



House of Commons
Treasury Committee

Closing the Tax Gap: HMRC's record at ensuring tax compliance

**Twenty-ninth Report of Session
2010–12**



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

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2 Closing the Tax Gap: HMRC's record at ensuring tax compliance

1 Introduction

1. We agreed to undertake this inquiry following completion of our inquiry last year on *Administration and effectiveness of HM Revenue and Customs*,¹ as it was necessary to take further evidence before drawing conclusions about HMRC's administrative and operational record at ensuring tax compliance.

2. In three further evidence sessions we heard from expert academics, practitioners, and HMRC officials. Our aim was to examine how HMRC measured what it saw as the shortfall between the tax it should collect and what it does collect, its strategies for addressing the tax gap, and how it might improve its performance in future.

3. We had two main reasons for undertaking this inquiry at this time. First, given the uncertain economic climate, it is more important than ever that HMRC collects the correct amount of tax. If HMRC is able to close the tax gap as it sees it, this will increase revenues for the Exchequer and aid the Government in its deficit reduction strategy. Conversely, if taxpayers pay too much tax, or if compliance with their tax obligations creates a costly burden upon them, this could impact negatively on economic growth.

4. Secondly, HMRC's settlement of tax disputes with its large corporate customers has been a source of controversy for some months and it has been suggested that HMRC allowed some of these clients to pay less tax than was due according to the law.²

5. In this Report we first consider how the tax gap is calculated and how it is used. In Chapter 3, we consider briefly the Government's investment in HMRC's compliance activities. In Chapter 4, we assess HMRC's current approach to compliance and make recommendations for its future work. Finally, in Chapter 5 we examine the Large Business Service and HMRC's work in settling tax disputes with large corporate customers.

1 Treasury Committee, Sixteenth Report of Session 2010–12, *Administration and effectiveness of HM Revenue and Customs*, HC 731

2 For example, "How Vodafone made tax dodging respectable", *The Guardian*, 14 November 2010

2 The Tax Gap

What is the tax gap?

6. HMRC defines the tax gap as:

the difference between tax collected and the tax that should be collected (the theoretical liability). The theoretical tax liability represents the tax that would be paid if all individuals and companies complied with both the letter of the law and HMRC's interpretation of the intention of Parliament in setting law (referred to as the spirit of the law).³

7. HMRC produces a report annually containing an estimate of the tax gap and a detailed breakdown of this figure. In 2010, HMRC estimated the tax gap to be £35 billion or 8% of the total tax liability.⁴ HMRC officials told us HMRC “invest[s] a lot” in producing the estimate.⁵ Dave Hartnett CB, Permanent Secretary, Tax, HMRC, told us that:

The tax gap is quite an important tool ... in promoting understanding of all the causes of non-compliance and helping us to focus on ways of reducing them ... it is a bit like a long-term health check for us.⁶

Problems with the tax gap

8. The tax gap figure was criticised by witnesses. We were told it is inaccurate, inconsistently calculated, includes too broad a spectrum of behaviours and is a poor indicator of performance. One witness called the tax gap “entirely misleading”.⁷ We assess these criticisms below.

Inaccuracy

9. HMRC acknowledges that “the [tax gap figure] ... is not accurate; it is our best shot”.⁸ As noted in our previous report, the size of the tax gap is disputed, and many widely-varying estimates have been made.⁹ Witnesses noted the difficulty of estimating the tax gap with any degree of accuracy. David Heaton, Chairman of the Tax Faculty, Chartered Institute of Accountants in England and Wales, told us that “there is a tax gap, ...[but] I do not think

3 HMRC, *Measuring tax gaps 2011*, September 2011

4 *Ibid.*

5 Q 179

6 Q 178

7 Q 114 [David Heaton]

8 Q 179

9 Treasury Committee, Sixteenth Report of Session 2010–12, *Administration and effectiveness of HM Revenue and Customs*, HC 731, para 156

we can use it in any meaningful way to set targets because we do not really know what it is".¹⁰

Inconsistency

10. HMRC combines two approaches in order to calculate different elements of the tax gap, referred to as "top-down" and "bottom-up".¹¹ To calculate the tax gap using the top-down approach, HMRC "Gather[s] data mostly from the Office for National Statistics (ONS) detailing the total amount of expenditure in the economy that is subject to [tax]".¹² It then uses this to estimate the tax it should be collecting and compares this to what it does collect. In the bottom-up approach, "components of the tax gap are estimated using departmental sources, such as surveys, administrative and operational data".¹³ HMRC use this data to estimate how accurate the returns they receive are, and calculate the tax gap by applying this to the amount declared in returns they receive. Richard Murphy, Tax Research UK, argues that this approach fails to acknowledge that "large numbers of people who are tax evading will never be in the system and will never send in a tax return".¹⁴ Giving a figure which uses different methods to calculate different components does not allow for the fact that each method may measure something slightly different or omit particular parts of the population.

Behaviours included

11. HMRC's calculation of the tax gap includes the tax it judges has been lost owing to a number of different behaviours. These are: error, criminal attacks, evasion, operating in the hidden economy, avoidance, legal interpretation, non-payment, and failure to take reasonable care.¹⁵

12. It is unhelpful to aggregate these different behaviours. They lie on a broad spectrum from criminal activity to innocent difference in legal interpretation. Combining them in a single figure implies they are of equal gravity and does not acknowledge that the action needed to address these different behaviours varies with the behaviour. A large loss of tax arising from the hidden economy requires a quite different kind of intervention to a difference in opinion between HMRC and a taxpayer on the tax due under an ambiguous law.¹⁶ Judith Freedman, Professor of Taxation Law, University of Oxford, questioned including any behaviour where HMRC felt the taxpayer had not adhered to the "spirit of the law" (see paragraph 6).¹⁷

10 Q 159; See also Q 70 [Judith Freedman]

11 HMRC, *Measuring tax gaps 2011*, September 2011, p 12

12 HMRC, *Measuring tax gaps 2011*, September 2011, p 19

13 Q 2 [Richard Murphy]

14 *Ibid.*

15 HMRC, *Measuring tax gaps 2011*, September 2011

16 See Q 114 [Chas Roy-Chowdhury]

17 Q 72

The Tax Gap as a Target

13. HMRC publishes “HMRC’s Vision” on its website, which “states the Department’s purpose, says where it’s going and describes how its people will deal with customers and with each other”.¹⁸ HMRC does not use the tax gap as a performance target, but its Vision begins “We will close the tax gap”.¹⁹ Mr Hartnett told us that this did not necessarily mean eliminating the tax gap, saying there had been discussion at HMRC about “whether ‘close’ means close so the door is aligned with the frame, or whether it is the process of closing, and it is the second of those that we are doing”.²⁰

14. However, even in this form this part of HMRC’s Vision risks focusing its employees’ attention on the wrong task. HMRC should not be aiming to collect more tax at any cost, but should be ensuring that all taxpayers pay the correct amount of tax. As one witness pointed out, in some cases, HMRC doing an accurate job could actually decrease the funds available to the Exchequer, by “making sure that the low-paid, for example, get all the credits and benefits that they are entitled to”.²¹ For HMRC to collect the right amount of tax, it would also need to address the many people who pay more tax than they need to by law.

15. The tax gap calculation is also misleading as a comparison from year to year, because its size depends on a number of factors which have nothing to do with whether the correct amount of tax is being paid, for instance the applicable rates of tax.

16. The tax gap can be a useful concept for assessing trends in the amount of possible unpaid tax. We are not, however, convinced that the process of calculating, publishing and publicising an aggregate figure for the tax gap is a sensible use of HMRC’s limited resources. The aggregate tax gap figure is misleading and risks focusing HMRC on the wrong task as it only provides an order of magnitude.

17. We recognise that it is useful for HMRC’s employees to have some idea of the difference between what HMRC should be collecting and what is collected, particularly in the case of criminal activity. However, in other areas it would be more useful for it to identify ambiguities in tax law rather than employ resources in calculating how much tax would be collected if everyone shared its interpretation of the law. Separate reports on how much tax was lost through criminal activity and areas where HMRC had encountered different interpretations of tax law would be a better use of resources.

18. We would welcome further submissions from HMRC and tax experts both on how the tax gap calculation can be improved, and on whether it serves any useful purpose in HMRC’s work.

18 <http://www.hmrc.gov.uk/about/hmrc-vision.htm>

19 Q 180 [Melanie Dawes]; <http://www.hmrc.gov.uk/about/hmrc-vision.htm>

20 Q 188

21 Q 113 [John Whiting]

3 HMRC's Spending Review Settlement

Background

19. In the 2010 Spending Review, HM Treasury allocated £917 million to HMRC with the intention of generating an additional £7 billion in compliance yield annually and £18 billion over the four-year life of the Spending Review.²² Given HMRC's estimate of the 2009–10 tax gap of £35 billion, this is a reduction of 20%, which is a very ambitious target.

20. HMRC has previously explained that the new money is targeted in the following areas:

Around 65% of the £917 million investment funding will be focused on the mass market and tax evasion ... Around 5% will be focused on large businesses and wealthy individuals... Around 10% of the investment funding will be focused on tackling organised crime ... The remaining funding will be spent on a range of interventions designed to collect more debt.²³

21. We accept that, based upon figures in HMRC's latest tax gap report, these seem to be sensible areas in which to invest. However the process by which the areas to be invested in, the amount to be invested, and the estimated additional yield were calculated and decided lacks transparency.

22. Mr David Gauke MP, Exchequer Secretary, explained the process as follows:

[HMRC] came forward with a proposal saying, "This is what we think we can do to reduce costs and this is what we can do to reinvest in a way that would increase the yield". I think it would be fair to say that pretty well the HMRC bid was accepted by the Government. The Treasury kicked the tyres very hard and examined all the detailed proposals that were contained within it, which broke down to, "Well, this particular programme we think would cost X and produce Y". We examined the various proposals and, by and large, the HMRC bid was accepted, and that is why we reached the settlement that we did.²⁴

In a further memorandum intended to elaborate on this point, the Exchequer Secretary told us that:

HMRC came forward with a number of investment cases to further increase compliance and reduce the tax gap that the Treasury were satisfied with on that basis... The final £917m reinvestment proposals therefore met the test of standing up to intense Treasury scrutiny.²⁵

22 HM Treasury, *Spending Review Settlement 2010*, October 2010 Cm 7942; Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, Q 258

23 *Ibid.*, Ev 119

24 *Ibid.*, Q 372

25 *Ibid.*, Ev 130

23. Neither the Minister's oral evidence nor his supplementary evidence makes clear what criteria were applied to assess HMRC's proposals for investment, or whether this assessment was systematic. This makes it difficult for us to scrutinise in detail whether the areas to be invested in are the right ones, whether the estimated yield from each area is accurate, and whether proposals which were rejected should have been accepted.

24. HM Treasury has not adequately explained the criteria it used to make decisions about the re-allocation of funds to tax compliance. This makes it very difficult to scrutinise these decisions. HM Treasury should explain more fully how it decided to accept or reject HMRC's requests for additional funds and how it decided on the allocation of funds between functions.

25. In making decisions on investment in compliance activities, HMRC and HM Treasury will need to have regard to ensuring that the right amount of tax is paid rather than as much tax as possible at any cost. David Heaton described the potentially harmful effect of too much pressure being put on taxpayers to pay the amount of tax HMRC believed was due, even where the taxpayer sincerely held a different view:

I have a particular case in mind where the company had just finished some lengthy litigation in the European Court and did not want to go into another tribunal case, whether or not it had a strong case did not matter, they just did not want another case. I was instructed by the finance director to settle at any price.²⁶

26. We welcome the Exchequer Secretary's view that "the Treasury could, in theory, seek to invest in HMRC until the marginal pound invested brought not less than a pound in return... [but i]n practice the Treasury considers each additional investment in HMRC on a case-by-case basis". However we encourage the Treasury to include in its consideration the question of whether the activity invested in will yield the right amount of tax and not just the greatest possible amount.²⁷

26 Q 121

27 Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, Ev 130

4 Compliance Activity

27. In this section we address some of the strategies pursued by HMRC to ensure compliance.

Voluntary Compliance

28. **By far the most efficient way of closing the tax gap is encouraging voluntary compliance. A process whereby taxpayers and HMRC work together to ensure that taxpayers voluntarily pay the correct amount of tax, sometimes following negotiation and agreement, is far less costly than the alternative.** The relationship between HMRC and taxpayers should not be an adversarial one in which HMRC seeks to collect as much tax as possible and taxpayers seek to pay as little as possible, regardless of what the law says. We believe that most people want to be law-abiding and that HMRC should encourage and enable them to be so. John Whiting OBE, Tax Policy Director, Chartered Institute of Taxation, told us that:

voluntary compliance is clearly better. It is more efficient all round, setting the right atmosphere, making sure people realise it makes sense to comply and pay their dues.²⁸

29. Key to encouraging voluntary compliance is that taxpayers feel they are being treated fairly: this includes receiving adequate customer service, not being subjected to unfair or unwarranted demands by HMRC, and, perhaps most importantly, ensuring that taxpayers believe that they are being treated equally, regardless of whether they are an individual or a business, and regardless of how wealthy they are. Many of the recommendations in this Report aim to encourage voluntary compliance, but there are also specific areas in which action could be taken to encourage it.

Simplifying the tax system

30. David Sproul, Chief Executive Office, Deloitte UK, told us that “there is no question that there is too much complexity in our tax system”.²⁹ Judith Freedman agreed, saying that the complexity created “costs for the businesses. In the small business area I think the problem is ... that you have complexity that makes it very hard, with the best will in the world, to comply precisely”.³⁰ Mr Hartnett acknowledged that simplifying the tax system was a work in progress, saying that HMRC has “succeeded in taking almost £600 million of burdens created by the tax code off business in the last five years and aim[s] to do more”.³¹ We welcome the creation in 2010 of the Office of Tax Simplification (OTS) with its “objective of reducing compliance burdens on both businesses and individual taxpayers”.³²

28 Q 109

29 Q 77

30 Q 80

31 Q 200

32 HM Treasury, *Office Of Tax Simplification Framework Document*, <http://www.hm-treasury.gov.uk>

Simplifying the tax system should be a legislative priority for the Government in this Parliament. The Government should commit itself to setting a fixed, published timetable for deciding whether to accept recommendations from the OTS, and for producing draft legislation to implement the proposals it accepts.

Public Education

31. Chas Roy-Chowdhury, Head of Taxation, Association of Chartered Certified Accountants, suggested that:

HMRC could do more to educate the ordinary person in the street, the ordinary business, so that they actually head off a lot of what then become tax evaders. People then realise two, three, four years down the track they have been evading tax, and then it is very difficult for them to contemplate coming back into the formal economy where they have to pay interest, they have to pay penalties, they have to work out what the tax was.³³

Other witnesses agreed that education and easily accessible information should be a priority for HMRC.³⁴ Frances Corrie, Technical Director, TaxAid, told us that TaxAid (a charity which provides tax advice) was:

contacted by people who are trying to get their tax right and often cannot find the answer to what may to us be quite basic questions, but they cannot identify where the information is online or they cannot apply it to their own circumstances.³⁵

32. It is vital that those who wish to be compliant with tax law should be able to be so. HMRC has a responsibility to educate the public about their tax obligations and to ensure that information about tax is readily available in a variety of media. We recommend that HMRC commission a study to identify the biggest gaps in the public's understanding of their tax obligations and develop a strategy for addressing these.

Making Disclosure Easier

33. A further suggestion made by a witness was that there should be:

a more permanent, visible and transparent route in either through the helpline or, as online is the preferred mode, something on the website that enabled people to effectively get themselves back into the system at the time when in our experience what prompts people back into the system is very often personal events in their lives. It is not the availability of a campaign or even the thought that the Revenue are more

33 Q 151

34 Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, Ev w45, Q 5 [Ian Holloway], Ev w23, 3.3 [TaxHelp for Older People]

35 Q 110

closely breathing down their necks. It is their partner who has told them to get themselves sorted out or there is a baby on the way.³⁶

34. We find this argument very convincing. We were told in evidence that it was difficult for those who wished to become compliant and settle previous years' tax to do so.³⁷ If there was a clearly signposted and easy-to-use disclosure facility on HMRC's website, this might encourage people to regularise their tax affairs. **HMRC should consider establishing a general disclosure facility to run alongside its targeted campaigns. The details of the facility should be easy for all taxpayers to access and understand.** These details would need to include clear information on HMRC's policy on prosecution (see below).

Prosecutions

35. Prosecution is a key measure available to HMRC both to punish tax evaders and as a deterrent to those who might consider evading tax. However, the Association of Revenue and Customs told us that:

The number of successful prosecutions by HMRC has declined by 41% since 2007, to just 157 in 2008–09. Even a fivefold increase would mean that HMRC prosecutions would be less than 10% of the 9,000 prosecutions by DWP each year. Yet benefit fraud is estimated at c. £1.5 billion each year, compared to the gross tax gap of £60 billion.³⁸

36. HMRC told us the fall in the number of prosecutions:

reflects a conscious re-prioritisation of resource away from offences by individuals to tackling serious organised attacks on our tax regimes. These cases ... take longer to investigate and consume more resource per case.³⁹

37. In response to this fall in prosecutions, HMRC's Spending Review settlement included:

investment to tackle fraud and evasion and specifically to increase the volume of prosecutions. We are developing plans to enable us by 2015 to deal with an additional 1000 cases per year; these increases will be mainstream evasion cases and will be aimed at both tackling cases of fraud and maximising HMRC's deterrent effect.⁴⁰

38. High profile prosecutions of tax evaders may serve to deter many thousands of other people from committing tax fraud. However, some have expressed doubt that the action planned by HMRC will be sufficient. The ACCA wrote that "For years, HMRC have been

36 Q 149 [Frances Corrie]

37 *Ibid.*, Ev w5 [TaxAid]

38 *Ibid.*, Ev 87 [ACCA]

39 *Ibid.*, Ev 116 [HMRC]

40 *Ibid.*

promising high profile prosecutions of tax evaders, yet the only examples yet brought to court are in the specific field of MTIC VAT fraud".⁴¹

39. We support HMRC's plan to invest more in prosecuting those evading tax, and urge it to consider how to publicise these to maximise their deterrent effect.

40. While supporting a strong approach on prosecutions, we have two reservations. Our first is that fear of prosecution may in fact prevent some of those currently outside the tax system from disclosing their earnings to HMRC. Frances Corrie told us that:

Most individuals think they will be prosecuted even if they voluntarily disclose, so the fear of that is something that positively holds back.⁴²

HMRC does publish on its website its criminal investigations policy, but this does not give a clear picture to the lay reader of when HMRC is likely to prosecute someone who is making a disclosure.⁴³

41. It is important that those outside the tax system who wish to become compliant are not deterred from doing so by an unfounded fear that they may be prosecuted. HMRC should publish on its websites case studies of taxpayers who have not been compliant in the past but who have approached HMRC to settle the tax they owe. These should make clear that in the vast majority of cases the taxpayer's disclosure did not result in prosecution and should be understandable to the lay reader.

42. We recognise that HMRC cannot guarantee that no one who makes a voluntary disclosure will be prosecuted for fraud. One reason for this is that it would allow people to remain non-compliant for as long as they wished in the knowledge they could disclose at any time with no negative consequences, and therefore discourage compliant behaviour. Another is that HMRC "understandably have to reserve the right to prosecute somebody who, frankly, has been doing very egregious tax evasion".⁴⁴

43. Our second reservation is that HMRC should prosecute those it believes to be guilty of tax fraud only where the facts make this appropriate, and not in response to targets, such as "a fivefold increase in the number of criminal prosecutions", which was a stated aim of HMRC's Spending Review settlement.⁴⁵ This strengthens the case for a clearly stated policy on when a criminal prosecution will be pursued.

Targeting and Campaigns

44. Mr Hartnett told us that HMRC:

41 Treasury Committee, *Administration and Effectiveness of HM Revenue and Customs*, Ev 87, [Association of Revenue and Customs]; see also Q 36 [Graham Black]

42 Q 152; See also Treasury Committee, *Administration and Effectiveness of HM Revenue and Customs*, Ev w6 [Taxaid]

43 <http://www.hmrc.gov.uk/prosecutions/crim-inv-policy.htm>

44 Q153 [John Whiting]

45 Treasury Committee, *Administration and Effectiveness of HM Revenue and Customs*, Ev 88 [Association of Revenue and Customs]

...target our compliance activity ... by reference to risk [of non-compliance of loss of revenue to the Exchequer], and particularly trying to take on the biggest risks, and the management of risk is different depending on the sort of customer we are dealing with. For example, the risk in big business is likely to be dealt with by a single team managing that ... For individuals, our approach is to have campaigns; a small number of our officials may deal with a large number of taxpayers.

45. HMRC has undertaken a number of campaigns in order to maximise compliance amongst a particular group:

Each Campaign targets an identifiable population to try and improve levels of tax compliance ... each campaign [has] an identifiable population at the outset for whom opportunities are provided that make it easier for them to choose to be compliant - offering an incentive to self correct.⁴⁶

Groups targeted currently or in the past have included plumbers, tutors and coaches, medics and electricians.⁴⁷

46. In general this risk-based approach to addressing compliance by individuals and big business has met with approval as an efficient use of resources.⁴⁸ Judith Freedman commented that “there is quite a lot of sense in trying to work out who is high risk and who is low risk from a resource allocation point of view”.⁴⁹ It should also reduce some of the burden on compliant taxpayers as they are less likely to be the subject of HMRC investigations. Graham Black, President, Association of Revenue and Customs, suggested that this approach also had the advantage of improving the relationship between HMRC and compliant taxpayers, saying:

What we have to avoid is sending out [a] blanket investigation to people and worrying them ... That could have the impact of alienating people, and I certainly think that the aim of the campaigns and different approaches that HMRC is trying is ... to avoid that and make sure that we focus on the people where we have a good suspicion that there has been some wrongdoing.⁵⁰

47. As with campaigns which target those who conceal funds offshore in order to evade tax, the success of campaigns will depend on following their closure with high profile prosecutions of those within the targeted population who do not make disclosures during the campaign and remain non-compliant (see paragraph 56, below).

48. A primary criticism of HMRC's compliance approach is that while it is effective at addressing non-compliance amongst those who engage to some extent with the tax system

46 <http://www.hmrc.gov.uk/ris/hmrc-campaigns.htm>

47 *Ibid.*

48 See for example Q 81 [Judith Freedman], Q 126 [John Whiting], Q 121 [David Heaton].

49 Q 81

50 Q 8

but are judged to be high-risk, it fails to address those who are not compliant at all and operate entirely outside the tax system. Chas Roy-Chowdhury told us that:

They are going after those who are actually in the tax system ... there are perhaps harder targets but ones which could yield a lot more ... which I think they should really be focusing on.⁵¹

HMRC has taken steps to address this. Part of HMRC's Spending Review settlement will be invested in tackling organised criminals.⁵² HMRC has also made use of an online tool to identify businesses advertised on the internet which do not engage with HMRC.⁵³

49. We endorse HMRC's targeted approach to compliance. We welcome attempts to identify those outside the tax system but believe HMRC could do more to ensure it focuses upon them with as much rigour as it focuses on those already within it. We recommend that HMRC reports separately in its annual report on its work on tackling those entirely outside the tax system.

Offshore disclosure

50. HMRC has in recent years undertaken three offshore disclosure campaigns: the Offshore Disclosure Facility, the New Disclosure Opportunity and the Liechtenstein Disclosure Facility.⁵⁴ The first two of these campaigns were general disclosure facilities for those who held funds offshore on which UK tax was due and unpaid. Both succeeded in raising revenue for the Exchequer. HMRC told us that:

The [Offshore Disclosure Facility] raised nearly £500m from voluntary disclosures and follow up enquiries whilst the [New Disclosure Opportunity] raised over £85m in voluntary disclosures from 5500 people and businesses who had previously unpaid tax.⁵⁵

51. The Liechtenstein Disclosure Facility (LDF) was launched in 2009 and will run until 2015. Under an agreement between the UK and Liechtenstein Governments, financial intermediaries providing certain services to clients who should be liable to UK tax on their Liechtenstein investments are obliged to identify these clients and cease providing the services if the client refuses to become compliant with UK tax law.⁵⁶ The LDF provides a mechanism for those with an unpaid UK tax liability to disclose this.

51 Q 126; See also Q 26 [Richard Murphy]

52 Treasury Committee, *Administration and Effectiveness of HM Revenue and Customs*, Ev 126

53 Q 193

54 HMRC, Campaign news and updates, www.hmrc.gov.uk

55 Ev 50

56 Memorandum of understanding between the Government of the Principality of Liechtenstein and Her Majesty's Revenue and Customs ("HMRC") of the United Kingdom of Great Britain and Northern Ireland relating to cooperation in tax matters, August 2009

52. Most recently, on 6 October 2011 the Governments of the UK and Switzerland signed the UK-Swiss Confederation Taxation Cooperation Agreement.⁵⁷ Under the agreement, Swiss banks will be required from 2013 to impose withholding taxes of 48% on interest and other income, 40% on dividends and 27% on capital payments to anonymous UK clients.⁵⁸ In addition, under the agreement Swiss bankable assets held by those liable to UK tax will be subject to a one-off levy ranging between 19% and 34% of their bankable assets in accounts held at 31 December 2010.⁵⁹

53. We are concerned that the levies on Swiss bank accounts will result in those who have sought to avoid tax by concealing their assets offshore receiving more favourable tax treatment than those who were compliant in the first place. The rates of tax to be withheld from income and capital are lower than the top rates of tax in the UK. This seems to reward those who have deliberately avoided tax over those who have not. Mr Hartnett explained that the reason for the withholding rates being slightly lower than the rates that would apply in the UK was that:

The 48% is a calculation based on the top rate of 50% when money would often not come in, or generally not come in, until 31 January following the end of the tax year. This money will come in earlier, so we calculated a withholding based on that anticipation of money.⁶⁰

54. This logic is not followed in domestic withholding taxes on UK income, where tax rates do not vary depending on whether income tax is withheld at source (such as through PAYE or withholding tax on savings income) or paid at the end of the tax year following the submission of a tax return. We do not see why those with offshore bank accounts, who may not currently be fulfilling their tax obligations, should be treated any differently. We are also concerned that withholding will not begin to apply until 2013, giving tax evaders a chance to move their assets. Mr Hartnett acknowledged this, but said that it was because “the Swiss have to build a system to make this happen”.⁶¹

55. Any perception that those with offshore accounts are paying lower taxes than compliant taxpayers creates a risk that the agreement may encourage taxpayers to seek opportunities to evade tax in the belief that they will be able to reach a favourable settlement in future. Also, any perception that some taxpayers are receiving more favourable treatment than others is likely to discourage voluntary compliance.

56. For offshore campaigns to be successful, those who do not take up the opportunity to disclose unpaid tax to HMRC should be prosecuted. These prosecutions should be well-publicised both to demonstrate to those who made the decision to come forward

57 UK-Swiss Confederation Taxation Cooperation Agreement, www.hmrc.gov.uk

58 *Ibid.*

59 *Ibid.*

60 Q 203

61 Q 202

that they are not in a less favourable position than those who did not, and to encourage others to make disclosures where they have not already done so.

57. The principle of the UK-Swiss agreement may turn out to be a step forward in reducing opportunities for individuals to avoid tax by concealing assets offshore. However, we are concerned that the rate of tax which will be withheld from anonymous Swiss bank accounts will be lower than the highest rate of income tax payable in the UK, and that the long delay before withholding begins will allow those with Swiss bank accounts to remove their assets before withholding is applied. We recommend that HMRC, when publicising the UK-Swiss tax agreement, explains clearly the reasons for the lower rates of tax being withheld from Swiss bank accounts. If there are to be similar agreements in future with other jurisdictions, the Government should seek agreement for the same effective tax rates that apply to UK taxpayers.

58. We have noted recent reports that the UK-Swiss tax agreement has been challenged by the European Commission.⁶² We will follow closely the Government's progress on implementing the agreement.

Automation

59. HMRC has made greater use in recent years of automated processes. While automation can significantly reduce the labour involved in compliance activity, it has in the past been problematic. In our Report *The Administration and Effectiveness of HM Revenue and Customs*, we noted the reports that aggressively worded letters had been sent to poorly selected targets regarding debts HMRC claimed they owed and the distress and alarm this had caused.⁶³ It was also reported last year that more than half of internal reviews of penalties issued for late VAT returns resulted in the penalty decision being overturned, which HMRC attributed to the automatic issue of penalty notices.⁶⁴

60. HMRC told us that it would "industrialise" the process for investigating information about potential tax evasion that it had received from Swiss banks.⁶⁵ This would involve sending a high volume of letters to individuals setting out the information HMRC had obtained and requesting further information.⁶⁶ It is clear that this will enable HMRC to process a far larger number of cases in a shorter period of time than it would be able to otherwise, but the success of this strategy will depend on the wording of the letters, correct identification of those who should receive the letters, and the availability of additional information for the recipients if they need it.

61. Successfully implemented, automation can enable HMRC to process a far higher volume of cases than it would otherwise. However, we have already seen instances of

62 "Writ looms over Swiss tax deal", *Financial Times*, 27 November 2011

63 Treasury Committee, *Administration and Effectiveness of HM Revenue and Customs*, HC 731

64 "HMRC reverses most VAT tax penalties", *Financial Times*, January 23 2011

65 Q 214

66 Q 218

automation either damaging HMRC's relationship with taxpayers or consuming resources with a high volume of appeals. Automated processes should be rigorously tested and piloted and reviewed externally before implementation. HMRC must also provide ready access to members of staff who can help if the automated process creates errors.

5 Large Business Service and Large Tax Cases

Introduction

62. We focused particular attention in our inquiry on how HMRC works with large businesses and how it settles disputes with these customers. This is for a number of reasons. First, HMRC's large corporate customers account for "up to a quarter" of the overall tax gap, and single cases can involve large sums owing to the size of these customers' turnover, profits and payroll.⁶⁷ Secondly, HMRC has attracted significant media criticism for its work with large corporate clients, suggesting that they receive particularly favourable treatment from HMRC.⁶⁸ Thirdly, because of this media criticism, large tax cases tend to be particularly visible to the public, and there is a risk of damage to HMRC's reputation if the public perceive these cases to be dealt with improperly. Richard Murphy suggested that this could have an impact on the willingness of other taxpayers to comply with their tax obligations:

If you have people seeing such issues arising they are going to turn round and say, "Well, if they can get away with something, whether they have or not got away with something, I will try to do the same".⁶⁹

63. Working with large corporate customers also creates a different set of challenges for HMRC from those raised by its other customers. Large corporations are more likely to engage in avoidance than evasion, which means that disputes are likely to be on technical points of tax law.⁷⁰ Many of these customers are multinational corporations operating across a number of jurisdictions, which further complicates their affairs. Large corporate clients also have the resources to obtain advice from highly qualified and experienced tax professionals who can be paid significantly more than any employee of HMRC.

64. The National Audit Office (NAO) conducted a review of HMRC's processes for resolving tax disputes and published its findings in a report in 2011. We draw on the findings of the NAO below. Later in 2011, the Committee of Public Accounts (PAC) published a Report, *HM Revenue and Customs 2010–11 Accounts: tax disputes*.⁷¹ We have also drawn on some of the evidence given to the PAC in the course of its inquiry.

67 Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, HC 731, Ev 127

68 For example "Revenue boss entertained by Vodafone accountants weeks before £6bn tax deal", *Daily Mail*, 27 March 2011; "How Vodafone made tax dodging respectable", *The Guardian*, 14 November 2010; "Outlook: above all, the taxman must be even-handed", *The Independent*, 13 October 2011

69 Q 64

70 Q 244 [Dave Hartnett]

71 Committee of Public Accounts, Sixty-first Report of Session 2010–12, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, HC 1531

HMRC's approach

65. HMRC describes its approach to working with large businesses as follows:

With large businesses ... HMRC explicitly seeks relationships based on openness and transparency. For the 2000 largest businesses, one-to-one Customer Relationship Managers (CRMs) ensure that HMRC has extensive understanding of tax and avoidance risks in the context of the commercial environment in which customers are operating...⁷²

HMRC's Large Business Service (LBS) works with HMRC's 770 largest customers "on a range of taxes, duties and regimes, and work[s] collaboratively with colleagues across ... HMRC in tackling risk and providing customer service".⁷³ Within the LBS the High Risk Corporates Programme has existed since 2006 and works with "the highest risk cases, which frequently involve multiple avoidance schemes".⁷⁴ The NAO explains that:

The approach [of the High Corporates Programme] includes Board-to-Board, or other high level, engagement between [HMRC] and the company with a commitment from both sides to apply high levels of resource to providing information and resolving issues within an accelerated timeframe.⁷⁵

66. The High Risk Corporates Programme Board "is a very senior body chaired by the Director of the Large Business Service. All of the business areas of HMRC that have an interest in [a particular case] are represented at Director or Deputy Director level".⁷⁶ The Board "brings together relevant expertise" and has a role in reviewing high profile or controversial tax settlements with corporate customers both within and outside of the High Risk Corporates Programme (see paragraph 73, below).⁷⁷

67. HMRC's approach to disputes with taxpayers is also governed by its Litigation and Settlement Strategy. A key development in this strategy is that with each taxpayer "each dispute must be considered and resolved on its own merits, not as part of any overall 'package deal'".⁷⁸ If this strategy is adhered to, HMRC should not engage in what David Sproul described as "horse trade of all open issues" resulting in picking "a middle number", but instead make a decision in each case based on the facts of the case and the law applicable.⁷⁹ This is a positive development.

72 Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, Ev 127, [HMRC]

73 HMRC, Large Business Service, www.hmrc.gov.uk

74 Treasury Committee, *Administration of effectiveness HM Revenue and Customs*, Ev 127 [HMRC]

75 C&AG's Report, Report by the Comptroller and Auditor General on HM Revenue & Customs' 2010–11 Accounts, HC 981, Session 2010–12

76 Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, Ev 129

77 C&AG's Report, para 2.23

78 HMRC, Litigation and Settlement Strategy, <http://www.hmrc.gov.uk>

79 Q 88

68. Much evidence suggests that HMRC's approach to large business is working well. In a 2010 survey of customers of the LBS, 86% rated HMRC's service as good or very good.⁸⁰ In addition, HMRC has previously told us that it has:

increased Large Business Service yield from £3.6 billion in 2005-06 to £6.3 billion in 2009-10. In addition, between April 2007 and April 2010, the number of LBS enquiries which were over 18 months old has declined by 58% from 2,612 to 1,092.⁸¹

69. Three of our witnesses also expressed approval for the LBS.⁸² However the close Board-to-Board working might give the impression that preferential treatment is given to large taxpayers. In his evidence to us in September 2011, Mr Hartnett said that he had "been to a supper with Goldman Sachs", but that he did "not deal with Goldman's tax affairs".⁸³ It later emerged in questioning by the PAC that Mr Hartnett had in fact intervened to help solve "a difficult relationship issue" while negotiations were taking place between Goldman Sachs and other officials at HMRC.⁸⁴

70. Mr Hartnett later wrote to us to explain the apparent disparities in his evidence. His letter is published with this Report. Mr Hartnett explained that:

I am called upon to advise and support colleagues in their handling of a range of tax matters. The meeting on 19 November with Goldman Sachs was an example of this. However, I do not deal with the tax affairs of any HMRC customer on an ongoing or day to day basis.⁸⁵

He did, however, concede that "In retrospect, I recognise a fuller response would have been to say that I do not deal with Goldman's tax affairs 'on a day to day basis'".⁸⁶ We accept Mr Hartnett's explanation of his comments.

