr Hartnett: You can look at the published accounts, you can look at the tax account and you can work out roughly what tax is paid against what profits, but the big challenge in the UK compared with, say, the United States, Australia and some other countries, is that we do not have a consolidation for tax purposes in the UK of group accounts.

Q15 Chairman: Should we have one?

Mr Hartnett: A consolidation, a merging of—

Q16 Chairman: Should we have one?

Mr Hartnett: I think it would be quite helpful in terms of measuring compliance, but in the past we have found it very difficult to come up with a proposal that works.

Q17 Chairman: You are working at it?

Mr Hartnett: We are certainly doing that.

Chairman: Thank you, Mr Hartnett.

Q18 Mr Touhig: Mr Hartnett, you will no doubt have seen the headlines generated when the Comptroller and Auditor General published his report last year: “One-third of the biggest UK businesses paid no tax” said the *Financial Times* on 27 August, “Revealed: how multinational companies avoid tax” from *The Guardian* on 6 November. Of course, the Chairman has asked the question that was on everybody’s lips, how come one-third of the country’s 700 largest businesses paid no Corporation Tax in 2005-06. You did give some response as to why that should be the case but can you give us a list of the 200 companies which paid no Corporation Tax in 2005-06 or 2006-07? You can write if you do not have them.

Mr Hartnett: We certainly do not have them to hand, Mr Touhig. We will look at that.

Q19 Chairman: You will look at it or you will do it?

Mr Hartnett: No, we will do it if we can. About 10% of those are gone, they no longer exist.

Q20 Mr Touhig: Can you also tell us which of these companies paid no tax because they did not make any profit?

Mr Hartnett: I think we can do that as well.

HM Revenue and Customs

Q21 Mr Touhig: Can you also tell us which companies paid no Corporation Tax because they successfully applied for tax relief?

Mr Hartnett: You will have to help me, Mr Touhig, because there are innumerable tax reliefs.

Q22 Mr Touhig: Can you give us some examples then?

Mr Hartnett: We can certainly give you some examples.¹

Q23 Mr Touhig: Can you also tell us which companies paid no Corporation Tax because they used tax avoidance measures which are appropriate and are allowable?

Mr Hartnett: Let me express a concern. You are beginning to ask me to disclose very great detail about individual companies where we have a duty of confidentiality and I would be very concerned indeed, Mr Touhig, if suddenly all this information was to be made public.

Q24 Mr Touhig: Do you not think the public has a right to know? The report says on page 19: "Tax avoidance is not easily definable but it can involve highly creative ways of using tax laws to reduce or defer tax". Should we not know which companies are doing that?

Mr Hartnett: I go back to where I am. I am under a statutory duty of confidentiality, as are my colleagues.

Q25 Mr Touhig: So you cannot tell us which companies are using methods of tax avoidance?

Mr Hartnett: I think we can help you with some details about this, but listing this company by company in the sort of detail you are now asking is very difficult indeed.

Q26 Chairman: This point raised by Don Touhig is very important. You say you have a duty of confidentiality.

Mr Hartnett: Statutory duty.

Q27 Chairman: We understand that it is a duty particularly to individuals but these are public companies.

Mr Hartnett: I am afraid all our legal advice is that they have the same statutory right of confidentiality.

Chairman: We are only trying to help you. Do you not think it helps your job getting this into the public domain. It is not just about naming and shaming, it is ensuring that there is public discussion about some very large companies that are not paying tax and you sheltering behind this blanket of confidentiality. I want you to think very carefully in the answers you give to Mr Touhig whether you cannot be rather more helpful to him. I hand back to you, Mr Touhig.

Q28 Mr Touhig: Perhaps you would like to reflect on the question I have asked and write to us and if we need further correspondence we can do so, but I do think it is in the public interest that we should know this.

Mr Hartnett: Certainly, Mr Touhig.

Q29 Mr Touhig: Mr Hartnett, Sainsbury, the supermarket giant, paid no Corporation Tax in 2005-06 or 2006-07, why was that?

Mr Hartnett: As I sit here I have no idea, I am afraid.²

Q30 Mr Touhig: They were given a tax credit by your Department of £3 million in 2005-06 and that went up 300% in 2006-07. You would not know why that was either, a £9 million tax credit?

Mr Hartnett: I am afraid I do not have those details with me.

Q31 Mr Touhig: It just appears, Mr Hartnett, that taxpayer's money is being used to give huge, rich companies some form of tax credits.

Mr Hartnett: What sort of tax credits are these, Mr Touhig?

Q32 Mr Touhig: These are credits they were given, it appears, and they paid no Corporation Tax in those two years.

Mr Hartnett: I am afraid I am lost as to what these credits might be.

Q33 Mr Touhig: I understand the credit was linked to the fact that Sainsbury's put money into its pension scheme.

Mr Hartnett: Ah, right.

Q34 Mr Touhig: I applaud that they, as a company, are looking after their employees' pension scheme but should the taxpayers subsidise that?

Mr Hartnett: They are not credits as such, and I apologise. They are a deduction which in law a company is entitled to for paying money into its pension scheme. It is a statutory tax relief.

Q35 Mr Touhig: You paid them £3 million and then £9 million for doing that.

Mr Hartnett: I am sorry, I do not have the details which tell me whether we paid for that. They would have been entitled to a deduction, against their profits, for Corporation Tax if it is as you say it is.

Q36 Mr Touhig: In 2006-07 Sainsbury's paid no Corporation Tax and had a profit of £189 million in the second half of the year. They paid no Corporation Tax and they got a credit from you.

Mr Hartnett: I would have to ask Sainsbury's whether they were—

² *Note by Witness:* Having looked at the position it appears that the question is based on a misguided premise because, as the published accounts for J Sainsbury Plc show, the 2006 year tax expense amounted to many millions and a tax expense also arose for 2007. In both years the effective tax rate was higher than the standard rate of corporation tax in the UK.

¹ Ev 16-17

 HM Revenue and Customs

Q37 Mr Touhig: With profits like that, they were not short of a bob or two, even though they put money into their pension funds.

Mr Hartnett: That sounds to me, in the way you have described it, like a pre-tax profit but, I am sorry, we do not have any detail. We will ask the company whether they are happy for us to respond in detail.

Q38 Mr Touhig: That would be helpful. If a company decides it wants to put money into the employees' side of the pension fund it can claim tax relief and tax credits for doing that and end up not paying any Corporation Tax?

Mr Hartnett: In broad terms, yes, but there are detailed rules to be applied in this.

Q39 Mr Touhig: It is interesting that the taxpayer is subsidising the pension fund. The Chairman mention that 58% of Corporation Tax inquiries focus on cases which collectively account for 1% of all tax under consideration and you said you were reducing that, but it is not a great use of resources. How did you get into chasing the minnows and leaving the big fish alone in the first place?

Mr Hartnett: I do not think we were very good in the past at resourcing to risk and we have got a lot better. As Melanie explained, one of the issues always with these smaller amounts is does the issue apply across a number of companies, is the risk only in relation to one company or in relation to many, and often that is why we have got into things like that. We are now much more rigorous about that.

Q40 Mr Touhig: I understand that, but I am asking how did you get into that where 58% of those you were chasing were going to bring you 1% as far as tax revenue was concerned?

Mr Hartnett: We were not sufficiently rigorous in applying the application of resource to risk in a central way and we have increased the rigour of our management approach.

Q41 Mr Touhig: The Large Business Service employees state that the likely retirement of one-quarter of staff over the next ten years is a key risk to the unit's ability to meet its objectives. What are you doing to ensure that you have staff who have got knowledge, experience and understanding of the industry in this key service?

Mr Hartnett: A number of different things, Mr Touhig. First, we are about to bring into the business the largest number of recently qualified tax inspectors, if I can put it that way, that we have ever brought in in one go. We arranged for them to be trained and developed in-house. We second some out to learn how business works. We have people coming to teach us and, as employees, we hire people who have retired from major accounting and law firms to help us develop our people.

Q42 Mr Touhig: So you do not think that is going to be a problem? Your staff have identified it as a key risk but you believe you are addressing it?

Mr Hartnett: We believe we are on to this risk.

Q43 Mr Touhig: Why have you cut back on-the-job training for frontline tax specialists?

Mr Hartnett: The particular programme there is the international course. We decided a better approach to international tax issues was for people to learn on the job from our own experts, from the people we bring in, and the centrally managed course that we sent people on was less effective than doing it at the desk.

Q44 Mr Touhig: The Report tells us that a third of your tax specialists and client relationship managers feel their training is not good enough to give them confidence for their role. You certainly have a problem there, do you not?

Mr Hartnett: We recognise that issue and we have invested a lot more in it. I will ask Melanie if she would not mind commenting on this because she has led that work.

Ms Dawes: It is important for us to be clear that this is a big challenge for us to keep our skills up in the face of an ever more complex tax environment, globalisation, a big change in the global economy, so to that extent this is something that we are always going to have to take very seriously and is always going to require additional investment. On the international point, as Dave said, we have switched our approach there. As well as having more of an emphasis on on-the-job training, we are increasingly creating specialist roles. We have got quite a large group now of international issue specialists within the Large Business Service whose sole job is to work in that area and we have training to back that up. We have very recently created new transfer pricing posts. We have 16 specialists joining the Large Business Service just to do transfer pricing with, again, a training package attached. Our staff have received this very well. It is the kind of very detailed, very technical investment in them that they recognise and value. It is an ever more specialised approach rather than more generic training.

Q45 Mr Touhig: This is important because it is clear if this does not happen then companies are going to run rings round you, yes?

Ms Dawes: Yes.

Q46 Mr Touhig: Mr Hartnett was rather concerned when I asked him about tax avoidance earlier, but if you do have companies that are involved in highly creative ways to avoid paying tax then you have got to have people as skilled and as creative in order to combat that, have you not?

