House of Commons

Committee of Public Accounts

Corporate tax settlements

Twenty-fifth Report of Session 2015–16

HC 788

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Twenty-fifth Report of Session 2015–16

Report, together with formal minutes relating to the report

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The Committee of Public Accounts

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Contents

Summary

A six year investigation by HM Revenue & Customs (HMRC) has resulted in Google paying a further £130 million to settle its corporation tax liabilities over the last 10 years. This vindicates the previous Committee's concerns in 2012 and 2013 that Google did not appear to be paying the full tax it owed in the UK. However, in the absence of full transparency over the details of this settlement and how it was reached we cannot judge whether it is fair to taxpayers. The sum paid by Google seems disproportionately small when compared with the size of Google's business in the UK, reinforcing our concerns that the rules governing where corporation tax is paid by multinational companies do not produce a fair outcome. Google's stated desire for greater tax simplicity and transparency is at odds with the complex operational structure it has created which appears to be directed at minimising its tax liabilities. Google admits that this structure will not change as a result of this settlement.

Introduction

The previous Committee's report on Google's tax affairs in June 2013 concluded that Google used an artificial tax structure which served to avoid UK taxes rather than to reflect the substance of the way business is actually conducted. The Committee noted that the "UK is a key market for Google but the enormous profit derived is out of reach of the UK's tax system."[1] It also found that to avoid UK corporation tax Google relied on "the deeply unconvincing argument that its sales to UK clients take place in Ireland, despite clear evidence that the vast majority of sales activity takes places in the UK."[2] In January 2016, Google announced that it had agreed to pay an additional £130 million in corporation tax, covering the period January 2005 to June 2015, following the conclusion of a six year investigation by HMRC. On the eve of our evidence session, with Google's consent, HMRC submitted a document setting out some further facts in relation to the settlement. We now know that much of the tax in dispute related to the application of transfer pricing rules, that £18 million of the settlement was interest on the tax due, and that HMRC did not apply a penalty. We also know that the UK is Google's second largest market (after the US), contributing over US$7 billion in revenue in 2015, or around 10% of Google's worldwide revenue. In its latest UK accounts, for the 18 months ending June 2015, Google reported a UK corporation tax liability of £46 million. HMRC also told us that Google's total charge for corporation tax and interest from 2005 to 2015 was £196.4 million.

1 HC Committee Of Public Accounts, *Tax Avoidance—Google*, Ninth Report of Session 2013–14, HC 112, June 2013, Conclusions and recommendations para 1

2 Ibid, Summary

Conclusions and recommendations

1. **The lack of transparency about tax settlements makes it impossible to judge whether HMRC has settled this case for the right amount of tax.** Taxpayers' legal right to confidentiality means that HMRC cannot explain how it has arrived at this or other settlements, or demonstrate that the rules have been applied correctly. In most cases corporation tax settlements only come to light because companies make a public statement or are required to disclose information about them in their financial statements. As a result, we only ever see partial information. More details of tax settlements can be made available if companies agree to the information being released. While Google provided some information it was insufficient to understand the basis for settlement and how it was reached. Google would not commit to providing further information at the evidence session. Tax settlements are not precise or scientific: judgement is needed to agree how much value is created by Google's activities in the UK, for example. The small amount of tax paid in proportion to the scale of Google's UK activities means that there are legitimate questions about this settlement; we still do not know if Google paid the right amount of tax. The public is highly sceptical about whether large businesses pay the corporation tax they should in the UK, and HMRC must address this if it is to protect the integrity of the tax system.