71. HMRC should work closely with large businesses to ensure that they fulfil their tax obligations given the sums involved in a single large business's tax affairs. However, the processes by which large tax cases are settled must be in a relationship based on openness and transparency and it is vital that appropriate checks be in place so that other taxpayers can be sure that all taxpayers are receiving the same treatment from HMRC. We consider below how this could be achieved and the extent to which the most recent proposals from HMRC achieve this.

80 Large Business Customer Survey – HMRC Research Report 102, August 2010, prepared by TNS-BMRB for HMRC, page 57

81 Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, Ev 100

82 See Q 81 [David Sproul and Judith Freeman]; Q 166 [Chas Roy-Chowdhury]

83 Q 235, Q 236

84 Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, Q 1 [Dave Hartnett]

85 Ev 53

86 *Ibid.*

Processes for agreeing tax settlements with large corporate customers

72. Media criticism of two settlements with large corporations in particular has driven an apparent public perception that HMRC treats big business more favourably than other taxpayers. These cases were extensively explored by the PAC last year.⁸⁷ In line with longstanding practice of observing taxpayer confidentiality, HMRC has not disclosed the terms of these settlements to us or the PAC, and we therefore focus our recommendations upon HMRC's processes for agreeing tax settlements with large corporate customers rather than the merits of any particular case.

HMRC's processes for reviewing settlements

73. HMRC's internal processes for reviewing and agreeing large tax cases vary depending on the amount of tax under consideration, the complexity of the issues and whether or not the case falls within HMRC's High Risk Corporates Programme. Large and sensitive cases are referred to the High Risk Corporate Programme Board to be reviewed, and the largest cases (historically with tax at stake exceeding £250 million) and those with potential to be particularly controversial must be signed off by Commissioners.⁸⁸ In the past, this meant in practice that two Commissioners were required to sign off settlements, usually the Permanent Secretary for Tax, as the Department's senior tax specialist, and the Director General for Business Tax.⁸⁹ On 27 February 2012 Lin Homer, Chief Executive of HMRC, wrote to us to explain new processes which will be introduced for reviewing tax settlements. HMRC will introduce "a new assurance role at HMRC Commissioner level with an explicit challenge role in decision-making on cases".⁹⁰ Ms Homer told us that:

Once this role is established, decisions on our largest cases will be taken by three Commissioners – the assurance Commissioner, the Director General (DG) for the relevant line of business and a third Commissioner from a different work area ... I intend this Commissioner to be an experienced tax professional. They will have no role in our engagement with taxpayers on their particular tax affairs, nor any line management responsibility for case-workers.⁹¹

HMRC will also reduce the threshold of tax at stake which triggers a decision on a case being made by Commissioners to £100 million, and publish a code of governance for tax dispute resolution.⁹² We address the package of changes from HMRC in more detail below.

74. The NAO's review of the resolution of tax disputes examined the processes by which 27 disputes with large businesses were settled.⁹³ It noted that in "four of the largest settlements

87 Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*

88 C&AG's Report, Report by the Comptroller and Auditor General on HM Revenue & Customs' 2010–11 Accounts

89 C&AG's Report, Report by the Comptroller and Auditor General on HM Revenue & Customs' 2010–11 Accounts, R25

90 Ev 53

91 *Ibid.*

94 C&AG's Report, Report by the Comptroller and Auditor General on HM Revenue & Customs' 2010–11 Accounts

93 *Ibid.*

we examined, the Department operated specific governance arrangements”.⁹⁴ Mr Hartnett told the PAC that:

For those cases, we set up bespoke governance arrangements because ... the people who sit on the high-risk corporate programme board were all people involved in the cases.⁹⁵

The use of “bespoke” governance arrangements suggests that existing arrangements were not sufficient.

75. Where settlements made between HMRC and its customers are particularly complex, this should not be an occasion to alter governance procedures, but a time when existing procedures should be applied most rigorously. When the new code of governance for tax dispute resolution is published, we expect it to encompass all eventualities and be followed meticulously. We recommend that HMRC publish its code of governance in draft for consultation before a final version is published to ensure that it is suitable for all eventualities.

76. It has been a matter of concern that in a small number of cases included in the NAO's review, one or both of the Commissioners who approved settlements had participated in negotiations.⁹⁶ It is encouraging that HMRC has recognised that “clear separation between the analysis and negotiation phase of resolving a dispute and the approval of the proposed settlement” is necessary,⁹⁷ and have provided for this in the new arrangements published on 27 February this year.⁹⁸

77. We are concerned that until recently, only one Commissioner at HMRC had “deep tax knowledge”.⁹⁹ Given the technical complexity of the tax affairs of many large corporations, it is unsatisfactory that historically those with ultimate responsibility for reviewing settlements with large corporations have not had deep technical knowledge. We would expect the creation of the role of assurance Commissioner, which it is intended will be performed by an experienced tax professional, to mean that there is always expert review of tax settlements which are either high value or controversial. HMRC should include information on this in its annual report on its tax settlement cases (see paragraph 82 below).

78. Where settlements of tax disputes are sufficiently large or controversial that they are escalated to Commissioners for review, this review must be independent and expert. We therefore welcome HMRC's recent announcement that a new Commissioner with responsibility for assurance will be appointed to review such cases and that the person appointed will be an experienced tax professional. We recommend that HMRC's

94 Ev 53

95 Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, Q 83

96 C&AG's Report, Report by the Comptroller and Auditor General on HM Revenue & Customs' 2010–11 Accounts

97 Ev 53

98 Ev 53

100 Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, Q 155 [Dave Hartnett]

annual report on its tax settlement work include confirmation that all cases which were escalated to Commissioner level were subject to review by a Commissioner with technical tax knowledge.

Error in settling large tax cases

79. In one of the four large tax cases examined by the NAO where usual governance procedures were not followed, a mistake was made and HMRC's governance procedures were not adhered to. Mr Hartnett explained that:

we reached a conclusion on an issue, not realising that an impediment to full application of the law no longer applied and that the official responsible for taking that to the High Risk Corporates Programme Board did not initially realise that was necessary.¹⁰⁰

80. This was identified in the NAO's review and discussed at length in the PAC. While HMRC has not revealed the amount of tax lost as a result of the mistake, the fact that it should have been (and eventually was) referred to the High Risk Corporates Programme Board suggests that it is a large sum. We accept that mistakes may be made in any organisation, but where they result in the loss of several million pounds in tax to the Exchequer, it is important that they are carefully examined. Mr Hartnett argued to the PAC that in the context of the total tax collected by HMRC, the mistake was less significant, saying:

I put together for myself a mental profit and loss account of the issues that I and my colleagues have dealt with over the past five years. The mistake that was made, for which I and my colleagues are very sorry, is one thing; the income side of this is billions of pounds.¹⁰¹

However, HMRC must accept that to ordinary taxpayers, a sum which may run into millions of pounds is not trivial and where a mistake results in such a loss the public are entitled to know why the mistake was made and what is being done to prevent its repetition. Transparency is particularly important where a mistake has been made in order to avoid allegations of impropriety or the suggestion that HMRC treat certain taxpayers with undue leniency.

81. It would be unreasonable to expect that HMRC will never make mistakes. However, it is important that HMRC learns from those mistakes and that the public's confidence in HMRC is not unduly eroded when mistakes are made. In the case of the mistake that was made in 2010 relating to a settlement with a large corporate customer, HMRC should publish the lessons learned from this mistake and how it intends to prevent such a mistake being repeated.

100 Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, Q 155 [Dave Hartnett]

101 Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, Q 45

HMRC's plans for improved governance procedures

82. As noted above, Lin Homer, the new Chief Executive of HMRC, announced on 27 February 2012 that she planned to introduce “a package of changes ... to provide greater assurance and transparency and improve public confidence in what we do”.¹⁰² These include:

- a new assurance role at HMRC Commissioner level with an explicit challenge role in decision-making on cases
- a systematic review programme of the processes used in settled cases
- an enhanced role for our Audit and Risk Committee on tax settlements
- an annual published report on our tax settlement work
- a new published code of governance for tax dispute resolution.¹⁰³

83. We note both the principle and the substance of these changes: HMRC has shown it is willing to take action to improve its processes and we broadly support the changes announced, although their effectiveness can only be judged once they have been implemented and tested. We will return to these processes in future hearings with HMRC, but at present we have comments on two aspects of the changes.

84. First, we support the suggestion that the assurance Commissioner be accountable for a process of reviewing settled cases and ensuring follow-up actions are taken, but it is currently unclear by what mechanism the Commissioner will be accountable.¹⁰⁴ **Therefore we recommend that the assurance Commissioner appear before this Committee as a matter of course after the publication of the proposed annual report on the outcome of HMRC's dispute work.**

85. We also urge HMRC, when producing its code of governance for tax dispute resolution, to keep in mind that the public must be reassured that large businesses will receive the same treatment as any other taxpayer. In her letter, Ms Homer states that the code “will demonstrate that our treatment of taxpayers is even-handed”.¹⁰⁵ **We recommend that HMRC's proposed code of governance for tax dispute resolution be explicit that the same rules apply to settlement of tax disputes with its large corporate customers as apply to settlements with all other taxpayers.**

102 Ev 53

103 *Ibid.*

104 *Ibid.*

105 *Ibid.*

External Accountability of HMRC

86. Both we and the PAC have questioned HMRC officials about specific settlements that were reported in the media.¹⁰⁶ HMRC officials believe that they are legally prohibited from discussing these because they must respect taxpayer confidentiality.¹⁰⁷ Mr Hartnett told us that:

I cannot talk at all about a specific taxpayer... I have been to see our most senior lawyers to see whether there was anything I could say about the newspaper reports on [specific tax settlements], and they have said no.¹⁰⁸

The NAO's review of large tax cases reviewed the processes by which HMRC reached settlements but not the settlements themselves. Giving evidence to our previous inquiry into HMRC, the Exchequer Secretary told us that "I must stress that I am not informed of any details that are not in the public domain".¹⁰⁹

87. HMRC is a non-Ministerial department, meaning that it is not led by a Minister. There are very strong arguments for not involving politicians in the work of HMRC. The Exchequer Secretary argued that:

if politicians from whatever party find themselves becoming intimately involved in decisions as to whether a taxpayer has paid the right amount of tax—a highly technical matter where, let us be honest, most of us, as Members of Parliament, are not hugely well qualified to make that judgement—the risk may exist in future that these decisions become increasingly politicised and popular taxpayers get a better deal than unpopular taxpayers.¹¹⁰

88. However, HMRC's current relationships with the Treasury and Parliament mean that allegations can be made about the propriety of HMRC's actions which its officials are powerless to refute. This has a detrimental effect on public confidence in HMRC which, as noted above, could impede HMRC in its work. If allegations were incorrect, then this would also be likely to affect morale at HMRC.

89. Another consequence of the relationship between HMRC and HM Treasury is that Ministers are unable to bring about changes in HMRC even where they are clearly needed. In our inquiry into the Administration and Effectiveness of HMRC we questioned the Exchequer Secretary about the unacceptable performance of HMRC call centres. He told us he was "not in a position to direct HMRC precisely as to where they spend their money",¹¹¹ and went on to say:

¹⁰⁶ For example, Q 231–242; Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, Q 160–163.

¹⁰⁷ Committee of Public Accounts, *HM Revenue and Customs 2010–11 Accounts: tax disputes*, Ev 65 [Dave Hartnett]

¹⁰⁸ Q 232

¹⁰⁹ Treasury Committee, *Administration and effectiveness of HM Revenue and Customs*, Q 420

¹¹⁰ *Ibid.*, Q 431

¹¹¹ *Ibid.*, Q 387

The governance as such is not one where I, as a Minister, can in any way micro-manage how HMRC do it, but I would expect and hope that my concerns are reflected.¹¹²

90. It is regrettable that the HMRC's relationship with HM Treasury can give rise to a situation where a Minister can recognise publicly that a problem exists in a department which is within his remit, but tell Parliament that he is powerless to take action to bring about improvement.

91. There is clearly tension between full accountability of HMRC for its work and the requirement for HMRC to be independent of politicians. These questions require separate and detailed examination and should be revisited. In particular, the following issues require attention:

- the legal status of HMRC;
- the power of Ministers to implement change in HMRC where it is needed;
- the need to balance these issues with the need to maintain taxpayer confidentiality, and
- the need to examine HMRC's corporate governance.

We will return to these issues. At present our concern is that HMRC ensures that rigorous internal governance procedures are in place and that they are adhered to.

112 Treasury Committee, Administration and effectiveness of HM Revenue and Customs, HC 731

Conclusions and recommendations

The Tax Gap

1. The tax gap can be a useful concept for assessing trends in the amount of possible unpaid tax. We are not, however, convinced that the process of calculating, publishing and publicising an aggregate figure for the tax gap is a sensible use of HMRC's limited resources. The aggregate tax gap figure is misleading and risks focusing HMRC on the wrong task as it only provides an order of magnitude. (Paragraph 16)
2. We recognise that it is useful for HMRC's employees to have some idea of the difference between what HMRC should be collecting and what is collected, particularly in the case of criminal activity. However, in other areas it would be more useful for it to identify ambiguities in tax law rather than employ resources in calculating how much tax would be collected if everyone shared its interpretation of the law. Separate reports on how much tax was lost through criminal activity and areas where HMRC had encountered different interpretations of tax law would be a better use of resources. (Paragraph 17)
3. We would welcome further submissions from HMRC and tax experts both on how the tax gap calculation can be improved, and on whether it serves any useful purpose in HMRC's work. (Paragraph 18)

HMRC's Spending Review Settlement

4. HM Treasury has not adequately explained the criteria it used to make decisions about the re-allocation of funds to tax compliance. This makes it very difficult to scrutinise these decisions. HM Treasury should explain more fully how it decided to accept or reject HMRC's requests for additional funds and how it decided on the allocation of funds between functions. (Paragraph 24)

Compliance Activity

5. By far the most efficient way of closing the tax gap is encouraging voluntary compliance. A process whereby taxpayers and HMRC work together to ensure that taxpayers voluntarily pay the correct amount of tax, sometimes following negotiation and agreement, is far less costly than the alternative. (Paragraph 28)
6. Simplifying the tax system should be a legislative priority for the Government in this Parliament. The Government should commit itself to setting a fixed, published timetable for deciding whether to accept recommendations from the OTS, and for producing draft legislation to implement the proposals it accepts. (Paragraph 30)
7. It is vital that those who wish to be compliant with tax law should be able to be so. HMRC has a responsibility to educate the public about their tax obligations and to ensure that information about tax is readily available in a variety of media. We recommend that HMRC commission a study to identify the biggest gaps in the

public's understanding of their tax obligations and develop a strategy for addressing these. (Paragraph 32)

8. HMRC should consider establishing a general disclosure facility to run alongside its targeted campaigns. The details of the facility should be easy for all taxpayers to access and understand. (Paragraph 34)
9. We support HMRC's plan to invest more in prosecuting those evading tax, and urge it to consider how to publicise these to maximise their deterrent effect. (Paragraph 39)
10. It is important that those outside the tax system who wish to become compliant are not deterred from doing so by an unfounded fear that they may be prosecuted. HMRC should publish on its websites case studies of taxpayers who have not been compliant in the past but who have approached HMRC to settle the tax they owe. These should make clear that in the vast majority of cases the taxpayer's disclosure did not result in prosecution and should be understandable to the lay reader. (Paragraph 41)
11. We endorse HMRC's targeted approach to compliance. We welcome attempts to identify those outside the tax system but believe HMRC could do more to ensure it focuses upon them with as much rigour as it focuses on those already within it. We recommend that HMRC reports separately in its annual report on its work on tackling those entirely outside the tax system. (Paragraph 49)
12. For offshore campaigns to be successful, those who do not take up the opportunity to disclose unpaid tax to HMRC should be prosecuted. These prosecutions should be well-publicised both to demonstrate to those who made the decision to come forward that they are not in a less favourable position than those who did not, and to encourage others to make disclosures where they have not already done so. (Paragraph 56)
13. The principle of the UK-Swiss agreement may turn out to be a step forward in reducing opportunities for individuals to avoid tax by concealing assets offshore. However, we are concerned that the rate of tax which will be withheld from anonymous Swiss bank accounts will be lower than the highest rate of income tax payable in the UK, and that the long delay before withholding begins will allow those with Swiss bank accounts to remove their assets before withholding is applied. We recommend that HMRC, when publicising the UK-Swiss tax agreement, explains clearly the reasons for the lower rates of tax being withheld from Swiss bank accounts. If there are to be similar agreements in future with other jurisdictions, the Government should seek agreement for the same effective tax rates that apply to UK taxpayers. (Paragraph 57)
14. Successfully implemented, automation can enable HMRC to process a far higher volume of cases than it would otherwise. However, we have already seen instances of automation either damaging HMRC's relationship with taxpayers or consuming resources with a high volume of appeals. Automated processes should be rigorously tested and piloted and reviewed externally before implementation. HMRC must also

provide ready access to members of staff who can help if the automated process creates errors. (Paragraph 61)

Large Business Service and Large Tax Cases

15. HMRC should work closely with large businesses to ensure that they fulfil their tax obligations given the sums involved in a single large business's tax affairs. However, the processes by which large tax cases are settled must be in a relationship based on openness and transparency and it is vital that appropriate checks be in place so that other taxpayers can be sure that all taxpayers are receiving the same treatment from HMRC. We consider below how this could be achieved and the extent to which the most recent proposals from HMRC achieve this. (Paragraph 71)
16. Where settlements made between HMRC and its customers are particularly complex, this should not be an occasion to alter governance procedures, but a time when existing procedures should be applied most rigorously. When the new code of governance for tax dispute resolution is published, we expect it to encompass all eventualities and be followed meticulously. We recommend that HMRC publish its code of governance in draft for consultation before a final version is published to ensure that it is suitable for all eventualities. (Paragraph 75)
17. Where settlements of tax disputes are sufficiently large or controversial that they are escalated to Commissioners for review, this review must be independent and expert. We therefore welcome HMRC's recent announcement that a new Commissioner with responsibility for assurance will be appointed to review such cases and that the person appointed will be an experienced tax professional. We recommend that HMRC's annual report on its tax settlement work include confirmation that all cases which were escalated to Commissioner level were subject to review by a Commissioner with technical tax knowledge. (Paragraph 78)
18. It would be unreasonable to expect that HMRC will never make mistakes. However, it is important that HMRC learns from those mistakes and that the public's confidence in HMRC is not unduly eroded when mistakes are made. In the case of the mistake that was made in 2010 relating to a settlement with a large corporate customer, HMRC should publish the lessons learned from this mistake and how it intends to prevent such a mistake being repeated. (Paragraph 81)
19. we recommend that the assurance Commissioner appear before this Committee as a matter of course after the publication of the proposed annual report on the outcome of HMRC's dispute work. (Paragraph 84)
20. We recommend that HMRC's proposed code of governance for tax dispute resolution be explicit that the same rules apply to settlement of tax disputes with its large corporate customers as apply to settlements with all other taxpayers. (Paragraph 85)
21. We recommend that HMRC's proposed code of governance for tax dispute resolution be explicit that the same rules apply to settlement of tax disputes with its large corporate customers as apply to settlements with all other taxpayers. (Paragraph 85)

Formal Minutes of the Treasury Sub-Committee

Tuesday 6 March 2012

Members present:

Mr George Mudie, in the Chair

Michael Fallon
Andrea Leadsom
Mr Andrew Love

Rt Hon Pat McFadden
John Thurso
Andrew Tyrie

Draft Report (*Closing the tax gap: HMRC's record at ensuring tax compliance*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 91 read and agreed to.

Resolved, That the Report be the Second Report of the Sub-Committee to the Committee.

Ordered, That the Chair make the Report to the Committee.

[Adjourned till Tuesday 13 March 2012 at 9.45 am

Formal Minutes of the Treasury Committee

Tuesday 6 March 2012

Members present:

Mr Andrew Tyrie, in the Chair

Michael Fallon
Andrea Leadsom
Mr Andrew Love

Rt Hon Pat McFadden
Mr George Mudie
John Thurso

Draft Report from the Sub-Committee (*Closing the tax gap: HMRC's record at ensuring tax compliance*), brought up and read.

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

Paragraphs 1 to 91 read and agreed to.

Resolved, That the Report be the Twenty-ninth Report of the Committee to the House.

Ordered, That the Chair 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 7 March 2012 at 2 pm]

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Professor Judith Freedman, University of Oxford, and **David Sproul**, Chief Executive Officer, Deloitte UK Ev 13

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John Whiting, Tax Policy Director, Chartered Institute of Taxation, **David Heaton**, Chairman, Tax Faculty, Chartered Institute of Accountants in England and Wales, **Chas Roy-Chowdhury**, Head of Taxation, Association of Chartered Certified Accountants, and **Frances Corrie**, TaxAid Ev 21

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Dave Hartnett CB, Permanent Secretary, Tax, HMRC, **Mike Eland CB**, Director General, Enforcement and Compliance, HMRC, and **Melanie Dawes**, Director General, Business Tax, HMRC Ev 34

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Oral evidence

Taken before the Treasury Sub-Committee Committee on Wednesday 29 June 2011

Members present:

Mr George Mudie (Chair)

Mark Garnier
Jesse Norman

John Thurso
Mr Andrew Tyrie

Examination of Witnesses

Witnesses: **Richard Murphy**, Taxresearch LLP, and **Graham Black**, President, Association of Revenue and Customs, gave evidence.

Chair: I am sorry we are slightly light on members. If you push any sort of vote, Richard, I think you have a good chance of winning it, we are so short of members. But it is a strange time of year. Thank you for coming. Mr Tyrie is going to open up.

Q1 Mr Tyrie: I would like to take a look at the tax gap. Mr Murphy, you told us that a tax gap of £120 billion is proportionately where Mexico is, or you used a phrase like that. I don't think we are Mexico. How do you respond to this?

Richard Murphy: I don't think that does imply that we are Mexico. Remember, in that £120 billion there is £25 billion of late-paid tax and I always do make that distinction. That is the outstanding tax at any point in time. But the Revenue include it in their theoretical numbers, so I do as well. In terms of tax avoided and tax evaded the figure is £95 billion, and of that £70 billion is evasion and that is not at the level of Mexico. That is about the level of a lot of OECD countries.

If we were at the level that the Revenue put us at, which is roughly £35 billion for evasion, we would be the cleanest country in the world, possibly, bar Switzerland. Well, Switzerland does not evade its own tax, it just helps everybody else do it. But we certainly aren't the cleanest country in the world, bar Switzerland—I am quite sure that is not true.

The Revenue's figures suggest an evasion rate of around 7%. My suggestion is it is around 13%. That would tie in with the World Bank figures, for example, published in the last year. I think that is a reasonable estimate. It means that roughly £1 in £8 of the UK's economy is in the black economy—I am afraid I suspect that is right. Of course, part of that is criminal, part of it is simply tax-evasion driven, but I think that is consistent with a European average of similar countries to ourselves.

Q2 Mr Tyrie: I have in front of me a pie chart derived from HMRC's 2009 estimates of this. I am sure you know the one. If one starts to look at this carefully a large part of the tax gap seems to melt away, and I am just beginning to wonder whether this is a useful tool for working out how to estimate HMRC's performance and behaviour.

Richard Murphy: I am afraid I don't think the Revenue's approach to this is a very useful tool.

Remember, they have two completely different methodologies in calculating the tax gap. One is with regard to indirect taxes, which they have done for longer, and one is with regard to direct taxes, which they have only done virtually in response to the work that I did for the TUC in 2008.

The indirect taxes are done in an economically logical way. They look at the total economy, they estimate the amount of VAT and other taxes that they should collect as a result, compare that total number with the amount of tax that they actually collect and say, "That is the difference". That number, by the way, is around 13%, so that number seems to be completely logical.

When they come to estimating the direct tax gap, they work on what they call a bottom-up methodology, which is to work from the tax returns that they get, find out the error rate in it and extrapolate it. The difficulty is that we are talking about tax evasion in large part here. Remember, tax evasion is much more significant than tax avoidance, and then I would have a different understanding of tax avoidance as well. But with regard to tax evasion the bit that they miss out and which is very obvious from their figure, is the fact that large numbers of people who are tax evading will never be in the system and will never send in a tax return. Therefore that is just missed from their data. So, they end up with a figure for moonlighting, for example, which is around £1 billion. Well, that is just crazily small. To believe that there is only £1 billion lost because of cash-in-hand, moonlighting labour in the UK is to be living, frankly, a fantasy. I just don't think that is true.

So, the methodology that is being used in that approach is wrong. I believe the Revenue should be using a top-down approach to estimate the loss of revenue on direct taxes just as they are with regard to indirect taxes and I have never seen a justification as to why they have chosen one method for direct and another for indirect. The two are fundamentally different, and yet they then add them together and say that is the combined total.

Q3 Mr Tyrie: Looking at it from a managerial perspective in HMRC it must follow from what you say that using the tax gap as a raw measure of success or failure is also going to distort the way you run your operation.

Richard Murphy: I think it has a significant impact. Looking at the work that I did that was published in March this year based upon answers from Parliamentary Questions, which Caroline Lucas and I worked on, I looked at the tax gap with regard to small companies and the fact that 500,000 companies are struck off a year in the UK. The Revenue don't raise objections to almost any of those cases, because they don't have a focus upon that form of evasion, and yet I am quite sure there is a vast amount of evasion there. One in three corporate tax returns that are sent out by the Revenue a year are not returned. That is 600,000 of the 1.8 million tax returns they sent out for 2009–2010 were not returned to them and they basically have done nothing about it. The point about that is that that is because the management focus is upon the returns they get, which is the basis of the estimates that they are publishing. They are not putting an estimate upon the returns that they don't get.

Q4 Mr Tyrie: Mr Black, is there anything you want to add to the significant exchange I think we have had on—

Graham Black: I think probably HMRC are perfectly capable of responding on the specifics of how they calculate the tax gap in terms of the specific issues that Richard mentioned. The truth is we know that measuring the tax gap is very difficult. A lot of countries find it too difficult and don't try at all. We have an estimate. We have a range of estimates. The HMRC one is the one that we tend to use when looking at things. It may be slightly conservative. The truth is once you get to a tax gap of £40 billion, £50 billion, £60 billion, I think our focus is on what we do about it rather than measuring it. Does it make any difference whether it is £60 billion or £70 billion? There is clearly money out there that should be coming into the Exchequer and it's not.

While that is difficult to measure, the impact of what we do we can measure. We can identify what additional funds we bring into the Exchequer from our activity and that is a reasonable measure of what HMRC is doing. So it is about how many angels can you get on the head of a pin to some extent. We know it is a very big figure, we know the money is out there. I suppose I am more concerned about what we are doing to bring it in.

Q5 Mark Garnier: HMRC is claiming that, if it achieves its target to raise an extra £7 billion a year through the compliance, the intervention yield by 2015 will be nearly three times that amount. We will start with you, Mr Murphy. Do you think that is achievable?

Richard Murphy: I believe the Revenue could achieve a lot more than that. I think that is a too modest target, but that is because I believe that the target that they are aiming at is bigger than the Revenue admit.

I think that the resources being allocated to achieving that result are also too modest. I think that if only the Revenue were willing to invest more heavily, then a significantly greater sum could be achieved. For example, I have identified some ways in which that

could be done. This work I have done on small businesses was deliberately undertaken to see if there was a market there that could be addressed when there was clearly money to be captured, which at the moment isn't being thought about.

Q6 Mark Garnier: Mr Black, what do you think? You have obviously argued that there is a cut in funding to HMRC and that that is the wrong approach. Do you still stand by that and agree that if you were investing a lot more into the resources you will narrow the tax gap quicker?

Graham Black: I think you can certainly make more of an inroad into the tax gap. The £7 billion is a stretching target. We know roughly where it is aimed at. I don't think we have a huge amount of detail as to exactly how it has been calculated. We know the areas that the £7 billion comes from, but I am not too sure for example how much of that is deterrent effect rather than cash-to-bank that we traditionally measure. Clearly, it is a very stretching target, particularly when you are aiming at the mass market, often small/medium-sized businesses. You have to do an awful lot of work on an awful lot of businesses to bring in £7 billion. I think it is achievable but it is a stretch and I think it will be a difficult target to achieve, bearing in mind the other pressures HMRC is under. However, I think there are other areas—the reinvestment that is bringing in that £7 billion—it is not hitting. There are significant areas of the tax gap that are likely to get worse while improving in others. So I think there is a bit of an opportunity missed, I suppose is how we see it.

Q7 Mark Garnier: Do you think they are aiming at the right target with SMEs? I appreciate that something like 50% of this problem is derived from SMEs but as you have just said, Mr Murphy, something like 30% of corporate tax returns are not completed and sent back and they do not seem to be bothering, and you have so many SMEs, do you think it is too difficult to be able to tackle the tax gap through the SMEs?

Richard Murphy: No, I don't, because I think that this issue has to be thought about a lot more systemically and in relation to specific legislation to ensure that the right data is available and access to the data is available to HMRC. For example, HMRC is not getting information on which companies in the UK have bank accounts or not. If it knew which companies had a bank account automatically, it would know which companies were likely to have a tax liability. If a company does not have a bank account it is highly likely to be dormant and the Revenue can safely ignore it. Therefore, on risk assessment terms alone, resources can be targeted at the right companies. If in those 500,000 companies that were struck off in 2009/2010 there were a high proportion who had bank accounts and never filed accounts, or who even had bank accounts at the time of the striking off, and I suspect we will find there were quite a lot of those—that is my suspicion, I can't prove it but neither can the Revenue—then we would be in a position to be able to target resources on the right companies.

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If then there were a right of the Revenue to demand information and when it wasn't supplied there was the right to go to the bank and say, "Please tell us who, under anti-money laundering regulation, you have recorded as being the beneficial owners of this company and the directors of this company, so we may make direct contact with them in a personal capacity to demand the information" we would be transforming the way in which information could be handled and managed by the Revenue to target resources against the SME community, some of whom of course are completely honest, upright and playing completely fairly, as we would wish, and those people who are being honest and upright are being undermined by this community who I am sure are evading through the weakness in our current administration system. So, it is about a combination of intelligent legislation to ensure the Revenue have the right tools and the right resources within the Revenue to follow that up. It is not one thing, it is a systemic approach.

Q8 Mark Garnier: You make a very good point, which is that there are a great many people out there who are very fine, upstanding either businesses or members of the community. Do you think that this kind of general approach from HMRC in order to try and tackle the tax gap may start alienating certain members of the community that otherwise should not be alienated?

Graham Black: Maybe I can answer that. I hope not. I think when looking at what the Department is aiming to do, some of it is a recognition that it has cut too far and too deeply in some of these areas in dealing with evasion. Evasion is a big part of the tax gap and there is a big behavioural impact if we don't tackle it. If we don't tackle evasion then everyone will see that and it will increase as a problem, so it certainly was right to be putting more people on to it. I think the Department has improved the way in which it can identify evasion. I think Richard is no doubt right that there are further tools that we can develop, but a lot of what the Department has done over the last few years is improving its use of IT to identify where the risks are. Therefore, you would like to think that its ability to identify the people that we need to look at will have improved. I think that has certainly proved the case. What we have to avoid is sending out blanket investigation to people who are clearly innocent and worrying them. That is clearly not what the Department wants to do. That could have the impact of alienating people, and I certainly think that the aim of the campaigns and the different approaches that HMRC is trying is designed to avoid that and make sure that we focus on the people where we have a good suspicion that there has been some wrong-doing.

Q9 Mark Garnier: You mentioned the relationship between evasion and avoidance. Mr Murphy, this is probably a question for you. The analysis suggests that the far greater part of the tax gap is accounted for by evasion and criminal activity, and yet there seems to be an awful lot of focus on tax avoidance in order to try and deal with the tax gap. Do you think this is a misallocation of resources?

Richard Murphy: It depends on for what purpose you are asking about that allocation of resources. We can't remove this from a political context. Tax is inherently political. In the sense that we are trying to change sentiment about tax, so that people pay their tax, then it is appropriate to bring the issue to the public's attention by using high-profile cases of avoidance where people will recognise the issue. In the sense that the greater sum of money is evasion, and without a doubt that is true, the on-the-ground work is quite probably going to focus more heavily upon evasion than it is upon avoidance. I don't see that there is a dichotomy between the two. Changing the environment, the culture of tax, so that people believe that compliance is the right objective and that they should be trying to comply, is an important part of the messaging of this whole issue. That does very much depend upon grabbing headlines, and avoidance does do that whereas evasion doesn't. The Revenue issue loads of press releases saying, "A fish and chip shop owner from so-and-so has been prosecuted". It doesn't get very much press outside of the local town where it happens. But if you have a big-name company it is very different.

Q10 Mark Garnier: You talk about the fact that we need to encourage people to be compliant with the tax rules. Do you think the tax rules are just fundamentally too complex for people easily to be compliant with them?

Richard Murphy: No, is my simple answer. Of course they are complex, but then so is life complex and modern business is extremely complex. As an accountant I have sat down and been responsible for preparing thousands of pages of documentation for business deals. I have seen the documentation put out by my own Institute of Chartered Accountants to regulate my behaviour as a Chartered Accountant. It is long, it is complex and it seems that the private sector is just as capable of producing lots and lots of complexity and regulation as the State is and it has been growing at the same proportionate amount, as far as I can see. My Members' Handbook in 1980 was that thick, and as people say, "Tolley's has grown", well, so has the Institute of Chartered Accountants Members' Handbook and so have the Accounting Rules. This is the nature of modern life, it is complex. Do I think it is beyond comprehension? No, as a practising accountant—and I have been a practising accountant, I don't do as much now as I used to—I never found I got to the point where it was completely incomprehensible or I couldn't if necessary go and ask somebody—if necessary, counsel—to interpret it, but there is a cost.

Q11 Mark Garnier: For the average SME owner who is trying to make widgets and not necessarily comply with this, it means they are going to have to spend quite a lot of money on getting extremely well-qualified people like you to come and do their work for them.

Richard Murphy: I think that in the modern environment of professional service, a good SME owner who is interested in making sure that they comply and focus upon being compliant, leaving them

to get on with the important task of making money, which is much more important in terms of their net wellbeing, they can afford to enter into a deal with a good chartered accountant, which is probably on a fixed price that includes unlimited phone calls for advice when they run across a problem. Those are available. A business that is really intent on being compliant, because that lets them get on with the business of making money, can afford to do that. I don't see that as a problem and that is my belief, having been in practice and serving 800 clients until a little while ago.

Graham Black: Can I just touch on one important aspect of Mr Garnier's question? I think, in terms of the avoidance and evasion, we have to tackle both. We have to tackle both for the reason that there is a large amount of money at stake. The tax gap in avoidance is huge, as is the one in evasion. So the money is out there, the country needs the money so we have to tackle both. We are probably seriously tackling the evasion side with the £900 million reinvestment but we are not tackling the avoidance as much as we could do, and there is a significant capacity for us to get more there. On whether the tax system is more complex—and we certainly didn't want Richard and I to sit here and disagree with each other—he said “no”, I say “yes”. I think it is increasingly difficult with the wealth of rules around employment taxes, around VAT, around Income Tax and Corporation Tax. It is very difficult. Not only is it difficult for businesses who are concentrating on running their businesses, I think it is also very difficult for local accountants who have to help the businesses. I think one of the areas we have not really done what we need to in HMRC is that we need to help those local accountants to be able to get their taxpayers' affairs right.

Q12 Mark Garnier: Sorry, I am going on a bit. You talk about the people who have to pay the tax. What about the people who collect it? What about your members? Do they find it quite complex, trying to apply the rules?

Graham Black: They do find it complex, and quite often of course our members will deal with one particular tax and a business will have to deal with all the taxes, so it is very difficult. If you look at the amount of statutes, Richard is right, it is a complex world. There are a lot of financial transactions now that weren't about 20 years ago. On the other hand, I have to say, at the end of the day, HMRC's job is to implement and carry through the legislation that Parliament passes, so it is not necessarily the case that HMRC is doing these things. I am not willing to pass things back to the other side of the table, but at the end of the day the laws are passed by Parliament and HMRC is there to ensure that those laws are conformed with.