Mr Hartnett: That is absolutely right.

Q47 Mr Touhig: What is your training budget?

Mr Hartnett: We will have to let you know, I am afraid I do not have that with me.³

³ *Note by Witness:* The Department's total training budget was £69.3m in 2006/07, which provides for a combination of in-house delivery and the procurement of specialist external training. Actual figures for 2007-08 are not yet available.

HM Revenue and Customs

Ms Dawes: I do not know the figure for that.

Q48 Chairman: Can I just ask one supplementary, which is quite important. Maybe you can answer this, Melanie Dawes. Whenever we raise an issue we are told that things are getting better and all the rest of it, but we did look at this in terms of Corporation Tax in local offices three years ago. Were you around three years ago, I do not know?

Ms Dawes: I personally was not, no.

Q49 Chairman: It was the same story, 40% of inquiries produced no additional Corporation Tax. I just wonder whether you are actually making a lot of progress or whether what you have told us today is prepared for this Committee, we had the same story three years ago and we will have the same story in three years' time, and whether this tax is just not too complex?

Mr Hartnett: I do not think that is right, Chairman.

Q50 Chairman: It is very complex. It is a very difficult tax, is it not?

Mr Hartnett: I do not think it is right, Chairman. If I turn to the review of three years ago that was smaller companies below FTSE 350-plus and we have made improvements there by stratifying our approach, by bringing in better risk assessment systems, but we will never be able to guarantee that every risk we examine leads to tax yield because it is risk, not tax sat there waiting to be collected. The numbers that Melanie gave you earlier demonstrate that we are making a real improvement in relation to the work of the Large Business Service. Although the yield from the inquiries can be lumpy year-on-year, more one year and less in another year, there is a trend over the last three years in terms of absolute yield of rising yield. I think we are getting better.

Q51 Mr Bacon: I would like to start by asking Melanie Dawes, it says in your biography that you co-ordinated the first Treasury assessment against the five Treasury tests for UK membership of the single currency. Is that right?

Ms Dawes: Yes, it is.

Q52 Mr Bacon: I would just like to say you did a great job, thank you very much.

Ms Dawes: Thank you very much.

Q53 Mr Bacon: Could I ask you another question about transfer pricing which you just alluded to. You just said you have taken on an extra 16 staff?

Ms Dawes: Yes.

Q54 Mr Bacon: On transfer pricing specialist posts. By the way, how many is that? How many people are there in total? You are the General Business Service and your colleague, Freda Chaloner, is the Large Business Service, how many staff are there in each one in total doing this?

Ms Dawes: In the Large Business Service we have 600 staff working on Corporation Tax but we also have specialists working in other roles in the Department. For example, we have nearly 350

specialists in our CT and VAT Directorate and another 100 in anti-avoidance. We also have lawyers and investigators across the Department.

Q55 Mr Bacon: On top of the 600?

Ms Dawes: Yes.

Q56 Mr Bacon: They could be called upon by any part of the service, either the Large Business Service or the General?

Ms Dawes: Yes, and some of them work on indirect tax as well.

Q57 Mr Bacon: So you have got 600 on the Large Business Service, how many on the General Business Service?

Ms Dawes: In the area dealing with small and medium-sized enterprises we have around 12,000 staff, I believe. That is working on individuals and small and medium-sized enterprises. I would have to confirm the precise figure but it is of that order of magnitude.

Q58 Mr Bacon: You are already as a matter of necessity devoting, in terms of employment cost, a much bigger proportion of your effort towards the long tail, and I suppose that is inevitable, than you are to the top, as well as within that top 600 devoting a lot of it to the smaller take rather than the big take, are you not?

Ms Dawes: That figure I gave you of 12,000 is across all the taxes and for all taxpayers, that is our entire compliance effort. Outside the very small number of large business customers come via the Large Business Service.

Q59 Mr Bacon: Can we go back to transfer pricing. You said you have just taken on 16 specialists in transfer pricing, when was that?

Ms Dawes: Those people are actually taking up post in the next three months.

Q60 Mr Bacon: When did the process of seeking to hire them start?

Ms Chaloner: We recruited them internally so we did it during the autumn. They are all being trained now.

Q61 Mr Bacon: My point is it started after the publication of this report?

Ms Dawes: Yes.

Q62 Mr Bacon: Was it a response to this report?

Ms Dawes: It was partly, yes. It was also a response to the review on Links with Large Business which we published in November 2006 where we made a commitment to overhaul our transfer pricing and, in particular, to shorten the amount of time we take for transfer pricing inquiries.

Q63 Mr Bacon: It is not just transfer pricing I am interested in. Paragraph 4.9 on page 26 says that although your initial training is highly regarded: "...the Department had reduced the additional training it provides to enhance the skills and knowledge of frontline tax specialists. For example,

HM Revenue and Customs

in 2002 it halted the international training courses which covered issues such as transfer pricing and it has cut back on the number of technical update courses.” Are you basically saying you went too far and you realised that you had better start getting more specialists and training them more? Is that what you are saying?

Mr Hartnett: We are saying something slightly different, Mr Bacon. We found that the international course was pretty good for a number of years, but that actually we could train and develop our people on the job, working alongside specialists and alongside economists and others we brought in to work with us on these very big cases. We have transfer-pricing cases which had a couple of billion pounds as the amount at risk. The teams are large and have our best specialists in, and they are training others as the job is taken along.

Q64 Mr Bacon: It strikes me as interesting that you do not know what your training budget is, and according to paragraph 9 in the November 2006 Large Business Service survey of staff, a third of tax specialists and client relationship managers felt that the training they received was not sufficient to give them confidence in their role.

Mr Hartnett: We recognised that concern, and we are addressing it vigorously now.

Q65 Mr Bacon: Is it possible that you can send us some information with the amount that you do spend on training?

Mr Hartnett: Of course.⁴

Q66 Mr Bacon: And as a proportion of your total salary bill; that would be interesting to see. I would like to turn to page 16, figure 6. It might help if I could ask Jane Wheeler of the NAO about this. I take it that the little diamonds represent one case each! If I take the case on the far left-hand side, between 140 and 160, that is basically saying there were over 150 staff days spent on that case—it is quite difficult to read, but one assumes these are split into billions, so this is about £10 million or £15 million at risk—and 150 days. Correspondingly, in the extreme right-hand corner, where there is about £470 million at risk, 20 days were spent on that. Am I reading that correctly? I am. Mr Hartnett, can you explain how that can be? There may be a perfectly reasonable explanation, and I am sure you have got one, but what is it?

Mr Hartnett: The first explanation is that we may invest a huge amount of staff time in a £15 million issue if it is one that runs across a large swathe of companies.

Q67 Mr Bacon: If you lost, it would have huge consequences for other—

Mr Hartnett: Absolutely. The case on the right—I do not know which case it is—could only involve 20 days of resource inside the department or inside the

Large Business Service, but might be in the hands of half a dozen leading counsel as we prepare to litigate something very significant.

Q68 Mr Bacon: At the end of it you might get a lot of money and a very clear answer.

Mr Hartnett: Absolutely.

Q69 Mr Bacon: Perhaps I will ask you this: I have often wondered—since you know, once you have collected the money in that it is just simply going to be squandered by other departments that perhaps it is better to leave it with the people from whom you are trying to take it in the first place!

Mr Hartnett: I am not brave enough to answer that!

Q70 Mr Bacon: No, I did not think you would be. On page 7 in the NAO’s recommendations, they say in (vii) that the NAO recognises that the Department should develop a set of performance measures that build on those which have already been outlined as a result of the Varney Review, and that they should include a compliance measure, intervention yield and so on. It says over the page: “The total estimated tax under consideration in open enquiries and its distribution, to demonstrate its approach to focusing resources on higher tax risks . . . ” and similarly underneath: “The total number and the age profile of open enquiries, to demonstrate its approach to closing long-running enquiries and dealing more quickly with new tax risks”. You are presumably happy to accept those recommendations.

Mr Hartnett: Absolutely.

Q71 Mr Bacon: Are you happy to publish the results of those performance measures?

Mr Hartnett: In terms of major cases and—

Q72 Mr Bacon: In terms of those blobs—in fact, my question is really about all of them.

Mr Hartnett: Two of them I think are in the report already, Mr Bacon.

Q73 Mr Bacon: They cannot be for the future, can they?

Mr Hartnett: No, no.

Q74 Mr Bacon: But you would be happy to publish them on an ongoing basis, say on your website?

Mr Hartnett: I am very happy to take that away and think about it, yes, indeed.

Q75 Mr Bacon: That is a very interesting answer.

Mr Hartnett: Let me tell you why I am giving the answer in those terms. What I do not want to do is—

Q76 Mr Bacon:—is commit yourself to something you would later regret—I fully appreciate that!

Mr Hartnett: It depends how I regret it. If I were to regret it in the sense that the numbers turned out to be an incentive in some way to tax avoidance, that would be a very unfortunate consequence. Those are

⁴ *Note by Witness:* The Department’s £69.3m training budget for 2006-07 is 2.6% of the £2.7bn pay bill published in that year’s resource accounts. Actual figures are not yet available for 2007-08.

HM Revenue and Customs

the sorts of things I want to go away and think about. If we can do this in a sensible way which is helpful, then we will do it.

Q77 Mr Bacon: One more question only, to Melanie Dawes: You might have put the word “globalisation” in there somewhere, but you used the phrase “ever more complex”. There is no libretto that says things will get ever more complicated in future; it is down to policy-makers, ministers and those who advise them. I am not trying to trick you into answering a policy question that you should not answer, but you said “ever more complex” as if, somehow, it is inexorable.