   Recommendation: ***HMRC should consult widely, including with other tax authorities, on the case for changing the rules that protect corporate taxpayer confidentiality to make the tax affairs of multinational companies open to public scrutiny. As the previous Committee recommended in 2013, HMRC and HM Treasury should push for an international commitment to improve tax transparency. HMRC should be prepared to go it alone if necessary to provide the means for Parliament and interested parties to judge whether tax settlements reached are reasonable.***

2. **It has taken far too long to reach this settlement.** HMRC does not know how much its own six year investigation of Google's tax affairs cost, but admitted that it had been "a very expensive and resource-intensive process."[3] HMRC claims it brings in £75 for every £1 spent on investigating large businesses: a ratio of 75:1. We doubt that this six year investigation met that standard. HMRC's investigations into transfer pricing arrangements take 22 months on average. HMRC attributed the time taken in this case to: HMRC needing to examine the relatively novel issues arising from it being a digital company; and changes in Google's UK business that meant HMRC had to review each year under investigation to see what had changed. HMRC told us that "ideally corporates would take a lower-risk approach to their tax planning and would deal with us in real time, and we would not have to do six-year audits into tax".[4]

3 Q183
4 Q185

Recommendation: ***HMRC should devote sufficient resources, and seek new powers if required, to ensure tax investigations are completed in a timely manner. HMRC needs to be clearer about the costs and benefits of its investigations. It should also seek the power to impose penalties on companies which do not cooperate fully with its investigations when tax is in dispute.***

3. **It is difficult for HMRC to penalise multinational companies for tax avoidance due to the scope for different interpretations of complex tax rules.** Google was not required to pay any penalty as part of the settlement. HMRC told us that the current penalty legislation does not work in relation to large businesses in the way that it should. In order to attach a penalty HMRC has to demonstrate firstly, that the tax return was wrong—which it clearly was in this case—and secondly, that insufficient care was taken in producing the self-assessment, which is very difficult to establish given the complexity of tax law on transfer pricing. We are concerned that this offers large businesses an advantage not enjoyed by the average taxpayer, who is less likely to be able to use interpretation of complex tax rules as an excuse for getting things wrong. HMRC has published draft legislation in the Finance Bill 2016 to remove the reasonable care defence from large businesses that are habitually aggressive tax planners and habitually understate their profits as a result. This is a step in the right direction, but as this is only draft legislation there is a long way to go before we can judge how effective this will be in practice.

Recommendation: ***We welcome HMRC's plans to strengthen the penalty regime so that it can penalise habitually aggressive tax planners. We expect HMRC to implement these changes as soon as possible and enforce them rigorously.***

4. **The international tax rules are not working, such that HMRC seems unable to collect a fair share of corporation tax from global companies with activities in the UK.** Multinational firms such as Google have made a choice to avoid tax, despite any claims they make to the contrary. Google told us that international tax rules are complex and that it just follows them. This is disingenuous. There is nothing in the rules that says you must set up two companies in Ireland and send large royalty payments, via the Netherlands, to a company that is tax resident in Bermuda. Multinational companies seem to be able to control how much corporation tax they pay in each country by the way they structure their business and allocate profits between their overseas entities. The fact that companies can do this within the rules shows that the corporation tax system is in urgent need of reform. We welcome the ongoing work by the OECD which is taking a fundamental look at how tax avoidance by multinationals can be addressed through international cooperation. Google's business model is not novel. Many multinational companies are internet based companies making online sales and the tax system needs to catch up.

Recommendation: ***HMRC should lead the way in pressing for changes in international tax rules to prevent aggressive avoidance by multinational companies. We urge HMRC to work with other tax authorities to ensure that changes to international tax rules take into account the way in which internet based companies operate.***

5. **We are concerned that HMRC appears to have settled for less corporation tax from Google than other countries are willing to accept.** It is reported that the French and Italian tax authorities have ongoing investigations into Google, and that the amount of tax they believe is due is much larger than the £130 million settlement agreed with HMRC. Although we cannot verify those claims, it does appear that other tax authorities have been more challenging in their assessment of Google's tax position. HMRC told us that it could re-open the investigation into Google if new evidence comes to light from investigations by other tax authorities. HMRC also said that it collaborates with other tax authorities and has a good understanding of what they are doing.