Richard Murphy: If I might, can I come back on the point that Graham has made? I think it is very important that HMRC has sufficient capacity to invest in its staff to make sure that they are able to answer the questions. I have just waited six months to get a reply to a technical question from the Revenue. It was a reasonable request that I made, I think, and it took

a long time to get an answer because they had to go all over the place until they could find somebody who could answer a reasonable question about a person's affairs. That was too long. It was because there weren't sufficient trained people in that particular area to deal with the question. I am worried that that is the result of too many staff leaving the Revenue, with too much experience that is now going to waste in this sense. That does worry me, and in that area I think there is a deficiency where the Revenue can't support local accountants to ensure that their clients get the answers they need.

Q13 Chair: Can I ask Graham to set some parameters? When I first heard the Budget, maybe even the Spending Review, when we got the figure of £900 million is being put back, I assumed it was £900 million a year and I thought that was considerable. All Governments do this; they write it in a form that they can read anything they like in it. It is £917 million over the four-year period?

Graham Black: It is.

Q14 Chair: Has it been broken down yet into years?

Graham Black: I think it has. I don't have the figures in front of me. I am sure HMRC can calculate those.

Q15 Chair: Can you get that for us?

Graham Black: Yes, I will request it, and I certainly think we now have a clearer picture of what that means in terms of staffing over the four years—

Chair: We are coming to that. That will be good.

Graham Black:—so I think the plans are there. That is in the context of I think £917 million reinvested and the overall cuts over the period are about £3 billion.

Q16 Chair: That is your good trade union hat getting on that. Staying on the amount of money going in, on the other side, it says £7 billion a year by 2014/2015. What the hell does that mean? What does it mean for 2011/2012, 2012/2013, 2013/2014, and what does it mean in 2014/2015? £7 billion: is that an accumulation or is that the platform we will build on?

Graham Black: I imagine HMRC has a more detailed breakdown of the figures, but my understanding is that it thinks, by the end of the period, there will be an additional £7 billion in that year, and it will ramp up towards that over the four-year period. So, I think the overall total—again, I may be wrong—may be about £16 billion or so over the income period.

Q17 Chair: Graham, your members are the top brass, with notable exceptions, in HMRC, so you must know what the target is for this year because we have lost a quarter already. So what is the target for this year?

Graham Black: I don't have that in front of me. Certainly I have not seen anything to suggest that they are falling behind any of the targets at the moment, but I haven't seen—

Q18 Chair: How would you know you were falling behind the target if you don't know what the target is?

Graham Black: I think if they were behind the target they would probably have been letting staff know that

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we had to do more in order to achieve it, but I really don't have that in front of me here.

Q19 Chair: Let me go back to last year. I keep seeing these figures about how successful you have been in terms of bringing brass in. How do you know?

Graham Black: We know because if we take a case of evasion we can measure the amount of tax that comes in at the end of the inquiry. If we do an inquiry into a technical issue, or an avoidance scheme, we have a clear measure of how much additional tax we bring in. So I think those are pretty hard and fast figures. They are not estimates. They are not plucked out of the air. Those are quite hard figures. I think it gets more difficult when you start looking at things like the deterrence impact of what we do. If we have a look at evasion, how many people are put off evading because they see that we are actually serious? That is always going to be a very difficult figure.

Q20 Chair: You are the trade union official and you don't know how much money has been allocated for additional staff. Do you know how many additional staff have been appointed? I don't mean fresh adverts, and so on, but moved across.

Graham Black: I think they are trying to balance moving staff out of areas like Pay As You Earn, where there has been a lot of pressure on the Department, with the need to move them into enforcement and compliance areas where they will be getting in the additional tax. I don't think anyone envisaged that happening on day one, but some moves have already started happening. I think they have a plan in place over the rest of this year, and over the years ahead, of moving people—once they have stabilised Pay As You Earn—out of that area and into the areas of evasion that they are investigating.

Q21 Chair: You may have answered this in the debate that has been going on, but we have their statement about how they expect to raise this £7 billion. There is £4 billion from SMEs. There is £1 billion clamping down on large businesses; £1 billion taking on organised crime—I don't know if that is the same as the one before, but never mind—and there is £1 billion improved debt collections. Are those the areas? That is the totality of it?

Graham Black: That is the totality of the reinvestment package and where we are intending to be bringing in the additional funds, on top of the baseline of what we do at the moment. So I think that is the additional money that is going to come in. Those are the areas where they are intending to use the reinvestment, so you would anticipate there will be more money coming in from our normal day-to-day activities.

Q22 Chair: I presume they have chosen this because largely this is where it will bring in, well, £7 billion, but it will bring in a lot of money.

Graham Black: It clearly will bring in a lot of money—

Q23 Chair: But do both of you agree with the priority areas as set out? They have this additional

money, we think. They are putting staff on, we think, and they are going to try and raise this money. How much this year we don't know. But would you have chosen these four areas? I am not asking you to prioritise these four, but what is missing, if anything?

Graham Black: There are a couple of very significant areas missing that I can allude to. I think the amount involved in putting money into avoidance is fairly limited and the reinvestment in large business is largely around training, it is not about putting extra staff on. We are going to be cutting the staff that are going looking at large businesses, multinationals, international transactions. That is where the very largest amount of avoidance takes place. That is where we get the biggest bang for our bucks. We get the most return from our compliance activity when we are looking at large businesses, multinational transactions, and cross-border transactions. It seems to me very odd that when we are reinvesting to get more money in that is an area where we really are not putting more resources. We are actually reducing the resources over the next four years. So that would be the big gap.

But there are other areas, such as the hidden economy, where I think again we have missed a bit of an opportunity. The third area in the tax gap, 15% of the tax gap is what is referred to as legal. It is a complex tax world and we have disagreements about how things should be taxed. You need tax professionals to argue those cases. At the moment that resource is being squeezed out, so we do not have anyone who is looking at those difficult, technical areas and again a lot of money is going missing. So there are significant gaps in the programme, but I do agree that every area that they have identified does need activity and does need additional resource.

Q24 Chair: Yes. But as a country we need money badly, don't we?

Graham Black: Yes.

Q25 Chair: If you took the £1 billion from debt collection, which on evidence seems to be scaring old ladies and pensioners, and put it in some other areas would it raise more money?

Graham Black: Yes. We could easily. The truth is that I think we have demonstrated, time and time again, that there are plenty of areas where we get an even better return than the areas identified.

Q26 Chair: Right, Richard, you can answer—why then have they put these on the table?

Richard Murphy: Because they are easy.

Chair: Because they are—

Richard Murphy: Easy. Because when you are management tasked to do a job and apparently you have to come up with some numbers, of course you choose those that you are most likely to be able to fulfil. The SME sector is an obvious target. My concern is that there is only £1 billion there for illegal activity. My belief is that we will, as you suggested, have the honest business targeted or even the relatively honest business, but which is least within the system, is operating PAYE, is charging VAT and so on, but which is going to make some marginal errors. Yes, there will be companies which make

marginal errors, of course there will be, who are going to be targeted heavily to try and recover that money because they are there on somebody's desk and there isn't going to be the effort put in to try to find those who are simply not there. The glaringly obvious, that we have an enormous amount of activity going on in the UK with regard to counterfeit goods, and yet we are not seeing Revenue officers turning up at every car boot sale on a Sunday morning and taking pictures of the number plates of people who are selling cigarettes at these locations. Why aren't they? You know the sort of activity: some very basic, old style Customs and Excise policing style activity, which is a little bit heavy handed perhaps but which is appropriate for the sort of activity that they are targeting, is not being put forward as a major component in this package. I think some of that is necessary, and as I say I think some very sensible targeting of fraud, which I am quite sure is commonplace through limited companies, for example, in this country, is not in that package; the ones who are just not making the returns. So the emphasis is going to be upon trying to get a bit more out of those returns that go in, and again on the easier ones, because if you are transferring people, for example, PAYE compliance officers, to a recovery investigations office, they are different skill sets. The two do require quite different people to do them. I think Graham will probably agree. I suspect you will agree.

Graham Black: Not necessarily having different people but certainly people who will have to be retrained.

Richard Murphy: Retrained significantly to do a different style of work, to make sure that they understand accounting in a way that may not be required for PAYE, which is a regulation-based system, to ask the right sort of questions, to pursue the right sort of avenues of inquiry. I don't believe that is easy and I think that those things are not being pursued, and that is why I would quite candidly suggest that that number is not bold enough and it is the easy number to pick up.

Q27 Chair: Okay, just a last question before I hand you over to John Thurso. Graham, it does seem to me important, in terms of scrutinising their accountability to us, to determine what they did last year in terms of this business, and you said, "Oh they are bringing money in all the time" and so on. Do we have an agreed figure for last year because I presume last year will continue and anything that is above last year will be the first tranche of this and, as they have said we are going to put £7 billion on the table in four years, we need to know where the hell they are starting from, don't we? Do we?

Graham Black: Yes, we have figures. Again, the Department can send them to you I am sure. It is between £12 billion and £13 billion. I think that is the baseline figure. So the £7 billion will be on top of that, bringing it up to about £20 billion a year at the end of the period and that is what they are planning.

Q28 John Thurso: I wanted to ask about the High Risk Corporate Programme, but can I just follow on

from something that has already been raised, which is about people in compliance; having enough qualified people to do the job? Graham, in your note to us, you note compliance activity will remain under severe pressure and you have insufficient legal resources, increasing privatisation on larger cases and reductions in coverage of some customer segments. But what about actual officers or members of staff with the capability to undertake the kind of work that is required by compliance? Do you think that there are enough? Are we losing people through redundancy programmes who we ought to be keeping? Do we have to recruit?

Graham Black: We certainly don't have enough and we haven't been recruiting as many as we should. Losing people? Yes, we do lose people through retirement; I have to say not redundancy as yet. The Department has done very well in trying to avoid compulsory redundancies. The fact is that—

Q29 John Thurso: We all know a compulsory redundancy is only voluntary when you are told you have no option, and if you don't sign up by tomorrow your package is half the size it would be if it is voluntary.

Graham Black: Yes, and we have a fear that that is where we are going to be over the next four years because over the next four years we are going to lose people at senior grades. I think I said about 400; over 400 that we are going to be losing. That is a lot of people. These are our top notch professionals across HMRC. That is a lot of people to be losing out of key areas. So we are under pressure. You cannot conjure these people out of the air at the flick of a switch. It does take a lot of training. These are key professionals. They have skills that they can use for outside firms as well as for HMRC so there is a market out there for them as well.

Q30 John Thurso: My reason for asking you about this is my well known interest in a particular tax office that, because Retford isn't near, I won't name. I was originally told it was the cost of the property that was the problem. We then came up with a plan that suggested that the people there who were in compliance might be able to work remotely. Recently, as in about two or three weeks ago, the staff were told, "We don't need any more compliance people. Your jobs are not needed"—to more or less go ahead and be voluntarily redundant. This seems to me from all the evidence that I have seen in this Committee to be wholly counterintuitive. Am I right or wrong in thinking that? Anybody who wants to support me please—

Graham Black: I would say it is counterintuitive. I can understand long-term plans. The Department has been under pressure with finances, so to reduce the estate and have a smaller number of presences around the country makes sense. There are parts of the country where that means that we withdraw our presence entirely and have to have people travelling a long way to do any compliance activity, and you have a deterrence impact if you don't have a local office. So I think there are sound arguments both ways. You have to look at it on a case-by-case basis, and I don't

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think you can say every small town in the whole country would, but there are strong arguments for it.

Q31 John Thurso: No, but if you had 10 or 15 high class compliance officers who could work remotely in premises supplied by another agency, that should be quite a useful human resource to keep for say three or four years.

Graham Black: In the context of a very stretched Spending Review period where we have to get a lot of money in, where we have trained staff who are capable of doing the job, to start retraining other staff elsewhere, it would not be my first port of call if I was asked, yes.

John Thurso: That will do me.

Richard Murphy: If I could just add, your logic seems completely sound to the entire tax profession that I speak to. Whether they are accountants on the ground, whether they are tax specialists, everybody knows that we cannot get the response that we want, because the people that we would like to talk to are not there; are being relocated, and so on. There is a universal demand outside the Revenue for there to be more Revenue staff to be able to undertake the jobs to help people to get their tax affairs right. The only people who seem to think that it is logical to cut staff in the Revenue at the moment are the senior management of the Revenue. It is very hard for anybody else to understand what that logic is, especially when as a country we are desperately short of tax.

Graham Black: If we have two offices, perhaps an ex-Customs and an ex-Revenue office in the same town, everyone can see the logic of closing one of those buildings. To pluck an example out of the air, when you get somewhere like Wyke, for example—

John Thurso: Oh gosh, never thought of that.

Graham Black:—which covers quite a broad geographic area, I think there are some other issues that have to be taken into account there. I think all we need is a balanced view as to what the right thing is for the Department, bearing in mind the costs of actually getting an office like that.

Q32 John Thurso: Funnily enough—and I am digressing hugely—I completely accept the model that says that a tax office per town is not a workable option for the future, but it seems to me that where you have a human resource that is specialised in something, for example, like a film partnership, has that knowledge, and if there is any way of taking the fixed cost out of what they are doing by remote working, then it is daft to drop that and then find you don't have the people who can do it. That is my own thrust on the argument.

Graham Black: There is a balance between that and perhaps working together in larger teams, which I think the business would take. You have to get the balance right. There is no black and white answer on these things and every case should be looked at, but I think there are certainly strong arguments in some remoter parts in the country.

Q33 John Thurso: Graham, can I come back to you on a different matter, which is the High Risk Corporate Programme, which has its critics and its

supporters. What are the advantages and disadvantages, and on balance is it working?

Graham Black: On balance it is working and the advantages are that it gets through things quicker. These can be very complicated cases, and there has been in the past a number of open issues, very technical, very legal and they can drag on for many years. I think the High Risk Corporate Programme brings together a team, involving inspectors, accountants, lawyers, all of whom are concentrating on settling and getting the right answer on a particular taxpayer in a short period of time. Working with the taxpayer in that timetable but making sure that it is moved forward very quickly. So I have spoken to a lot of teams who do HRCP work. They are very committed. By far the majority of cases, they come out the other end of it thinking it has been a very effective way of working and it has brought in the right amount of money to the Exchequer. So overall, I am not saying it works in every case and that we don't have issues or problems around some of the edges but I think you have to get in the context of something that is probably working overall.

Q34 John Thurso: Two criticisms that have come in and they are at opposite ends. One is that tax inspectors don't like it because it is a board-to-board contact—it cuts them out—and at the other end, the public who say this is sweetheart deals being done to shift it off the books. Is the reality that it is halfway between the two and working, or is there some merit in either of those accusations?

Graham Black: I think when you are looking at a high risk corporate, you probably have a multinational that has been engaged in some fairly aggressive avoidance normally, and what you are doing here is you are dealing with the technical issues. There are technical people trying to make sure that we get the right answer on the tax issues, but there will be board-to-board contact because the idea is that not only do we get the right answer but we discourage the company from engaging in that sort of aggressive behaviour. So there has to be something more than simply the technical issues being answered, you want to change the behaviour. As to how much that has succeeded, I think the jury is out on whether we have changed the behaviour on any of these major corporates, but it is certainly working well at bringing money in and getting to the right conclusion quickly. So that is certainly the case.

The sweetheart deals; I can't talk about individual taxpayer cases. I haven't seen anything that is untoward in any case in the Department, but what I can say is that it is not only important that we do the right things but there has to be public confidence that we are doing it in the right way as well. I know the NAO is currently finalising a report about the way in which we settle large cases. I think there is something about clarity around the governance on big cases, to make sure that not only the taxpaying public but companies and people in HMRC all have complete confidence that that governance is being followed through. I think it is but at the moment there is not enough clarity around that, and we have to get—

Q35 John Thurso: That is the critical point. We have had exchanges earlier in this inquiry with David Gauke and, from memory, with Dave Hartnett, basically saying—I think, based around Vodafone, which was being publicised at that time—how do we know this is the right thing, and of course a Minister can't get into individuals. You can't have Ministers deciding what your tax is. But where you have a very high profile and, therefore, political case with the potential for a political dimension to it, how do we assure ourselves that the right decision has been made? Have you any suggestion as to how the governance could be on that, which does not involve politicians too much but does ensure that we can be reassured?

Graham Black: We are almost there. I think we have improved the governance in these larger cases significantly. I think the difficulties come when there are very large cases and we can start getting board members involved in the cases, perhaps at an earlier stage. I think it is absolutely vital if we have a really major settlement that, effectively, it should end up with the Commissioners looking at whether we should litigate or settle. But that should be a final decision. If we manage to just leave it to the professionals on the ground to deal with the technical issues and eventually put that forward to people at the highest level through a proper governance system, I think there is no lack of clarity there. There is no possibility of people thinking that any influence has been brought to bear. I don't think influence has been brought to bear in any of these cases, but at least then people would be absolutely sure that the first time it was being considered by people at that level was when they see all the facts and it was a decision as to whether we should litigate or not. I think it is a question of getting that last bit of the governance in place and we can satisfy taxpayers and, I think, members of HMRC that everything is as we want it.

John Thurso: Anything to add to that, Richard?

Richard Murphy: I am not convinced that there has not been political influence brought to bear, or that there was not at least some willingness to look at the political consequences of some decisions, and Vodafone is a perfect example. The chance that that was settled a week before George Osborne was in India promoting Vodafone seems to me to be odd. The timings were unusual. I can't prove anything from them. Circumstantially, they were strange.

Q36 John Thurso: That is a quite a chunky little grenade to chuck out that George Osborne went out—

Richard Murphy: It was an extraordinary circumstance that, one week before the Chancellor was in India talking about Vodafone and promoting their activities in that country, their tax affairs were settled in the UK. There may be absolutely no coincidence whatsoever, but you can see the possibility for misinterpretation as a result. Was that well managed from a public relations point of view? Clearly not, because it is possible to come to that conclusion from that chain of events; that is the point I am making. Therefore, in that circumstance, it is not clear that there was a process that went on that was as transparent as it could have been to satisfy the

public that the right amount of tax was being paid particularly when, which is undoubtedly true, Vodafone had budgeted for a bigger settlement. Whether the settlement was for the right sum or not, I don't know, nor does any commentator who has commented on the subject because none of us have been privy to the information. All we know is that the company provided for a bigger sum and that is surprising, but those coincidences are strange.

Q37 John Thurso: Most PLCs, in providing for a contingent liability for tax, will over provide because the one thing you never want to do is go back a second year running with your results and say, "Look, you know that X-billion we provided for, frightfully sorry O shareholders but it is double that". You want to do it the other way round.

Richard Murphy: Looking at the PLC accounts, on average there are adjustments of previously declared liabilities downwards. Yes, in 80% of cases the adjustment is downwards, not all, but in 80% of cases the adjustment is downwards, and they are required to disclose their adjustments to prior year liabilities. That does mean then that there does need to be a better procedure for ensuring that the management of these cases is transparent and there can be confidence in the board of the Revenue in doing so. I think one of the weaknesses in the system, at the present time, is that too much attention is being focused upon one particular member of the board. I am not questioning Dave Hartnett's honesty in any way at all, but there has been too much emphasis given to one particular member, and that is partly because he is very unusual in being somebody who has worked in the Revenue through his career.

There is, in my opinion, a lack of expertise of tax trained people on the board of HMRC. That does mean that there is potentially an over-dependence on a particular expertise on its board, which may be inappropriate. I think there should be more representation of properly trained people, plus a clearer role for the non-executive directors, most of whom are very anonymous and whose appointment process is not clear and transparent, as far as I can see, to make sure that they are saying, "We have been involved in reviewing these cases". They don't have to disclose any detail. All they have to make clear is that they have had a role in reviewing these activities. That would increase the confidence that there was a genuine review process on these high profile cases going on.

Q38 John Thurso: So the message is that it is a 50% probability in either direction. It may well have been that this was a coincidence; it may well have been that it was not. The problem is that there is a perception and that has to be dealt with. Therefore, there needs to be a more robust procedure for these big ticket cases to ensure that the perception of there might have been something somewhere simply can't exist. That is basically what you are saying?

Richard Murphy: Yes. Can I come back to another point that you did make? One is I do not think that there has been a change in behaviour on the part of large corporates. There is no evidence of a change in

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behaviour as a result of this that I have seen anywhere, and secondly—

John Thurso: That would surprise me if there was, I would have to say.

Richard Murphy: In that sense, this policy is not working as far as I can see. There is no clear indication that there has been any change in behaviour, despite some attempts of investment on the Revenue's part in it; and secondly, I think that we are not going to see a change in behaviour because of the change in direction of corporation tax in the UK, when we are going to be retreating from the whole world back to being a territorial system for the UK. That is going to present the most wonderful boundaries for abuse for large companies deciding when something is within or without the UK for taxation purposes, which is going to open up a whole new avenue for opportunity for tax avoidance that has not previously existed, and will give rise to plenty more challenges in the future, which will probably increase the tax gap and reduce the tax yield. I am very worried about that as a particular risk for the time to come.

John Thurso: I think that is a subject in itself. I think I had better hand back to the Chairman before we get going on it.

Chair: Andrew.

Q39 Mr Tyrie: I just wanted to clarify this coincidence with Vodafone so that we are clear what you are saying. Are you saying that we should or that we should not read anything into the fact that Vodafone over provisioned?

Richard Murphy: Look, I am saying that it is very strange, in terms of the timing of announcements, that the Chancellor should have gone to—

Q40 Mr Tyrie: Okay, hang on, hang on, we will come on to timing in a minute. You raise over provisioning, and I want to be clear what significance we should apply to that.

Richard Murphy: It is well known that large corporates have played plenty of games with their tax provisions over many years. One of the reasons why I suspect some of them are quite happy not to close tax inquiry cases, is that they would rather like to have a number of years open so they can play around with their provisioning to make sure they can deliver the results that the market wants of them. But the point in this case was that they had made a specific provision and it appeared that it was generous in terms of the settlement made. Candidly, I am surprised that they would have made such a large provision if they had not received advice that they should put a number of that scale on their balance sheet, given the risks involved. It would be a risk assessment. It turned out that the liability was substantially less than their internal risk assessment, one can presume, as a result.

Q41 Mr Tyrie: Even though the majority of firms over provision, you are nonetheless surprised that Vodafone over provisioned?

Richard Murphy: The amount of over provision we are talking about generally is very, very much smaller than that. If we are talking about a percentage of the

tax charge, we are talking, say, if the effective tax rate is 23%, they might have provided 24% and it would be revised by a percent the year afterwards. We are talking about something that is much smaller.

Q42 Mr Tyrie: So this was a sufficiently large over provision. I am trying to clarify exactly what you are really saying. Are you saying that the size of the over provision was sufficiently large for you to be concerned—suspicious, at the very least surprised—by the settlement coming in so much lower and we assume this may be caused by some other motivation?

Richard Murphy: This was a very large provision. It was a sufficiently large provision that when it was first disclosed to exist, when the nature of this dispute was first disclosed, it became press news in its own right. It had an impact upon Vodafone's share price, if I recall correctly, when it was first noted that the provision existed. Therefore, the settlement was itself a major event with regard to the company's fortunes and to find that you have over provisioned by around £1 billion or so is significant, in terms of the overall tax charge and the overall results for the company for that period. It is therefore inevitably going to attract attention. Nobody knows, and I do not know and I have no way of knowing, whether the outcome was right or wrong, and I am not making any aspersions—

Mr Tyrie: I am not asking you to do that, I am asking you—

Richard Murphy:—I am simply saying that the timings were unusual.

Q43 Mr Tyrie: We will come on to timing in a moment. I just want to be clear, I am still on this question of your surprise at the over provisioning. This was a sufficiently large over provisioning for you to be surprised about it.

Richard Murphy: Yes.

Q44 Mr Tyrie: That is, that you think that it might lead one to want to ask questions about why it was so large?

Richard Murphy: Yes.

Q45 Mr Tyrie: Okay, I have understood that. Now let us get on to the timing. There are two possibilities, aren't there? Well, three: one is that there was a coincidence, one is that the Chancellor of the Exchequer intervened, and the other is that Vodafone looked at the timing and they decided to try and force the pace, or I suppose it is possibility that all of them all at once simultaneously had the same idea. Have I exhausted all the possibilities or would you like to add some more?

Richard Murphy: I suppose that is a reasonable range of possibilities. There are only so many players we can put together on this.

Q46 Mr Tyrie: Let us go through them one-by-one. Do you think that George Osborne might have intervened on the HMRC side? Is that what you are suggesting, deriving from your surprise?

Richard Murphy: Look, let's lay my cards on the table. If I was in doubt about this, it would be that we have a situation where we have a new Chancellor,

who it seems has a very different approach from his predecessors, and we have a board of the Revenue who have outstanding cases to resolve. George Osborne has a longstanding relationship with Vodafone. It is not new. His interest in the company has gone on for a long time and the matter was resolved early in his tenure. It so happened at a timing that suited his political agenda. I doubt if he chose that. I think it was convenient that it happened at that time.

Q47 Mr Tyrie: It was a coincidence? You think it was a coincidence?

Richard Murphy: I think there may have been a subconscious desire to close the deal on the part of many of the parties involved, to get it out of the way early in his tenure as Chancellor.

Q48 Mr Tyrie: Then no mens rea here? Is that what you are saying?

Richard Murphy: Maybe.

Q49 Mr Tyrie: I am asking what you are saying, not "maybe". You have made a very significant—by implication—allegation, an extremely serious one, of the current Chancellor of the Exchequer—

Richard Murphy: I am not saying the Chancellor, no.

Q50 Mr Tyrie: I am trying to get to the point of what exactly you have really said and what you are not saying.

Richard Murphy: It looks unusual, and I am far from the only person because I did not put this into the press.

Q51 Mr Tyrie: I am asking you, you may ask others.

Richard Murphy: In my opinion the timing was unfortunate, from the Revenue's point of view, that this case was resolved a week before a high profile relationship arose between the Chancellor and the company in question. It could have been much better managed if it had been released later, so that this did not give rise to suspicion that there could have been something untoward. Tax has to be seen to be managed fairly on behalf of all parties. The risk that any suggestion could arise, and I am not saying that anybody was corrupt in this case or did anything untoward, but the fact that an unusual decision of this nature arose a week before a political event took place, at which the Chancellor was present with the company in question, does give rise to the risk of suggestion that did subsequently occur, not from me—I make that very clear—by other parties, and I think—

Q52 Mr Tyrie: You are not sharing those allegations?

Richard Murphy: I am not saying that it was right or wrong. I am saying what it does suggest is that some people could quite reasonably think that some were getting favours out of the tax system, which they were not, and that was not right and that puts a question mark over the equal treatment of all taxpayers. That would be unfortunate because equity has to be at the basis of the administration of the UK tax system, and if there is risk that there could be suggestion of a

failure to deal with all taxpayers equally then the Revenue should take every step possible to avoid that risk arising. The fact that the Chancellor was going to India was known. The fact that he was presumably making an announcement with regard to Vodafone was known. I think that should not have therefore become an announcement by Vodafone the week beforehand, and every step should have been taken to try to avoid that.

Q53 Mr Tyrie: This is a press management issue?

Richard Murphy: It is press or political management but because the consequence is you may have undermined belief on the part of the ordinary taxpayer in the equity of the management of the UK tax system, and that has to be to its detriment. That is the point I am making.

Chair: Okay. Cross examining finished?

Mr Tyrie: For the time being.

Q54 Chair: Can I say, I think—leave the Chancellor out—this is the difficulty we are in. We had the Minister in front of us, and I don't know why he bothers to be Minister with the restrictions placed upon him, in terms of what he sees, what he does, what he says. Because of the obvious tie up and the protection needed to insulate politicians from individual people's tax affairs, it has got to the degree where this is almost a secret society and that is why, when things are raised, I think it places innocent individuals in a very, very difficult position, which I think all politicians have been in, some time in their life, where allegations are thrown.

Graham, what I haven't had through all the discussions, which HMRC have been clear on, is that a new policy is instituted that is highly individual. A senior officer goes in and makes it clear he goes in to meet the managing director or the chairman, has a cosy chat and—not so cosy—makes threats about putting all these people in, and over dinner a settlement arises. If that happened in open Government all hell would be let loose, and quite rightly. I am relaxed about that, but what I want to know is, what was the system before, and what were the safeguards, right? That is the first thing. There must have been a system and there should have been—and hopefully there must have been—safeguards. We now have this highly individual system that is highly dangerous to the reputation of people going into it. The great protection is transparency. Somebody looks at it, well away from them, and says, "Yes, that is right". Did we have that under the old system and do we have it now?

Graham Black: I don't recognise the system that you think we have now. I don't think it works with somebody going in and having a cosy chat.

Q55 Chair: That is what he volunteered at this meeting before the Committee.

Graham Black: No, bear in mind what was said at the beginning, which is that the vast majority of big, high risk corporate cases are dealt with by a team of professionals. They go through it. They go through a proper governance procedure, with people looking at

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the case, the strengths and merits of the individual case, and at the end of that we either litigate or we—

Q56 Chair: There are various protocols for that that are all written down and could be made available to this Committee?

Graham Black: Yes, absolutely.

Q57 Chair: That is very good. Who scrutinises this?

Graham Black: I would hope that the National Audit Office would.

Q58 Chair: No, I am not interested in your hopes. We all share them. What is the system, to your knowledge?

Graham Black: The system involves a fairly complex corporate governance procedure, which has various layers in it throughout the whole process of the inquiry. There are a number of people involved.

Q59 Chair: That is written down?

Graham Black: That is written down as the governance system.

Q60 Chair: So we could ask for both documents, but do you have any idea how arm's length is the scrutiny? It is not going up to Dame Lesley. It is going sideways to people who are non-executives, is it?

Graham Black: The scrutiny is normally going up the chain towards the Commissioners, ultimately, in very, very large cases, or there is a governance board within the high risk corporate system that will look at the case, which involves all sorts of technical experts and legal people who will look at the case. It is not a small cabal looking at this. It is quite a large group looking at the technical—

Q61 Chair: I think that is very useful, and we could ask for the papers because I think that is absolutely key to stifling speculation that harms individuals' reputations, and so on.

Let me just ask you this. I was going through my files before I came here and I came across *Sunday Times*, Google. You are mentioned, Richard, you have commented on it, but Google have a £2 billion business here and pay £3 million tax. To anybody that raises all sorts of questions. Tell me, Graham, where in the vast HMRC exercise is someone looking at that sort of operation? I will broaden it away from Google.

Graham Black: Thank you. You could see my answer coming there.

Q62 Chair: There is a shadow Chancellor. I am just saying they are a company doing business and the article was very interesting, going through Dublin, going through Amsterdam, where on earth they pay tax to it is not clear but it is this business. Who does it in the HMRC, which unit, which exercise deals with multinational companies? Is this what we are talking about?

Graham Black: Yes, we were.

Chair: Large businesses and so on; and secondly, the offshore operation, who follows it through and can we follow it through?

Graham Black: Most of that would be dealt with within the bit of HMRC called Business Tax. We have a Large Business Service that looks at the very largest several hundred multinationals, and we will also look at ones that we think ought to be in the largest several hundred, but are not. So they risk assess the whole of the large business population to see that they are dealing with the right cases.

When it comes to international aspects, we have our specialist section within FSS tax that looks at international corporate tax issues, and again they will be helping LBS to risk assess and they will be—a horrible phrase—horizon scanning to see if there are issues coming up or cases that they need to be looking at.

So there is quite a complex risk process in place within HMRC that would enable them to identify cases where they want to have a closer look. The difficulty we have is that we don't have enough people on the ground to do as much of that as we ought. We may see a risk, but do we have enough people trained to a sufficiently high calibre that they can deal with the risk? The answer is we don't. We have to pick and choose which risks we look at. That means there are a whole range of risks that we effectively park, "Hopefully we will come back to it later, but maybe not".

Q63 Chair: Do we have individuals or do we have the power, do we have the interest, do we take the initiatives in terms of delving, following the trail, Google's trail? If you are raising risk that must be ringing bells somewhere, a big corporation like Google paying £3 million. I think it is £3 million. Richard, your memory is probably—but I have the cutting. They had a £2 billion revenue stream. The way they do it takes it out of the UK. Do we have the ability to follow that and is it the same unit that would go following it?

Graham Black: I can't talk about that particular taxpayer in any shape or form.

Chair: You mean Google? No, I was speaking about generally then.

Graham Black: That sort of area is definitely high profile for HMRC. We do have people who look at international companies, what activities they do in the UK and whether they pay the right tax in the UK. It is a very, very complicated tax issue. Of all the complicated tax issues we have, cross-border international ones are the most complex and require the most skills resource. We certainly have units that look at this, but I have a question mark over whether we have enough people to follow up all the risks.

Chair: Yes, okay. Richard, do you want to say anything? Dare you say anything? No, I am not challenging you. No, no, don't take it as a challenge.

Richard Murphy: The risk in this sort of situation—and let us be clear it is not just Google, it is a very common situation with regard to intellectual property—is that it is incredibly easy to relocate assets outside the UK to arrange, as Google and many sales companies do, that there is just a selling agent in the UK, very small amounts of tax paid but the revenue is being booked in another location, Ireland of course being a common place where no tax is paid either,

incidentally, by most of these companies. So we have a complex structure that is opaque. We need to have two things: one, a political willingness to demand that companies be accountable for where they operate. We don't know enough about where multinational corporations operate, which is why so many organisations are now calling for country-by-country reporting by multinational corporations with an individual profit and loss account for every country in which they operate. That would then let us answer these questions about, how much do they record here? How much do they pay here? How much do they record in tax havens and elsewhere? That is part of the political willingness to take on this issue to make sure that not only are we willing to take on companies but create the international co-operation that solves these problems. This is political willingness. It is not just part of the Revenue's will, this is a political issue, and I am not sure that that willingness has been created yet to take on these large corporations.

Q64 Jesse Norman: I apologise for being late to this session, and I hope my questions don't cover any ground that has already been covered. Can I direct a question to Mr Murphy to go back on the issue of Vodafone? Mr Murphy, did you look at the Vodafone settlement yourself in any sense, as it were run a slide rule over it, given your understanding of the profitability of the company?

Richard Murphy: I have made clear that I don't have the details of how that Vodafone settlement was reached. I don't believe that anybody who has commented has. I was making a point about the management of the expectations within that situation. The point that I was making is not that anybody has necessarily done something wrong, but it certainly was not managed well to make sure that the confidence in the equitable management of the UK taxation system was there, and that is the concern. If you have people seeing such issues arising they are going to turn round and say, "Well, if they can get away with something, whether they have or not got away with something, I will try to do the same". If I can draw a comparison, not in this session of the Parliament but the previous Parliament when we had a problem with expenses, people turned round and said, "If MPs are getting away with something", we had a whole host of SMEs saying, "then I will try and get away with things". It is about the management of the message of the way in which the UK tax system was managed that I was making a point about, not about the propriety or otherwise of that settlement.

Q65 Jesse Norman: From your point of view, the amount of tax paid by Vodafone was perfectly adequate?

Richard Murphy: I have no idea whether it was adequate or not because I don't have a way of knowing, and nor has anybody else because that would be privy to the taxpayer and the Revenue.

Q66 Jesse Norman: That is helpful to me, thank you. Can I just ask another question, which is, given the

unfortunate coincidence of the trip and the announcement, do you not think that is capable of an alternative interpretation? I am making the point that it seemed to argue for the probity of the system that these things could coincide and were not managed away.

Richard Murphy: I think it—

Q67 Jesse Norman: It bore that interpretation. You have made that point. In that case, I withdraw. That is fine, thank you for that.