Ms Dawes: I was talking about that in the context of the global economy. Perhaps at some point there will be a slowing down in that rate of change, but the sort of thing I am talking about is the fact that around half of growth in global trade comes from intra-company trade within large multinationals, with increasingly large multinationals managing their products across national boundaries. It is a complex business to manage that with a national tax system. That is just the reality of the environment we are operating in.

Q78 Mr Bacon: You are obviously in competition with other tax authorities around the world because to some extent you get the money and they do not very often, or *vice versa*; but to what extent is there scope for you to co-operate with them?

Mr Hartnett: We work a lot with other tax administrations. I can give you a couple of examples. We have a Joint International Tax Shelter Information Centre based in Washington DC and here in London. The partners in Washington are the US, Canada, Australia and ourselves; the partners in London are Japan, Australia, US and ourselves—and more will join. Recently, the UK led a study for the OECD which we presented to 43 countries on the role of tax intermediaries, tax advisers, investment bankers and the like in the tax system, which focused particularly on the role of the chief financial officer in multinational and other large businesses in ensuring compliance. We work together a lot.

Q79 Mr Bacon: Paragraph 2.15 talks about the Australian Tax Office and how it uses effective corporation tax rates on a business, and comparing them with the statutory corporation tax rate as a rule of thumb or a quick-fire way of assessing the risk, rather than going into great detail. It says at 2.17 that the Canadian Revenue Agency is basically copying the Australian Taxation Office. Generally and specifically, do you think that is something you should look more at, and in what other senses are you looking around the world and thinking you could learn from other tax administrations?

Mr Hartnett: Effective tax rates are something we in the UK used for a long time, but only on a company-by-company basis because, as I explained to the Chairman earlier on, we do not have consolidation of groups. The Australians and Canadians can apply and calculate effective tax rates in relation to a group. What they both tell us, though, when we meet

to discuss compliance, is that effective tax rates are useful; they are absolutely not perfect and quite often they mis-state what the true ratio might be. I expect all our people who handle large businesses to have a feel for the effective tax rate in bigger companies within a group so they can see the change year on year. What do we learn from other countries? A great deal. The disclosure rules that I mentioned briefly earlier on we learnt a lot about them from the United States and how to make them work and what not to do. We have learned a lot from some of the work the Australians have done with small business; but both of those countries spend a lot of time with us, learning what we do as well.

Q80 Mr Mitchell: Following up on the point on transfer pricing, how much tax have you actually collected from transfer pricing investigations every year since 1999?

Mr Hartnett: I am not sure I have got every year since 1999 to hand, but for the last few years it has been around £500 million a year.

Mr Mitchell: I hope you can give us some figures on that for the report.

Chairman: You will get them.⁵

Q81 Mr Mitchell: I have an estimate here which is compiled under the Freedom of Information. For 2004-05 it was £186 million; in 2005-06 £291 million; 2006-07, £539 million, but that includes £300 million from a single case.⁶ Do those estimates sound reasonable?

Mr Hartnett: They sound like the right numbers. I was thinking of the present year and where we have got so far and the previous year. It is 186, 291 and 539 that are the numbers I have got.

Q82 Mr Mitchell: Are those estimates higher than in the previous period, in the 1990s? Were you raising more then from transfer pricing?

Mr Hartnett: We will have to let you know the answer to that, Mr Mitchell.

Q83 Mr Mitchell: It is my understanding that the Australian authorities collected a billion in five years, which is about the same as we are collecting over the same period. The Australian economy is about a quarter of our size. Why are they so good and you are so lousy?

Mr Hartnett: Maybe their companies are rather more mischievous and full of gay abandon in relation to transfer pricing than ours! I think I would need more information.

⁵ *Note by Witness:* The yield from transfer pricing enquiries on large businesses was £118m in 2003-04, £138m in 2004-05, £230m in 2005-06 and £473m in 2006-07. Information is not available in relation to earlier years because in many cases the records do not distinguish between the yield from transfer pricing and the yield from other interventions in respect of international tax avoidance.

⁶ *Note by Witness:* The figures given by Dave Hartnett to the PAC are correct and are consistent with those given in a recent FOI request from Richard Brooks of Private Eye. The figures quoted here by Austin Mitchell MP appear to be a misreading of the FOI figures, omitting the LC figures for 2004-05 and 2005-06 and transposing two digits in 2006-07.

HM Revenue and Customs

Q84 Mr Mitchell: But why are they collecting so much more than you are?

Mr Hartnett: Perhaps because their corporates are less compliant than corporates in the UK; that is a plausible explanation. We have been working on transfer pricing for a very long time. We talk to the corporates in the UK about it and we talk to their boards about it, and we are vigorous. It was the UK that led an awful lot of the OECD work on developing international transfer pricing rules.

Q85 Mr Mitchell: In 1999 you introduced penalties for transfer pricing. How many have been imposed? How much has been collected under that system?

Mr Hartnett: A relatively small amount generally in relation to large business because until very recently—

Q86 Mr Mitchell: What is “relatively small”? Can you give us a figure?

Mr Hartnett: Maybe a few million. I will look to my right and left to see whether there is more detailed information. I am sorry, what I am being told is that we do not have precise figures for those years.⁷ What I wanted to say, Mr Mitchell, was this: until the Finance Bill 2007 it was open to large groups of companies, in fact any group of company, to readjust the way group relief operated so that they could move profit that arose from transfer pricing adjustment and cover it by group relief and let the profits arise in another company where there would be no negligence and therefore no scope for—

Q87 Mr Mitchell: There have been some incredible examples of transfer pricing and how this is fiddled. It has obviously been going on on a large scale. Are you satisfied you have the staff competent to do it with 16 new appointments? It is very labour-intensive, checking up on transfer pricing.

Mr Hartnett: I believe we have some of the best people in the world working on transfer pricing, and the addition of industry economic specialists to them is transforming the way in which we do transfer pricing in the UK. As I hope I said to Mr Bacon—otherwise I got slightly confused—we have some very big transfer pricing inquiries indeed that we are—

Q88 Mr Mitchell: Okay. You say that not much has been collected in penalties: why are you so nice and kind and generous to big companies? Why are the fines here in terms of peanuts to them, whereas in America it is capitalism, is it not; and the land of free enterprise; and they are much tougher on dealing with in particular the Big Four? I have some examples here. KPMG admitted to criminal wrongdoing and agreed to pay \$456 million. They were then dealt with—because through some fiddle in the sale of their consulting arm to Cap Gemini,

which was sold to British partners of Ernst & Young as well—they were fined for the tax fraud involving the sale to Cap Gemini of their consulting arm. Other countries—Australia, KPMG were hit with a claim for up to 100 million of unpaid taxes and penalties for allegedly breaching tax avoidance law. Why are we so gentle? Do we want to show that we are nice to them, to attract them to work here; is it Government policy to be nice to big capitalism and not want to frighten them away?

Mr Hartnett: We are not gentle, Mr Mitchell; that is not the approach. In the UK there are three factors. First, we have done a lot of research with big business as to the behavioural effect of penalties; and we have been leading work for the Government on modernising—

Q89 Mr Mitchell: I notice you are just schmoozing up to them to teach them the way of virtue, which sounds about as useful as telling drug addicts to stop fixing?

Mr Hartnett: Let me just explain the three issues, and then perhaps I can deal with that. We talk to business, and they tell us that a penalty of £10 million could lead to the resignation of a CEO or a CFO, and they take great care not to get exposed to the penalties; and we see that. I explained earlier on the difficulty we had with group relief. The third issue is that the new rules introduced by Parliament to provide the penalties which come in for events during 2008 and tax returns after April 2009, will make it much easier to obtain a penalty where a corporate or anyone else does not take sufficient care, or worse.

Q90 Mr Mitchell: You still have not told me why the Americans are so much tougher—

Mr Hartnett: They have a different regime.

Q91 Mr Mitchell: --- and why fines for practices, which are heavy there, are so much lower in this country for the same kind of thing?

Mr Hartnett: But the law is completely different, Mr Mitchell. That is the issue. I am very pleased to say in the UK that thus far at least we have not seen as serious criminal activity as you described by KPMG.

Q92 Mr Mitchell: Can you tell us how many staff from the Large Business Service—I get the impression, frankly, that you are overrun with work and understaffed—have left to join the Big Four in, say, the last three years?

Mr Hartnett: No more than between six and twelve. If you need a precise figure, Mr Mitchell, we will give you one.⁸

Q93 Mr Mitchell: Are you paying them enough to ensure that we get—

Ms Dawes: We have recruited quite a lot of people from the Big Four over the last few years. It has been an active part of our strategy. In fact, to have a flow of staff in both directions is really quite healthy.

⁷ *Note by Witness:* Penalties can be charged in respect of transfer pricing adjustments only where there is evidence of negligence or fraud or due to failure to keep adequate documentation. Penalties were charged in five cases during 2005/06 and one case in 2006/07. Information is not available for earlier years.

⁸ Ev 17

HM Revenue and Customs

Q94 Mr Mitchell: I notice you are calling in the poachers to help the gamekeepers and taking advice from them—

Ms Dawes: We have certainly found that the people we recruited who have got recent experience of working in the big firms have brought a knowledge and an expertise that have been really, really helpful. Sometimes that has been about avoidance and approaches to avoidance, but sometimes it has just been a commercial understanding and a different perspective.

Q95 Mr Mitchell: You are satisfied that you are paying staff enough to keep quality gamekeepers dealing effectively with the situation?

Mr Hartnett: I think the simple answer to that is that businesses in the UK, and those who advise them, look at our people and rate many of them very highly indeed; thus the concern that Mr Touhig raised earlier on about what will happen when 25% of our people go over the next however many years it was.

Q96 Mr Mitchell: I want to know why board members get involved in specific investigations. Do you get involved in specific investigations?

Mr Hartnett: Occasionally.

Q97 Mr Mitchell: If I were to come to you and say, “This inspector has been beastly to us . . .”

Mr Hartnett: I cannot remember anyone doing that in the last many years. The reason I get involved is the law can require me to. As a Commissioner of Revenue and Customs—

Q98 Mr Mitchell: Can you tell us how many you have got into in the last two years?

Mr Hartnett: I would say probably half a dozen major cases—because we changed our approach. We have in those a board-to-board engagement. I expect to see the chairman, the CFO and CEO of major corporates that we are investigating, to tell them why and put them on notice about how we are going to conduct the investigation—

Q99 Mr Mitchell: Do they get a better deal when you get involved?

Mr Hartnett: I sincerely hope not.

Q100 Mr Mitchell: So do I! But is it good corporate governance for board members to be schmoozing up at this level?

Mr Hartnett: There is no schmoozing going on, Mr Mitchell.

Q101 Chairman: It is. You are going in to look at the reports of inspectors. He might have hit a brick wall and you then come in as all emollient.

Mr Hartnett: No, not at all. If I go and see the chairman of a major public company in the UK or the subsidiary of a major US public company in the UK, it is to look him straight in the eye, tell him how we are investigating, what we are looking at, and how we will take it forward. That is why I told the

chairman of a major public company not very many weeks ago that we would be putting 150 tax inspectors into his company.

Mr Mitchell: The Chairman, I expect him to be called in—

Chairman: Mr Hartnett, you can now start schmoozing with Angela Browning!

Mr Mitchell: Just one more point!

Q102 Chairman: No, no, you have had your time. You have done your schmoozing; you have had ten minutes. All right, as it is you!

Mr Hartnett: I do not think he has schmoozed me at all, though!

Q103 Mr Mitchell: If you cannot, as you told the Chairman, estimate the tax gap for large companies, how do you know how well or how badly you are doing?

Mr Hartnett: Well, we certainly know how well or how badly we are doing on individual cases when we see what sort of money we bring in. We are changing, as I said earlier on, how we apply resource-to-risk, and I am very hopeful that very shortly we will have sufficiently robust figures for tax gap to be able to make those available. We have some ideas at the minute, and that gives us some insights.

Mr Mitchell: End of schmaltz. Thank you very much.

Q104 Angela Browning: Mr Hartnett, I would like to concentrate on the 700 of the 2,400 large businesses, the ones that bring you in £23.8 billion in corporation tax; and the 7% of that 700 that are responsible for 67% of the revenue. We have heard quite a lot about what you are doing, and I would like to focus first on the here and now and the future, and then at the end I would like to come on to this backlog of old inquiries. If you look at part II of the NAO report, page 19, and this question of the work of your Department to tackle corporation tax avoidance, we see that since the Government required disclosure of tax avoidance the Department has received nearly 900 disclosures, and the Government has closed 350 schemes, almost 40%. In the light of the comments that were made earlier about offsetting tax liability by the use of pension input and so on, presumably those would be the sort of schemes that would fall into the 60% that the Government has sought not to close!

Mr Hartnett: No, I do not think so. The schemes that require disclosure under the 2004 rules, which have been improved since then, are schemes of tax avoidance; they might involve artificiality or cross-border transactions; some very artificial use of things like Scottish partnerships, which are opaque in some countries and transparent in others. The pension relief you talk about is simply a statutory deduction for contributions to pension funds, and I am not sure I have ever seen a corporate simply invest in a pension fund to lower its tax bill; it seems to me to be a very expensive way to get a reduction in tax.

 HM Revenue and Customs

Q105 Angela Browning: Thank you for that, because I think we all understand it on a personal basis, where sometimes people use pension input to ensure they keep below the higher rate of tax and things like that; but I was just concerned that, on that sort of scale, corporates were using some of these devices; and, if so, should not the Government be looking at it, because we see further on in the NAO report here, which I thought sounded a little bit as though the Government felt they had exhausted—and the graph itself shows that it is tapered down in terms of where these disclosed avoidance schemes have been dealt with by the Government; but we also see, worryingly, in 2.30 that the Department has identified a move from the generic avoidance schemes to bespoke schemes that are often specifically designed to cover large, one-off transactions, or companies with specific structures. Can I put it to you bluntly? Are you dealing with a backlog of historic laws of unintended consequences, where companies that can afford the smarter tax lawyers and tax advisers are, if you like, out-pacing you in terms of the future and what they are doing to avoid tax?

Mr Hartnett: The outcome of the 2004 disclosure rules is that we initially saw a very significant number of disclosures of schemes that had been marketed often to many different corporates. There is one in the courts at the moment, the tax-efficient off market swap scheme, which Revenue and Customs won at the first stage and will be going on. What it does in terms is take a swap, which is flat normally in economic and tax terms, and front-load it to get a deduction, and then if by magic seeks not to reverse that later on. Magic plays a part in a lot of this! We have pursued schemes like that vigorously and we have asked for legislative change when it has been needed to stop the scheme. The major accounting and law firms, the big corporates and commentators in the media say that those disclosure rules have been very successful in stopping marketed schemes—not entirely, but making a big impact. What we are seeing now is different arrangements to try and reduce tax bills. For example, someone with a very valuable product—I will not be more specific but you will get a feel for what I mean—someone with a valuable brand in alcohol may seek to move the brand out of the UK and into a low tax country, and then pay for the use of it. We would seek to apply our transfer pricing rules to that because we think that that is not a straightforward way of reducing tax liability. We are beginning to see clever structuring arrangements in big corporates. Structuring is an issue all over the world in tax administrations at the minute, trying to do things like that. We and others are working through the OECD to determine the best way to address it.

Q106 Angela Browning: Can I put to you a very blunt question? Of the schemes that you have identified on which the Government has then legislated to close the loophole—have they responded 100% to your list of loopholes you have identified, or are there outstanding ones you would like them to close; and, if so, how big is that list?

Mr Hartnett: I think that the overwhelming majority (I do not have a number for you) of schemes that have been flushed out through the disclosure rules have either been addressed by legislation, or are being addressed in litigation because we do not believe they work; or, as a precautionary measure, both litigation and legislation. This has been a very successful approach.

Q107 Angela Browning: I wanted to focus on this 7% of the 700. We are looking here at quite a small number of companies on which you have to concentrate. They clearly are advised by very clever people in terms of their tax liabilities and tax law: have you identified a pattern, not from the companies in that group but from those who advise them and whom they employ to assist them on the legal side? Is that an area you have looked at—the companies, but those advising them?

Mr Hartnett: We have done two very big pieces of work around that. As I said to Mr Bacon, we have set up with other countries the Joint International Tax Shelter Information Centre. We did that because the four international countries could see that major firms of tax advisers which were global in their nature were saying: “We have got something that works in Australia; we know the UK rules are different; but why do you not have a look at it and see how you can make it work?” In the past it might have taken years of exchanging information under a double taxation treaty to give us insight into that; now we have seen arrangements where that exchange happens quite literally within days of something becoming clear in one country. The other piece of work I mentioned to Mr Bacon is UK-led with the OECD, the study in tax intermediaries. Forgive the plug, but it is a great read. It is on the OECD website. That is about managing the risk that big firms of tax advisers produce for tax systems, and putting it fairly and squarely in the lap of chief financial officers of big business to take responsibility for their advisers. I am not sure that always happened in the past.

Q108 Angela Browning: You said you had specifically head-hunted people who would deal with exactly this sort of area. Presumably, it is changing all the time and there are new things coming. Are you absolutely certain you are keeping pace with these changes? Are you putting the resources in?

Mr Hartnett: We are putting the resource in. Am I confident that we are keeping pace? No, I am afraid not. We are keeping pace faster than we have ever done before, but there are still—we call them boutiques—that operate in the big financial centres—New York, London and one or two other places, which are trying things out all the time—still in the shadows—and we and our partner countries in JITSIC are trying to flush these out.

Q109 Angela Browning: On the backlog of old inquiries, which clearly is labour intensive, is there any conflict now in the need for resources to go into

 HM Revenue and Customs

the new tax avoidance situations that you have just talked about, and the need to mop up this backlog as quickly as possible? Where does the pressure come?

Ms Dawes: In practice a lot of the oldest inquiries do tend to be the most complex, often avoidance schemes, particularly often transfer pricing; so there is not a lot of conflict between tackling some of the old issues and the bigger issues. We have made a lot of progress, nonetheless, in bringing down the number of old inquiries but there were also some smaller ones that needed attention.

Q110 Angela Browning: In this backlog of old inquiries, what sort of analysis have you been able to make in terms of whether, again, they can be grouped in terms of where the genesis of them is? Are you able to identify, for example, certain companies that are assisting these companies: are they deliberately going slow so that they have got the money for their use now while you sort out the problem? Pay late—as with anything, very often gives people a good cash-flow situation. Is there a pattern there, or are they just complicated old inquiries?

Mr Hartnett: There is a pattern but it is not universal. Some are complicated old inquiries which are just fiendishly difficult, where what is going on in industry and commerce is not easily translated. I am going to give you an example, if I may, which again demonstrates what can go on. We have an investigation at the minute into an issue we are very worried about. It has been around for a while as an investigation. We are meeting obstruction at every stage from the tax advisers and the company, challenges to our rights to ask for information and challenged to our interpretation—

Q111 Angela Browning: I am sorry, but I am going to run out of time any second now. Do you have discussions, and are they of any help, with the Chartered Institute of Taxation?

Mr Hartnett: We consistently discuss things with the Chartered Institute of Taxation and the other bodies, but also with the heads of tax of major tax advisers with their chairmen for UK and Europe, and relatively recently with their global chairmen as well, to make very clear our concerns.