Let me ask one final question. This is a question for you, Mr Black. In the case of Vodafone, there was some evidence given to this Committee by the relevant Treasury Minister that Vodafone had paid tax on its settlement. Have you covered that, colleagues? It now appears that they did not pay tax on the settlement.

Graham Black: Do you mean interest?

Jesse Norman: I mean interest. That is right. Do you think that implies that there was in fact further tax that could have been collected on that settlement from the interest that was not charged?

Graham Black: I must admit I have no details of it, and I am still an HMRC employee so I cannot answer anything about an individual taxpayer in any way, my apologies for that.

Jesse Norman: If it has not been covered already, Mr Murphy, you don't have a view on that either?

Richard Murphy: These documents are not put in the public domain. How can I have an opinion on something that I haven't had a chance to see? My answer is, if interest wasn't paid that would be surprising because if I were representing an SME in such a situation I would expect interest to be paid. In that circumstance, again there is the question arising as to why does it appear that one case is different from another? I go back to the point that I was making that an equitable treatment of all taxpayers, irrespective of size, seems to be a fundamental of the UK tax system and if there is a perception that that is not arising and it is not occurring then, of course, it will give rise to an undermining of confidence in the tax system. That is the point that I was trying to make, that that appears to not be present in some of these announcements and in some of these settlements as they have been reported by others. If that is the case, then there is an issue of message management on the part of the Revenue, but perhaps on the part of the Treasury, to ensure that that perception of favour is eliminated. That doesn't seem to be going on.

Chair: Thank you, Richard. Thank you, Graham. Thank you very much and I am sorry we have overrun but you are too controversial both of you, but there you have it. Thank you very much.

If we can have the next two witnesses in straightaway we will plough on, if you are ready. We are very apologetic about overrunning. Some people can't be controlled but there we are. I know how the Chairman feels in a full Committee.

29 June 2011 Professor Judith Freedman and David Sproul

Examination of Witnesses

Witnesses: **Professor Judith Freedman**, University of Oxford, and **David Sproul**, Chief Executive Officer, Deloitte UK, gave evidence.

Chair: Good evening. Mr Tyrie is going to start on the tax gap analysis.

Q68 Mr Tyrie: Can I begin where I began the last session—I will give you a second to settle in—which is, what is your view of HMRC’s estimate of the overall tax gap, Mr Sproul, and then I will come to Professor Freedman?

David Sproul: It is very hard for us to have a view without knowing the fact base on which they have estimated the numbers, as to whether the £40 billion-odd that is quoted is realistic or not. I have seen and read the evidence that Mr Hartnett has given in terms of how that is computed. I have no basis on which to say it is wrong but equally I find it very hard to say that number is accurate.

Q69 Mr Tyrie: You are on record as saying that the UK corporation tax gap is a myth.

David Sproul: I am, and that was five or six years ago; possibly a little longer. I think back in 2006 I authored an article that was published on that. In terms of the statement “it is a myth”, that was a piece of journalistic prose that was used at the time. The point of the article was that the real issue that impacts the corporate tax system is around the competitiveness of the tax system. That is what the focus of the article was and it was trying to draw the line that that is where, in our view, HMRC should spend their time and attention and that is what will bring the biggest benefit to the UK Exchequer.

Q70 Mr Tyrie: To expand on that just a little before I bring in Professor Freedman, the competitiveness of the tax system?

David Sproul: When one looks at the corporate tax system—let me context that—most of our experience is with larger corporates, therefore dealing with LBS and large and complex and less with the SME sector. But if one looks at the competitiveness of the UK tax system there are three things that really drive the competitiveness: one is the overall rate and allowances in the tax system; secondly, is the complexity of the system; and thirdly, is the certainty in the system. What I was saying in the article at the time was that we saw a significant risk of the lack of competitiveness, in terms of rate, complexity and certainty, causing the UK to become unattractive for large business. I think the evidence is that, post that article, 25 UK companies moved their headquarters offshore, which I think evidences that was a concern. But that is the point around the competitiveness, those three elements.

Mr Tyrie: Professor Freedman?

Professor Judith Freedman: I feel as strongly as anyone that avoidance and evasion should be tackled, but I don’t think that the tax gap is a concept that is a very useful tool in that war against avoidance and evasion because I don’t think it is a conceptually sensible thing to try to work out. In particular, I cannot agree with the definition that is in the latest 2010 document that the theoretical tax liability represents

the tax that would be paid if all individuals and companies complied with both the letter of the law and the spirit of the law. I really take issue with the spirit of the law part, because either you have law or you don’t have law and the law has to state what it is.

Q71 Mr Tyrie: You seem to be describing something you think is wrong culturally with HMRC. That they are discussing the spirit of a tax system when they should—I think, what you are saying is—be looking only at means by which they can collect the correct amount?

Professor Judith Freedman: I don’t think there is such a thing as the correct amount. There is a problem, and Dave Hartnett has made this point in evidence to this Committee, that tax is an indeterminate thing sometimes, particularly when you are dealing with large businesses. We are living in a very complex world and you cannot say what the correct amount of tax is, any more than you can say that there is a definite amount of profit. Unfortunately, these are sometimes quite subjective concepts but I don’t think it is right for the Revenue to talk—as it does now more and more—about the spirit of the law, because either something can be taken through the courts and the Revenue can prove that they were right in their interpretation, or if they were wrong in their interpretation, because the courts say they were wrong, then we have to change the law.

Q72 Mr Tyrie: In your initial remarks you gave the impression, which I would invite you to take the opportunity to correct if you want to, that evasion and avoidance were both things that needed to be tackled in equal measure. Do you draw a distinction between these two or do you think it is now redundant?

Professor Judith Freedman: No, I think there is a very important difference between evasion and avoidance.

Mr Tyrie: I am pleased to hear that.

Professor Judith Freedman: I spend a lot of my time writing about that difference. That is why I am concerned about this blurring of that boundary, with the notion of the spirit of the law, which is defined in this document, *The Tax Gap*, as HMRC’s interpretation of the intention of Parliament. With respect, it is not for HMRC to decide what the law is. It is for the courts ultimately.

Q73 Mark Garnier: HMRC is aiming to raise an extra £7 billion a year through compliance, the intervention. That is quite a significant amount of money. Do you think that is an over-ambitious target or do you think that is easily achievable?

David Sproul: My view is it is achievable. If you look at the targets, that is the target at the end of that four-year period, so £7 billion. The reason I say that, if one looks at the evidence to date—I heard the earlier evidence—so you have looked at one particular

taxpayer where £1 billion was raised from that taxpayer. If one looks at the offshore disclosure and Liechtenstein disclosure initiatives, between those they raised I think it is £4 billion. It is in the public record. So, if you look at the initiatives that have been taken and the focus on particular risk areas, then it seems to me it must be possible for HMRC to be optimistic about raising that target of £7 billion in that fourth year of the period under review.

Q74 Mark Garnier: Should they be targeting more?

David Sproul: It is very hard to say. I think they should be in a position where they are flexible on that target. We are in the first year of those four years. I would like to see how effective they are in this first year and the second year, but I do think it is important to focus on what HMRC have done, which is a risk assessment of where in their view they believe the greatest area of tax avoidance is and where they believe the greatest prospect of tax raising should be. So I would support and continue to focus on areas of greatest risk and reassess that target as they go through the next two years.

Q75 Mark Garnier: If they become over-zealous about this it might affect the relationship that HMRC have with business in general, small, medium and big businesses. Do you think that is a justifiable risk or do you think it is a red herring?

David Sproul: I think HMRC's relationship with large business is very good. If you look at the last report of the NAO, which did a survey of LBS, for example, there was an 89% satisfaction rating with large business with LBS in terms of that relationship. I think the efforts that HMRC have made since the introduction of LBS, since the introduction following the Varney review of links, in terms of the approach to large business, has been effective in achieving HMRC's objectives in terms of tax collection but has been done in a way that has improved the relationship with large business.

Q76 Mark Garnier: Professor Freedman, in giving evidence to us in May, Stephen Banyard told us that HMRC research—in fact, this was backed up, I think, possibly by Richard Murphy after—has shown that a third of small businesses were attitudinally non-compliant. Richard Murphy suggested that a third of businesses just don't bother sending in their tax returns at all. Do you think that is a fair criticism?

Professor Judith Freedman: I haven't done any recent empirical research on small businesses. My recent research has been on large businesses, but there is certainly academic research in the United States as well that suggests that small businesses are more likely to be non-compliant than large businesses. I think that there is also a question of how much resource they can put into compliance, so they have to deal with a lot of cost in relation to the amount of profit that they make. It would be understandable if they simply didn't have the resource to make sure that everything was exactly correct.

Mark Garnier: When you say "they", do you mean the business?

Professor Judith Freedman: The small businesses, yes. When one looks at the figures in *The Tax Gap*, a lot of the cases of non-compliance are quite small amounts. The numbers of cases where there are really large amounts at stake are very small. So they may simply have been making errors, because it is a complicated world out there and it is a very complicated tax system and it is possibly not reasonable to expect those small businesses to work to the same level of accuracy as larger businesses can.

Q77 Mark Garnier: You neatly bring me on to my next question. I don't know if you were here for the last session but I asked the previous two witnesses: do we fundamentally have a tax system that is far too complex for most people to deal with? I don't just mean the people who are paying the tax, I also mean the people who are doing the collection. Both of you can help me with this one.

David Sproul: I think there is no question there is too much complexity in our tax system. The difficulty is working out where you go first in terms of reducing that complexity, and the efforts the Government has made in introducing the Office of Tax Simplification I would say is a move in the right direction. But complexity leads both to error and uncertainty, and neither of those are good either for the taxpayer or the Exchequer.

Professor Judith Freedman: I am on the Consultative Committee of the Office of Tax Simplification looking at small businesses, and so obviously I believe that that is an important thing to do. I also have concerns about that whole exercise because I think the only way to simplify the tax system is to simplify the underlying law and not just mess about with a few administrative things. So I am concerned that there is pressure on that Office to come up with quick wins, when in fact you cannot really simplify the system without looking at the concepts behind the tax, such as, for example, merging National Insurance and income tax, which would be a really big way of reducing compliance costs.

Q78 Mark Garnier: Yes, but it is ferociously complex, as we know.

Professor Judith Freedman: It is ferociously complex, but you have to put the resource in to do that because otherwise year-on-year it gets more and more complicated.

Q79 Mark Garnier: Coming back to my original point, I think most people accept that if you are a small business owner you are going to be concentrating on making widgets and not concentrating on the tax system, so obviously you get an accountant to come and do it for you but then that is a cost of compliance. I come back to my main point, which is, with a tax system that is so complicated does it make it impossible to be able to effectively deal with this tax gap because at the end of the day there is too much for the investigators to be able to deal with?

Professor Judith Freedman: Again, it depends what you mean by the tax gap. If you are saying that every single inaccuracy is a tax gap then probably, yes, it

does. If you are concerned with tackling evasion then I don't think the complexity is the problem.

Q80 Mark Garnier: In terms of avoidance, complexity creates opportunities for it, doesn't it?

Professor Judith Freedman: It also creates a lot of costs for the businesses. In the small business area I think the problem is not that you have complexity that gives opportunities for avoidance but that you have complexity that makes it very hard, with the best will in the world, to comply precisely, for example, on employee expenses. It is tremendously complicated. There are pages and pages of guidance and you can't really expect all small businesses to be able to deal with it.

Q81 Mark Garnier: No, fair enough. On any analysis, evasion and criminal activity account for more of the tax gap than avoidance does. Do you think that this great sort of argument that has been going on in the press about tax avoidance has led to resources being directed to the wrong area and in fact we should be concentrating more on criminal activity?

David Sproul: I can give a view. I don't think it is an either/or. I think HMRC need to be focusing on both elements. If one looks in the VAT area, for example carousel fraud, there is a very real effort by HMRC to attack that, given the scale of the loss to the Exchequer. That is a very good example of where resource was put on something that is clearly evasion and clearly criminal. Equally, I think the resource HMRC have put into the HRCF programme—I heard the evidence earlier—is the right resource, in terms of the risk assessment process they have gone through in working out where there is the potential to realise tax to the Exchequer. So I think it is very hard to say it is a binary choice—I understand you are not suggesting that—and therefore it is quite hard to say at a time of scarce resource for everyone, including HMRC, should they move resource from one area to the other? Our view, based on what we see of the large business sector, is the resource HMRC have put to it is very well used and gets a good return for HMRC.

Professor Judith Freedman: One of the points of the risk raising process is to allocate resources, so it is not only about changing behaviour. In fact, it is mainly about allocation of resources. So it is not surprising to hear that the Large Business Service is able to cut staff, because the whole point is to work out who is a low risk taxpayer and then you don't have to spend as much resource on that low risk taxpayer. So I think there is quite a lot of sense in trying to work out who is high risk and who is low risk from a resource allocation point of view. But I do think avoidance has to be tackled because in the end avoidance, on my definition, is showing where there is a problem with the law and then the law has to be changed. So you can't ignore avoidance, although it is not necessarily a case of pouring in a lot of people on the ground. It may be that you have to focus that work at the top end.

Q82 John Thurso: Can I come, first of all, to you Professor Freedman? I want to talk about the High Risk Corporate Programme. I think you were here

when I was asking the questions. You heard Graham Black tell us that broadly his view was it was working quite well. I will come on to the corporate governance questions in a moment, but do you think that was an accurate view and one you would concur with?

Professor Judith Freedman: Yes. The research we did at the Centre of Business Tax in Oxford suggested that it was working quite well. We did a pilot study that suggested there were some problems and by the time we did our main study some of those problems had been worked through, and subsequently I think there have been further improvements. So I think there is a general view that it is working quite well, from the allocation of resources point of view. I don't know how much it is changing behaviour and I am not entirely convinced that those two objectives are consistent; the resource allocation and the modification of behaviour. The modification of behaviour part worries me more but I think the resource allocation part is fine.

Q83 John Thurso: Can I just pursue that, because Richard Murphy said much the same thing and I think—I don't want to put words into his mouth—to sort of paraphrase, you don't actually change the behaviour of big corporates. They make a calculated assessment of what is in their best corporate interest, and if you have a high risk group chasing you basically you pay up.

Professor Judith Freedman: I would never want to say the same thing as Richard Murphy, but I wasn't quite saying the same thing. I was saying that there are two different objectives, so you may find that some businesses will change their behaviour because it will be important to them to be low risk, and other businesses may think, "Well, we are so complicated anyway and we want to carry on engaging in complex cross-border transactions. We want to be very transparent, but we don't want to change our behaviour to the extent that we won't engage in innovative tax planning". In that case, I think you could have a clash between your objectives because you may want to encourage them to be transparent and at the same time they may continue to want to behave in what the Revenue might think is an aggressive way, but they might think it is just pursuing their planning in an appropriate way. I think that could be problematic.

Certainly, there is some evidence that some businesses want to be low risk, want to be openly low risk and have modified their behaviour for that reason. So I think some businesses have decided, for example, not to engage in any scheme that has to be disclosed under DOTAS, but I don't think you will change every business' behaviour through this.

Q84 John Thurso: It goes a bit to what you were saying earlier with the difference between the spirit and the letter of the law. There is no such thing as the spirit of the law but there is the letter of the law, and if you have a construct that says a Korean based operating company that is owned by a corporation in Thailand that has a tax treaty with the Dutch Antilles that imports its dividend into a Jersey-based company before arriving in the UK, which actually reduces the

tax by about 35%, is all legal, that is fair and dandy and the fact that it is completely against the spirit is not the point and they are not going to change their behaviour.

Professor Judith Freedman: Who is saying it is against the spirit? That has been called by one of my academic colleagues a “shadowy parallel legal world”. How do we know what the spirit is? As taxpayers and advisors to taxpayers we can only look at what the law says, so if the structure of the law allows that then how do we know it is against the spirit?

Q85 John Thurso: On this question of effectiveness of the programme and the group and that second point about “spirit” versus “letter”, your comments.

David Sproul: Yes, thank you. On the effectiveness, again, from what we see, I would say it has been effective. If one looks at the programme, in terms of dedicating resource in HMRC to those areas where they see the ability to resolve issues quickly and therefore save litigation costs and maximise tax collection—I will come onto the point about behaviour—then, in terms of the effectiveness of that, our perspective would be it has been effective. It has not caused wholesale behaviour change. That is a very hard thing to measure. But I would agree with Judith that it has caused behaviour change in certain organisations that see an advantage in being classified as “low risk” and agree very transparently to make some changes to their approach, particularly in relation to dealing with packaged tax schemes—far fewer of those around—or a scheme to provide disclosure.

Is it possible to say there has been a wholesale change in behaviour? It’s not. But I think it is worth remembering that, when one looks at large corporates, there is a very heavy burden of corporate governance that applies to large corporates, which covers the approach they take to tax policy in the same way it covers the approach they take to anything else. I wouldn’t overlook the importance of that, in terms of the approach most large corporates take to tax planning or tax avoidance.

In terms of the spirit of the law, all I can do is echo and agree with Judith’s comments in terms of the fact that there is the letter of the law, and this notion of some extra governmental organisation being able to interpret the spirit of the law and then apply that is just wrong.

Q86 John Thurso: Can I come on to the question of “big deals” and the governance thereof that we covered. In particular, the Vodafone deal was used as an example. Richard Murphy made the point that it was settled a week before George Osborne went to India; the implication being that it was somehow deliberately done. The critical point, surely, is not that that might have happened but that people can think that it might have happened. Therefore, is there not a compelling case for some greater degree of corporate governance and signoff, in these kinds of deals, so that there can be no suggestion of any impropriety on anybody’s part?

David Sproul: I think one has to position this in the context of the statutory obligation HMRC have with

taxpayer confidentiality. Therefore, it is very hard to—in fact it is impossible—to go into the public domain with what the details of any particular settlement are. In terms of the governance process around HRCP cases—and I don’t have the HMRC guidance—my understanding is there is governance within HMRC, which is separate from the officers leading the settlement discussions, the negotiation, the work over that period, from those who ultimately approve the terms of the settlement. So my understanding is there is some governance there; there is appropriate governance. I think the thing we are facing is the difficulty of making that process and the detail of that process public, given the appropriate confidentiality of taxpayers’ affairs.

Q87 John Thurso: That was the point that we were coming to. In his evidence, David Gauke quite clearly said, “Look, you can’t have a Minister making a decision about an individual tax case” and everybody accepts that. Dave Hartnett gave very similar evidence, but Dave Hartnett basically is the person who is in the frame, as we heard from the last session, as having signed off that particular deal. The problem with that is, you have one person who may be doing it—and I am absolutely certain is doing it—very responsibly, but the perception is still that it has been signed off. So how do we get to the point where we don’t reveal the details publicly—because we don’t want to do that—but politicians and the public can have confidence that the deal that has been arrived at, the sum that has been paid, the details of the negotiation are actually correct and in the correct interests of the system? How do we get that?

David Sproul: There are two points. The first is, my understanding is that in all settlements within HRCP there are two Commissioners who have to approve the deal. I know Dave Hartnett has made the point he was one of them. I think there is always another Commissioner on the board that has to be involved in that. I heard Mr Black’s evidence earlier, some of his evidence about the written guidance internally, and it seems to me that may be something that can be put in the public domain in terms of the procedures that have to be gone through in HMRC, as with any body that reviews those sorts of settlements. If one looks at HRCP—and I can’t talk to the specifics of Vodafone—generally we understand what we see is these are recommendations made by senior officers of HMRC, based not on a fireside chat, but on weeks and months of detailed work looking at the potential liability. Those recommendations are then assessed by Dave Hartnett and others on the board before the detailed negotiations were discussed and then started with the taxpayer. I would say there is a very rigorous review in governance process. I understand the concern that that isn’t public and therefore that creates the risk of a perception that it is not rigorous and fair.

Q88 John Thurso: Maybe we should ask the Governor of the Bank of England to do it because we are asking him to do everything else at the moment. Sorry that was facetious; I do apologise, Chair. The strategy of HMRC requires that if they think there is a liability, they should go for the full liability plus the

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interest and not back down, and litigate if necessary to get it. Yet the whole ethos of what we have been discussing seems to be around negotiation. Is that actually a misunderstanding of the process, in that the process is about two interpretations of the law and therefore liability, which are being tested in a dialogue as to arrive at a common view of the law and it is that common view that gives the liability, which is then paid. It is not actually a negotiation as to the quantum.

Professor Judith Freedman: I don't want to comment on any specific case when I don't have any knowledge.

John Thurso: No, I am talking about generality.

Professor Judith Freedman: I think in general terms there is an on-going process. There could be case law going through the courts, there could be case law going through the European courts, which might be changing things. So you could have a company that was making a provision, but then things could change over time so that the advice made initially would be varied if they went and took advice again. HMRC could be aware of changes that are coming up, so it is not that there is one figure that one side thinks should be paid, and one figure that the other side thinks should be paid because it may be genuinely uncertain what would happen if the case were litigated, and in that case it may make perfect sense to settle because litigation is very expensive.

David Sproul: May I add a comment on that because I agree with what Judith said. Our experience is that, in looking at HRCF cases, there is a whole range of tax issues being looked at. There will be issues, which are exactly as Judith said, where there is uncertainty; the law is not clear; the facts are not clear, and it is not about horse trading. It is about working through, based on that fact, and coming up with best view and that will be part of a negotiation. There are other issues within the remit, which HMRC will say are clear on their view. They are not prepared to negotiate in any way on that issue, and the taxpayer either accepts HMRC's view or litigates. In those cases, in our experience with HMRC, if the taxpayer chose not to accept it then HMRC would take that out of the HRCF programme and that would continue to litigation.

So I wouldn't like anyone to have the impression that this is a negotiation or horse trade of all open issues, and "Let's come up with a middle number". The details are looked at very seriously, and those issues that tend to be resolved through that are those where the law is unclear, where there are alternative interpretations of the law or the fact pattern.

Q89 John Thurso: This is a very important point because I think most people think that, in these very big companies, there is mediation between two points to arrive at something both sides agree as a number, but in actual fact it's not. The numbers are generated by the mediation on the points of law where they arrive at an interpretation that they can both live with, and once they have done that then the computations fall from the decisions on the interpretation. Therefore, none of it ever should be a negotiation in terms of, "I want 10. You can have five. I will give you seven, take six" that type of thing.

David Sproul: I think that is an accurate assumption.

John Thurso: Thank you.

Q90 Chair: Can I just come back to you, David, in terms of one of the answers you gave of concern because of the necessary confidentiality? Something hits the headlines and we all start asking, and we need reassurance. You had the response to me in terms of "Was there a system and was there an independent system of scrutiny". There is this new system that seems to be highly personal; there is some difference between the witnesses in past meetings as to how personal it was. The point was made today about it being a group rather than an individual, but the individual claimed he went into a room face-to-face with the chairman or something. You know it better than us; we are just politicians, lay people. When you said two Commissioners have to sign this off—and I think you said Dave Hartnett is a Commissioner—it struck me as how those are individuals who are well away from the place, because I sometimes get letters and your appeal is to a Commissioner, and I think that is like an ombudsman, but it is not, it is one of the characters who manage the people who have taken the decision. Can you tell me, do you know specifically how neutral or divorced or separate is the body that would scrutinise and approve the deal, so that I, as an ordinary taxpayer, an ordinary member of the public, when reading the paper thinking, "This looks bad", know that somebody well away from it says, "No, we have looked at the papers and it is okay"? Is that a fact or is it, as you say, two Commissioners, two colleagues of the person taking the decision?

David Sproul: To use your description, it is muddy in terms of, "are they close, or not?" I agree with you. This is not an independent body; it is not an independent ombudsman in the way you described it; they are officers of HMRC. My point is that they are independent from the process that has been gone on; they are independent from the working process, and if I may add a comment because, having seen these processes from the taxpayer side—we have acted—it is important to understand that this is a very intensive process. This will have five, six, seven, eight very senior HMRC officers involved intensely over two, three, four, five months, with similar teams from the taxpayer's side, going through the issues, going through the legal position, going through the financial implications, and through that process coming up again—and I go back to Mr Thurso's comment—not with a horse trade or a negotiation, but with proposals based on each issue as to what the appropriate level of tax is. That is the proposal that is then put to Mr Hartnett, for example. So to that extent he is independent from that thought process. In the end he and his colleagues are going to have decided whether they support that recommendation.

Q91 Chair: Just say I am with you up to now but a senior individual says, "Yes, I will go in with that and I will finish these negotiations off." It blows up in the unfortunate circumstances because of this contingency fund. It looked as though he had negotiated weakly. If you were Deloitte—you can't speak for Deloitte—would you actually be recommending a system of

scrutiny, of confirming so the public can be reassured that this confidential matter has all been dealt with to the standards, and so on, that it is separate enough in HMRC? Somebody mentioned non-executives for example and I thought, “Well, that is a bit further away than seems to happen”.

David Sproul: Of course what we do have is the NAO reviewing LBS and the process, so that is independent. Now whether that will review individual settlements, but certainly the NAO is in the middle of their review of the LBS and I think we are expecting their report in the next few months, and I am assuming that will go to their view on HRCF, for example. So I think there is an independent review of the whole process that is out there and coming. It is hard for me to comment from the outside, because I am not in the inner workings of HMRC, as to whether there would be a better or worse answer were those who handled the negotiation—I think that is your question—totally independent. What I would say, as in any negotiation, you have to assume that both sides are equally satisfied and dissatisfied with the outcome or there would not be a settlement.

Chair: That is not a great comfort to me as an individual taxpayer.

Q92 Jesse Norman: I must say I found that last point very odd. The fact that negotiations reach a settlement in no sense necessarily results in the idea that they are both equally happy with it. One of them may be incredibly unhappy with it but it is better than any alternative they have, and that may be the situation the Revenue finds itself in with large multinationals that can move profits around at will. So I don’t think there is any suggestion that a settlement implies equal happiness or dissatisfaction. I also disagree with my colleague John Thurso. It seems to me that, in thinking about these large corporate tax negotiations, there will always be a price tag attached to certain outcomes on specific negotiations. Both sides will know—or at least certainly one side will know—what its upside and downside is in each particular part of any ramified negotiation, and they will try and win on the big ones and lose on the small ones. There is no dissociation between the decisions on points of law and the financial consequences of that; that would be omnipresent, or the negotiation will have been very badly handled.

Professor Freedman, you said there is no certainty in some of these situations. It makes a very subtle and important point. There may be, in fact, no exact answer as what is the correct amount of tax to be paid. Am I right in thinking that was your view?

Professor Judith Freedman: I said that, yes.

Q93 Jesse Norman: So that would mean that the Revenue would have had no warrant to say that it only collected the amount of tax that was due in some of these cases because it could not know?

Professor Judith Freedman: It will have done its best to collect the amount that is due on the best advice it has.

Jesse Norman: Yes, it will have done its best. That is a slightly different claim—

Professor Judith Freedman: But had the case continued and gone to court we cannot know exactly what would have been decided, because courts are independent and courts can come up with different views.

Q94 Jesse Norman: If it had been litigated, and with all those costs and benefits gone to a court, a court might have decided in one way or the other, and in that sense there may have been a toggle in the amount of money that would have been owed.

Professor Judith Freedman: But usually a court would have decided no liability or liability. So the courts have to come, in the end, to a binary decision, yes or no.

Q95 Jesse Norman: So the number would either be above or below the number that was reached in some cases, and in some cases it might be quite different. But the point is also that the other thing that might determine it would be the quality of the negotiation that was done from each side. A poor negotiator, even though someone who was right on the law, perhaps right without knowing it, would end up with the lower amount of settlement than perhaps the tax that was really owing. That is possible, isn’t it?

Professor Judith Freedman: They would have to take the best advice they could and come up with the—

Q96 Jesse Norman: I agree, but the point you have made is right; if there is no certainty then the Revenue cannot correctly claim that it collected the amount of tax owing because it does not have the warrant. There is no certainty. All it can claim is—

Professor Judith Freedman: It can claim it collected the amount it considered on the advice it had received to be correct. Yes.

Q97 Jesse Norman: I think that is right. Would you be surprised in general, Mr Sproul, if a major multinational did not have interest charged on taxes owing? Would that be a normal part of a negotiation?

David Sproul: It would be a normal part of the administration of the tax system that, if tax is paid late, interest is charged, absolutely. What I can’t comment on is whether, in a negotiation, that interest is compound or packaged with the overall financial settlement. But on your first point, absolutely, in the normal administration of the tax system you would expect that, if tax is paid late, interest is charged.

Q98 Jesse Norman: That seems to happen to everyone else. So then the question would be, if the interest wasn’t charged on the taxes owing that might point to a failure of negotiation. The thought might be, “We came out with a number and it was not the number in fact that we were owed”, if you included the full interest but it was whatever the negotiation resulted in. That is a possible outcome, isn’t it?

David Sproul: It must be a possible outcome, yes.

Q99 Jesse Norman: Would you be concerned, Mr Sproul, if there were certain flags in the process of reaching a tax outcome for the Revenue that went the wrong way? For example, if it subsequently proved

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that the advice was not perhaps as uniformly mixed, it was perhaps a bit stronger than the Revenue believed, or perhaps that the Revenue did not commission enough advice to support the position or did not commission it from the very best relevant authorities. Those would be signs that they had not done what was necessary to extract the full amount of the tax owing?

David Sproul: They could be, yes.

Q100 Jesse Norman: Would it not also be true that another sign would be, if the case officers responsible for a particular case dissented from the amount that was actually ever raised, if they registered an internal concern that not enough money had been raised out of the settlement that would be another flag, in retrospect?

David Sproul: It might well be, yes.

Q101 Jesse Norman: Thank you. As representatives of the taxpayers, how are we supposed to know that these things have happened since the Minister is never shown any information that isn't what a private citizen would, therefore, be entitled to in the public domain?

David Sproul: That is a very good question. I don't think I have the answer to that. I think it goes to the earlier question about—

Q102 Jesse Norman: It does, it picks up on the question that John Thurso raised. Professor Freedman, do you have a thought on that because it does seem there is a huge gap of accountability, and what is very striking is that this accountability gap has been worked around in other interestingly parallel situations? Let me take one, for example, in the review of intelligence. We have people who were given specific responsibility, accountable to Parliament—Lord Carlile, in the case of intelligence, judges often—to review intelligence or review the collection of intelligence, in order to satisfy a public need for the knowledge that it has been done in a proper, correct and publicly accountable way. Do you not think we should be looking at this kind of approach in the case of these—

Professor Judith Freedman: As has been said already, we do have the National Audit Office and we will have to see how extensive a review they can do. I have been—

Q103 Jesse Norman: But that would be ex post. That would not be able to influence the process of negotiation, which is sometimes rather protracted.

Professor Judith Freedman: I have just been in the United States where they have something called the Treasury Inspector General for Tax Administration, TIGTA, and that might be something that your Committee might want to look at because that was set up in 1998 for precisely these reasons. I have been discussing these cases with academic colleagues in America and they said, "Oh but we have TIGTA" so perhaps there is a need—

Q104 Chair: Could you send us the details; can you send us some details?

Professor Judith Freedman: I can send it to you, yes. But it could be that there is a need for some kind of procedural change or openness, not necessarily because something has gone wrong but, as people have pointed out, just to protect all the players.

Q105 Jesse Norman: Some of these settlements may take years and possibly decades to solve. It is a long term thing. Of course, some of them may also take shorter periods of time but point to systemic failure in how they are concluded, which would be picked up by this more interventionist approach, which would not be picked up by an NAO report some way after the fact.

Professor Judith Freedman: I am not sure whether TIGTA does intervene in the process, I think it is rather more like the NAO, but one could look at it.

Jesse Norman: It would certainly be a useful model, and I think we, as a Committee, ought to give some consideration as to ways to fill that accountability gap, based on these other models because you have very helpfully described how it exists and reminded us of its centrality in one or two key cases. I think that is it for me.

Q106 Chair: I wonder, Professor, if you know the constitutional position of the HMRC? It doesn't only extend to confidentiality of people's accounts. The last set of hearings ended up with how badly HMRC treat their customers, and some of the experiences are horrifying; call centres. When we pressed the Minister it was almost, "This is operational". It was like speaking to a chief constable, or a chairman of a police committee, "I may be the elected head, but I have nothing to do with anything that happens". "Well, why on earth are you there?" Do you know the constitution position? Each agency has a different status and there is a status where you cannot touch them and there is a status where you can interfere. This seems to be one that is outwith the power of any politician to do anything.

Professor Judith Freedman: They are answerable to the Public Accounts Committee, aren't they?

Q107 Chair: They are accountable to us, and they go before the Public Accounts Committee. We discussed yesterday with the Bank of England, the Governor, what that means. It just means they come here for a couple of hours, flannel, get out there as quickly as possible with the least damage. That is about the basis of it. In terms of saying, "At Call centres half the calls are not dealt with, do something now". "No, nothing to do with you", you know. There you are.

Professor Judith Freedman: That does seem to me to be something that needs to be explored.

Q108 Chair: Okay, but you will send us something. A last thing—you may not want to say anything, I warn you now before I say it—I will accept a no. I am a sort of individual who comes into this not being part of the exercise. It is like the Emperor's clothes, I come and I hear things going on and I think, "This is not true". That reference I made to Google, the headline is not that they only paid £3 million; it was that Google avoided paying £3 billion tax in the UK.

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I am just a layman; I represent ordinary people who are paying their taxes and working hard for it, and I think well, “Why on earth does this happen?” You are deep in the tax world; do you not sometimes sit and think, “Why on earth is this happening?” Do you say, “Why is it happening operationally?” or if you ever say anything, do you say, “Why aren’t the politicians doing something about it?”

Professor Judith Freedman: I am an academic, so I look at it at a much more theoretical level.

Chair: But that makes you more objective, doesn’t it?

Professor Judith Freedman: I am also not in the tax world, in the sense that some of your other witnesses

are, and I say—but this is not something your Committee can do much about—that the problem is probably the international tax system. So I don’t say necessarily something is going wrong with the administration but that we don’t have the right rules, so at each point I try to recommend ways of changing the law rather than just the administration.

Chair: You don’t have anything to say on it, do you?

David Sproul: Nothing further.

Chair: Wisely. I apologise for overrunning the first session, but thank you very much for your evidence. It has been very objective and most useful. Thank you.

Wednesday 13 July 2011

Members present:

Mr George Mudie (Chair)

Stewart Hosie
Andrea Leadsom
Mr Andrew Love

John Thurso
Mr Andrew Tyrie

Examination of Witnesses

Witnesses: **John Whiting OBE**, Tax Policy Director, Chartered Institute of Taxation, **David Heaton**, Chairman, Tax Faculty, Chartered Institute of Accountants in England and Wales, **Chas Roy-Chowdhury**, Head of Taxation, Association of Chartered Certified Accountants, and **Frances Corrie**, TaxAid, gave evidence.

Chair: Good afternoon. Can I apologise to you, we are going to go very quickly and I know you are always brisk and brief, but if you could stick to that it would be much appreciated. We are coming to the end of the session and meetings are piling up and we are attending two or three meetings at the same time. Members, we could lose a quorum if we are not going through it quickly. I am taking too long already. Welcome and thank you for coming. Andrea Leadsom will start the questioning.

Q109 Andrea Leadsom: Good afternoon. Thanks for coming. I would just like to talk to you briefly about compliance to begin with. The fact is that, as you all know, just under 80% of the theoretical tax take is voluntarily paid by the British public and only 2.9% roughly is paid following compliance, and similar figures in the US. Would you agree with their assessment in the US that actually the best way to improve compliance is to increase the voluntary compliance? Could you comment on how we might achieve that if you think that is a realistic possibility? Mr Whiting, will you start?