Q112 Dr Pugh: I will be very brief because much of what I want to ask has already been asked by Mr Mitchell, so I will not repeat that. Can I ask you for confirmation of some answers you gave to Mr Mitchell? You are going to give us figures on the number of poachers becoming gamekeepers and gamekeepers that become poachers—in other words the transfer of staff from the Revenue to the private sector and so on tax lawyers and firms and everyone else?

Mr Hartnett: Yes, of course.⁹

Q113 Dr Pugh: Have you given us figures, or are you going to give us figures on the turnover in senior management at the top where you have obviously the most skilled people?

Mr Hartnett: I am not sure I quite understand the question. We can try and give you some figures about retirements and people who leave the for private sector, where we think the number is very small. As I think I was saying to the Chairman right at the start, we have a larger number of fledgling specialists coming through to be trained to replace people going. We can try and do that.

Q114 Dr Pugh: It is a very complex game being played between the tax authorities and various corporate lawyers on the other side, and all of them very skilled and intelligent people. It would be—

Mr Hartnett: So are our people as well.

Q115 Dr Pugh: Absolutely, which is why I am very interested, if they are intelligent and able, that they stay there and there is not a haemorrhaging of any sort to other walks of life or, for that matter, to the corporate tax sector. You can give us some indication of that.

Mr Hartnett: We will certainly do that.

Dr Pugh: The NAO report states on page 37: “The Department has based its strategy on the premise that the majority of businesses want to pay the right amount of tax at the right time.” That is your strategy, and the premise you based it on. Is it not slightly optimistic or Panglossian? I would have thought that most businesses wanted to pay as little tax as possible and as late as possible!

Q116 Chairman: For those watching, just describe Panglossian.

Mr Hartnett: Chairman, I was going to be able to cope with Panglossian. It is the first time, Dr Pugh, if I may say that in this Committee Voltaire has come to the fore to my knowledge!

Q117 Chairman: Well done!

Mr Hartnett: Let me read you something that I have brought along as an aid. It is a quote from the widely published corporate responsibility statement of a major company. They say this: “Tax planning is perfectly acceptable provided it is consistent with the laws of the jurisdiction concerned . . . ”—here is hope for you in the next few words—“ . . . and has regard to the intention of the legislature as well as the strict letter of the law.” I am with you entirely: four or five years ago, before we really began to bear down on tax avoidance, I would have been surprised to see that, and it is now happening. The next three lines state: “Artificial transactions whose sole purpose is to reduce tax should not be undertaken, particularly those that have no economic effect other than tax-saving.”

Q118 Dr Pugh: To be fair, it is a commendable ethical position; I am just sceptical of whether they always carry it out.

Mr Hartnett: May I quickly give you another example?

⁹ Ev 17

 HM Revenue and Customs

Q119 Dr Pugh: I am sure you will—yes.

Mr Hartnett: We have seen recently a major corporate, with whom we settled a number of issues, come to us and say: “We settled all those issues for the last seven or eight years. We did a scheme of tax planning the following year, and this is just to confirm that we will be reversing it in our taxation computations and we do not want to take advantage of it.”

Q120 Dr Pugh: If we had a boom in 2006/2007 and the amount of tax-take did not increase, does that not suggest that there is some serious evasion going on or that you are getting less capable of identifying it?

Mr Hartnett: I think there were policy changes, which either Melanie or Freda may want to comment on, that affected the tax take.

Q121 Dr Pugh: It was an odd year!

Mr Hartnett: No, I think it was just a year when there was some change, and you see this; but I think both corporates in the UK and their advisors, were you to go and talk to them quietly, would say that the Large Business Service in HMRC and our specialists are a pretty determined bunch and very good at driving down tax avoidance.

Ms Dawes: Perhaps it would be helpful to clarify corporation tax receipts on large business. There was indeed a small fall in real terms between 2005 and 2006, but there was a very large rise in 2005 compared to the year before. It was a 33% in real terms rise. That is the broad context. The very small fall can be entirely explained and indeed reversed by the fact that there was a change in the instalments regime for North Sea taxation and we effectively collected an extra quarter’s worth of tax in 2005/2006 which raised the figures, and that was not repeated the following year. There was not that falling-off that—

Q122 Dr Pugh: For the moment I will accept your explanation. Can I go to the two big ideas in the NAO report? One is that you should concentrate on the big fish rather than the minnows. Is there a dilemma here, because I would be very happy, as a minnow, to have my tax affairs rather loosely looked at and for you to go after the bigger fish; but there is a principle of equality here, is there not, a principle of zero tolerance? How do you balance things out?

Mr Hartnett: In this way: when we started taking forward our response to what is described in the report as the review of links with business, and modernising the approach of the Large Business Service, as I have said on a number of occasions, we wanted to match resource-to-risk. We thought that we would have a very low engagement level with what seemed to us to be low-risk corporates. The corporates did not want it like that; the corporates said to us: “No, we need an engagement with you; we need to be able to talk to you about issues.” It is not zero engagement, if I can pick up your term with smaller corporates, and no-one is getting away with anything that we are aware of. We will always collect

tax that is there to be collected. What we will not do is pursue very small risks when there are very big risks to be pursued.

Q123 Dr Pugh: The second big idea is a more client-centred approach; we get rid of tax inspectors and we have client relationship managers. Is there any real evidence that that makes any significant difference?

Mr Hartnett: I think it does make a very real difference. We have not got rid of the tax inspectors; they are still there and some of them have become client relationship managers. We have two tasks to balance out, Dr Pugh. We need to help and support business in relation to the tax system and we need to be pursuing tax liabilities and tax risks as well. For a very big corporate, it may have stamp duty, corporation tax, PAYE, National Insurance—I will not go further—to pay, and what we are doing through our case relationship managers is saying, “Here is one person who will manage your relationship with HMRC”¹⁰—

Q124 Dr Pugh: I know what you are saying and I know the proposition you are putting forward and what you are suggesting you are going to do; what is your evidence for thinking this works any better than any prior system? Have you got any evidence?

Ms Dawes: We have got lots of evidence of individual cases, when actually having somebody going in as the client relationship manager across all the taxes has allowed them to—

Q125 Dr Pugh: You have evidence of the general trend as well as the individual cases, have you?

Ms Dawes: I think the general trend is the progress we have made by re-prioritising our work over the past year. We could not have done that without the client relationship managers in place who knew the business inside out.

Q126 Dr Pugh: If you have any general evidence, can you submit it, please? I came across the expression in this report, “intervention yield”; that is your public sector target, is it not? There is a public sector target as a whole of £3.5 billion under-payment of tax to be sorted out and obtained. Intervention yield though, which you are marked on, is really money you get when you have to go looking for it; you have to knock on the door of a firm and insist that they pay it. Is it a good indicator of how well you are doing; and can you give me a general picture of what you think the corporation tax element will be in that £3.5 billion of underpaid tax that we are looking at?

¹⁰ *Note by Witness:* During 2007 HMRC commissioned research on the experience of our large business customers. The findings identify what is important to business and where improvements have been made. The introduction of the Client Relationship Manager role is seen as both important and as having had a positive impact on LBS customer experience. Across the large business population as a whole, 1 in 5 customers have noticed an improvement over the last year, with the perception of improvement significantly higher (31%) for customers dealt with wholly by LBS, reflecting the impact of the CRM.

 HM Revenue and Customs

Mr Hartnett: Let me unpack it a bit by saying this. Our yield in relation to big business comes in three forms. It comes from investigation and inquiry, and this is a straightforward amount of money. It comes from looking at issues and perhaps seeing that big corporates are taking a tax relief a year or two earlier than they should, and so we reverse that. The big issue where we have got good evidence about improvement is that a lot of our work, more and more every year, is happening in real time before tax returns are sent in, before accounts are signed off; and we are able now to measure the impact of our work there, and it is growing.

Q127 Dr Pugh: It is a fair indication of the progress you are making; the question you did not answer is that if we are going to get £3.5 billion from underpayment of tax which we did not get before, what percentage of that will be corporation tax?

Mr Hartnett: I do not think we targeted a percentage, but perhaps we could give you an answer in writing when we have got to the end of the period, when we can break it down.¹¹

Q128 Keith Hill: Mr Hartnett, I was a bit worried that you were not able to complete the answer that you were giving to Angela Browning when you were describing a company where you were meeting regular obfuscation difficulty from tax advisers. Do you want to tell us a little bit more about that? You implied that this was part of a pattern.

Mr Hartnett: It can be a pattern, Mr Hill, sometimes. Again, a quick illustration: if a firm of advisers has sold a scheme to a corporate, and we believe the scheme does not work, then we will invite the corporate to agree that and pay the tax. It will not surprise you that sometimes they do not do that and we are forced to litigate. We then see the firm of advisers maybe appear in support of the litigation, and work really very hard to slow that litigation up as much as they can. We use all the powers and techniques available to us to try and move things along faster. Have we got perfect powers to put in what I describe as jet propulsion behind that? No. We are constantly looking at our powers to see if there are ways to improve them, and the review of powers that is going on could lead to further modernisation of information powers. We are determined. If we think there is something improper about the approach taken by the tax advisers, we will not hesitate to go and see the chairman or someone else at a major firm. Not very long ago, probably 12 months ago, we went to see the vice chairman of a major firm to say that we were very concerned about what they were selling to clients—they had sold it about a dozen times—and how they were defending it. That vice chairman agreed with us and wrote to all the clients to say that that scheme did not work. We welcome that.

¹¹ *Note by Witness:* This information is not yet available. We will send the Committee a further note following the end of the financial year.

Q129 Keith Hill: There is a pattern.

Mr Hartnett: There is a pattern of those who have devised a scheme and sold it, of wanting to defend it. They have got a big skin in the game, as they say; they have got a big investment in it.

Q130 Keith Hill: How many cases do you take to litigation in a year?

Mr Hartnett: Quite a lot. We developed a litigation strategy, which is referred to in the NAO report, where we will not negotiate if we are confident that our interpretation of the law is right, and we will take them to litigation. Can we move them all ahead as fast as we would like? Not often.

Q131 Keith Hill: That is why you are looking for new powers, or possibly looking for new powers. How many cases will you have in court at any one time?

Mr Hartnett: I cannot give you at the moment a precise figure. We can drop you a line.¹²

Q132 Keith Hill: That would be helpful—and also for a year.

Mr Hartnett: Sure.

Q133 Keith Hill: On the whole, is it worth it, taking companies to court?

Mr Hartnett: I think it is. Sometimes we lose. More often recently we have won and demonstrated that our interpretation of the law is right. Yes, it is well worthwhile.

Q134 Keith Hill: The Large Business Service deals with 700 companies. How many of these will get their returns wrong in an average year?

Ms Chaloner: It probably depends what you mean by “wrong”. A large proportion of them—there will be issues that we will need to question, to look at to understand whether or not our interpretation of the tax treatment is the same as the company’s interpretation of the tax treatment. Some of the companies’ systems may be faulty, and therefore what comes out in the computations is wrong. Clearly, in those circumstances we want to work closely with the company to get them to a point where their systems are right. The other big area is the avoidance schemes, where they would say very clearly that in their view their computations are right; and we would say that we do not agree with the interpretation. It is hard to say it is black or white.

Q135 Keith Hill: Are both of those cases of the company making an innocent mistake?

Mr Hartnett: You can certainly see that, Mr Hill. Again, a quick example: I remember being, frankly, fascinated by the tax implications when I first saw a satellite leasing arrangement by a major bank. We did not think the bank had got it right but we did not think they had got it wrong deliberately in any sense. This was really the cutting edge in telecommunications and taxation and we worked together to get to a right answer. It was very difficult.

¹² Ev 17

HM Revenue and Customs

Q136 Keith Hill: How many of these 700 do you reckon are deliberately trying to dodge their tax liabilities in any given year?

Mr Hartnett: It is very hard to give you an answer. We see now much fewer schemes than we have seen before, but they would regard themselves under an obligation to reduce their tax liability, and it is a question of how they go about doing it.

Q137 Keith Hill: If you look at figure 10 on page 23, which analyses the additional yield resulting from your compliance activities, leaving aside accelerated yield, the pre-return—I would take that to be an example of your good practice; you are working with the company in advance and trying to advise them how to make an accurate return and all the rest of it. By contrast, direct yields is when you think it has gone wrong, and you have actually gone in there, intervened and said, “Now look here, this is a serious mistake”. You might say that the yield of pre-return work is the correction of innocent errors and misconceptions and all the rest of it, but that does not seem to produce very much, only 6% of the overall return, whereas 79%, which is the direct yield, is when you have had to go in there and say, “Your self-assessment is inadequate; we want to look at this more seriously.” That suggests to me that there is perhaps more deliberation in inaccurate returns than innocence in inaccurate returns, but I may have got it wrong.

Mr Hartnett: With great respect, one might draw that conclusion just from one year, but if one went backwards over a period, I think the pre-return work—one would be able to trace back to a point—I do not know where the point is—where there is almost nothing because those pre-return discussions with corporates did not happen. It is a much more effective use of our time to look at an issue in real time with a corporate and resolve the issue if we can, than to have to put a big team together to undertake an investigation that could take—

Q138 Keith Hill: I am sure you are absolutely right, that it is the best way to do it. It seems to me co-operation is the best way of handling these things. Let me just ask my final two questions—we are under tremendous pressure from our Chairman here! Let us go back to the £8.5 billion of corporation tax under consideration each year. What kind of things does that under-payment result from or putative under-payment?

Mr Hartnett: It is not necessarily the same amount each year. That is the amount of corporation tax that our people have registered as at risk in the 12 months to February 2007. It could be any of the things we have discussed this afternoon. It could be because maybe we were concerned about a scheme of tax avoidance, about how capital allowances have been claimed; and even perhaps about deduction for pensions, as Angela Browning was talking about earlier on and whether or not it fitted with the rules. It could be literally anything.

Q139 Keith Hill: One final observation: if £8.5 billion is the figure that you kind of estimate for one year, looking back what is the total, do you think? Is it possible to arrive at an estimate of what may be the under-payment under consideration?

Mr Hartnett: I do not think we can give you an estimate with any accuracy. The only thing I can say with certainty, Mr Hill, is that some of that £8.5 billion will turn out to be not actually tax that we should be collecting—we have seen a risk and examined a risk and we agree it has been treated properly. Some of it will be tax that we absolutely do need to collect and may end up fighting our way through the courts to do so.

Q140 Geraldine Smith: Looking at the staffing figures, you spend £28 million a year on 600 staff, and they manage to bring in £23.8 billion in tax, which seems pretty good. If you had more staff, could you bring in more money?

Mr Hartnett: That is a very good question, if I may say so! I do not think we know. There will be a law of diminishing returns somewhere. We are investing in the Large Business Service and in other areas. Just below the Large Business Service are a lot of pretty large companies dealt with by our local compliance people. We are investing there and training there. The issue that is hardest of us for all time is how we protect the integrity of the whole tax system in all its manifestations—small business through to big business. We need to get the resource-to-risk ratios right but we need to protect the whole system. It goes back to Mr Touhig’s point: are we training enough people? As we bring in these 140 new people to do taxation work, we have been asking ourselves that same question.

Q141 Geraldine Smith: Are they on performance-related pay?

Mr Hartnett: To an extent, but not very significant.

Q142 Geraldine Smith: I find it amazing you have got 50 businesses out of the 700 that are paying 67% of the total corporation tax in one year. How do those businesses feel? Why do they pay the tax when you have got 220 paying none and another 210 less than 10 million? Do they not feel that you may be missing something? What is the difference?

Mr Hartnett: An awful lot of these corporates absolutely want to pay tax, and work very hard at doing that.

Q143 Chairman: What did you say?

Mr Hartnett: I said a lot—the rest, Chairman, is a matter of record—want to pay.

Q144 Geraldine Smith: The 220 do not, do they? They are not paying anything!

Mr Hartnett: I gave you part of the answer to that earlier on. A large number of those are only in London for access to the capital markets and have no taxable profit in the UK. Others have large accumulated losses and still more have actually failed, and do not exist.

 HM Revenue and Customs

Q145 Geraldine Smith: What about the 210 that pay less than 10 million?

Mr Hartnett: Maybe that is the right profit. If you imagine the FTSE100, there are the mighty multinationals at the top. I think the UK has one or two of the top seven banks in the world. Go down to the bottom of the FTSE and there is a constant rotation as things are happening to companies, and they are very much smaller. I can see Melanie wants to come in and add to this.

Ms Dawes: I just wanted to explain why it is that a such small number of the top 50 pay 67% of the corporation tax. If you look at the market capitalisation of the largest 700 UK-owned businesses in the UK—it is not quite the same as the Large Business Service population but not far off—you will find that 67% of market capitalisation comes from 50 companies. It is a very similar proportion. To some extent we are seeing a reflection of the economy; the large corporate economy in the UK is reflected in the corporation tax system.

Q146 Geraldine Smith: Are you reasonably confident that everyone who should be paying corporation tax is?

Mr Hartnett: We are reasonably confident. We are not completely confident because the work we do, the yield we produce, shows that that is just not right. However, we believe we are very effective in monitoring whether the corporates are paying what they should pay, but we are not complacent.

Q147 Geraldine Smith: Do you think the penalties are strong enough when people are avoiding tax? When does efficiently managing your tax affairs become tax avoidance?

Mr Hartnett: I am sorry, I need to be slightly technical for a split second. Penalties where there is dishonesty—and avoidance will, pretty regularly, not involve dishonesty—penalties for evasion, penalties for serious lack of care. The new regime I mentioned which comes in through 2008 and then applies to returns from 2009 will I think give us a very useful weapon to use with corporates and other taxpayers so that innocent errors are not subject to penalty, but serious lack of concern about getting things right and worse will pay more penalties than have been paid before.

Q148 Geraldine Smith: Going back to the issue of staffing, if it is a difference between paying zero tax and hundreds of millions, then I expect they are going to invest heavily in making sure they have got people that know exactly what they are doing and know the tax system inside out. How can you compete with that? Do they poach your staff? I think you have been asked earlier for some information about that, but has there been any in-depth work done, looking at that to see how many staff you are losing?

Mr Hartnett: We are constantly looking at that and why it happens and what people are paid when it happens. For the last two years it has happened in very small numbers, and that is what we are going to provide. We have been doing some of this too. We

have been hiring people out of the major accounting firms. We have more tax-qualified accountants working with us today than ever before. But the other group we have tried to persuade to join us are quite senior partners out of the major firms who retire, rather earlier than tax inspectors do, and we ask them to come and join us and help us with our very complicated technical work—and they do.

Q149 Geraldine Smith: This has been touched upon earlier, but do you think corporation tax is too complicated? Do you think if it was simplified you could gather more tax?

Mr Hartnett: This is a cheeky answer—if I may! I would rather you asked me a slightly different question but I will answer both. I would rather you had said to me, “Mr Hartnett, what about the complexity of business, global business and multinational business in particular?” I think the way both domestic and international business has grown—commerce is complicated. I remain to be convinced that a massive simplification of corporation tax would necessarily lead to more yield.

Q150 Chairman: I was very surprised by this statement, which I do not think has been adequately covered so far, in paragraph 2.24; that 49% of all open inquiries were over two years old, with 13% over four years old. That seems incredible to me, that you are allowing these inquiries to go on for so long. That might explain some of the problems we have been talking. When can you clear this backlog?
Mr Hartnett: It has reduced, Chairman, already. I will be corrected from the left or right if I have got it wrong, but 49% is now down to 42%; the 13% is down to 10%.