John Whiting: Yes, by all means. Basically, yes, I agree, voluntary compliance is clearly better. It is more efficient all round, setting the right atmosphere, making sure people realise it makes sense to comply and pay their dues. Of course, that is not to say you give up on policing the hidden economy, tracking evasion, avoidance, but encouraging people to comply, making it easy for them to comply, has to be in my view the right route. What that means is giving a certain amount of incentives. If we touch on the hidden economy, giving incentives and encouragement to come out of the hidden economy and get straight, rather than just automatically hitting people with a penalty, is very often a better route.

Q110 Andrea Leadsom: Would any of you care to disagree with Mr Whiting?

Chas Roy-Chowdhury: No, I think John is absolutely right. I also say that what we need is a simpler tax system where the taxpayer actually understands their obligation. I think that is where we have the biggest problem in the UK—with the high level of complexity. Certainly, with the OTS, which John chairs, there has been a lot of work done in this area and further work in the coming years, but we need to make sure that is actually driven home and we do end up with a simpler system rather than just the standstill.

I think that is one of the areas that the ordinary person in the street and businesses have a real problem with. They do not actually know when perhaps they are doing something wrong or when they are not complying.

David Heaton: Could I just add I think one of the issues we have is the increasing drive to making everything happen online. There is a big slug of the population, mainly pensioners, who are not e-literate yet and I think it is very difficult to get to those in the same way as you would get to employers, for instance. I do think I would agree with both John and Chas. We do need to make it easy for people to comply, but I do not think the answer is all “e”.

John Whiting: Exactly.

Frances Corrie: Could I say for the unrepresented that we see at TaxAid we are obviously contacted by people who are trying to get their tax right and often cannot find the answer to what may to us be quite basic questions, but they cannot identify where the information is online or they cannot apply it to their own circumstances. Therefore, they are left without the feeling of certainty that they have actually met their obligations, which is what they are looking for.

Q111 Andrea Leadsom: That takes me on to the next point, which is we had evidence from the FSB a couple of months back who said that they felt that the complexity and the poor service of HMRC was actually causing new businesses to fail to register for VAT, for example, because it was simply too difficult. I wonder to what extent you would all agree or disagree with the risk that HMRC’s problems with its administrative effectiveness have had a knock-on effect on the level of voluntary compliance because it is so difficult to comply.

Frances Corrie: If I can come in on that, I would certainly say that the difference, I think, with agents, who have been very vocal about the lack of service that they have met, but agents are paid to persevere and to carry on until they get it right, but the individual who fails to get through several times may just give up. If it is giving up on registration, if it is giving up on making a time to pay arrangement, you have lost them out of the system.

Q112 Andrea Leadsom: Then, if I am not putting words in your mouth, you would agree that HMRC’s own internal problems would cause a worsening of their voluntary compliance?

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Frances Corrie: I think that is right. The people who start off with the will to comply may lose that will if it is made too difficult, as John has said. It needs to be easy.

John Whiting: I would echo that completely. I think our Low Incomes Tax Reform Group would say that it has to be easy; people have to be able to get through. As David rightly says, it must not all be electronic. I know, if I put my Office of Tax Simplification hat on for a minute, this is one of the biggest difficulties that small businesses cite to us, the difficulty of getting certainty, closure on their dealings so that fundamentally, coming back to your first question, a vast majority of taxpayers are compliant. They want to close, move on to the next thing. That must be easy; no worry, as Frances says, about, "Oh, have I finished everything?"

Q113 Mr Tyrrie: I would like to discuss the treatment of HMRC and the tax gap to start with. Could I begin with you, Mr Whiting? The HMRC vision is to close the tax gap, among other things. Do you think that is the right vision for HMRC to have?

John Whiting: I go along with it up to a point and I think it is like any business; you have to have aims and objectives in mind and things that you measure. It worries me if that is the only vision and objective that they have in mind, partly because of the difficulties of measuring it and partly because another objective, surely, should be possibly to increase the gap by making sure that the low-paid, for example, get all the credits and benefits that they are entitled to. As I say, I think it is something that has to be looked at and has to be a guiding light, but certainly it should not be the only one by any stretch of the imagination.

Q114 Mr Tyrrie: What would be the others you would like to—

John Whiting: Well, as I said, a certain vision of making sure everybody's tax bills are right, I think, would be a very good one.

Chas Roy-Chowdhury: May I say something about the tax gap? I think in terms of the definition, if we looking at this pie chart that I think you have cited in previous hearings, to what extent are they going to close the part about legal interpretation, about avoidance, about failure to take reasonable care? The failure to take reasonable care you can do something about. Evasion you can do something about. But the 15% relating to legal interpretation or the 17.5% relating to avoidance, that is just their opinion. There is a big definitional problem and, I think, "What is a tax gap?" It is like trying to get hold of smoke. There is no proper idea what that is and then we are trying to close it. I think we should be going after compliance and people trying to pay the right amount of tax and these sort of things we have been talking about where those who are unrepresented, small businesses or large businesses, they can actually comply and pay the tax they owe easily. Then we should be going after the tax evaders rather than having these kind of fairly esoteric difficult to define ideas within the tax gap, which no one can really ever agree on.

David Heaton: I think, if I may, I would probably go further than John or Chas. I think the tax gap is entirely misleading. The definition of what taxpayers should pay compared to what is actually paid is not very helpful, it is less than helpful, because nobody really knows what taxpayers should pay. I do not think the Revenue is in a position to identify that number. I think the tax gap is wholly misleading and I think, as John says, that the effort should go into helping people to comply and policing people to make them comply.

Q115 Mr Tyrrie: It is hardly surprising, therefore, that a department that some have described as close to failing is in that condition if its vision, the first line of its vision, is something that is describing an impossible task. The first words of the vision line are, "We will close the tax gap," which you are saying is meaningless.

David Heaton: No, there is a tax gap, there is no doubt about that, but I do not think that is the way to attack what they really want, which is collecting more money.

Q116 Mr Tyrrie: I will bring you in in a moment, Mr Whiting, again on a slightly different point. Did you want to add something?

John Whiting: Purely that I come back to I think the tax gap is worth looking at and if it is measured on a consistent basis and if one sees it spiralling up, then that does suggest things are not going right or it is a source of questioning. But it should not be, as I think we are all saying, the only driver. It is worth looking at.

Q117 Mr Tyrrie: I was actually going to come on to you anyway, Mr Whiting, so bad luck. The Chartered Institute of Taxation, with which you have had something to do over the years, the inaugural address of the president stated, "We need to get back to taxing in accordance with the rule of law". By that he presumably means collecting the right amount of tax, using the phrase you used a moment ago, or often you hear the phrase "the correct amount of tax." Do you think it is possible simultaneously to achieve that, while using tax gap estimates based on judgments about what has been called the spirit of the law rather than the rule of the law? The spirit of the law is a phrase that a number of people have used with reference to HMRC's approach to tax collection.

John Whiting: If you start using the spirit of the law, it is very much as David has alluded to, whose spirit? Who is saying what is the right answer? Inevitably, HMRC are suggesting their interpretation is right. We have always much preferred—as our president, Anthony Thomas, has stressed—taxing by what the law says, not by opinions or whatever.

Q118 Mr Tyrrie: It is clear that the purpose, vision and way of HMRC is in a terrible mess. That is what has just been told to us in evidence, although HMRC will have an opportunity to rebut that. But then that leaves the question is that their fault or is it the fault of the legislation they have been asked to administer?

John Whiting: The legislation that we have in this country is very complex. I totally go along with

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Chas's earlier comments. It is over-complex. As you well know, Mr Tyrrie, I am trying to do a little bit about it and trying to simplify in certain areas, but it is only a very small part that I can do something on. But what we need—

Q119 Mr Tyrrie: The question I am asking is, is it fair to bash HMRC for what appear to be constant failures when the cause may well lie in the legislation that they have to administer or implement?

John Whiting: I think it is reasonable to say HMRC take a certain amount of the blame, but in a sense we all are involved in getting the legislation through. Hopefully, we are getting a better process on new legislation, more consultation, steadier evolution, which should get us to legislation that is easy to apply, better framed in the first place. As I say, clearly Parliament has its part to play in that process. You quote the HMRC vision, Mr Tyrrie. The vision of HMRC also talks about their job being to collect taxes to pay for Government services, but actually what they talk about is making sure the money is available for Government services. I have always had a slight problem with that because I thought that was more Parliament's job and, again, HMRC's job is to collect the taxes that are due under the law.

Q120 Mr Tyrrie: Judging by the evidence we are hearing, it strikes me that this purpose, vision and way needs quite a bit of redrafting. That is the first line of the purpose section of this document you have just quoted and you seem to be making pertinent remarks about that. The first line of the vision section seems to be under attack. While we are on this HMRC vision, I just would like to take some evidence on one more line, which says, "Our way". I have to admit I am expressing a view myself rather than collecting evidence in saying this, but I wonder whether you share with me a concern with the line, "We are passionate in helping those who need it and relentless in pursuing those who break the rules".

John Whiting: Well, certainly I and my body have expressed concern about that. It is perhaps inflammatory language, some of it, but it is right to say that they should pursue those who break the rules.

Mr Tyrrie: And that we should try and collect the right amount of tax.

Q121 John Thurso: Can I ask about the intervention yield and how relevant or not this is? I do not know quite who would like to have a go. Mr Heaton, perhaps I could start with you. I have a chart here that shows that the intervention yield has gone up every year between 2005–2006 and 2009–2010, starting at 7.4 and going up to 12.6. What does that tell me, if anything?

David Heaton: I think I should preface this by saying that I do quite a lot of tax investigations work, so I have seen quite a lot of that intervention yield in the clients I have had to deal with. I think, to give the Revenue credit, their efforts over the last few years have improved immensely. Their targeting is better; their risk assessment is better; their focus is better. On the negative side, I think that they have been criticised for being too aggressive and some clients will pay

rather than prolong the process. From personal experience, I have a particular case in mind where the company had just finished some lengthy litigation in the European Court and did not want to go into another tribunal case, whether or not it had a strong case did not matter, they just did not want another case. I was instructed by the finance director to settle at any price. Not strictly at any price, but he was not too worried about it. They had made a provision in the accounts because the Revenue had written to them and said how much they thought they owed, and we settled. I think the figure the Revenue had started asking for—off the top of my head—was £1.2 million. We settled at £65,000 in the end.

Q122 John Thurso: Bit of a difference between the two.

David Heaton: Yes, there was an argument about principle and we agreed in the end that the principle that HMRC were looking at was not the right principle to consider in that case. We came to what was probably the right answer at the end of the day. I think Professor Freedman said a couple of weeks ago there is not a right answer in tax, and I think that is probably fair in that kind of situation.

Q123 John Thurso: That case you have just raised could be the system working rather well, which is somebody at the Inland Revenue says, "What ho, this looks like a chunk of money we should get." The company hire a very qualified and efficient professional, and you end up arriving at the right answer based on the correct principle and the proper amount of tax is paid.

David Heaton: Yes, that is right.

Q124 John Thurso: But how does that help me with my intervention yield? Are they saying that the 1.2 is in the figure or the 65?

David Heaton: Well, that is an interesting point and it goes back to Mr Tyrrie's question about the tax gap. The way the tax gap was described to me by somebody in the Revenue probably 12 months ago now was the difference between the tax that the Revenue thought was payable and the tax that was eventually paid, but the issue was with that first number, which comes back to your intervention yield. It was described as, "We tell our people how much their target is, what the yield is that we need from them, and they have to issue assessments to achieve that yield". They go out and they look for values on the jobs that they cover in a particular month. It is clear they have targeted yield. They break it down into chunks just like any business would. They have a job to go out and look for errors that taxpayers have made and correct those errors. The first number they start with is the number that they aim for, so there is a certain amount of self-fulfilling prophecy about it, I think.

Q125 John Thurso: HMRC print a table of key performance and it has intervention yield and, as I say, 2005, 7.4; 2009–10, 12.6. What I would really like to know, is how robust are those numbers? What do they mean and what do they tell me about HMRC?

Because, superficially, they say HMRC is doing a great job, but if all the numbers are as flaky as they might be, it could tell me absolutely nothing.

David Heaton: Well, I don't know how the Revenue compiles those statistics.

Q126 John Thurso: Anybody have any help there or shall I stop?

John Whiting: I can do no more than echo David's earlier points and I have no immediate example to cite in parallel to his. But the Revenue, I think, has got better at targeting, looking in the right places, assessing risk. That is the basis of the intervention yield seemingly improving. Are they, of course, tackling only the easy situations? Are they missing some of the others? That is a different question.

Chas Roy-Chowdhury: Well, I think there is this issue of the low-hanging fruit. They are going after those who are actually in the tax system. We have already mentioned about the taxpayer trying to comply and they are getting it wrong, and if the Revenue are then picking those targets based on, well, hopefully based on the risk assessment strategy, then there are perhaps harder targets but ones which could yield a lot more in the evasion part of their pie chart, which I think they should really be focusing on. Some of which they are slightly focusing on through the offshore disclosures, the trade disclosures, the doctors' and dentists' disclosures, but perhaps they are going too much after those who are more visible and not after those who are less visible or invisible.

Q127 John Thurso: Another table that we have had from the Revenue is the average revenue generated per tax officer. Clearly, if you can say that activity is producing more per person than that activity, as a manager, key performance indicator, you go that way. I might look at this and I see that air passenger duty is 425.7 per officer, whereas inheritance tax is 6.9. I could come to the conclusion I do nothing about inheritance tax and I spend a great deal of time chasing air passenger duty. But doesn't that actually tell me that air passenger duty is very simple, administered by honest people and there is no real need to do much compliance, whereas inheritance tax probably needs a lot more work?

David Heaton: It could also be a feature of the number of people doing the work. Air passenger duty is a very, very specialised area. I cannot imagine the Revenue have more than a handful of people working on it.

Q128 John Thurso: But according to statistics, it is a huge yield?

John Whiting: Yes, it is very simple and in many ways if you quote the statistics on VAT, that all has a very good payback for the numbers of people involved because, of course, the taxpayer does most of the work. The trader does most of the work on VAT, air passenger duty. Inheritance tax does involve far more work by everybody, far more negotiation. Therefore, in terms of yield per Revenue official, it is much less.

Q129 John Thurso: The point, therefore, is that these statistics, while interesting, have to be taken in the context of what they really mean?

John Whiting: Yes.

John Thurso: And not just used as simplistic—

John Whiting: Again, look at a trend.

Chas Roy-Chowdhury: I think also the taxes, because I think with air passenger duty you either got it right or you got it wrong, whereas I think for inheritance tax IHT is a grey area. There is no exact answer, perhaps.

Frances Corrie: Could I make a point here on the improved targeting? Some of what we do is explaining to taxpayers that actually the Revenue have this absolutely right. They have been inadvertently evading tax because—well, I could come up with a list of examples but probably not at the moment. The question there sometimes from the taxpayer is, "Well, why have they allowed me to do this for so long?" If their targeting is that good, if it is picked up after the first year, you can put it right and everybody can go forward on the right basis. But if it has gone on for four or five years and they are then coming back for the tax on all that, it has put the individual, who did not intend to do this, in a very difficult position.

John Whiting: Because typically there is a number of years of the personal allowance that has been double allocated or whatever to claw back and the taxpayer in his or her innocence did not realise this and, of course, the Revenue have little incentive to actually sort it out because the target is not framed in that sort of way.

Q130 John Thurso: What would happen if we introduced a rule in Parliament that anything the taxpayer had not got right within 18 months, too bad, they have missed it?

John Whiting: Well, of course, it has been cut down generally from six years to four years fairly recently.

Q131 John Thurso: But do you think we ought to be much tougher and say two years or 18 months and just say—because the point you make, I have a lot of constituents who suffered from the problems with PAYE, many of them pensioners, and actually the claim that they have now had for two years is giving them quite big difficulty.

John Whiting: Well, exactly.

John Thurso: What they all say is, "How come these people are meant to know this Government did not get it right?"

Frances Corrie: Yes. We also see it, in fact, in cases of outright non-disclosure. This would be evasion if they had really known what they were doing, but they have fallen into some of the traps of complexity sometimes and then you are looking six years with no problem.

John Whiting: The problem about cutting it right down to perhaps two years is, of course, still there are plenty of people who are actually due some tax back through no fault of their own. There are the mirror images of the examples that Frances and I are referring to that Tax Help for Older People sees regularly, and to cut them off after two years would be unfair. I think it would be a little precipitate to cut

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it down further. If everything is running smoothly, then perhaps we can come back to this in a few years' time.

Q132 John Thurso: The point, John, I think made before us often is this whole struggle is a bit one-sided, which is if HMRC make a mistake they can come after you whenever they feel like it and you have to pay and that is an end of it. If they have your money, they are frightfully sorry but that is the end of it, whereas if you make a mistake and you have their money, then it is massive fines and they come after you with the full force of the law and they are frightfully aggressive. It is a bit of a one-sided battle.

John Whiting: Yes. We had the earlier example; the thread of VAT registration was mentioned. Of course, if you fail to register for VAT that is quite an offence and in many ways rightly so. But for a small business that then suffers from the Revenue's delay in registering, that can be extremely painful because when you finally get your registration through, you were, of course, supposed to be charging VAT from the moment you applied. Now, the Revenue have done a lot to try and reduce that gap, but the penalties and the pressures are a bit lopsided as effectively you are alluding to, Mr Thurso.

David Heaton: I do think that we have to be fair to HMRC as well in that your 18-month example of a cut-off date would make it extremely difficult for them to make system changes. One of the issues we have at the moment is the problem with converting all the Pay As You Earn databases on to a single database, the NPS. That is what has caused a lot of the problem with the coding notices, which were in many cases spurious. I even had a self-employed client who received one because of an old employment that had not been wiped off the system. They cannot do that kind of change quickly and if we simply brought down the shutters to say, "I am sorry, guys, you only have 18 months to make sure this tax is collected," I think it would make their job intolerable.

John Thurso: Thank you very much, and back to you, Chairman.

Q133 Chair: Thank you very much, John. Could I just ask Chas there, you say they would be better chasing the hard to find targets? I am particularly exercised by offshore, for example. I would be told by some that if you chase after it there is not much money there because they are all honest people paying taxes in various—you are suggesting we go for them. What returns do you think we would find?

Chas Roy-Chowdhury: Well, I think by the very nature of the evasion it is very difficult to actually pin down, but if we look at the pie charts that there are, there is a significant number under criminal activity, under tax evasion, and I think we ought to be looking at those areas rather than those people who are getting it wrong or the Revenue interpretation does not agree with what the people are doing or they have made errors. Because these are people who are actually registered for tax; they are trying to comply; they are getting it wrong or they are making the wrong payments. But over and above that there is this population that just are trying their best to stay below

the radar and we do not seem to be doing enough to really tackle those. I think under the various disclosure regimes it has been a good thing to go after people with offshore bank accounts, with the Lichtenstein agreement, the people who have been under-declaring, but we should also just be going after those who are just not on the system at all. I think there has probably not been enough work done on that. I do not know what the yields from that would be, but clearly, we talk about tax ethics, from an ethical point of view they are the people who just do not want to pay any sort of tax whatsoever. They are the ones we should really be focusing on so they realise that there is this line in the sand that they cannot cross in terms of not paying tax, and to actually draw them into the system and going forward they will start paying tax, which has been a part of the disclosure strategy but perhaps not sufficiently tough enough to capture enough of the tax evaders.

Q134 Chair: If I can ask you as a group, are you content you know where they have targeted in the past? Let us say up to this year, where they have been targeting? Are you just taking their figures where they say, "We have this from our scrutiny of people and our chasing people."? Do you know the areas? In other words, if HMRC said to you, "Well, we are doing that but it is difficult," would you be able to say, "Well, you are not."?

Chas Roy-Chowdhury: No, in terms of that sort of forensic analysis we do not have the information to do that. We have been part of groups to deal with the offshore disclosures, etc., but not in sufficient detail to actually say, "Well, actually, you could do this in a certain way." We have been told after the event in some cases, such as when they have gone after the doctors and the dentists. Yes, they were doing that and we could have a different approach, but we have not perhaps been brought in close enough to what they were doing to be able to say, "This would be better," or "That would be better," other than after the event.

David Heaton: I would echo that. I think they have had some success where they have picked a target and announced that target. We do not always know what their projects are and for obvious reasons if you are the police you are not going to tell people they are about to be raided. Today, I think they announced from HMRC that they were going to concentrate on takeaways in London. That is their latest project.

Q135 Chair: Clearly easier than looking at the Cayman Islands, isn't it?

David Heaton: Well, probably. It follows on from Chas's point, really. If they pick a target because they have found some non-compliance in that area, it makes sense to go after more non-compliance in that area. The difficult judgment they have to make is where to stop. When does the law of diminishing returns kick in? We know about the doctors; we know about the dentists; we know about the Plumbers Tax Safe Plan; we know about Lichtenstein. We do not know what other major projects they have on, but trends do emerge.

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Q136 Chair: The point I am trying to make, are you up to date with the areas they are targeting now with their £900 million?

John Whiting: Only to the extent in a sense everybody is, because they have not shared their plans with us, if that is what you are meaning, Chairman.

Q137 Chair: Yes. Did they share them with you last year, John?

John Whiting: Not really, no. It is no more than Chas says—

Q138 Chair: When they come back to us and say, “We were very successful,” if you do not know the target, we are only taking their word that they—

Chas Roy-Chowdhury: To answer your question, I think the only way we find out in terms of their targets, leaving aside these specific type disclosures, is when clients or members come and say these are the areas that HMRC have been writing to them about. We find out from the other side, if you like, from the taxpayers’ point of view, but we do not get told from HMRC this is the compliance activity.

John Whiting: But if you go back, and to use an example, the Plumbers Tax Safe Plan that David has mentioned, we knew about that slightly in advance because they did share some of the draft ideas and plans with us, the draft documentation, on a very confidential basis just before it was launched. We and I suspect the other bodies gave some feedback on it and tried to tweak it, but that was solely tweaking and adjusting. What it was not was, “Do you think it is a good idea to go for plumbers?” In many ways, I respect that. That is up to them to make the decision. One of our general feedback points was why not make sure that this is a generally available facility and, coming back to earlier threads that I think Frances and I both touched on, which is encourage more people generally to come out of the hidden economy and get compliant. We had said that to them. So far they have not picked that up.

Q139 Chair: You see, in the written evidence to us, they suggested 65% of their investment, the £970 million, would be focused on the mass market. I was asking David before the meeting what the hell the mass market was in tax evasion. We have a Division. We will be back in 15 minutes, hopefully.

Sitting suspended for a Division in the House.

On resuming—

Chair: Sorry, you were saying to my very intelligent question—probing it would be called? Who is picking it up? Was it you, John? Were you stopped in mid-flow? You were going to bare all, weren’t you?

John Whiting: Probably, Chairman, if you could remind me of your precise point. What was the question?

Chair: Just give me an answer, John, never mind the question.

John Whiting: Forty-two.

Q140 Chair: Andrew, what were we speaking about downstairs—offshore? You have no idea. The tax gap seems to be imagined; 42 is the official figure, but who accepts official figures? That is the official figure,

so that is the lowest it can go and it goes to over 100 million. What about offshore money that we should be picking up?

John Whiting: I am sorry, Chairman, I should pick up on your question obviously.

Chair: Yes, you remembered.

John Whiting: You are right. One of the things I think the Revenue has to do, and it clearly is a balance, is to get the message over to taxpayers that there are no easy ways of avoiding—

Q141 Chair: Have you taken me off offshore?

John Whiting: Well, bear with me. There are no easy ways of avoiding/evading tax. There is a message to be got over and there is an element in recent years that the message has become, at one stage, that if you parked money offshore the Revenue could not find it. Now, of course, they have done a good deal to try and tackle that with some of the disclosure arrangements, with more of the exchange of information, to start getting the message clear that there is no easy hiding place for money. There is clearly a need for the Revenue to keep up the pressure on offshore money. There is a lot of discussion about agreements for exchange of information with Switzerland, for example, which would be very significant. There is a need to pursue that, and—it is quite challenging for the Revenue—a need to pursue all areas, to keep up the pressure generally. Difficult as it is, it comes back to the need to pursue all these difficult areas, not just the easy, low-hanging fruit or pressurise small businesses.

Q142 Chair: I will come back to you, Chas, and you can think about your answer. But when you say there is no easy hiding place, aren’t the offshore areas easy hiding places? I am just thinking of two schemes. When Leeds United were bought out under doubtful circumstances, the Leeds members asked HMRC who on earth owned Leeds United because it was based in the offshore. No answer was ever forthcoming. To this day nobody can say who owns it. The transparency, the opacity, I suppose; it is a black hole, isn’t it? Then there was the business of Barclays with the company they formed and put their bad assets in. I have not seen any explanation from HMRC about their arrangements. The financial press raised it, gave it up after a couple of articles, and Barclays have carried on with it. I know there have been developments, but they have gone unimpeded with a lot of money at stake. Now, isn’t that a hiding place?

John Whiting: Yes, and what you are getting at is that there are not the transparent rules of ownership. There is not the equivalent of Companies House in many places where you or I can go to look up a company, find out who owns it and trace it through, which we can do in the UK. That does not necessarily apply in lots of other jurisdictions. Without wishing to sound as if I am splitting hairs, it is more of a regulation/corporate law/disclosure-type issue rather than a tax one, but the two are interrelated. From the Revenue’s point of view they are clearly right in continuing to pursue exchange of information agreements and getting information about tax matters from other overseas authorities.

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Q143 Chair: I understand, but, coming away from the Cayman Islands because we have a connection, but an offshore that is not a British protectorate, you could speak about regulation, but it still is a tax matter here. Our regulator cannot regulate another designation, but our tax people have every right and every duty to be following the money and making sure that whatever proceeds are properly taxed, yes? Do you think Inland Revenue do that? Do they have the facility to do that?

John Whiting: They do. They are pursuing it.

Q144 Chair: Are they doing it?

John Whiting: They are doing quite a good job of getting more exchange of information agreements with increasing numbers of territories. If they find that Ruritania is being used as a haven, I think they are quite switched on to go to Ruritania and try and pursue that.

Q145 Chair: Do you think they have done it with the Cayman Islands?

John Whiting: I cannot comment specifically on that. I know that they are—

Q146 Chair: Ruritania sounds a bit easy to get at, but the Cayman Islands and the like seem to be harder nuts to crack.

John Whiting: They have at least got as far as an exchange of information agreement and how much that is being used I do not know. I do not know if colleagues have—

Q147 Chair: Right, Chas, should we pursue these? What are your observations on John's very pertinent comments? Somewhat guarded, but pertinent.

Chas Roy-Chowdhury: Yes, we certainly should. I think once we have these various agreements such as with Liechtenstein and other jurisdictions, we need to stick at it, because it is much easier, if you like, once the car is running to push it along than to actually then go back and reinvent it. I think we need to make sure we pursue people who have squirreled away money from activities in the UK, when they have never paid tax in the UK and they are clocking up interest or other forms of gains outside the UK, and we need to make sure they actually pay tax on those monies. There is no question about it, and that is exactly the sort of tax evasion that I was talking about earlier. Rather than going after those people who are on the tax radar, let's go after people who are out and out evading, who are not paying at all any sort of fair share of tax they should be towards the UK economy.

Chair: David, I will just stop you because my colleague wants to go and when he goes we almost have to finish the meeting, so I had better bring him in. Carry on, Stewart.

Q148 Stewart Hosie: I have all the time in the world, within reason. Frances, there seems to be a growing consensus that the Revenue are neglecting people who are outside the tax system entirely. Do you have any evidence that they are making any serious efforts to get those who are outside the tax system into the tax system?

Frances Corrie: Well, the efforts that we have seen are in the area of the campaigns that have already been mentioned, so at my end of the scale and possibly not even then. The offshore, of course, does not on the whole tend to affect our clients. Plumbers, possibly, but I have to say we did not see a huge number contacting us because they were worried about this campaign. Some of the areas that I think have been floated as possible on the horizon, like eBay traders and what is the other? Oh, part-time coaches.

John Whiting: Tutors.

Frances Corrie: The sort of moonlighting add-on ones. I think there is a mixture there of people who do not know that they should be paying tax on this, have a suspicion but have not got round to doing anything, and are quite clear that they should be and are determined not to. We probably deal with the first two out of those three. To revert to a point that John has made, campaigns in their nature, as I understand it, are fairly limited. They give limited opportunity and from the Revenue's point of view the advantage is that there can be specific follow-up, though I do not think we have really yet seen the impact of that as far as individuals are concerned. They had not seen the results of people being found out and possibly prosecuted.

Q149 Stewart Hosie: Obviously, if people are found out and prosecuted in a sector, it might well provide an incentive for others in that sector to suddenly discover that they perhaps should have submitted their accounts, and that is perfectly reasonable. But in terms of the proactive work the Revenue are doing to encourage those outside the system into the system, I think you said yourself that the Revenue operate this Tax and Benefits Confidential Hotline, the TBCH, but that it is not publicised anywhere and it is difficult to find on the Revenue's website. Is this something they do often?

Frances Corrie: That is right. The Revenue will, in fact, say that anybody can volunteer if they have been outside the system. They can make a voluntary disclosure at any time and they will in practice get terms similar to those that have been announced in the campaigns. But this in itself is a message that is not widely publicised. We would like to see a more permanent, visible and transparent route in either through the helpline or, as online is the preferred mode, something on the website that enabled people to effectively get themselves back into the system at the time when in our experience what prompts people back into the system is very often personal events in their lives. It is not the availability of a campaign or even the thought that the Revenue are more closely breathing down their necks. It is their partner who has told them to get themselves sorted out or there is a baby on the way.

John Whiting: It is not just the amount of tax, it is also being very ready to spread the payment, because too often somebody approaches the Revenue from the low income sector, finds that understandably they have tax to pay, the Revenue start adding interest and penalties, you can understand it, but then asking for

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that amount to be paid immediately, well, it will put people off and it is just not a runner.

Q150 Stewart Hosie: Indeed, I understand that perfectly well. But I just want to keep probing this TBCH, this helpline, because apparently they refuse to help anyone who is reflected anywhere on HMRC's system. This is apparently what tax agents have said to us. Now, if that is true and someone had a part-time job or a seasonal job and they were in the system and then out the system and there was perhaps a discrepancy, and then a year or two later they say for whatever reason, "I want to get back in, get this sorted out, and I know I have some stuff to pay", the helpline would help them. Is that not back to front? Surely these are precisely the people that we want to—

John Whiting: Because they are wanting to come in.

Stewart Hosie:—legalise and regularise?

John Whiting: Of course, the Revenue cannot be a soft touch because it cannot be, "Oh, I have just decided to drop out for a year. Give me a deal for coming back". The Revenue are entitled to probe the circumstances, but the mindset must be there, dare I say it, a little more commercial, to encourage the customer—bear in mind that we are all customers—back into the Revenue's tender embrace, to make it encouraging, to make it worthwhile and, as Frances has said, to make sure the facilities are there to get them back on the straight and narrow.

David Heaton: Probably worth pointing out that the Revenue have for some time had what are known as Grabiner groups within their special investigations teams around the country. They have had people who are specifically devoted to identifying the ghosts and the moonlighters. They glean their information from various sources. So they are making efforts to attack that sector of the market. What you do not see very often is a prosecution to encourage people to—well, the stick side of the carrot and stick approach. John has been talking about the carrot. You do not see the stick either.

John Whiting: It is needed, I agree.

David Heaton: It goes back to the Chairman's point about offshore. The Revenue did a campaign where they served information notices on the five big banks and received information about people who had offshore accounts. Have we seen any prosecutions as a result of the people who they think they have found but did not come forward under the amnesty opportunity? I do not think we have seen any yet.

Q151 Stewart Hosie: It might also be, of course, that they are inundated with data and that 99% of the people with offshore accounts are paying €250 a week or a month to fund their Portuguese apartment, at which point it is frankly meaningless in terms of the tax system. However, you mentioned moonlighting and ghosting, and an incentive or a stick in order to encourage more. Is there anything else that the Revenue could do to tackle ghosting and moonlighting other than the obvious campaigns or the obvious publicised prosecution? Is there any specific action they could take other than the things they are already doing?

David Heaton: I can't immediately think of anything. They have been at it a long time.

Chas Roy-Chowdhury: Well, the latest disclosure is about VAT registration. That in itself is one of those areas where education is necessary. I think there are a lot of businesses that do not realise that they need to register for VAT based on turnover, not based on profit. Really, to answer your question, and things we discussed earlier, we have a very complex tax system where people do not understand the jargon and the language we all use. I think HMRC could do more to educate the ordinary person in the street, the ordinary business, so that they actually head off a lot of what then become tax evaders. People then realise two, three, four years down the track they have been evading tax, and then it is very difficult for them to contemplate coming back into the formal economy where they have to pay interest, they have to pay penalties, they have to work out what the tax was. It is just better that they just do not do that. I think rather than let people get into that situation, let's get out there and educate people. We had a situation where HMRC used to go and see new businesses to make sure that their records were all up to scratch and businesses used to use them, but then they stopped when HMRC then, where they found mistakes, started to take action against them. We need a situation where HMRC are more proactive in teaching people when there is a tax obligation and what that is and how to deal with it.

Q152 Stewart Hosie: That is helpful. Can I just go back to the encouragement to get people into the system? Because I have certainly seen some facts that many people do want to be in the tax pot, they do actually want to make their contribution. It strikes me there is a place for third party agencies, bodies, charities to help people, but the Revenue rules do not allow these discussions to take place. They might with a proper accountant, a certified accountant, but not with a third party body, even if they are experienced. Is there some merit in the Revenue having a register of, I don't know, trusted third parties where they could have these preliminary discussions to allow a trusted third party to say, "You are not going to be hit for £20,000, you are not going to be thrown in jail, but there will be an agreement of repayment terms to be reached"? Is there a place for that kind of trusted third party organisation in the big picture on this?

David Heaton: I do not think you need that trusted third party. I think the Revenue is perfectly capable of fulfilling that role. It just needs a change of attitude.

Frances Corrie: I think to some extent that that is the role that we find ourselves doing. It is not one we can take on to any huge extent because it is very resource intensive. To some extent, we would as usual be pushing back to individuals to self-help as far as they can with guidance. One piece of information that you mentioned there, which is very important, is the question of prosecution. Most individuals think they will be prosecuted even if they voluntarily disclose, so the fear of that is something that positively holds back. Now, if there was a statement on the Revenue website, "Give us your information through this secure link and as long as it is a full disclosure and

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honest and so on, you will not be prosecuted” I think they would get a lot more customers.

Q153 Stewart Hosie: Why don't they do that?

John Whiting: Because they do not want to say a blanket, “Of course, you will not be prosecuted if you give the information” because they understandably have to reserve the right to prosecute somebody who, frankly, has been doing very egregious tax evasion.

Q154 Stewart Hosie: Indeed. David, you spoke about changing the culture, but when we had the Revenue here a little while ago I think they said something like a small percentage of people do evade and a large number, I think it was about 30%, would evade if they thought they would get away with it. The culture of the Revenue is a third of the people in this room want to cheat. This is just an extraordinary starting point for the Revenue, is it not?

David Heaton: I think the survey they shared with us suggested that 7% of taxpayers are deliberate wrongdoers. That is an attitude of mind, I think, and most of those people will not be converted easily by any Revenue department, however draconian the powers might be. Going back to John's point from earlier, I think there are ways and means of persuading people, helping people, to get things right. The Revenue systems do not help them at the moment. I will give you a real life “for instance”. A company came to us referred by the solicitor because they had bought another company and found irregularities in the Pay As You Earn. They wanted to make a disclosure, put it right. Absolutely exactly what you would expect; nobody supports evasion and most businesses do not support evasion. We wrote to the Pay As You Earn district, which I think was in Lincoln, off the top of my head. We heard nothing for weeks. When we followed it up, they had sent the case to another office. We left it a couple of weeks because internal post at the Revenue is notoriously slow so we did not chase it. Eventually, we did chase it again, “Oh, no, we have sent it to Bradford”. So we chased it in Bradford. Bradford told us it had gone to Glasgow. Nothing happened coming back from Glasgow, so we chased Bradford again and they said—because of a personal connection I managed to speak to somebody in the Bradford office because it is on my doorstep. They said, “We will see what we can do” and they managed to retrieve the case from Glasgow back into Bradford so that somebody could deal with it. Part of the issue in dealing with cases like that is it is not easy to do.