Q151 Chairman: Still, 10% over four years old.

Mr Hartnett: A major transfer pricing case—and this is true of every developed country in the world—say involving half a billion pounds or more, will rarely be settled in under that. Some of them go on for ten years, be it in the UK, the United States—

Q152 Chairman: You are getting all this money back with interest, are you?

Mr Hartnett: Absolutely.

Ms Dawes: Can I just add to that, that although the percentages may not seem to have fallen very much because we have reduced the overall number of inquiries open quite significantly by nearly 40%, we have cut by 46% the number over two years old in the last year and by 51% the number over four years, so there are some quite big reductions.

Q153 Chairman: You are a very convincing witness, Mr Hartnett, and you keep trying to convince us things are getting better, but reading a couple of things here, in paragraph 2.19: “Our consultation with the large businesses in early 2007 indicated they had high expectations from the Department’s new approach of focusing resources on higher values of Corporation Tax under consideration. But some

 HM Revenue and Customs

businesses reported that they had yet to experience the new approach and expressed frustration at the continued number of low value enquiries and additional work involved in responding to questions on a large number of enquiries.” We read later on, in paragraph 2.39: “In our consultation with large businesses, they expressed support for Sir David Varney’s proposals and the operating model and welcomed the Large Business Service’s more collaborative approach, which they considered a move towards best practice . . . But some reported that they had not experienced the more open and trusting relationships the Department was advocating and that the old enforcement culture still existed.” I put it to you that despite your convincing performance this afternoon, that old enforcement culture still exists and it is here in the report. Do you agree?

Mr Hartnett: What I would really like to say, Chairman, is “trust me”.

Q154 Chairman: Trust you! In God we trust, not in Mr Hartnett!

Mr Hartnett: Let me say this. We have more work to do on the old tough enforcement culture as is described here, and we are doing it. We survey our big business customers on a regular basis and 31% of them said to us recently that they had noticed a big improvement since we had introduced relationship managers that Dr Pugh asked me about; and I hear, as do Melanie and Freda, more and more often, that our approach in managing resource-to-risk is making a difference. I mentioned earlier the OECD study, which we presented recently to the OECD’s forum for tax administration to 43 countries, and we talked to business leaders there from all over the

world who talked about the approach that we talked about here today, and commended it to tax administrations, and meant it.

Chairman: Right. Shall we give Mr Mitchell the last word if he wants it?

Q155 Mr Mitchell: It would be nice if we had a yield per capita for your inspectors in the Large Business Department compared to the yield per capita for the people involved in pursuing benefit fraud—a much larger number, I think, involved in pursuing benefit fraud. That is just an observation. I wanted to follow up a question unctuously that the Chairman asked right at the start. If the Companies Act required companies to publish the profits generated in this country—take an imaginary company and call it News International or something—and it was required to publish the profit generated in this country and the tax paid in this country, the corporation tax paid in this country on those profits, your job would be much easier, would it not? That is the question. We would all be able to see how well you were doing!

Mr Hartnett: I fear, Mr Mitchell, you are leading me out on thin ice again, but—

Q156 Mr Mitchell: Would it make your job easier?

Mr Hartnett: It might, but the whole purpose of, for example, double taxation treaties, is to resolve issues like that. I am not sure it would make my job a whole lot easier because we would want to explore all those published figures because the tax rules are not so simple that they would enable us to say, “Thank you for publishing the figure of profits in the UK; we are simply going to tax that.” We would want to explore that in great detail, as we do now. I do not think it is a panacea.

Chairman: Thank you Mr Hartnett. That concludes our enquiry.

 Supplementary memorandum submitted by HM Revenue and Customs

Questions 18–23 (Mr Don Touhig): *List of the 200 businesses mentioned in the report which paid no corporation tax in 2005–06 and 2006–07, broken down by those who:*

- (a) *paid no tax because they did not make a profit;*
- (b) *paid no tax because they applied for a relief; and*
- (c) *paid no tax because they used “appropriate and allowable” tax avoidance measures.*

The NAO Report published in July 2007 explains that “around 220” large businesses paid no corporation tax in 2005–06. Since the publication of the report the number of large businesses that paid no corporation tax in 2005–06 has been revised from 220 to 181 as a result of seven of these businesses being tax paying and the remaining 32 largely relating to businesses that ceased to exist because of takeovers.

Our statutory obligations on confidentiality prevent us from releasing the names of the specific businesses. However, it is possible to provide a breakdown as to why these businesses did not incur a corporation tax liability.

- 53 (29%) of the 181 businesses paid no corporation tax because of historic tax losses;
- a further 97 (54%) had tax losses arising in the year. This was for various reasons, including relief for pension contributions, research and development expenditure or finance costs as well as the use of avoidance schemes. For 12 companies, avoidance extinguished all tax liabilities in 2005–06. In all 12 of these cases, the avoidance schemes are currently being challenged under enquiry with litigation being considered in three cases;

- a further 19 businesses (10%) were largely inactive during the period; for example having gone into liquidation, reduced their UK business presence or are no longer trading;
- of the remaining 12 businesses, six were “partnership associates” providing services to large, profitable partnerships, on a nil profit/nil loss basis.

We are currently unable to provide the information requested in respect of 2006/07 as some businesses have until 31 March 2008 to file their tax returns. Comparable data is therefore unavailable.

Question 92 (Mr Austin Mitchell): *How many staff from the Large Business Service have left to join the Big Four accountancy companies in the last three years?*

Questions 112–113 (Dr John Pugh): *Total number of Departmental staff leaving for those companies and the number of retirements?*

Eight staff, at all grades, left the Large Business Service (LBS) in 2007 to take up posts in the “Big 4” accountancy firms. No figures are available for earlier years.

146 people will complete tax professional training in 2008–09 as part of the ongoing recruitment and training of staff to replace those retiring. All 17 staff retiring from LBS this year will be replaced by these tax-trained professionals.

Both LBS and the wider Department recruit staff with external experience from both the Big 4 and other leading accountancy firms. A number of staff gain external tax qualifications and fill tax inspector roles. Other staff have been recruited to fill more specialist positions, including:

- a pool of 18 advisory accountants largely from the Big 4 recruited over the past 10 years;
- 10 avoidance consultants during 2005/06, six from the Big 4; and
- a further four specialists recruited in 2007/08, three of whom were from the Big 4.

In addition to this, the Department’s Anti-Avoidance Group are currently running a recruitment exercise to bring in external expertise into this specialist unit.

Questions 130–131 (Mr Keith Hill): *How many cases the Department had in litigation:*

- (a) *at any one time; and*
- (b) *for a year*

In calendar year 2007, 178 litigation cases were referred to the Courts. As of 5 February 2008, there are 112 current litigation cases on hand.

This includes all types of dispute about liability to pay taxes or duties, or entitlement to tax credits. It does not, for example, cover litigation to recover debts, Information Tribunal cases or HMRC employment litigation. Complaints about HMRC administration are included to the extent that they are pursued through Judicial Review.

It does also not include cases which are currently being dealt with by the first-level tribunals for the various taxes, for example the Special and General Commissioners of Income Tax, VAT tribunals etc.

HM Revenue & Customs response to supplementary questions submitted by Mr Austin Mitchell

1. *Mr Hartnett said he had intervened in half a dozen big cases. Which cases has he intervened in, why and what the outcome of his intervention was?*
2. *You mentioned that you had been personally involved in half a dozen major cases in two years. I’ve had indications that you were in fact involved in more. Which is correct?*

Mr Hartnett met with senior officers of major corporations where it has been apparent that intervention at that board level can lead to issues being progressed and an improved relationship between the taxpayer and HMRC. This sort of board to board engagement is a key feature of HMRC’s High Risk Corporates Programme. Statutory rules of confidentiality prevent cases from being identified.

3. *Mr Hartnett said loopholes had prevented the penalty rules they've established on transfer pricing working until this year. HMRC have known about these loopholes for a long time so why haven't HMRC acted to close them before and why weren't Ministers advised to close them?*

Legislation was introduced in 2007 on penalties for incorrect returns that means penalties now apply to group companies in exactly the same way as to singleton companies. Before that it was possible to escape a penalty by offsetting losses arising in one group company against a transfer pricing adjustment (or indeed any adjustment) in another group company, reducing the tax effect of the adjustment to zero and eliminating a penalty position. This change was introduced as part of a balanced package which sought to support those who seek to comply with their tax obligations whilst coming down hard on those seeking an unfair advantage by not complying. It is a product of the wider HMRC Review of Powers, Deterrents and Safeguards set up following the merger of Inland Revenue and Customs and Excise.

4. *Mr Hartnett said that HMRC don't have penalty figures but now I've looked back through my records and I was told in a PQ answer on 6 July 2006 that there have been, then, five cases of transfer pricing penalties. What are they?*

Statutory rules of confidentiality prevent individual cases from being identified.

5. *Mr Hartnett seems, from the NAO report, to be working under the impression that very few large companies avoid tax (p37 and Dr P Pugh p115). I don't think that is right. Could HMRC give us an estimate of the number of groups dealt with by the large business service who have undertaken an avoidance scheme in the last five years?*

HMRC does not keep a running total of the number of groups engaged in CT avoidance.

6. *Mr Hartnett quoted approvingly from an unidentified company's views on corporate responsibility. Is it correct that this was in fact a quotation from HMRC's Varney review?*

No. The extract from a company's corporate responsibility statement does indeed appear in the report of the Review of Links with Large Business. A copy of the relevant statement was obtained before the Review was published and what appears in the Review was an extract of that statement.

7. *Mr Hartnett alluded to the law of diminishing returns to suggest that more staff would not always mean more income. How many thousand staff are you away from that point?*

As Mr Hartnett said in his response to the Committee, we do not know precisely whether an increase in staff would lead to increased revenue from compliance work.