Q155 Stewart Hosie: So a company identifies a discrepancy from a company they have acquired. They want to sort it out. The paperwork goes all round the country and the poor company are sitting there panicking, this is taking such a long time, they have found something wrong. It is debilitating for senior management, debilitating for the company.

David Heaton: Yes.

Stewart Hosie: Who is responsible for that?

David Heaton: Well, I think the issue at base is that HMRC have reorganised the way they work and as part of that reorganisation responsibilities have been

dissipated in different directions. Some of the time people just do not know who is responsible.

Stewart Hosie: Extraordinary.

John Whiting: On your point about whether a third party group could help, yes, I think they could. I accept David's point; it is really the Revenue's job to help. Being realistic, people will not trust them completely. Is there scope for TaxAid, Tax Help for Older People, groups like that to help? Yes, there is. The stats will show it is actually money quite well spent if there is a bit of seed corn money passed from Treasury, Revenue, to help bodies such as that to help them.

Q156 Stewart Hosie: The Revenue rules, as I understand it, do not really permit this?

John Whiting: No, but to the Revenue's credit they have actually funded TaxAid and Tax Help for Older People and the Low Incomes Tax Reform Group to a degree. There is scope for doing more.

Q157 Stewart Hosie: You are very experienced and you know the Revenue inside out, is there an open door this Committee might want to push at to encourage them to be more supportive of trusted third-party organisations.

John Whiting: I am not going to say there is an open door. There is a door. It has been opened, a little bit has been put through and it has been shut again. You could have a go at opening it a bit more.

Stewart Hosie: That is helpful, thank you.

Q158 Mr Love: I want to focus on the role and activities of HMRC, but before I do that I want to go way back to our beginning and really to talk about the tax gap. Our inquiry is focused on the tax gap and I was rather surprised to discover that there seems to be quite a difference of view about what, if any, role the tax gap can play. I accept that there are areas like avoidance or legal interpretation where it may be somewhat dubious to contain firm figures, and we have heard here Richard Murphy, who I am sure is well known to all of you, who is at one end of the spectrum and of course some of the attacks and inquirers are at the other end of the spectrum. So, we accept that there will be no unanimity about the figures, but I think we can expect unanimity about there being a gap. There doesn't seem to be unanimity about the role it should play with HMRC and I think some of you were emphasising that perhaps they played too central a role in what they have done. So, the question I am asking is, do you accept there is such a concept as the tax gap, and do you think it is beneficial for the work of HMRC that that plays a role in the way that they address the public and people who should be paying their taxes? I do not want to go on with this for a long time but if anyone has—

John Whiting: Just briefly, yes, I accept there is a tax gap, yes, it should play a part. My concern is it is up there graven in stone, too rigid and playing too central a part because of all the issues about what exactly is the gap and how is it defined.

Q159 Mr Love: Would you all agree with that?

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David Heaton: I am not sure I would agree that it should play a part in the target-setting. Because of the uncertainties about how that number is calculated, and they are major uncertainties because it is an essential part of our assumption, I think it is very difficult to use that in any kind of meaningful way in setting a target for increasing collection. We have evasion, we have avoidance, we have mistake, Chas's pie chart. I think it is difficult to put anything meaningful on that number. Yes, there is a tax gap, I would not disagree with that. I do not think we can use it in any meaningful way to set targets because we do not really know what it is.

Mr Love: I think that is agreeing with the point that John Whiting made; how HMRC choose to use it is an issue.

John Whiting: That is certainly what I see as—

Q160 Mr Love: I just wanted to be absolutely clear about that. I am going to jump around a little so I do apologise for this. All of you commented on the role that HMRC seems to be playing, if I can put it broadly, in the legislative process, directions, guidance. It seems to be filling a vacuum and I think the view that you have taken collectively is this is not their role, they should collect taxes. The question I really want to ask is, if it is not their role, if there should be a minimal use of directions and guidance, how do we fill that gap? Are politicians not performing properly and how do we ensure that we do the necessary that does not drag HMRC into that vacuum?

Chas Roy-Chowdhury: I think HMRC should provide guidance and it should provide its own view but I guess the main problem that I have is that a part of the tax gap is legal interpretation or avoidance. I think that is the real area where they should be interpreting the tax gap, producing figures on the tax gap. That isn't really, I think, part of it, or certainly legal interpretation isn't. I think for the ordinary, unrepresented taxpayer especially, the website does contain quite a lot of valuable guidance and information and I think that can help people. So, I think they should provide guidance but they should not frame what they say as being the law. That is really where we are talking about this, if you like, ethical taxpayer type dimension that they should not really be encroaching on to.

Q161 Mr Love: Can I perhaps ask you, John? There has been quite a lot of criticism of the way Parliament goes about this process and secondary legislation seems to be more and more in use. Do we have the boundaries correct? Is HMRC only going up to where it is expected that they would or are they being sucked into a more quasi-political role?

John Whiting: In short yes, they are being sucked into that. You say secondary legislation. One of the problems we have is that HMRC guidance becomes tertiary legislation and is portrayed as having virtually legislative force. What is the problem? Well, the problem is that the base legislation is not clear enough. I agree with Chas, there is always going to be a place for some guidance and that could be very helpful, provided it is written properly, but it should

not be a substitute for getting legislation right in the first place. We cannot have tax by law, untax by concession. We should be taxed by what the law is. The solution is clearly a better process of getting the law right in the first place, giving it proper time, proper consultation, proper debate.

I have high hopes for the Government's tax policy-making programme. The ideas that they have set out, that is very promising. But it does require an acceptance that getting the right answer on tax will take time and if you look at the current Finance Bill, which I am conscious that certain Members will have been looking at, possibly more than they would wish to, there is a lovely example in there, "disguised remuneration". It is over 60 pages and really one looks at that and thinks, "There must be a better way" particularly as you know there are going to be more amendments in next year's Finance Bill.

Q162 Mr Love: The Office of Tax Simplification must have been somewhat perturbed after all their good work that they were—

John Whiting: I do put up a slide regularly that quotes two numbers, which are 100 and 382 and ask people to recognise which is which, as I am sure you and the Chairman will get it. One hundred is the number of pages of legislation that is being abolished as a result of the OTS' work and 382 is the length of the Finance Bill before it was amended. So, we are losing but we are not losing by quite so much.

Q163 Mr Love: I don't want to get into this because this is not in a sense our inquiry, but, John, perhaps you could set out for us very briefly how you think Parliament could do better and not drag HMRC into areas—

John Whiting: I think I come back to give it time, do the tax policy-making process properly, so that what comes to Parliament has basically been almost stamped as approved by bodies such as ours to say, "This works". Then the HMRC guidance can concentrate on arguably what it should do, which is just to help the ordinary person understand it.

David Heaton: One of my close colleagues has been working with Revenue on the disguised remuneration in particular and I echo everything John said. It was first published in draft in December, then we had another draft for the budget, now we are on to the third or fourth version—is it the fourth version at report stage? There are so many issues with those 60 pages of legislation. We have 214 pages of internal revenue guidance that have been published plus umpteen frequently asked questions. It is not satisfactory that the legislation has been changed three times in six months and we still don't know what all the answers are. Again, John's point, tax it now but let some people off by concession, is not right, but that is exactly what is going to happen because there is some collateral damage in that legislation that is not intended.

Chas Roy-Chowdhury: I am on the Revenue committee dealing with disguised remuneration, but in some ways that piece of legislation is defective to start with because it is a rules-based piece of legislation that you will have to change every year as

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other tax legislation occurs that may be caught by this. So, what we need is a system where it is much more principles-based and it can stand the test of time.

Q164 Mr Love: Because of time constraints I am going to have to ask not everyone replies to every question, so I shall direct them. If I have the wrong person then perhaps you can holler at that point. I wanted to ask you about relations between HMRC and the tax profession. There has been some suggestion that it is at an all-time low. Would either Mr Heaton or Mr Chowdhury want to comment on that?

Chas Roy-Chowdhury: I sit for ACC on the Agent and Strategy Committee with HMRC and we worked together to produce the consultation document that has been published, so a discussion document that has been published, and we have meetings with them next week, so it is an ongoing dialogue. I think at the professional body level we have a lot of useful contact and we do try and make some useful changes for the taxpayer, for the agent and for HMRC, and for Government obviously. I think on the ground there are some real issues for taxpayers and for agents dealing with HMRC because a lot of the work that we do at the HQ level with HMRC is one thing, but in terms of where agents are trying to engage with HMRC at the grass roots, trying to deal with tax problems, that is where the real work needs to be done where there is, I think, a feeling that things have hit an all-time low.

Q165 Mr Love: So, you would not disagree with that. At the professional level and contact it is reasonable, but out there, when people have to contact their local tax office or officials, it is really very bad.

John Whiting: A very important distinction, and I refer you to my President's article, I think you may have seen.

Q166 Mr Love: I think we have it here. I wanted to go on and just touch upon the intervention yield. You will be aware, and the Chairman mentioned this earlier on, that the Government has agreed an additional £970 million and in return the intervention yield is to rise by £7 billion over the next four years. That is a significant advance. I wanted to ask, if we are to believe the figures of course—and I understand that it is difficult to get absolutely accurate figures from HMRC—the intervention yield has gone up every year. The suggestion is, and you have touched upon this earlier on, that they have had to focus their activities. We need to remember continuously the number of employees has gone down by roughly a third I think it is during that period when it has been going up, so they have had to focus. One of the suggestions is that they have done that on the large businesses rather than low-level compliance. You have talked a lot about low-level compliance. Have they been focusing on the larger cases? Is that the reason why they have been able to bring in these increased takes from the intervention yield?

David Heaton: I am not sure that it is all to do with large business. One of the numbers I think in the £7 billion yield was the offshore disclosures, which I think is not going to be repeated. They offered the opportunity to come forward. They offered a deal,

which people who really wanted to come forward will have taken, so I don't think that will be repeated so I do have doubts about whether they can sustain that.

Chas Roy-Chowdhury: I think the LBS strategy, the risk-based strategy on large businesses, is yielding revenue. Clearly in the NAO report last week there are something like 2,700 aspects still open that the NAO have looked at. That is yielding very well and that is about discussion and agreement between taxpayers who are well represented and well advised on both sides. So, I think that is a strategy worth pursuing. It does seem to be yielding significant amounts and so it is an area which is—I don't think it is low-hanging fruit in that particular area, I think it is something that is an area that should be looked at where there is just a, if you like, disagreement in interpretation, or not agreement in interpretation but there is the ability to agree amounts of additional tax for HMRC for the UK.

David Heaton: I think it is important not to miss the small print in that NAO report though. The 2,700 issues are issues that they have identified, not issues where there is tax due, and they have come up with a figure, I think it was £25.5 billion, at stake in relation to these 2,700 issues.

Q167 Mr Love: I want to come back to other aspects of the NAO report, but let me just ask you about the litigation and settlement strategy, because we have been told that HMRC were planning to re-launch that. What is the rationale behind that?

John Whiting: I think it is refresh and re-launch. I suppose any initiative needs looking at again every now and again so I would not argue with that. But I think there is a feeling that it does need bringing up to date, particularly in the context of what in many ways has been quite successful, the HMRC internal review process, which over the last couple of years has allowed quite a lot of taxpayers to challenge things that have come up, has led to quite a few things being withdrawn, and it all needs another look at the whole litigation and settlement attitude of the Revenue. If you go back to when it was first launched we heard a lot about how they were going to litigate their clear cases, and that goes back to something we touched on earlier. Yet we have not seen, for example, litigation come out of the offshore disclosures. So, it does need looking at again I think is about all I can say on it.

Q168 Mr Love: Let me ask you, because of course one of the reasons I suspect the NAO looked at this area was a growing perception that a consequence of the litigation strategy was that they were, in perception at least, going easy on some of these big businesses. Do you think that is a danger? It would appear that the industry, if I can call it that, thinks that this is a sensible way forward, but in terms of public perception—maybe HMRC have handled it badly—there is undoubtedly a perception that big business is getting away more easily than they should be.

David Heaton: I think there is a job to be done to correct that perception. I think the perception is wrong, if indeed that is what people think. The litigation settlement strategy really only affects the

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way that cases are handled. Going back into the pre-LSS days, it was quite often the case that you would sit down with an inspector and argue the pros and cons of a case and you would reach an arrangement. Something would be agreed that made sense for both the taxpayer and for the Revenue. The LSS in some ways created a binary situation where you have either you win or you lose. If the Revenue decided to take it on they thought they were going to win. If they did not decide to take it on it was because they thought they did not really have a sensible chance of winning, like more than 50%. I think creating that distinction with the litigation settlement strategy, even if it is only a perception of that distinction, because the Revenue do not think that it is quite that binary, you are in a way forcing the Revenue to abandon cases where in the past they might have negotiated a settlement. Equally there are taxpayers who will abandon cases where in the past they might have decided that they would probably fight on the basis that they would be able to get a reasonable deal. I think there is something to be said for reviving the pre-LSS period when taxpayers and Revenue could have a proper discussion of the pros and cons of all the issues in the case without resorting to law and come up with a sensible answer.

Chas Roy-Chowdhury: I think the large business strategy quite often does come to settlement without going to court. That obviously does not come out because the information is confidential. So, I think they have not gone soft at all, because where you have a complex organisation the business itself may not be entirely clear if there is UK tax to be paid or not and so I think that and some of the other things we have heard about offshore jurisdictions, I am not sure that the Revenue have gone soft on any of these areas. In fact what has happened for large businesses is where they are probably paying as much tax as they need to within the UK. I am not saying “need to” in terms of what they can get away with but in terms of what they are required to pay.

John Whiting: The thing to pick up on in some ways is, certainly from my experience with big businesses, they do not see the Revenue as any sort of soft touch, whatever the public perception is. The large business service, as colleagues have said, is successful.

Q169 Mr Love: John, let me put this to you. If you take the Vodafone case, clearly it was going to end up in litigation over many, many years. Do you think there is any impact on the attitude of other large businesses that might say if we continue to threaten litigation they will deal with us and they will settle at a lower level because they don’t want to go through the litigation process?

John Whiting: I can’t comment directly on Vodafone. The perception that large business will have is they know the rules of the game, they know how easy or difficult the Revenue is. They will not be influenced by any perception of the Vodafone deal because they will know that Vodafone, just like themselves, like any other FTSE 100 company, will have arrived, after some pretty tough negotiations, with what both sides feel is a fair estimate of the tax due. Of course what the problem with it is, it is the optics, if you like, it is

the perception that a company gets away with it, but I think the rest of the large business types of companies will know that Vodafone or whoever did not get away with anything.

Q170 Chair: I am an ordinary bloke and in my constituency we would say you are wrong, John, in terms of perception. In this room we challenged a Minister on the letters that were being sent out to ordinary individuals, often vulnerable, often elderly, that suggested they owed a certain amount of money, never negotiable, often thousands of pounds and it had to be paid within a month, and if they did not there would be bailiffs put into their house. They would take goods, they would sell the goods, and they actually spelled out how they would sell them at a reduced price. They would advertise this to their embarrassment among the community, and there was no appeal and there was not even any suggestion to contact us if you disagree. How can you say—

John Whiting: I completely agree with you, Chairman.

Q171 Chair: You cannot say big businesses are not being treated differently from the individual.

John Whiting: With respect—

Chair: That means you do not agree, with respect.

John Whiting: With the greatest of respect, Chairman—

Chair: That is even worse.

John Whiting: I know. We are talking about different situations. I totally identify with the sort of situation you say about the elderly person. I have seen a number of those cases through Tax Help for the Older People—

Q172 Chair: John, did it happen last year? Is this a new departure? Is this part of getting this money in?

John Whiting: It does seem to have been ramped up a bit, and that needs sensitive handling. It comes back to the point I was trying to pursue with Mr Hosie that having a known sort of third-party organisation that would be there and was well known—

Q173 Chair: But, John, with the greatest of respect back, why do you need a sensitive person to object? If anybody who was doing business with you sent you that letter you wouldn’t need a third party. If they were not a public body you would take the business from them and go elsewhere.

John Whiting: I completely agree, but they need help as to how to challenge the Revenue.

Chair: They should never receive that letter. Never, ever send that letter.

David Heaton: It is not just vulnerable taxpayers who are receiving that kind of letter. One of my clients is a multi-millionaire, he is a qualified solicitor not in practice anymore, he received one of those letters for £2,500. They were going to come and seize his TV and his car to settle the debt. As it happened the debt did not exist. The tax return had been amended online, and we had an electronic acknowledgement that it had been amended online, so the debt did not exist but the debt collectors did not know about it and when they sent the letter out they sent it out based on false

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information. They are not just targeting the vulnerable.

Q174 Chair: No, I said these letters were going out to ordinary, individual taxpayers, a number of them vulnerable, a number of them elderly, but it was the indiscriminate nature of the letters going out. The tone of them, the threats in them, that you would not expect a public body would lower themselves to that level.

John Whiting: This clearly should not happen.

David Heaton: It should not happen. There is a certain amount of, I may be using a made-up word here, but “processising” of the compliance system. They are relying a lot on computers to send out letters.

Q175 Chair: I do not challenge them on sending out letters but I challenge them in terms of the tone, the threats and also—we discussed it earlier, I don’t know if it was Andrew or Stewart—it is their attitude that they are not there to collect money in the nicest possible way. They are there, they will tell you how much money you owe and if you don’t do it the threats start emerging. No that they might have made a mistake or they wish to discuss it or that you have a right of appeal. That is always absent. It is just “we want this money” and that is what it is.

Chas Roy-Chowdhury: I think it is lack of human understanding, commercial understanding. Because they would not like to receive a letter like that themselves, they wouldn’t like their mother to receive a letter like that, so I think they need to understand more about the impact they have on the outside world.

Q176 Mr Love: I wanted to touch upon the NAO report because in terms of these large company cases it commented on a need for greater transparency and I would ask you to comment on that.

Chas Roy-Chowdhury: In terms of the settlements?

Mr Love: In terms of the settlements. It went on to say that the governance procedures were not entirely to the satisfaction of the NAO in that some of the people that were involved in the cases then signed them off. Do you think there are governance changes that ought to be made? Then of course there is the suggestion that there should be some independent verification a bit like the American system where there is an appointed official that independently verifies what the—how do you comment on all of those?

Chas Roy-Chowdhury: On the governance issue, I think clearly we need to make sure that the tax agreement is something that is acceptable to the Government, i.e. HMRC, in terms of this higher fiduciary role. Within HMRC the person looking at the situation as a totally objective observer who would have nothing to do with the case at all would need a lot of legwork to get to the same conclusion and understand the reasons why the final settlement was agreed. So I think there probably needs to be some interaction between the person signing off the settlement and being involved in the settlement itself.

So, I do not necessarily think that as long as there is more than one individual involved, et cetera, that should present a problem.

John Whiting: But again it comes back to a point I was trying to make to the Chairman. It is the optics of the thing; it would make it look far better if there was more independent sign-off. So, if commissioner A has finally done the negotiation then to have two independent members of the HMRC Board—

Mr Love: Which I think is the point that the NAO was making.

John Whiting: Yes, not so much to redo the work but to confirm that proper process has been followed. There is a role here I think for stronger non-executive directors, or whatever the term is, of the HMRC Board. Some people there who perhaps have more tax experience who could be in on this. You could envisage people who sat as non-executive directors who represented the sort of organisations we four represent and who could say, “Yes, HMRC are following good process. Not going to argue with the settlement one way or the other, but there has been a good process followed”.

Q177 Mr Love: What about the system in America—the Inspector General for Tax Administration? I am not sure if you are aware of that system, but that gives an entirely independent—

John Whiting: It is one way to go, but—

Mr Love: You don’t seem overwhelmingly enthusiastic about the American way.

John Whiting: It seems like another quango. I think I would rather try to cure it within the Revenue.

David Heaton: It does seem like an attempt to cure a problem that does not really exist.

John Whiting: You can improve the Revenue, I think, rather than create something new.

David Heaton: Knowing the people who are involved and knowing the processes that are gone through within the Revenue at local level and above that, the levels of supervision involved in cases like this, I have no doubt whatsoever that the cases that have been signed off have been signed off correctly. I probably have not seen the evidence the NAO have seen, obviously, but I don’t think there is any suggestion that there was any impropriety at all in any of these situations and I am not sure that anything would be added, other than as John says optically, by having some kind of independent oversight.

Chas Roy-Chowdhury: I would also add that in terms of the timing—as previous evidence has said—of some of the settlements, I don’t think that timing has been influenced by anything whatsoever from a political perspective.

Chair: Thank you very much for your evidence. It has been a very constructive session. I am sorry you had so few people here but it has been well worthwhile.

John Whiting: It is the quality that counts.

Chair: I am sorry we had that Division, but there you are. Thank you very much.

Monday 12 September 2011

Members present:

Mr George Mudie (Chair)

Tom Blenkinsop
Michael Fallon
Mark Garnier

Stewart Hosie
Jesse Norman
Mr Andrew Tyrie

Examination of Witnesses

Witnesses: **Dave Hartnett CB**, Permanent Secretary, Tax, HMRC, **Mike Eland CB**, Director General, Enforcement and Compliance, HMRC, and **Melanie Dawes**, Director General, Business Tax, HMRC, gave evidence.

Chair: Good afternoon. We are going to be a bit lighter today; there are important matters, such as the Vickers report and parliamentary boundaries. I do not know which is the more important, but there are a lot of people wandering about with maps today. You may not get full attention, which sometimes is not a bad thing. We are going to start with Mr Hosie.

Q178 Stewart Hosie: The tax gap has caused a deal of debate for a variety of reasons. How much importance do you attach to it, or estimates of it, when you produce your plans and priorities for the work that the Revenue is going to do?

Dave Hartnett: I think, Mr Hosie, for us, the tax gap is quite an important tool, if I can put it that way, in promoting understanding of all the causes of non-compliance and helping us to focus on ways of reducing them. If I can put it this way, it is a bit like a long-term health check for us. A definition of it is the difference between what the Government can expect to receive and actually do receive, but I think, as you may have seen, unlike some other countries, we include avoidance in it, and also the slightly contentious issue of measuring that in line with the spirit of the law—what the intention of Parliament might have been.

Q179 Stewart Hosie: Can I say that the beginning of that answer was deliciously civil servant? It is an important tool for understanding the causes of non-compliance, but it is completely unsettled. Some people will disagree over the size and scale of it; others will say it effectively does not exist; others will say, “Goodness, it does exist, but we have absolutely no way of accurately measuring it.” Are the estimates you have robust enough to make operational decisions on investment and performance, for example, around the estimated £7 billion you expect to deliver in extra gain—extra yield—by the end of this Parliament?

Dave Hartnett: The one thing we know for certain is that the £42 billion, which is the present estimate—there will be another one in a couple of weeks’ time—is not accurate; it is our best shot. We invest a lot in making that estimate. We think it is the best estimate in the UK. If I look to some of the larger ones that are around, they include all sorts of things, including some of the reliefs and deductions that Parliament has said taxpayers should have, and there are various other failings in them. We think it is pretty reliable.

Q180 Stewart Hosie: That is interesting, because some of the professional bodies take the £42 billion and say it is inflated because it includes legitimate disagreements over legal interpretation, which is a perfectly valid position for them to take. Others say it is understated due to inadequate information. You say it is your best guess but you invest a lot in calculating it. What could you do better or what should we, as the Committee, or Parliament, do more of, so that we really understand whether it is £25 billion or £42 billion, or indeed the £127 billion, which was the biggest estimate we have seen? What more do we all need to do to get this right, given how important it is?

Dave Hartnett: I am going to bring Melanie in in a minute, because her area is responsible for the calculation, but let me just say on legal interpretation and other things in particular, the focus we put on legal interpretation is where we lose—but not while the argument is going on—and where the Government are therefore going to receive less than expected. We recognise that “legitimate debate” contention around issues will always happen.

Melanie Dawes: Yes, and it is important to say on avoidance that where we resolve an issue with a taxpayer and we agree with their legal interpretation, we do not record that as a tax gap. We record that as the tax gap having been closed because the treatment has been agreed. In terms of what we should be doing with this, I think it is very good to see that there has been so much interest in it. We have been asked by a number of NAO reviews and by the Public Accounts Committee in the last few years to keep publishing the tax gap and to do more of it. We think it is a very useful strategic tool. We used it to get a feel for the overall big areas of risk when we were putting together our plans for the spending review, for example, so it is very helpful.

The important thing is not to use it in the wrong way, so we are not using it for performance targets to measure our actual operation performance in the business. That is what a number of witnesses said was right, and that is indeed the approach we follow.

Q181 Stewart Hosie: That is helpful. Just one final question on this. It is only us in the room and a few people watching, so let me ask this: gut instinct, is the £42 billion an underestimate or an overestimate? Where do you think the real figure is? Do you think we should be looking for more, or can this be eroded down?

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Dave Hartnett: We have a tiny, tiny indication of where the number may be going, because we publish a year in advance the VAT gap. I cannot remember precisely what we published last year—it will form part of the calculation this year—but that VAT gap has gone down by about, I think from memory, 20%. I will correct it in a note if I am wrong.

Q182 Stewart Hosie: That is quite a significant decrease.

Dave Hartnett: Yes, but if you look at the trend, it rose the year before and it is now coming down again.

Q183 Stewart Hosie: Just on that, if that metric was comparable, that would result in an £8 billion reduction in the tax gap forecast; that is a significant change year on year, isn't it?

Dave Hartnett: It is a very big change year on year, but the tax gap tends not to work proportionately like that.

Melanie Dawes: Perhaps I could just explain the VAT point. The increase in that most recent year was because there was an increase in VAT debt as a result of the recession, and the figures that we had already published for the subsequent year show that has fallen. It is one indication of how the tax gap trends need to be interpreted with caution. In this instance, this was due to the economic cycle. In answer to the question of whether £40 billion is about right, as an order of magnitude, yes, we believe it is. We are very clear that some of the very big estimates that have been suggested—around £120 billion—are way, way out of range, so that is the order of magnitude we think we should be working with, and it is very comparable. It is at the lower end of international estimate.

Stewart Hosie: That is helpful. Thank you.

Q184 Mr Tyrie: Mr Hartnett, is it right or wrong that individuals and companies should structure their arrangements to minimise tax?

Dave Hartnett: It depends whether you are asking me a moral question or a legal question. The case of the Duke of Westminster establishes that it is perfectly right for individuals and companies to do that.

Q185 Mr Tyrie: Is this the correct course of action for them to take?

Dave Hartnett: That is what the case effectively says. Our challenge is to make sure they have done it properly.

Q186 Mr Tyrie: So people can quite reasonably do everything they can to avoid tax?

Dave Hartnett: We challenge that and examine it, but tax avoidance is not illegal.

Q187 Mr Tyrie: Do you not think that the best method of reducing the tax gap might be to simplify the tax system, so that people know whether they are avoiding it or evading it?

Dave Hartnett: I think that depends on who the people are. Simplification of the tax system, I think, is something that my Department, the Office of Tax Simplification and others are focused on, because we regard it as very important, particularly for taxpayers

who do not have advisers and the like, so that they can understand, in a more ready way, what is required of them. The simplification of the tax system for banks, to go to the other end, so that something like taxation of repos was simplified, is, I think, a jolly difficult proposition.

Q188 Mr Tyrie: You say in your mission statement that you will close the tax gap. You are not actually going to close the tax gap, are you? You are going to reduce the tax gap; isn't that right?

Dave Hartnett: We had much debate on this, Mr Tyrie, as to whether "close" means close so the door is aligned with the frame, or whether it is the process of closing, and it is the second of those that we are doing.

Mr Tyrie: That is another classic Sir Humphrey reply, if I may say so.

Dave Hartnett: That was the debate we had.

Q189 Mr Tyrie: Out of the top drawer, if I may say so, above the doorway. Impressive. What concerns me most of all about this whole debate is that we find ourselves stigmatising people for doing something that is perfectly logical, reasonable and, indeed, inevitable, and we have to be very careful in this debate, have we not, to avoid ending up there?

Dave Hartnett: I think that is absolutely right for individuals who do not set about avoidance that is complex or hidden or convoluted in some way, but there are forms of avoidance that I think most people would agree would be reprehensible.

Q190 Mark Garnier: We have heard that HMRC has improved its results in targeting higher-value, higher-risk cases, but that presupposes that you have not done very much in the lower-value, more mass avoidance because of inability to fill in a tax return. What is your rationale for going for higher value ones, and what are your plans for dealing with the more widespread, lower-value ones?

Dave Hartnett: We target our compliance activity, Mr Garnier, by reference to risk, and particularly trying to take on the biggest risks, and the management of risk is different depending on the sort of customer we are dealing with. For example, the risk in big business is likely to be dealt with by a single team managing that. The risk in relation to individuals may be dealt with by some of the—

Q191 Mark Garnier: Sorry, when you say "the risk", what do you mean?

Dave Hartnett: The risk that—

Mark Garnier: Of non-compliance?

Dave Hartnett: Of non-compliance, and that the Exchequer is losing money. For individuals, our approach is to have campaigns; a small number of our officials may deal with a large number of taxpayers. That is our approach there.

Q192 Mark Garnier: This presupposes that you are going for, broadly speaking, the easy targets, the easy targets being, for example, people who are already in the tax system. What about people who just have not

engaged with the tax system at all? How are you going to approach people like that?

Dave Hartnett: In lots of different ways. We have hundreds of people working on the hidden economy using internet search, following adverts in the *Yellow Pages* and doing many other things to identify those people.

Q193 Mark Garnier: Presumably, you are not Googling “tax avoidance” and seeing what it comes up with. Do you want to elaborate a little bit on that? What sort of thing are you looking for?

Dave Hartnett: I will bring Mike in, if I may.

Mike Eland: We use internet search. We have a device called a web robot that identifies websites in particular areas. People in the hidden economy will often use websites to get business. With our new risk tools we are able to check that against our tax records and see whether they are known to us. So we identify quite a large number of people who are active in the economy but not declaring tax, and we can pursue them in that way.

Equally, with new information tools, people can leave a number of signs that they are economically active, which we can identify and then compare to our tax records. That is the sort of thing that we are doing. We then follow through on that with an investigation.

Q194 Mark Garnier: I want to follow up on this investigation thing. Is it not the case that some people might find themselves the subject of an investigation and suddenly decide that the cost of defending it or complying with it—in terms of getting their accounts sorted out—is going to be x , and that they could just pay you a cheque for x minus y , which is what you are after, and is it not therefore easier just to say, “Here is some money, go away,” the underlying point being that it was not necessarily a valid investigation in the first place?

Mike Eland: We do not believe that is the case, because what we are interested in with an investigation is establishing the correct tax liability. That, if we get co-operation, can be dealt with fairly swiftly. Obviously, if it is an area where we identify evasion and suppression, it will take longer.

Q195 Mark Garnier: I am sorry to interrupt you, but you talk about co-operation. Co-operation, to me, where you say you can come to a swift conclusion, is when somebody turns around and says, “Yes, that is right, I think I owe you x ,” and you broadly agree with it, but I have people who come and see me in my surgeries who say that they find it incredibly frustrating dealing with HMRC. It gets in touch and says, “You owe some money,” and they write back and say, “Here is all the paperwork.” They discover that when they do that, they find themselves having to talk to a different person, department or adjudicator. There is the cost of going through this process, in terms of time; a great many of the people who come and see me do not necessarily have accountants, so the cost is their personal time. They are finding it breathtakingly frustrating. I try to lubricate the wheels in order to try and get this through, but the frustration is that it is incredibly time-consuming. There is no

sense of any real process at HMRC that makes it easy for people to deal with one individual, as a result of which people eventually pull their hair out, come and see their MP or, indeed, in the end just pay up to get you off their backs.

Mike Eland: It is not in our interest to have a long-drawn-out investigation any more than it is for the business concerned. We have worked with the agents to develop a process, which we call open and early dialogue, which is designed precisely to sit down at the beginning of an inquiry, work out what the issues are, and pursue those and resolve them as quickly as possible. We are looking all the time to make sure that what we are doing is proportionate, and that we are focused on the real risks. The whole strategy that underlies our approach to the spending review is to deal with error through either designing it out of the system or dealing with it in a very low-intensity way, and to concentrate our skilled and face-to-face resource on evasion, not error. That is very much the direction we are looking to move in.

Q196 Mark Garnier: I understand from another constituent—a business, this time—that you can levy a fine, as a percentage of an error, in terms of a tax return. Is that the case?

Mike Eland: That is correct.

Q197 Mark Garnier: I think it is 15%, isn't it, of an erroneous number? I think in the case of this business, there was £250,000 that should not have been there. In fact, it did not make any difference to their tax return. They were charged 15% of £250,000. I am trying to work out in my head what that is, but I cannot. Anyway, it is a reasonable amount of money. They challenged it, and they had a really rough time of it. When you are levying those fines, do those get counted as part of closing the tax gap, or is this another sort of accounting? You are not looking at that in terms of—

Dave Hartnett: Let me pick this up. We do not count it in that way, Mr Garnier. Maybe I can make three points. The first is we would prefer somebody who believed they had done absolutely nothing wrong and was certain of it, and were being incorrectly investigated by us, to complain—quite simply, to move up the chain and register a complaint. We will then have a look at it.

Secondly, I am not sure what sort of fine it was—whether it was a fine in relation to unpaid tax, business tax of some sort, or Pay As You Earn.

Q198 Mark Garnier: It was business, but it was a cell filled in incorrectly. The fine was levied as a percentage of the number that was filled in incorrectly.

Dave Hartnett: I clearly know nothing of the case, but if it is that simple, I would say that we very recently carried out our powers review and changed the approach to penalties to one of focusing on behaviour. Innocent error, certainly the first time, does not attract a penalty. That is important, so you may want to write to me about that, if it is that simple.

Mark Garnier: I think I will do, because in this particular case, after a fairly extensive process, you guys eventually turned round and decided not to go

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ahead with fining them, but none the less, the cost to them in terms of management time and all the rest of it was pretty extensive. I will write to you about that.

Dave Hartnett: Thank you.

Q199 Mark Garnier: Just carrying on, getting back to the smaller taxpayers, according to your annual report, 50% of taxpayers were willing and able to pay their tax on time in 2010–11. It is not very many, is it?

Dave Hartnett: It is a number we are trying very hard to increase. There is a greater number who have some difficulty, and our aim is to support them in paying the right tax at the right time. Then there is a group that has a propensity to think it is all right not to pay at the right time, and then there are some who are determined not to pay at the right time, or not to pay at all. We are developing—if it is helpful, I will ask Melanie to explain, because she is responsible for our strategies—different approaches to different sorts of taxpayers to increase the numbers who do pay the right amount at the right time.

Q200 Mark Garnier: I come back to a point that Mr Tyrie made a little bit earlier. Is it not the case that the tax code is just so ferociously complex that it makes it very difficult for people to be able to comply with it? Indeed, we have had two sets of witnesses here, one of whom is somebody I disagree with, so I will not necessarily mention his name, but he quite categorically said that if anybody wants to operate in this country, they should learn this, but he was rather a pompous man. The rest of them, including the unions, all agree that this was a big problem. It is just very, very difficult indeed to be able to comply with this country's tax code. You talk about how we are trying to aim for more simplification, but even after the Budget last year, one of the comments made was that the rate of increase in complexity of the tax code had merely slowed down; it had not been reversed. We talk about this Office of Tax Simplification, but the fact of the matter is: what is genuinely being done about proper, significant, tax simplification? At the end of the day, should we not perhaps rip up the tax code altogether and start again from scratch to make sure that people can understand what they are supposed to be doing?

Dave Hartnett: Let me say two things again. The first is that we have succeeded in taking almost £600 million of burdens created by the tax code off business in the last five years and aim to do more. I think the Office of Tax Simplification—I sit on its board with one of my Treasury colleagues—is determined to simplify. The sort of thing that we want to simplify is the approach for small business. One of the most interesting pieces of research we have done recently shows that a small business starting up that is not, if I can put it this way, on the straight and narrow on taxation within about nine months might not get on the straight and narrow until we intervene—which usually comes with a big bill. That has to be improved significantly, and we are looking at how to do that. I think the Office of Tax Simplification will come up with some pretty good proposals in relation to the taxation of small business.

I think that some of the changes to the plan for Pay As You Earn—particularly the simplification of end-of-year procedures in the next couple of years, probably ending the life of forms P45 and P46, which the nation at least knows the names of, if not what they do in the tax system—will help a great deal with individuals' understanding of the tax system. We are determined to do more, and there will be an announcement shortly about a new, additional programme for the Office of Tax Simplification.

Q201 Tom Blenkinsop: Estimates suggest that as much as £125 billion potentially liable to the UK could be in Swiss bank accounts, and that the potential liability under this deal is around £20 billion. However, the Government expect to raise only £3 billion to £6 billion. Why is that?

Dave Hartnett: I think the first thing to say, Mr Blenkinsop, is that no one really knows the number. £100 billion is probably a fair estimate—£100 billion, £125 billion. One of the first issues is the extent to which individuals who are not domiciled in the United Kingdom have money in Switzerland after remitting their income or gains, and therefore have no tax to pay. That will take a large part out of a rough estimate of the tax liability.

Secondly—I do not say this to make you smile, but you may—a lot of UK residents who bank in Switzerland pay their tax in the UK. We see lots of tax returns with Swiss income on. Gradually, you get down to a lower number. It may be helpful for me to say that as we have taken forward our work with Switzerland, we have approached the calculation in three different ways. First, HMRC analysts looked at it on the basis of publicly available information and came up with a range of £5 billion to £7 billion. Secondly, the Swiss banks looked at it and came up with a best estimate—this was done through a major accounting firm—of £4 billion, and then we used another external organisation ourselves, which came up with a figure of just over the £7 billion that we came up with. I do not know what the right number is, but it is interesting that, roughly, these three calculations are in the same ballpark.

Q202 Tom Blenkinsop: Why does this particular law change have a two-year lead-in time, and what is to prevent evaders moving their money in the interim?

Dave Hartnett: There are two things there. Why the lead-in time? The Swiss have to build a system to make this happen. This is a novel arrangement among states; it is the first time, I think, any tax administration will have created something that sees withholding against capital. Withholding against income is normal in taxation, but withholding against capital is not.

The second thing is people can move their money. We recognise that, and the Swiss recognise that, but the Swiss have pledged that they will not be complicit in helping people to take money out of the scope of this. If I may pause with a minor digression, it will be good when everyone can read the full agreement, because much more of this will then become clear. The world is getting a smaller place. First it was Liechtenstein, now it is Switzerland, and other tax administrations

with which we are working are focusing on other so-called tax havens, and we will be approaching them in due course.

Q203 Tom Blenkinsop: The tax rate that will be applied under this arrangement is marginally lower than the equivalent marginal top rate of tax in the UK. How do you justify creating an HMRC-endorsed tax break for people who hold their money in Swiss bank accounts?

Dave Hartnett: Are you thinking of the 48% withholding? The 48% is a calculation based on the top rate of 50% when money would often not come in, or generally not come in, until 31 January following the end of the tax year. This money will come in earlier, so we calculated a withholding based on that anticipation of money.

Q204 Tom Blenkinsop: So if an account holder does choose to disclose the details to HMRC, they will become liable for the full amount of any taxes, plus interest and penalties?

Dave Hartnett: Absolutely.

Q205 Tom Blenkinsop: If they take up the back tax rate, these obligations are deemed to be settled?

Dave Hartnett: Yes.

Q206 Tom Blenkinsop: Is that not somewhat counter-productive?

Dave Hartnett: I don't think so. It is not everybody who can get that degree of certainty. We have made sure, for example, that people we are already investigating cannot obtain certainty through this arrangement; that those involved in non-tax crime cannot; and that those involved in organised crime cannot. We recognise that people are going to do some calculations here. I think that many will not come straight through the doors of 100 Parliament Street and say, "I want to make a disclosure," but they may take themselves into the Liechtenstein disclosure facility instead. Others will want withholding because that gives them a different sort of certainty.

Q207 Tom Blenkinsop: Is this policy not counterintuitive to closing the tax gap?

Dave Hartnett: No, because we are recovering tax that we have wanted to recover for tens of years, but have never been able to, and the important judgment here was whether the United Kingdom or the international tax community generally was going to be able to break down banking secrecy in Switzerland any time soon. The judgment made was that, certainly in the next 10 years, that seemed very unlikely, and therefore it seemed reasonable to take a very large slice of money in a way that Switzerland had never previously contemplated.

Q208 Tom Blenkinsop: By pursuing that policy, are you not entrenching part of it by abandoning the pursuit of full liability?

Dave Hartnett: I do not think we are abandoning the pursuit of full liability. We cannot find people in Switzerland, and one of the really important features of this arrangement is that the Swiss are now going to

give us the opportunity of obtaining more information about named individuals than we can obtain under the standard approach of article 26 of the OECD model double taxation treaty. Part of this arrangement will give us much more than we have ever had before, and we will be able to pursue individuals. Some of those individuals would say to us, "Here is my certificate from Switzerland, which proves I have already settled for the past," but going forward we will be able to check in detail in Switzerland whether people have paid all their taxes.

Q209 Tom Blenkinsop: The Liechtenstein deal was not open to people who were already the subject of HMRC investigations. Will this deal prevent HMRC from taking action against those who are already being investigated by HMRC for tax evasion in Switzerland?

Dave Hartnett: No. The people already being investigated are excluded from this arrangement. If they suffer withholding on their Swiss money, that amount of withholding will be a payment on account, and not a settlement of liability.

Q210 Tom Blenkinsop: So if people sign up to this, they could be paying a premium for anonymity, as it were. Does that not suggest that they may be involved in other illegal activity?

Dave Hartnett: It depends what the illegal activities are.

Q211 Tom Blenkinsop: You are not going to know, are you?

Dave Hartnett: If the illegal activities are criminal in some way, other than in relation to tax, then they will not get the certainty that they are seeking. That is the important thing. If I can, Mr Blenkinsop, I will give you an illustration. I think the whole nation probably knows that our Department has a disc from the Swiss—from the Geneva branch of a major UK bank—with 6,000 names, all ripe for investigation. Unless, as we check them, we find they are already paying tax, they will all be outside this agreement.

Q212 Chair: A good question to ask is where you are with those 6,000 names.

Dave Hartnett: Mike may want to come in to help me in a minute, but we have a—

Chair: I am not suggesting you need help, Mr Hartnett.

Dave Hartnett: Let me try, Chair, if I may. We have hundreds already under investigation. Some of those—

Q213 Chair: When did you get it?

Dave Hartnett: The disc?

Chair: Yes.

Dave Hartnett: June last year, about that. So we have got 100—

Q214 Chair: And you are doing 100 a year?

Dave Hartnett: No, no. We cannot do that, because it is a sad fact of life that some people will die. We are then restricted as to the number of years we can seek to collect tax, so we want to act on these data as fast

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as we can. We have hundreds under investigation, some of them under criminal investigation, and we are about to challenge another 800. Then we will industrialise the process, challenging 1,000 at a time, with a view to having all those who need challenging challenged pretty quickly.

Q215 Tom Blenkinsop: That is the question: had you challenged them before?

Dave Hartnett: I am sorry, I do not understand.

Tom Blenkinsop: The people on this list—have they been investigated before?

Dave Hartnett: Some have been.

Q216 Tom Blenkinsop: Do you know how many of them?

Dave Hartnett: I do not know the answer to that.

Mike Eland: No, I do not.

Dave Hartnett: But they are in much more difficulty with us than those who have not been investigated before, because if they have lied to us in a prior investigation, that is an issue that we take terribly seriously, and we would want our criminal investigators to consider cases like that.

Q217 Stewart Hosie: Mr Hartnett, I have a question on this Swiss issue—not necessarily the 6,000, but the Swiss issue generally. If it becomes clear that large numbers of these people put their money into Swiss bank accounts or wherever, having paid tax in the UK, and if they have paid their tax in Switzerland, quite properly, as I suspect many of them will have done, when are you going to report—or will you report it?—that 50% or 60% have done the right thing, and that of the remaining 40%, a small number are doing particularly naughty things, some of which have been criminal? When will we get a breakdown of the nature of the 6,000 and the bigger numbers that you have?

Dave Hartnett: I think when we have it. I do not mean that to be a trite comment. I am sure that this Committee will want more information from us on that, and maybe the Public Accounts Committee will as well, but the challenge for us at the minute, to use a slightly strange word, if I may, is to industrialise process here, so that we can use the minimum number of investigators that fits with collecting the maximum amount of money.

Q218 Chair: What do you mean by “industrialise”?

Dave Hartnett: Chair, it is what I was saying to you earlier on. We are about to challenge 800 of these investors by post. What we are going to say to them is, “Here is what we know. We are going to investigate. Here is your chance to come forward and tell us exactly what has gone on here if you have a problem with us.” The advantage of that sort of approach—

Q219 Chair: But I just call that sending them a letter, not industrialising. How long does it take you to send letters to 6,000 people? Every politician round here does it almost weekly, I think, it is alleged.

Dave Hartnett: If I can be very bold for a second, we want to do a little more perhaps than the politician

who simply sends the letter. What we want to do is send the letter—

Chair: Your letters are more threatening than those that politicians send, but that is another question later down the agenda.

Dave Hartnett: We send the letter, let people see what we know, and then act if they have not responded within a relatively short period of time.

Q220 Chair: I am not being funny. If you have 6,000 names and addresses and it amounts to sending them a letter—a carefully considered letter—why, after 15 months, has that letter not gone out?

Mike Eland: Can I come in here? What we have done is look at the names we had on the list and identified those whom we want to pursue through investigations straight away, either because they are known to us as they have committed an offence before or whatever, or because we consider them to be high-risk cases. We have, I think, around 750 investigations of that sort going on—a mixture of criminal and civil investigations.

What we are now looking at is the remainder of the population, having, if you like, creamed those off, and we are looking to try and identify those who either have a good explanation as to why they have the account, so we can weed those out quickly, or people who will voluntarily come forward and do a full disclosure, and we can dispense with them quickly. This is the next stage in the process. The first stage in the process was to comb through the 8,000 and identify the high-risk cases and get those investigated.

Dave Hartnett: Chair, can I add that we were not idle for 15 months? The data that we received needed analysis; it needed sorting as between families, and as between trusts and other complicated structures, before we could really challenge anybody. Other countries that have had similar data in relation to the same bank have all had to do that. I think the UK is pretty near the forefront of those mounting a large number of challenges.

Q221 Chair: So the other 5,300 letters will go out soon?

Dave Hartnett: They will go out, on a programme, over the next short number of months, subject to us continuing the process of checking whether they have already paid their taxes—

Q222 Chair: Can I just press you on that? I have always been aware of the vagueness of time scales and amounts, and so on. What do you mean by “a short number of months”? This year?

Dave Hartnett: No. Six to nine months was the estimate I was given yesterday.

Q223 Chair: Under your agreement, requests to disclose information on specific individuals from you have to be on plausible grounds. What in the banking industry are “plausible grounds”?

Dave Hartnett: What the agreement specifically says is that if we have grounds to consider that somebody has hidden money in Switzerland, we can ask the Swiss Government to identify all their bank accounts in Switzerland, which is not something that happens

under any other agreement I am aware of. The Swiss have the facility to check all their banks, and that is what is going to be happening, going forward.

Chair: But what are “plausible grounds”?

Dave Hartnett: As I think I was saying to Mr Garnier earlier on, where we identify what appears to be a tax risk in relation to an individual, that will be a plausible ground.

Q224 Jesse Norman: Mr Hartnett, the NAO talks about governance errors. What is a governance error? What does it mean in this case?

Dave Hartnett: A governance error is where there is a process to oversee—I think in the context of the NAO, you are thinking of settlement of an investigation—and that governance does not happen in line with our processes.

Jesse Norman: We are now back in Sir Humphrey world.

Dave Hartnett: I am not.

Q225 Jesse Norman: Perhaps you could be a little bit more explicit as to why the governance has not, in some case referred to by the NAO, gone in accordance with your processes. What does it mean to say that it has not gone in accordance with your processes, and why has that happened?

Dave Hartnett: I think there are two cases that the NAO identified. There was one where a settlement was approved without the whole of the High Risk Corporate Programme Board being consulted before the taxpayer was told that the case was settled. In another, we reached a conclusion on an issue, not realising that an impediment to full application of the relevant law no longer applied and that the official responsible for taking that to the High Risk Corporate Programme Board did not initially realise that was necessary. The governance worked very well, because the High Risk Corporate Programme Board identified that issue.

Jesse Norman: I have certainly misunderstood what you have just said. In the second case, what happened?

Dave Hartnett: In the second case, there was a misunderstanding of a particular aspect of the law.

Jesse Norman: Of the law?

Dave Hartnett: Of the law. There had been an impediment, which had prevented the law being applied in a particular way, and the individuals involved in the case did not realise that that impediment had been removed.

Q226 Jesse Norman: So they could have got more if they had not thought the impediment was there. Then it was discovered the impediment was there, and they then went and got the extra.

Dave Hartnett: In this particular case, the matter was referred to the High Risk Corporate Programme Board later than it should have been—only by days—because the individual responsible for the case did not realise it had to go there.

Q227 Jesse Norman: In the first case, where the board was not consulted—

Dave Hartnett: Not fully consulted.

Jesse Norman: Not fully consulted. What is the problem with that? Why is that an error of governance?

Dave Hartnett: Because we have a process laid down, and it was not fully followed.

Q228 Jesse Norman: I suppose I am asking why the process is the way it is. What problem is the process designed to guard against?

Dave Hartnett: The process is designed to ensure that for cases under a particular amount of money, there is a broad oversight among our tax leaders of a proposed settlement.

Q229 Jesse Norman: In other words, you do not want individual people going off and striking a settlement unless it has been properly shared. You do not want people running off and doing private deals.

Dave Hartnett: Absolutely.

Q230 Jesse Norman: Were you personally involved in doing this particular deal?

Dave Hartnett: The one that was not approved by the whole—

Jesse Norman: Yes.

Dave Hartnett: No.

Q231 Jesse Norman: That is helpful. Are we talking about the Goldman Sachs deal, just so I understand?

Dave Hartnett: Mr Norman, you know I cannot answer that.

Q232 Jesse Norman: Okay. There has been a deal done with Goldman, I think I am right in saying, in which they were—

Dave Hartnett: I am really sorry, but I cannot talk at all about a specific taxpayer. To make sure I could not do that, twice in the last 10 days, I have been to see our most senior lawyers to see whether there was anything I could say about the newspaper reports on this, and they have said no.

Q233 Jesse Norman: Take the case we are talking about. The error has now been put right, is that correct?

Dave Hartnett: Mr Norman, there is huge speculation that the case referred to in the NAO report is Goldman Sachs, and my legal advice says I cannot say anything that adds to or detracts from that speculation.

Q234 Jesse Norman: My last statement was not intended to be dispositive either way on that; it is just a question, which is: if there was a governance error, has the error been corrected, regardless of who the institution or not may be?

Dave Hartnett: I am very sorry, but because of the huge media speculation that that second case is Goldman Sachs, I am unable to answer any questions. I do not want to be difficult with the Committee. I knew this would arise, and colleagues and I got legal advice to see what we should do.

Q235 Jesse Norman: While we are on the issue, which you do not want to talk about and I do, have

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you ever had corporate hospitality from Goldman Sachs?

Dave Hartnett: I have been to a supper with Goldman Sachs. I would not call it corporate hospitality from them. I went with a managing director from the Treasury to talk to about 20 chief finance officers from FTSE 100 companies about developments in tax policy and tax administration.

Q236 Jesse Norman: Was any dispute with Goldman outstanding while you had this experience?

Dave Hartnett: I knew nothing of Goldman's tax affairs when I was at that supper. I do not deal with Goldman's tax affairs.

Q237 Jesse Norman: That is a helpful clarification. By extension, I assume you cannot talk about Vodafone, although we had a conversation about Vodafone when you were last in front of the Committee?

Dave Hartnett: The advice I had then was that because there were a lot of non-issues in the media, I could correct those, and that is what I sought to do.

Q238 Jesse Norman: That is helpful. One of the questions that has been put about the Vodafone settlement is that the Treasury never collected the interest owing on the tax that was payable. I forget if you addressed that issue last time; did it in fact collect the interest that was payable on the tax that was owing?

Dave Hartnett: I am in the same place again, Mr Norman. Can I just say, I would really like to answer these questions for the good of our Department and to make clear my own position, but your interim report in July made clear that the law really does not allow us to defend ourselves when it comes to having to talk about individual taxpayers?

Jesse Norman: I am not seeking to attack you or anyone else. I just need to get the facts straight.

Dave Hartnett: I understand that.

Q239 Jesse Norman: For the record, you cannot clarify whether or not interest was charged on the tax that was payable. Let me ask another question: does the law require that interest be paid on tax that is owing?

Dave Hartnett: Depending on the circumstances, yes.

Q240 Jesse Norman: What kinds of circumstances would release HMRC from this obligation?

Dave Hartnett: Let me try to give you an example, which I hope is helpful. One of the areas where we have not sought Interest—I am just trying to find a note I wrote to myself on this—is in relation to certain controlled foreign companies, where following a change in the law on the taxation of overseas dividends in 2009, so that the majority of dividends paid by overseas companies were no longer taxable, we looked again at how certain exemptions applied. We discussed this with our own lawyers, other lawyers, and business extensively, and developed something called the new approach to CFCs. We consulted widely. This applied to the motive test in relation to the CFCs, so that where a company pays a

dividend now—post-2009—and elects to be taxed on it, and is therefore regarded as passing the motive test, no interest arises on that. I am sorry that is rather complicated. We can set it out in a letter, if that helps.

Jesse Norman: That would be helpful, if you would. I am grateful for that offer and I accept it. Just to be clear, circumstances under which interest might not legally be required to be paid on tax owing are of the kind you describe.

Dave Hartnett: There are others.

Q241 Jesse Norman: In the case of Vodafone, this interest had been long-standing for a very long period of time, much later than 2009. It is absolutely opaque as to why the treatment of dividends would have any bearing. I suppose that may have been the cause of the tax that was owing?

Dave Hartnett: I am feeling, Mr Norman, as though I am thwarting all your questions, but I cannot answer questions on Vodafone. I am very sorry.

Q242 Jesse Norman: When you last came before us, you said that, in terms of avoidance, some £6.2 billion had been protected through litigation, and I subsequently had a letter from Dame Lesley suggesting a list showing £6.5 billion. Something like just under £6 billion of that was from fighting group litigation challenges. Only about £100 million was on corporation tax avoidance cases. That is £100 million out of the £6.2 billion. In the list of legal decisions that I was sent, just seven cases had been taken to the tribunal since 2000. My question is: can that really be a decent response to issue of corporate tax avoidance, amounting to evasion?

Dave Hartnett: I think, Mr Norman, the first thing I would like to do is look at the analysis of those numbers, because one case—we mentioned it at the last hearing, so it is in the public domain—Prudential, which is about off-market swaps, has produced about £1 billion through the immediate case and the 30 or so following cases. The analysis you have given, which I have not made for myself, so I cannot really comment on now, is not right, in terms of the money that has flowed from some of those cases.

Melanie Dawes: Can I add, Mr Norman, that on corporation tax, we also have a lot of other cases with large businesses that are following on from some of those cases? Whereas on VAT, it is more usual to find that each case has to be heard on its own merit, so you will find that there are often a lot of other companies standing behind what may appear to be quite a small number of cases but actually involves quite a large amount of tax.

Q243 Jesse Norman: Thank you for that. You will know from previous discussions that I feel very strongly about the high penalties being imposed on small business, and the small penalties being imposed on large business. My colleague, Mr Blenkinsop, raised the question earlier about percentages being charged in penalties and, of course, when you have a negotiated settlement, almost by definition there is no standard compared to which you can charge penalties, which build in a bias in favour of large companies,

who can negotiate their terms of settlement, and against small companies.

However, the Revenue is occasionally successful in these cases, and here is an example: Prudential had a scheme involving deliberate mislabelling of payments in order to arrange a tax break. In that case, there was no penalty charged at all, as far as I am aware, but there are countless cases—every constituency has them—involving small businesses in which HMRC is relentless in chasing large penalties on small business. I am just wondering why you are not charging penalties in cases like Prudential's. In 2008, you told the House that penalties from large businesses would increase, but in fact they have gone down, haven't they?

Dave Hartnett: Yes, they have.

Q244 Jesse Norman: Why should that be? That seems to me a pretty poor outcome.

Dave Hartnett: We did touch on this at the last hearing.

Jesse Norman: Let us talk about Prudential then. We do not need to expand on the point; I have made the point about the drop in paying penalties.

Dave Hartnett: Our people will have looked incredibly carefully at every case that we have litigated and won that involves avoidance, or that we have settled, to determine whether the law allows a penalty to be taken. Forgive me, but I do not have the transcript of last time with me; however, one of the points that I know Mr Clasper wanted to make—I cannot remember whether he made it—is that evasion in large business, or dishonesty in relation to taxation, is something that we do not see very often; I certainly made the point first. In order to take a penalty from large business, we have to find that the law can be applied. With smaller business, there is more often dishonesty, or—

Jesse Norman: There is more often provable dishonesty. If someone goes into a negotiation with you with a bunch of numbers that they just want to get away with, and you make your way to a negotiation, it is hard to prove dishonesty, although they may have started miles away from where you were, in terms of negotiation.

Dave Hartnett: We do search out for dishonesty and our investigators are very good at it. Over the years, we have often asked our criminal investigators and other specialist investigators to take up an inquiry into big business avoidance and search out the dishonesty.

Q245 Jesse Norman: The Prudential case is a counter-example to that. I have here a copy of the legal report: "HMRC win on 'mis-labelling' (Tax newflash, June 2009)". It says that the Court of Appeal affirmed the judgment on the Prudential issue in favour of HMRC. You win the case; where is the money? They should pay the penalty. The Court of Appeal has found for you in this. It seems cut and dried that penalties should be paid. These people have attempted to get away with not paying, and they have been found out.

Dave Hartnett: I am afraid, Mr Norman, that all our legal advice is that winning in the Court of Appeal is not enough for us to be able to take a penalty.

Q246 Jesse Norman: Is that because you fear that it may go to the Supreme Court, or is it because you simply regard a Court of Appeal judgment, uncontested or unrefereed successfully, to be an insecure basis for charging a penalty?

Dave Hartnett: No. A decision by the Court of Appeal, or indeed the Supreme Court, is not of itself enough to bring the case within the legislation that leads us to be able to charge a penalty.

Jesse Norman: I would be very grateful if you could have someone write to the Committee on that. It seems to be an extraordinary thing.

Dave Hartnett: Of course.

Q247 Jesse Norman: We have procedures for deciding what is within the law. In some cases it is unclear what the law is. The judges make a decision; the people pay up. A final question. You have talked a little bit about the Swiss deal, which I think in many ways is important and good. You have also said that HMRC cannot find people in Switzerland, so my question is: first of all, how are you able to make any estimate of what the revenue from that deal is going to be, given that you do not know who they are? We bracketed out the disc you have received. Secondly, how on earth are you going to be doing it, since in many of these cases these accounts are under nominee names, or in the names of trusts or foundations or other institutions, and the Swiss themselves may not know the ultimate beneficial owner? How have you been able to get to this £5 billion number? How properly and responsibly have you been able to get to that number? Not, as it were, just by guesswork?

Dave Hartnett: If I may, it is certainly not by guesswork. We have expected, throughout the discussions with the Swiss, to be tested on the numbers. We started out in two ways, looking at the number. The first was by looking at various research that had been undertaken and is available in the public domain, which puts some numbers on the amount of money held by United Kingdom residents in Switzerland.

The second thing we did was ask the Swiss banks, under supervision of the Swiss Government, to come up with a number, and those two numbers were not very far apart. I cannot remember how far apart, but it was a small difference. Then we applied the sort of issues that I was talking to Mr Blenkinsop—non-domiciled status and the like.

Where we have gone with the structures and trusts is that Swiss banks will require disclosure to them of beneficial ownership, and if that shows a connection to the United Kingdom, there will be withholding against those investments, and the Swiss tax authority will audit this in relation to the Swiss banks. It has a pretty fearsome reputation for the way in which it audits Swiss banks.

Q248 Jesse Norman: Why did you offer immunity to the bankers involved as part of this deal?

Dave Hartnett: We have not technically offered immunity. We have said we will not start criminal investigations, and the reason for that is that we have no evidence on the basis on which to start them.

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Jesse Norman: But you might well discover evidence in the course of the implementation of this deal that creates serious concern about it.

Dave Hartnett: We thought it was very unlikely indeed that we would get evidence against Swiss bankers during the course of this. Can I switch across to Liechtenstein to illustrate the point, just for a moment?

Jesse Norman: Yes, of course.

Dave Hartnett: We thought, there, because the Liechtenstein disclosure facility is different, that we would, or could, get a great deal of evidence about some bankers, and none has been flushed out at all.

Q249 Jesse Norman: Does that apply to historical misdeeds, as well as to the current moving of assets out of the jurisdiction?

Dave Hartnett: The focus of what I am saying is about historical misdeeds.

Q250 Jesse Norman: Finally, one thinks of the parallel case of the Americans with UBS. As you will recall, they were extremely tough about it, prosecuted a lot of tax evaders, got some convictions, fined a bank and then had an amnesty, so that other evaders could see what was potentially facing them. Why did you not adopt that approach?

Dave Hartnett: Because we did not think that we would succeed with that approach. I am probably going to be slightly clumsy in what I say now, but let me try. The Swiss banks have a huge market in the United States, operating out of New York and, I think, up to 40 other towns and cities. They necessarily have to have a huge amount of data and material in the United States. We have found in other inquiries that there is very limited data and evidential material in the United Kingdom held by Swiss bankers because the sort of transactions we would be interested in are more often than not done out of Geneva, Zug, Zurich or wherever, where the evidence is available.

Jesse Norman: I will not proceed any further on that. Thank you very much.

Q251 Mark Garnier: Can I just come back to you on the question of the errors and appeals process? I have the HMRC figures on internal review for the year ending on 31 March 2010. I think you had something in the region of 13,500 cases,¹ of which about 25,000 were completed, so obviously a number were not completed. On the outcomes, excluding penalty cases, the HMRC decision was upheld 60% of the time. You have lost 40% of the time. On outcomes of penalty cases, you lost 54% of the time. That is an awful lot of occasions where it is upheld against you.

Dave Hartnett: In the internal review process?

Mark Garnier: In the interview review process, yes.

Dave Hartnett: I agree with you, Mr Garnier. That has caused us to look very carefully indeed at the issues that have arisen, and we have an external penalties oversight group, which we set up through the review panels, which has helped us look at that. I think, from memory—please correct me if you have the details in front of you—many of the cases that were set aside were in fact in relation to VAT—

Mark Garnier: And most of those went against you.

Dave Hartnett: Yes. We have been producing new guidance for our people, and we are looking to develop new processes to reduce that number and to ensure that we are not seeking to impose penalties on people where it is just not due.

Mike, do you have anything to add?

Mike Eland: Only that this is a new system that has come in. The VAT penalty system has been changed, so it is a matter of getting people used to a new system, which is why we are keeping it under very close review, as Mr Hartnett has explained.

Q252 Mark Garnier: But it is an awful lot of errors against businesses, if you are talking about VAT. These people out there could be sole traders—they could be all sorts of people—who are struggling to cut their furrow in very difficult economic conditions. I think it is entirely right that HMRC is trying to make sure that you collect tax where it is due, but it is entirely wrong that in so many cases you are wasting people's time, and are distracting them from the job of sorting out the economy and diverting them into a review process, albeit it an internal one, because you have made a hash-up of the process in the first place in thousands of occurrences.

Dave Hartnett: We agree. The move to behaviourally-based penalties has been a big change for UK tax administration, and we have invested a lot of time with our people to help them understand that. As well—the tax profession has applauded this—the internal review process has demonstrated its worth here clearly. The feedback that comes to us from it now—we started doing this some months ago—means that we have to change the way we ask our people to pursue penalties, and we are doing that.

Q253 Mark Garnier: If a business has been subject to a wrongful penalty, and the internal review process finds in its favour and against you, how do you compensate those businesses, or indeed individuals?

Dave Hartnett: Certainly we set aside the penalty to start with, but more importantly, we have a compensation and redress policy in the Department. If people have incorrectly incurred expense, and that is down to us, they are entitled to seek compensation from us.

Q254 Mark Garnier: And you pay it?

Dave Hartnett: And we pay compensation and redress.

Q255 Mark Garnier: You pay the full compensation?

Dave Hartnett: It depends what—

Mark Garnier: It is quite an important point. The other interesting point is that 80% of internal reviews are put forward by an individual with no agent acting on their behalf, so this is an individual. It may be that they have a big finance department in the business and can afford the time—well, who says they can afford the time? It is a nightmare for them. But the important point is you will have a number of charges. Some of those will be direct charges for an accountant or tax expert. Some of the other charges will be the cost of

¹ Note by witness: The published figure is 30,500 cases

time, and the opportunity cost of having your business winners taken away from going out and selling their product, and instead coming and dealing with this. This is a big deal. On top of that—this is also very important—you have a reputational cost. Again, if a small business is suddenly distracted away from looking after its customers, and somebody discovers that it is dealing with an investigation from HMRC, that again has a knock-on effect. It may lose business on the back of that. Some of the costs are very directly quantifiable; some are a bit more unquantifiable. What are you doing to compensate those businesses that you could effectively put out of business by an erroneous penalty?

Dave Hartnett: We will always meet the costs that taxpayers have incurred.

Q256 Mark Garnier: If they send you a bill for £20,000 from their tax adviser, you will pay that for them?

Dave Hartnett: If we have led them to incur a bill of £20,000 from tax advisers directly as a result of our mistake, then our approach would be to pay that compensation.

Q257 Mark Garnier: And other costs—costs of management time?

Dave Hartnett: Not usually. We follow the approach that the Parliamentary Commissioner for Administration takes, where there have been some changes recently, but we will look carefully at the costs that are incurred, internal and external. Each case needs careful analysis.

Q258 Mark Garnier: Has HMRC ever been subject to a legal case for reputational damage?

Dave Hartnett: Not that I can recall.

Mike Eland: We would have to check.

Dave Hartnett: We will have a look.

Q259 Mark Garnier: Just one final question: there have been some suggestions that the new tribunal system, which is now running, is much more bureaucratic and slower than the old system of General Special Commissioners. Do you have any view on that? Is that true, and if it is, is it a pain in the neck?

Dave Hartnett: I do not think one can make an overall statement that it is true. In some circumstances, it can take longer for cases to come on at the first-tier tribunal than it used to take in front of the General Commissioners, but the General Commissioners, generally in the past, were bodies of local businessmen and other local people, with, in more recent times, a lawyer as their clerk, whereas now there are judges in the first-tier tribunal, assisted by lay people.

We have noticed that some cases are taking longer to come on, but often this is a location issue. It is something we pick up with the user group for the first-tier tribunal.

Q260 Chair: We have a few more minutes. We have had people—elderly people, people from all over the country—being chased for money that they did not

think they owed, and threats were made at them. Are you saying there is now an official appeal procedure that starts with asking for an internal review, and if it is not in their favour, that they can go off to a tribunal? Is there now official appeals machinery in Inland Revenue?

Dave Hartnett: I think, Chair, there always has been.

Chair: It has not been very well broadcast.

Dave Hartnett: What is relatively new—

Chair: Just say whether there is one now.

Dave Hartnett: It exists. The internal review—

Q261 Chair: Very good. What about this business of section 29 or something, at the height of the crisis? It was never volunteered that people could ask for an independent review or go to a tribunal. People were told, “You may be considered for being let off under this part of the code.” Can people challenge you? Do they have a right to an internal review, and can they then go off to a tribunal?

Dave Hartnett: People can ask for an internal review—

Q262 Chair: Ordinary taxpayers whom you have mishandled, or who feel they have been mishandled? Wonderful. It is good to put that on the record. One last thing. On that business that you were speaking to Jesse Norman about, I have every sympathy with you for not being able to answer questions because of legal advice. You may have noticed in our report that we found the Minister similarly unable to say anything, do anything, and tell us anything. We found it quite amazing, and a pretty disturbing state of affairs, that a Minister cannot come to Parliament and pass on information on his responsibilities. You are similarly placed in a position where you personally had the problem of your name being used, and your actions being misconstrued, if you wish, and you cannot reply or answer. The lack of transparency, and the damage that it does to our officials, seems to be unacceptable. How on earth do we get out of this? Do you have a suggestion for us? It is uncomfortable for you and it is unacceptable to us as guardians of the guardian. Do not be too specific, because we might do it.

Dave Hartnett: That I recognise, Chair. I think there is clear concern on the part of the Committee and others about the lack of transparency, but I believe this has to be balanced against taxpayer confidentiality, which exists all over the world.

Q263 Chair: That does not make it right.

Dave Hartnett: No, it does not make it right. There are countries—some of the Nordic countries—that require all cases to be settled by an appeal tribunal. That is every single case. In the United Kingdom, if every single case had to be settled that way, that would mean hundreds of thousands, maybe more. I do not have a bright idea for you today, but the thing that worries me most—and I would hope we could find a solution to it—is that when I was here before I called what my Department has called the urban myth of the £6 billion absurd. We have seen a number of calculations of that £6 billion, which include roundings and all sorts of things, and the Commissioners of Revenue and Customs—as, I

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imagine, are Ministers, but I have not talked to David Gauke in particular about this—are worried about the impunity with which people can attribute alleged deeds, actions and calculations to us, which we know to be not right, but we cannot answer.

Q264 Chair: But we do not know that they are not right, and there is a difficulty in terms of being open and transparent to the public.

Dave Hartnett: I agree.

Q265 Jesse Norman: I have to go in a second, so I apologise for that, but your question, Chairman, obliterated a distinction, which is that the Minister does not know anything about these cases. The Minister is in exactly the same position vis-à-vis the Revenue as the members of this Committee—that is to say, complete ignorance. Therefore, there is not even that first tier of accountability to Ministers that we normally find, subject to a duty of confidentiality, elsewhere in the system.

Melanie Dawes: Can I perhaps come in on this? I think one very important part of this is what our governance is, which you were talking about earlier, and that is why I think we did welcome the NAO report into this, and we welcomed the fact that it has said that the governance is strong, and that in the substantial majority of cases we were abiding by it very well. I think that is quite important, because it is about everybody understanding how we reach decisions, and understanding who in the Department is making those decisions, so that we can make sure they have the right qualifications and background and so on. It is quite an important part of that, and it is quite new for that information to be out in the public domain.

Q266 Jesse Norman: Just for the avoidance of doubt, will it be given full details of specific cases?

Melanie Dawes: It was absolutely exhaustive on the—

Q267 Jesse Norman: So there is no question of withholding information, or lack of transparency?