As the Committee has heard, the Large Business Service has been changing the way it works by resourcing to risk; moving staff away from low risk and low yield work and focusing on higher risk businesses and issues and it is true to say that compliance yield has increased.

We are also investing in the developing the professional and technical skills of staff to better deal with those increased risks.

But this also needs to be balanced against the need to protect the integrity of the whole tax system and the need to respond in an appropriate and proportionate way to non-compliance.

8. *You mentioned that 150 tax inspectors had gone into one company. That would be a huge proportion of your inspectors working for one of your 700 customers. Is it correct? There must have been something horribly wrong to merit this.*

Resourcing to risk involves the Department moving the focus away from customers who have been classed as low risk to those customers deemed to be a greater risk.

At the top end of this process is the High Risk Corporates Programme, which deals with customers whose behaviour is considered to cause serious risk to the payment of tax.

Alongside board to board level engagement persuading customers to change behaviour from the top down, is the deployment of concentrated resource from across the Department to these highest areas of risk to carry out in-depth investigations with greater intensity and faster timescales.

This approach is consistent with the risk management principles that were set out in the framework announced by the Department in March 2007, which has been widely publicised.

9. *The response to Q3 (clarification as to the reason for the delay in taking action to close the loopholes affecting the implementation of the transfer pricing penalty rules) does not answer the question put.*

We are not able to comment on advice to Ministers. Work on closing the loophole was taken forward as part of the HMRC Review of Powers, Deterrents and Safeguards which was set up following the merger of the former Inland Revenue and Customs and Excise. Legislation was introduced in 2007.

10. *The response to Q4 (I was told in a PQ answer on 6 July 2006 that there have been, then, five cases of transfer pricing penalties. What are they?) should give the number of cases, even if it is not possible to identify the companies involved.*

The latest figures show that there have been seven cases of transfer pricing penalties from 2004–05 onwards. Again, statutory rules of confidentiality prevent individual cases from being identified.

11. *On the issue raised in Q5 (Could HMRC give us an estimate of the number of groups dealt with by the large business service who have undertaken an avoidance scheme in the last five years?) Mr Mitchell understands that you have surveyed 70 large companies and established levels of avoidance. He would be grateful if you could let the Committee have the survey.*

As part of an *ad hoc* survey on a number of issues, carried out in autumn 2004 and early 2005, HMRC questioned departmental Case Directors on perceived levels of avoidance. Results were obtained for 102 large companies. HMRC's statutory rules of confidentiality prevent the release of the survey data.

12. *You said during the hearing that 150 of your officers were recently applied to one case. The response to Q8 (You mentioned that 150 tax inspectors had gone into one company. That would be a huge proportion of your inspectors working for one of your 700 customers. Is it correct?) does not confirm this. Mr Mitchell would be grateful if you could clearly confirm or correct your statement during the hearing and give as many details of the case as possible.*

As previously explained, the High Risk Corporates Programme is a new approach to our highest risk customers that involves working enquiries in greater depth and to much faster timelines.

150 staff were involved in the case quoted at the hearing. Some were engaged full time but the majority would have had varying degrees of involvement whilst continuing to be deployed on other cases or work areas. This level of deployment was necessary for a few months whilst we worked with our customer to accelerate and conclude around 200 open enquiries.

HM Revenue & Customs response to supplementary questions submitted by Mr Don Touhig

1. *Detailed references to the statutes that prevent the Department from releasing the names of specific businesses.*

HMRC's statutory obligation of confidentiality is set out in section 18 of the Commissioners for Revenue and Customs Act 2005.

Section 18(1) provides that Revenue and Customs officials may not disclose information which is held by the Revenue and Customs in connection with a function of the Revenue and Customs. The names of the business requested are held by HMRC in connection with our corporation tax functions.

2. *Further explanation to claims in the Financial Times article, published on 27th August, as to how J. Sainsbury plc received a "tax credit" by making contributions to its pension fund in both 2005–06 and 2006–07.*

The summary cash flow statement in the March 2007 published accounts of J Sainsbury plc Group reports that £240 million was paid into defined benefit pension schemes during the year and £110m was paid in the year to March 2006. The summary cash flow statement also confirms that £9 million and £3 million corporation tax was received by the group in each year respectively. However, there is no direct relationship between these two sets of figures, as inferred by the *Financial Times* article.

Corporation tax received or paid, as shown in a group's cash flow statements, is not its corporation tax charge for the year. The cash flow figure represents corporation tax paid by that group to HMRC, or other tax authorities, less corporation tax repaid to that group by HMRC, or other tax authorities, during that accounting period. This includes, for example, corporation tax that may have been over or under paid by UK or overseas subsidiary undertakings of that group in earlier accounting periods.

It is correct to infer that corporation tax charges are reduced by tax relief in respect of employer pension contributions. The timing of that tax relief is dictated by pension specific tax legislation. This tax relief does not take the form of "credits", it simply reduces the profit assessable for tax purposes. Sainsbury's published

accounts showed that after all statutory tax reliefs, there was still a tax charge arising on the profits reported for each year. The tax charge is reported as an “income tax expense”. This includes both corporation tax and deferred tax, as detailed in note 8 to the 2007 accounts.

HM Revenue and Customs response to further supplementary questions from Mr Mitchell and Mr Touhig

1. *Further clarification as to how a situation arose in which J Sainsbury was owed so much in corporation tax by HMRC that in March 2006 and March 2007 £3 million and £9 million had to be paid to J Sainsbury by HMRC*

Confidentiality rules preclude HMRC from providing specific information about the corporation tax affairs of J Sainsbury Plc. However, it is not unusual for HMRC to repay large corporate groups any amounts they have overpaid at the end of the year. This situation arises because large groups are obliged to pay corporation tax in four instalments, three before the final taxable profit figure is known. If a group overestimates its liability during the year, they may end the year having paid too much and be due a repayment from HMRC. In addition, repayments made by HMRC may reflect the final settlement of earlier years that may have been the subject of HMRC enquiries or litigation.

2. *A list of the Department's Business Dinners the Department has hosted so far or plan to host in the future, including the names of invited dinner guests, along with an explanation as to why the Department is spending taxpayers' money in this way, and the benefits gained*

HMRC set up this series of dinners to bring together UK business leaders and senior officials dealing with business issues to discuss delivery of tax administration in the UK and other topical issues. They are intended to foster dialogue with business in the spirit of the Review of Links with Business published in 2006.

You will see from the table below that HMRC hosted four dinners between January 2007 and January 2008. These dinners are an important opportunity for HMRC's key business directors to meet with opinion-forming business leaders and we are presently considering the development of the next series of events.

“Series of informal dinners with business leaders to give them an opportunity to share with us their views on the delivery of the UK tax system.”

<i>Date</i>	<i>Business leader</i>	<i>Accepted the invitation</i>
15 Jan 07	Richard Lapthorne Chairman—Cable & Wireless	Dave Hartnett, Director General, Business Richard Alderman—Director, National Teams & Special Civil Investigations Stephen Banyard—Director, Business Customer Unit Melanie Dawes—Director, Large Business Service Naomi Ferguson—Director, Local Compliance Geoff Lloyd—Director, Corporation Tax & VAT Chris Tailby—Director, Anti-Avoidance Group
17 April 07	Mark Otty Chairman—Ernst & Young	Dave Hartnett, Director General, Business Richard Alderman—Director, National Teams & Special Civil Investigations Stephen Banyard—Director, Business Customer Unit Melanie Dawes—Director, Large Business Service Geoff Lloyd—Director, Corporation Tax & VAT Chris Tailby—Director, Anti-Avoidance Group
18 Sept 07	Hanif Lalani Finance Director—British Telecom	Dave Hartnett, Director General, Business Stephen Banyard—Director, Business Customer Unit Melanie Dawes—Director, Large Business Service Geoff Lloyd—Director, Corporation Tax & VAT Judith Knott—Deputy Director, Business Customer Unit Ian Valentine—Deputy Director, Large Business Service
29 Jan 08	Steve Lucas Finance Director—National Grid	Dave Hartnett, Acting Chairman Stephen Banyard—Director, Business Customer Unit Melanie Dawes—Acting Director General, Business Tax Naomi Ferguson—Director, Local Compliance Geoff Lloyd—Director, Corporation Tax & VAT Chris Tailby—Director, Anti-Avoidance Group Peter Michael—Director, Central Policy Freda Chaloner—Director, Large Business Service

3. *Further clarification as to how many major cases has Mr Hartnett intervened in, in two years*

Mr Hartnett stated at the hearing that he has intervened in “half a dozen” major cases in the last two years and he has no reason to change that view. Mr Hartnett can intervene for a variety of reason but generally the focus in on resolving difficult tax issues. Statutory rules of confidentiality prevent the release of the names of the companies involved.

Mr Hartnett also meets representatives of a larger number of businesses in board to board discussions of tax issues.

4. *In relation to the ad hoc 2004–05 survey of case directors into perceived levels of avoidance (ref question 11), what confidentiality rule means no data whatsoever can be released and is it not possible to say, for instance, that “x out of x companies” have established levels of tax avoidance?*

The Department is unable to provide the survey data to the Committee under HMRC’s statutory obligation of confidentiality as set out in section 18 of the Commissioners for Revenue and Customs Act 2005.

5. *How many of the “approximately 150 staff” previously mentioned as working on one particular High Risk Corporates case were tax inspectors?*

The Department no longer refers to the role of tax inspector, however staff involved in this case were drawn from across the Department and included people with a range of specialist skills. This includes HMRC trained tax specialists, advisory accountants, solicitors and avoidance consultants with recent experience of working outside of HMRC. All 150 staff were deployed in some way to accelerate and conclude the approximately 200 open tax enquiries which made up this particular High Risk Corporate case.

27 June 2008