Melanie Dawes: No, absolutely none at all, and they themselves say one of its criteria—at any case where it had any concerns raised with it, so we certainly felt it was pretty comprehensive.

Q268 Jesse Norman: But it has no tax expertise, so it is not in a position to judge on the substance of the information it sees, as to whether or not—

Dave Hartnett: Mr Norman, where it lacks tax expertise and feels it needs it, it goes out and gets it from the big four, or elsewhere.

Chairman, there is maybe one thing I can add that would be a little helpful today. On the back of the National Audit Office report, not so much on the two cases Mr Norman was exploring, but the four cases earlier on, which were dealt with outside the HRCF process, we are going to change our governance arrangements.

Q269 Chair: And you will tell us the details when you take that decision?

Dave Hartnett: Of course.

Chair: Lovely. On that happy note, I am sorry to disappoint you—this session has been so small—but I have run out of members. Thank you very much. On behalf of the Committee, I wish Dame Lesley a full recovery. It is really sad, the illness she has had. I hear that she is progressing; I hope she is progressing well. You will convey the Committee's best wishes to her.

Dave Hartnett: Thank you, Chair, and of course I will do that. I saw her on Friday. She is up and about, having had an operation, and is now preparing for the next stage of her treatment.

Written evidence

Supplementary written evidence submitted by the Low Incomes Tax Reform Group

ADMINISTRATION AND EFFECTIVENESS OF HMRC—THE TAX GAP AND ERROR AND FRAUD

Introduction

1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.

2. The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it—taxpayers, advisers and the authorities.

The “Tax Credits Gap”

3. The size of the tax gap in 2008–09 was estimated at £42 Billion across HMRC-administered taxes, representing around 9% of total tax liability¹. In addition to that, some £2.1 Billion a year of overpayments of tax credits are officially attributed to either fraud or customer error, representing about 8.9% of total expenditure on tax credits.²

4. By way of background, entitlement to tax credits is based on a claimant's income and circumstances during a whole tax year. As it is not possible to predict what will happen, any credits paid to the claimant during the tax year are provisional in nature, being based initially on a claimant's current circumstances and previous year's income. They are then subject to adjustment after the end of the tax year when the claimant's income and circumstances are known. Hence overpayments of tax credits—and underpayments—are an essential part of how the tax credits system works.

5. In this short note, we discuss some concerns we have around the £2.1 Billion figure, which needs closer analysis than it has received to date. In our view, existing analyses materially underestimate the contribution of official error to this £2.1 Billion a year “tax credits gap”.

6. The causes of tax credits overpayments are diverse, including incorrect reporting of changes by claimants, delays by claimants in reporting changes, incorrect capture of data by HMRC, delays by HMRC in processing changes reported by claimants, incorrect advice by HMRC on which the claimant acts to their detriment, income falling then rising again during a tax year, large increases in income, and adjustment of an award following an investigation by HMRC.

7. Yet the official statistics³ (which are based on a study of the results of a selection of random enquiries—the Error and Fraud Analytical Programme or EFAP) divide the estimated error and fraud figures into (a) error favouring the claimant, (b) fraud favouring the claimant, (c) error favouring HMRC. This analysis presupposes that error and fraud are the sole causes of overpayments, when in fact many are due simply to the way the system operates (as described in para 4). It also leaves no room for official error which we believe is materially underestimated.

8. We also think it is wrong to conflate “fraud and error” or “error and fraud” as HMRC tend to do: the two components are completely different in cause, impact and potential remedy.

Official Error within HMRC's Administration of Tax Credits

9. An important part of the plan announced in the October 2010 Spending Review to reinvest £900 Million in combating evasion and avoidance is a joint initiative by HMRC and the DWP to target “fraud and error” in tax credits and benefits. The joint HMRC and DWP strategy document *Tackling fraud and error in the benefit and tax credits systems* (October 2010) estimates annual revenue losses due to fraud and error in the welfare system (both benefits and tax credits) at £5.2 Billion, or almost 3% of total expenditure. It also shows the following breakdown of overpayments of benefits and tax credits in (respectively) DWP and HMRC (see page 12):

DWP:

- Customer error £1.1 Billion
- Official error £1.1 Billion
- Fraud £1 Billion

HMRC:

- Customer error £1.5 Billion

¹ Measuring Tax Gaps 2010, HMRC (<http://www.hmrc.gov.uk/stats/measuring-tax-gaps-2010.htm.pdf>)

² Tackling fraud and error in the benefit and tax credits systems, HMRC & DWP, October 2010

³ Child and Working Tax Credits: Error and Fraud statistics 2009–10 (HMRC June 2011)

— Fraud £0.6 Billion

10. According to this analysis, approximately two-thirds of overpayments are accounted for by error of various kinds, whereas fraud counts for only about one-third. That in our view suggests that the two should be studied independently of one another, and at least as much attention paid to analysing and tackling the causes of error as of fraud. Conflating the two into a composite concept, “fraud-and-error”, is unlikely to lead to an accurate understanding of what causes this part of the gap in public finance. Interestingly, in *Child and Working Tax Credits: Error and Fraud Statistics 2009–10*, the element of fraud in 2009–10 is estimated at a lower figure (1.4 as opposed to 5.9 as a percentage of final entitlement).⁴

11. In our observation, “error” can constitute careless (negligent) or innocent mistakes by customers, mistakes by officials (eg in advising customers incorrectly by phone or in person), mistakes in published information on which customers rely to their detriment, or erroneous programming of Government computer systems. In addition there is a whole range of error which is primarily customer error but to which officials have contributed in some indirect way—for example misleading or incomplete information or guidance can lead to customers acting or failing to act on the basis of misunderstandings so generated. We need a better understanding of how each type of error contributes to the overall figures.

12. Another point to remark on is the absence of official error from the figures quoted for overpayments of HMRC-administered credits. A footnote (page 13) explains that “HMRC does not record levels of “official error” in tax credits, as errors made by staff can be corrected at the end of the year when awards are finalised and so represent a small sum”. Yet to our certain knowledge HMRC frequently write off overpayments that are due to official error, and Code of Practice 26 makes specific provision for HMRC not to collect overpayments where “we fail to meet our responsibilities”. It would take a considerable leap of faith to accept that levels of official error within HMRC were so very much lower than equivalent levels within DWP as a proportion of total expenditure.

13. The publication referred to above (*Child and Working Tax Credits: Error and Fraud Statistics 2009–10*) casts some light on how HMRC arrive at this extraordinary conclusion. It acknowledges that “error” “could also cover a situation where the correct information has been provided but this information has been incorrectly processed by HMRC”⁵. It goes on to say that as part of the EFAP exercise, compliance officers were asked “not only to classify whether or not a case that was found to be incorrect was due to either error or fraud, but also whether or not the error was due to HMRC. However, HMRC error figures for 2009–10 are not included in this publication due to the small number of cases in the sample found to be affected”.⁶

14. This suggests that the information used to decide on levels of official error is collected from compliance officers at the point where an enquiry or examination is completed. But surely HMRC should also look at overpayments collected and subsequently repaid to the claimant following a complaint or an appeal, whether settled or determined by a tribunal. In our experience, an overpayment debt is often written off, and any amounts already recovered are repaid to the claimant, if a sound case for official error is later established in correspondence. HMRC should keep and publish data showing the extent of official error thrown up by these cases.

15. We recommend that HMRC take steps to understand the nature and extent of official error within tax credits, how to measure it, and what needs to be done to counter it; and revise the fraud and error statistics accordingly.

Reflecting Successful Appeals, etc, in the Error and Fraud Statistics

16. The remainder of this evidence picks up the point made in para 14 above—that error and fraud figures should take account not only of the results of enquiries carried out by compliance officers, but also of subsequent reversals of compliance officers’ decisions.

17. In the last year or so, the increase in HMRC’s compliance activity has been accompanied by a growth in the number of investigations we have seen that have been misconceived. Some of these investigations have resulted in tax credits being wrongly clawed back.

18. For example, a number of investigations have been launched into claims involving the disability element of working tax credit. There are a number of qualifying factors which entitle a person to claim the disability element, one of which is that they have been entitled to the disability element itself within the last 56 days. This enables a person who initially qualified for the disability element via certain other benefits, such as incapacity benefit, to continue to qualify for as long as they meet the disadvantage in work test. However, the compliance teams who planned the investigations were clearly not briefed about this possible route to entitlement, with the result that many had their payments unlawfully stopped.

19. Also, we have seen several flawed investigations into single claims where HMRC allege the presence of an undeclared partner, particularly where the single claimant is married but living separately from his or her (usually her) spouse but not taken any steps towards a divorce or judicial separation. In such cases, several

⁴ Ibid, table 3.

⁵ Ibid, Annex A, para 3.

⁶ Ibid, Annex A, para 5.

pieces of evidence need to be taken into account to determine whether the separation is likely to be permanent, but HMRC will typically reach a conclusion on the basis of a single piece of evidence (such as the spouse using the former matrimonial home as his address for the purpose of his credit card or driving licence) while discounting evidence that might point the other way (such as a restraining order against the spouse following an incident of domestic violence). On that basis HMRC often end the single claim, and treat all the tax credits which the claimant has received in that capacity as a recoverable overpayment.

20. The question we ask is whether in compiling error and fraud statistics HMRC take account of the fact that some compliance decisions are subsequently reversed, either on appeal or because HMRC are persuaded to change their mind after corresponding with an adviser. For example, say an HMRC investigation identifies £50k as recoverable because a single claimant should have claimed jointly with someone else. The claimant objects, or appeals, and succeeds in showing that for half of that period he or she was indeed single so that only £25k should be clawed back. Will £50k be treated as error and fraud favouring the claimant, or only £25k? All we have seen indicates the former.

21. We recommend that where the results of an enquiry or other compliance initiative have passed through EFAP and found their way into the error and fraud statistics, there should be some way of adjusting them subsequently if the finding of the compliance officer is later overturned, for example on appeal, or simply because HMRC is persuaded to review the matter and reaches a different conclusion after doing so.

5 July 2011

Written evidence submitted by HM Revenue and Customs

What measures are HMRC undertaking to tackle offshore tax evasion and reduce the scope for evasion of this nature?

Much of HMRC's work on evasion and avoidance applies wherever the offence takes place. For example recent initiatives aimed at Managing Deliberate Defaulters and Publishing Details of Deliberate Tax Defaulters apply where offshore evasion is detected. Over and above this, HMRC is also undertaking a range of innovative approaches to tackling offshore evasion. These include:

Focusing skilled investigators on offshore issues

- As part of its £900 Million reinvestment HMRC will create a new taskforce of 100 skilled investigators who will use data regarding offshore accounts to target those that evade or avoid UK tax. Exemplary action, including high profile prosecutions, will make evasion too big a risk for the non compliant. This team will also have a role in continuing to develop the Offshore Strategy and co-ordinating work across HMRC.
- HMRC is adding new Fiscal Crime Liaison Officer posts to work with partners worldwide to identify significant illicit activity targeted on the UK.
- HMRC proactively targets, prosecutes and confiscates illicit offshore assets gained from wider criminal attacks such as Missing Trader Intra Community (MTIC) fraud. The work of our Criminal Investigations Directorate has resulted in the successful prosecution of more than 85 MTIC fraudsters who held offshore accounts containing illicit monies.

Working with international partners to make it harder for tax cheats to hide their assets

- Securing a new agreement with Switzerland which will see significant amounts of tax recovered from money already hidden in Switzerland, a new withholding tax on to ensure the correct taxation of investment income, and new powers for HMRC to find out about Swiss accounts.
- HMRC's negotiations with Liechtenstein led to a TIEA and the Liechtenstein Disclosure Facility (LDF) (see below for information on LDF) ensuring this former tax haven is no longer available to those hiding their assets from UK tax.
- Increasing the number of Tax Information Exchange Agreements and bringing a number of the UK's older agreements up to the international standard for exchange of information in tax matters.
- Working with HMT to actively support the G20 transparency agenda. As a result of a recent "peer review" we are consulting on a change to our information gathering powers to allow us to provide increased assistance to other countries.
- Information received from another country under the terms of a Double Taxation Agreement has provided significant detail of the UK investors of a major offshore bank. Approximately 750 individuals are presently subject to civil or criminal investigation for tax evasion. A large amount of data is being taken forward and further interventions are currently under consideration.

Providing innovative disclosure facilities to encourage people to regularise their affairs

- The LDF runs from 1 September 2009 to 31 March 2015. By the end of the disclosure period it is expected that all existing Liechtenstein investors, in addition to those eligible to move qualifying investments to Liechtenstein, with a potential UK tax exposure will have to demonstrate that they are UK tax compliant. Those who choose not to regularise their UK tax affairs will have relevant services withdrawn by their Liechtenstein financial intermediary or, in exceptional circumstances, face a retention tax from their Liechtenstein investment. In December 2010 the Liechtenstein Government completed implementation of changes to their law as required by the agreement which requires Liechtenstein financial intermediaries to identify persons who may have a UK tax liability.
- The Offshore Disclosure Facility (“ODF”) ran from 17 April 2007 to 22 June 2007 and was the first disclosure facility of its type. The ODF enabled taxpayers with a tax liability arising from funds held offshore to settle with HMRC by paying the tax and interest due together with a penalty of 10%.
- The New Disclosure Opportunity (“NDO”) ran from 1 September 2009 to 12 March 2010. The NDO is now closed and HMRC is using intelligence held on offshore accounts and assets to identify and challenge those who chose not to come forward. Penalties applied to these cases may be as high as 100%.

Further powers to tackle offshore evasion

- New higher penalties—of up to 200%—for offshore evasion apply for IT and CGT from 2011–12.

What measures are HMRC undertaking to reduce the opportunities for offshore tax avoidance?

HMRC is a member of the Joint International Tax Shelter Information Centre (“JITSIC”) which was set up in 2004. Other current members, represented by their tax administrations, are Australia, Canada, Japan, China, USA and South Korea. (France and Germany are currently observers and may become members in the near future.) JITSIC has offices in London and Washington DC with senior UK inspectors in each office.

JITSIC works to identify, analyse and combat existing and emerging tax avoidance within or across the members’ tax systems using exchange of information powers under the terms of the existing bi-lateral tax treaties between the members and observers where appropriate. (The treaties broadly cover personal and corporate income and capital gains taxes.) The work done ranges from bi-lateral exchanges on specific schemes/taxpayers to multi-lateral consideration of themes or trends that we are seeing.

Whilst JITSIC does not engage directly with any non-JITSIC territories its work naturally involves consideration of the use of any offshore arrangements in aggressive tax planning/avoidance schemes by UK taxpayers, both corporate and individual.

What arrangements are in place to ensure HMRC has access to the information it needs?

HMRC benefits from:

- Third party information from a range of sources
- Information from over 130 jurisdictions via its network of bilateral tax agreements, the multilateral convention on mutual administrative assistance in tax matters (open to all countries since June 2011) and through EU law instruments such as the European Union Savings Directive.
- Extensive information powers which HMRC uses to obtain additional information—for example in 2009 HMRC requested information from over 300 banks in respect of UK taxpayers with offshore bank accounts. This information resulted in the successful NDO campaign.

HMRC has now accumulated information relating to approximately half a million UK individuals with money held in offshore accounts and is analysing this data to identify those who are not tax compliant.

How successful have these measures (on both evasion and avoidance) been over time?

A number of the initiatives are still at an early stage of their life-cycle and it will be some time before the full extent of their success can be fully evaluated. However, there are early positive indications that the measures are successful.

- HMRC expects to raise **more than £1 Billion directly from the LDF** over the course of its lifetime. The LDF runs until 31 March 2015 and we expect to see numbers substantially increase as persons are identified by their Liechtenstein financial intermediaries and are required to disclose to HMRC. The most recently published figures showed that by 31 March 2011 there were 1351 registrations and £140.08 Million paid by those registered under the facility. LDF is proving to be very successful and HMRC is pleased with the response to date. In the light of this success, we are optimistic that it may deliver even more than our official forecast and we share the aspiration for it to do so.

- **The ODF raised nearly £500 Million** from voluntary disclosures and follow up enquiries whilst **the NDO raised over £85 Million** in voluntary disclosures from 5500 people and businesses who had previously unpaid tax. Following closure of the NDO, over 1000 enquiries have already begun into customers who we think may not have paid what they owe. These initiatives have also delivered sustained benefits in that we estimate that the returns of those who did disclose submitted for later years include additional yield of approximately £20 Million. Some of these are those who have made ODF/NDO disclosures which may be inadequate. Others relate to customers who have chosen not to participate in either the ODF or NDO. We expect that number to grow substantially as our analysis of the data we have obtained continues. Those who have failed to disclose what they owe face either criminal investigation or substantial penalties.
- **Criminal Investigation** has been at the forefront of identifying and tackling high value frauds that lead to illicit monies being held offshore. In 2009 and 2010 the Department acted quickly and decisively to protect UK revenues and cut off the opportunity for MTIC fraud in specific markets. Owing to the success of the action taken by HMRC we **prevented losses of at least £1.5 Billion** from the UK Exchequer. A significant proportion of this money would have been hidden in offshore accounts or gone to fund other serious crime.

What are the major obstacles facing HMRC in tackling these issues?

It remains difficult to obtain information about assets held offshore. This is being addressed through the extension of the UK's network of agreements providing for the exchange of tax information, our leadership of the G20 agenda and through innovative approaches such as the LDF and the agreement with Switzerland. [We have also benefited from an increased willingness of whistleblowers to bring concerns and information to HMRC and other tax authorities.

Traditionally there has been a perception that hiding money offshore is not serious, and some taxpayers consider it low risk. We are tackling that through extensive investigation initiatives such as the NDO and LDF, together with proactive media coverage including the publication in the national press of anonymised real life case studies. And we have increased the seriousness of consequences of being caught. This is part of the rationale for the increased penalties for those who hide funds in the least transparent jurisdictions. Whilst the penalties only come into force this year there is already some evidence that other jurisdictions want to improve their information sharing arrangements so that lower penalties are applied to those who seek to hide funds in their financial institutions.

7 September 2011

Letter from the Permanent Secretary for Tax to the Chairman of the Committee

I am writing to draw the Committee's attention to the publication today of the report "Measuring Tax Gaps 2011" which includes the first estimate of the 2009–10 tax gap. The figures were published at 9.30 am this morning and a copy of the full report is available on the HMRC and ONS internet sites. <http://www.hmrc.gov.uk/stats/mtg-2011.pdf>.

We were unable to share the latest estimates at the recent TSC hearing on 12 September because of official statistics protocols. However, given the Committee's interest in this area we thought it might be helpful to explain our interpretation of the figures.

The tax gap figures set out the broad picture of the compliance challenge that HMRC faces. The latest data broadly confirms our overall understanding of the key areas of tax risk, and is consistent with HMRC's continued progress in improving compliance. The tax gap has reduced from 8.5% of total liabilities in 2004–05 to 7.9% in 2009–10 and HMRC has almost doubled compliance revenues since 2005 to £14 Billion. The latest estimates do not affect our commitment over the Spending Review period to accelerate this progress on the back of the reinvestment of £917 Million. We remain committed to delivering an additional £7 Billion a year by 2015.

Summary of the latest figures

The tax gap is broadly constant as a share of liabilities between 2008–09 and 2009–10, falling slightly from 8.1% to 7.9%. The tax gap as a share of liabilities is more meaningful measure than the cash figure, as it strips out changes to tax rates and the impacts of inflation.

There are two changes to which we should draw your attention. First, in cash terms, the tax gap has fallen from £39 Billion in 2008–09 to £35 Billion in 2009–10. This is primarily due to the reduction in the VAT rate to 15% for most of 2009–10. In general terms, a lower tax rate will lead to a lower amount lost from non-compliance. The increase in VAT back to 17.5% and subsequent increase to 20% means that, other things being equal, the VAT gap will grow when expressed in cash terms in future years.

Second, the tax gap has been revised downwards in 2008–09. In September 2010, we estimated the 2008–09 tax gap to be 8.6% of liabilities or £42 Billion. We now estimate it to be 8.1% or £39 Billion.

The biggest reason for the revision in 2008–09 is a fall in the tax gap from corporation tax on large businesses, which was previously estimated to be £3.1 Billion in 2008–09 and has now been revised down to £1.3 Billion. This is partly due to data improvements—this is still a very new data series, with figures only available since 2007. But it also reflects our recent experience that large corporates are engaging in less tax avoidance, and that HMRC is tackling what we do see more effectively. Because corporation tax returns are filed in arrears, the new 2008–09 data is more soundly based in operational results than last year’s estimate, which relied largely on extrapolating previous years’ trends. These arrears mean that this series will always be subject to annual change and revision as our staff work through the returns.

We are confident that the methodologies that we are using to measure the tax gap continue to be appropriate, and that the estimates are robust. While the figures are subject to margins of error and revisions, as is inevitable for a series that is based on concepts of theoretical liability and relies on ONS national accounts data, we are also confident that the overall scale of our estimates is right. As we mentioned at the Committee’s hearing on 12 September, estimates that are sometimes quoted of around £120 Billion are very wide of the mark. The flaws in this calculation include (i) all outstanding debt at a particular point in time is included whereas we know that the vast majority of debt is eventually paid and (ii) the use of legitimate tax relief is counted as avoidance.

We believe that the tax gap is an important strategic tool for the department and gives the public important information with which to judge our long-term performance. However, as many of your witnesses, commented, the error margins and timeliness of the data means that it is not suitable for use in setting targets or monitoring operational performance, and we no longer use it in this way. Our targets for the spending review period ahead are based on additional revenue generated through compliance activity, which is also how the overall £7 Billion spending review target has been calculated and will be monitored.

Annex

HEADLINE STATISTICS

| | 2004–05 | 2005–06 | 2006–07 | 2007–08 | 2008–09 | 2009–2010 |
|--------------------|---------|---------|---------|---------|---------|-----------|
| Numerical tax gap | £35 bn | £36 bn | £37 bn | £36 bn | £39 bn | £35 bn |
| Percentage tax gap | 8.5% | 8.3% | 8.0% | 7.4% | 8.1% | 7.9% |

- The figures show that the tax gap is broadly stable as a share of receipts between 2008–09 and 2009–10, falling slightly from 8.1% to 7.9%.
- In cash terms, there is a decrease in the estimated UK tax gap of £4 Billion from 2008–09 to 2009–10.
- The decrease is mostly due to a reduction in the 2009–10 VAT Gap (£3.2 Billion out of a £4 Billion decrease), mainly because of the reduction of the VAT rate from 17.5% to 15% between 1 December 2008 and 31 December 2009 (£2.0 Billion). The lower the tax rate, the lower the losses from non-compliance (for example the same arithmetic error has produces a lower tax impact in monetary terms).
- We would therefore expect the VAT gap, and therefore the overall tax gap, to increase again in 2010–11 in cash terms because of the increase in VAT back to 17.5% and then 20%.
- There has been a downward revision of the total tax gap estimate for 2008–09, from 8.6% of receipts or £42 Billion to 8.1% of receipts or £39 Billion. This is mainly due to a fall in the CT tax gap for businesses managed by Large Business Service (LBS) from £3.1 Billion to £1.3 Billion. The revision reflects improvements in the quality of information recorded, together with a downward trend in the number of risks recorded and a higher rate of conversion of these risks into extra revenues.

21 September 2011

Supplementary written evidence submitted by HM Revenue and Customs

Questions 240–241 (Jesse Norman)

What kinds of circumstances would release HMRC from the requirement that interest be paid on tax that is owed?

In the example given at the hearing, payment of a dividend on which tax is payable means that there is no tax charge under the Controlled Foreign Companies (CFC) legislation, and that interest does not arise.

In 2009 the law on the taxation of overseas dividends was changed so that the majority of dividends paid by overseas companies were no longer subject to tax in the UK. As a result, another CFC exemption, the acceptable distribution test, was removed because it dealt with the situation where dividends were taxed in the UK. However, in certain circumstances it was still open for groups to elect for overseas dividends to be subject to UK tax. This led HMRC to consider the situation where a group elected for dividends to be taxed, and how this impacted on the application of the motive test in the CFC legislation. As a result HMRC specialists reconsidered their approach to the motive test and concluded that it should be possible for a company to pass

the motive test if a substantial amount of its chargeable profits were effectively brought within the charge to UK tax.

This operational policy development was implemented on the basis of advice from HMRC lawyers and was discussed with business and their advisors. It has been applied consistently to settle CFC issues with appropriate fact patterns.

It is inherent in the “new approach” to the application of the motive test that a company pays a dividend now and elects to be taxed on it and therefore is regarded as passing the motive test within the CFC regime. On that basis no interest arises.

General interest policy

Where tax is due but not paid by the due date, the legislation for many tax regimes provides for interest to be payable. In the case of Corporation Tax, S87A TMA 1970 provides that corporation tax shall carry interest from the date that it becomes due until the date of payment.

However, HMRC may exercise its discretion under S5 CRCA 2005 to not pursue interest if it has somehow created a legitimate expectation that the tax is not due (for example, where failure to pay has been caused by HMRC error).

Questions 245–246 (Jesse Norman):

When can HMRC charge penalties?

Tax law provides for a range of penalties to be payable. These are designed to encourage taxpayers to comply with tax law. Some penalties are charged where a taxpayer fails to provide information at the correct time, or where the taxpayer completely hides from HMRC. Other penalties are charged where a taxpayer provides information to HMRC, but it is subsequently found to be inaccurate. This note primarily deals with these “inaccuracy” penalties.

The way in which penalties are charged has changed recently, but there are key features in common in both the old and the new systems. In particular, inaccuracy penalties are charged where (1) there is an inaccuracy in a return, etc, that in some way leads to a loss of tax, and (2) some aspect of the taxpayer’s behaviour led to the inaccuracy. This second condition has traditionally been regarded as the “culpability” of the taxpayer; penalties are charged where the taxpayer has been careless or negligent, or has deliberately or fraudulently submitted an inaccurate return.

We would expect to charge a penalty where a taxpayer has misrepresented the facts about what has happened, if we have sufficient evidence. If we could show that a taxpayer left out transactions from their books with the intention of keeping his tax bill low, then HMRC would charge a penalty. However, where the taxpayer can demonstrate that they genuinely considered that the interpretation they have used is correct, perhaps with evidence that they sought objective advice in order to understand the treatment, and that there is no reason to think the taxpayer’s interpretation is unreasonable, then it is unlikely that HMRC would seek to charge a penalty.

In each case, HMRC makes a decision on whether a penalty should be charged in accordance with the law. As noted, where the taxpayer has based their returns on incorrect facts (as a result of carelessness or deliberate action), then HMRC will charge a penalty where there is sufficient evidence. If this results in litigation, it is unlikely that such litigation will go beyond the First-Tier Tribunal, since this is the body which makes a finding of the facts, and it would be very unusual for higher courts to overturn the Tribunal’s findings regarding the facts of the case.

In contrast, where the point at issue is the interpretation of the law, as applied to facts that HMRC can agree, it is more likely that litigation will proceed to the higher courts. The fact that permission for appeal to these courts is granted is, in many cases, indicative that there is a genuine question of legal interpretation, and therefore it would be more unusual for such cases to result in penalties being imposed. There is nothing in tax law to penalise taxpayers for exercising their rights to appeal the decisions of HMRC or the lower courts.

HMRC actively considers whether a penalty is appropriate whenever there is an inaccuracy. Where we consider that the legal criteria for imposing a penalty are met, we would normally issue a penalty.⁷

Question 258: (Mark Garnier)

Has HMRC ever been subject to a legal case for reputational damage?

In the context of penalties, HMRC has not been subject to a legal case for reputational damage. There have been claims alleging reputational damage in relation to the exercise of other enforcement activity, for example, following the seizure and detention of goods in connection with the payment of excise duty.

29 September 2011

⁷ The key exception to this is where we judge that the cost of issuance of a penalty outweighs the gain to the exchequer from the penalty

Letter from the Permanent Secretary for Tax, HMRC, to the Chairman of the Committee

Thank you for your letter dated 20 October and for the opportunity to clarify the statements I made at the Treasury Sub-Committee (TSC) on 12 September and the Public Accounts Committee (PAC) on 12 October about my relationship to Goldman Sachs.

It may help if I first outline how the department engages with its large business customers on a day to day basis.

Each of the largest businesses with which HMRC deals is allocated a Customer Relationship Manager (CRM), who sits within the department's Large Business Service (LBS). The CRM is responsible for managing the overall relationship with the customer and all aspects of the customer's tax affairs. Goldman Sachs is no exception. The CRM is a qualified and experienced tax specialist and, for very large businesses such as Goldman Sachs, a member of the Senior Civil Service. The CRM will manage the work of a team of more junior tax specialists and commission work from other experts across the department as necessary. The CRM will report to a Sector Lead, who will have an overview of all large businesses in a sector (such as banking). It is the CRM and his or her team (under the supervision of the Sector Lead) who will deal with a large business customer's tax affairs.

As Permanent Secretary for Tax, I am the Head of the Tax Profession in HMRC and the department's most senior tax professional. In that capacity I am accountable to the Chief Executive, amongst other things, for building tax professional capability within the department, supporting an effective policy partnership with the Treasury, engagement with international, City and major business stakeholders on tax matters and for oversight of the largest and most complex tax settlements and issues in HMRC. In this capacity I am called upon to advise and support colleagues in their handling of a range of tax matters. The meeting on 19 November 2010 with Goldman Sachs was an example of this. However, I do not deal with the tax affairs of any HMRC customer on an ongoing or day to day basis.

When asked by Mr Norman at the TSC on 12 September whether any dispute with Goldman Sachs was outstanding when I spoke at an event at Goldman's on 19 May 2009, I explained that "*I knew nothing of Goldman's tax affairs*" at that time—and I did not. That was because the Goldman Sachs CRM and others in HMRC deal with Goldman's tax affairs, not me and it was why I said that "*I do not deal with Goldman's tax affairs*". In retrospect, I recognise that a fuller response would have been to say that I do not deal with Goldman's tax affairs "on a day to day basis".

I attempted to clarify the apparent ambiguity when asked by the PAC on 12 October. In retrospect, I ought also to have written to the TSC and I apologise for not having done so.

Dave Hartnett CB
Permanent Secretary for Tax

31 October 2011

Letter from the Chief Executive, HMRC, to the Chairman of the Sub-Committee

I am sorry that we have not yet had the opportunity to meet or to have a discussion, though I hope we can do so soon. I thought it would be helpful to write, however, because the Department is responding today to the Public Accounts Committee's (PAC's) report on settlement of tax disputes which came out in December. Our high level response will be set out in the formal Treasury minute but you may find it useful to have a fuller explanation of the changes that I plan to implement.

The Public Accounts Committee has expressed two key concerns about our handling of large tax settlements. First, blurring of the responsibilities for negotiating tax settlements in the largest cases and making decisions to accept those settlements. Second, the lack of a transparent assurance process for settlements of a significant size, leading to a loss of confidence that settlements are reached on a basis that respects the interests of taxpayers at large.

I believe that the package of changes I plan to make will address those concerns by introducing clear and structural separation of roles in our decision-making and by strengthening, and making more transparent, our assurance processes.

Before I set out the detail of what I propose, it may help to recap briefly on the context. The vast majority of differences of view with taxpayers as to the correct amount of tax to be paid are settled by agreement under long-established statutory provisions, with only a minority (less than 10%) going to litigation. All disputes with taxpayers, whatever the amount at issue, must be resolved in accordance with our published Litigation and Settlement Strategy which requires that any settlement must be consistent with the law and represent an outcome that we might reasonably have expected to obtain from litigation. Our internal governance processes are designed to ensure that settlements by agreement are reached on that basis.

I now plan to bring in a package of changes to those processes to provide greater assurance and transparency and improve public confidence in what we do.

The package comprises:

- a new assurance role at HMRC Commissioner level with an explicit challenge role in decision-making on cases;
- a systematic review programme of the processes used in settled cases;
- an enhanced role for our Audit and Risk Committee on tax settlements;
- an annual published report on our tax settlement work
- a new published code of governance for tax dispute resolution.

Taking each of those elements in turn:

The new assurance role

I plan to introduce an assurance role at Commissioner level (which will be an appointment as 2nd Permanent Secretary in HMRC). For our largest and most sensitive cases, where settlements have to be agreed by HMRC Commissioners, this Commissioner will explicitly take the challenge role of ensuring that:

- the proposed settlement secures the right tax efficiently and in so doing treats taxpayers even-handedly; and
- HMRC's internal governance procedures have been followed.

Once this role is established, decisions on our largest cases will be taken by three Commissioners—the assurance Commissioner, the Director General (DG) for the relevant line of business and a third Commissioner from a different work area. In this way, I intend to put transparent challenge and separation of roles at the heart of our decision-making.

If proposals to settle a case are not agreed by all three Commissioners, the case will be sent back for further work, with the possibility of seeking to bring the case to litigation if agreement cannot be reached on an acceptable basis.

I intend this Commissioner to be an experienced tax professional. They will have no role in our engagement with taxpayers on their particular tax affairs, nor any line management responsibility for case-workers.

Reflecting the recommendations in the PAC's report, we plan to reduce the current £250 million threshold for decision-making by Commissioners to £100 million tax at stake. We estimate this would broadly double the number of cases considered by Commissioners in a year (that is, to around 20 cases). We are also considering how a sample of cases over £10 million can be decided in a way that provides robust assurance but keeps the numbers manageable.

Scrutiny of settled cases

To improve scrutiny of our tax settlement work, we will introduce a programme of reviewing processes in settled cases to check that they are sound and that we have applied them correctly. The programme will cover all of our tax settlement work, with samples of cases drawn to be proportionate to risk. This approach will not involve re-opening settled cases—the objective will be to learn lessons for the future and improve our processes. The assurance Commissioner will be accountable for the programme of reviews and for ensuring follow-up actions are taken.

Audit and Risk Committee

I will also be asking our Audit and Risk Committee—which is chaired by a non-executive Director with tax experience and includes NAO representation—to take on an enhanced role in overseeing our tax settlement work. The Committee will consider the findings of the review programme on settled cases (outlined above) and recommend follow-up actions.

Annual report

Under this new model, we intend to produce a report each year on the outcomes of our tax dispute work (while respecting taxpayer confidentiality). The Audit and Risk Committee will sign off the report which will be published (probably as part of HMRC's annual report). We would expect to make the report available to your Committee and to the PAC.

Code of governance for tax dispute resolution

Finally, we will pull all of this together into a published code of governance for tax dispute resolution. This will set out the processes we apply across the range of cases to ensure that tax settlements are reached on an appropriate basis; the levels of authorisation in place; the separation of the negotiation role from those making settlement decisions; and how we ensure consistency of decisions when the same tax issue occurs in several cases. This will help us to bring out that we have a coherent and proportionate approach for cases of all sizes, underpinned by our Litigation and Settlement Strategy, and will demonstrate that our treatment of taxpayers is even-handed.

I believe that this is a workable package of changes that builds clear separation and challenge into decision-making, improves scrutiny and introduces much more transparency. Key to the package is the role of the assurance Commissioner, because he or she will be a decision-maker on the largest settlements. We will introduce much more systematic review of our settled cases. We will provide more information about the way our processes work. And by using our Audit and Risk Committee more fully in this area, we will increase independent oversight of those processes.

I aim to have put these changes in place by the summer. You may, of course, once the new model has been put in place, want to discuss how it is working and assess how well the changes address the concerns that have been identified. I will be happy to discuss that with the Committee. I too will wish to keep these changes under review.

The Treasury minute will be laid later today. We will also be issuing a press release after that, so that there is transparency about our plans. You may well want to explore in more detail how we see the new model working and I would be pleased to have a meeting to talk you through that.

I have written in similar terms to the chair of the Public Accounts Committee and am copying this letter to Amyas Morse, C&AG.

Lin Homer, Chief Executive

27 February 2012