   Recommendation: ***We expect HMRC to monitor the outcome of other tax authorities' investigations into Google, and re-open its settlement with Google if relevant new evidence becomes available. HMRC should also examine the approach adopted by other tax authorities to see what lessons it can learn, should they succeed in securing larger tax settlements from Google.***

1 HM Revenue & Customs' investigation into Google

1. In 2012 and 2013 the previous Committee took evidence from Google on how it arranges its tax affairs.[5] The Committee noted that the "UK is a key market for Google but the enormous profit derived is out of reach of the UK's tax system."[6] It also found that to avoid UK corporation tax Google relied on "the deeply unconvincing argument that its sales to UK clients take place in Ireland, despite clear evidence that the vast majority of sales activity takes places in the UK".[7] In January 2016 Google announced that following a six year investigation it had reached a settlement with HM Revenue & Customs (HMRC) to pay £130 million in back taxes for the period January 2005 to June 2015.[8]

2. There has been significant criticism of this £130 million settlement from the media, the public and MPs. The amount of tax Google pays does not appear to match the scale of its business in the UK; Google earned over US$7 billion, or around 10 per cent of its global revenues, from sales to UK customers in 2015.[9] On 11 February 2016 we took evidence from HMRC about the Google settlement and its approach to taxing multinational companies. We also took evidence from Google on its tax arrangements and its settlement with HMRC.

3. HMRC sought and obtained Google's consent to provide more information about this settlement than would normally be in the public domain and provided a written statement which we received on the 10 February, the day before our evidence session. Google confirmed some of the facts of the settlement and its tax affairs. Most of these were already in the public domain due to reporting standard requirements for this information to be reported in the United Kingdom and the United States.[10] Google confirmed that it recorded revenues of £1.18 billion in its UK accounts for the 18 months to June 2015. Google reported profits of £106 million on that revenue in its financial statements. Google told us that its profits for tax purposes were around £230 million, resulting in corporation tax of £46 million for the 18 months to June 2015.[11]

4. HMRC formally opened an investigation into Google's tax affairs in 2010, following a risk assessment of the company. The issues at stake in the investigation were transfer pricing and the fair value of Google's economic activity in the UK.[12] Under the settlement reached as a result of this investigation Google agreed to pay an additional £130 million for the period 2005 to 2015, of which £18 million was interest.[13] Google told us that it had also agreed with HMRC to apply the methodology used in this settlement to its activities

5 *HM Revenue & Customs: Annual Report and Accounts 2011–12*, 19th Report, Committee of Public Accounts, HC 716, 3 December 2012; *Tax Avoidance—Google*, 9th Report, Committee of Public Accounts, HC 112, 13 June 2013;

6 HC Committee Of Public Accounts, *Tax Avoidance—Google*, Ninth Report of Session 2013–14, HC 112, June 2013, Conclusions and recommendations para 1

7 Ibid, Summary

8 '*Google agrees £130m UK tax deal with HMRC*', BBC News interview with Matt Brittin, 23 January 2016;

9 *Alphabet Inc. and Google Inc. Form 10-K for the fiscal year ended December 31*, 2015, Alphabet.

10 *Report and financial statements, period ended 30 June 2015*, Google UK Limited; *Alphabet Inc. and Google Inc. Form 10-K for the fiscal year ended December 31, 2015*, Alphabet.

11 Qq 1–2, 103–116; *Report and financial statements, period ended 30 June 2015*, Google UK Limited

12 Qq 120, 196; Transfer pricing sets the price for goods and services when companies within the same multinational group trade with each other. Tax authorities examine this issue because manipulation of the price can artificially reduce tax liabilities.

13 Q 50

in 2004, rather than open up a new investigation for that year, and had paid an additional amount for that year which was not included in the settlement figure.[14] Google also told us that following HMRC's investigation it has changed its approach to how it includes share-based compensation within its tax calculation.[15] Google had previously set aside £24.1 million for HMRC's investigation of how share-based compensation is treated for corporation tax purposes.[16]

5. HMRC could not tell us how much its six year investigation of Google's tax affairs cost, but admitted that it had been "a very expensive and resource-intensive process."[17] HMRC claims it brings in £75 for every £1 spent on investigating large businesses: a 75:1 ratio.[18] HMRC told us that on average a transfer pricing cases takes 22 months to conclude and attributed the time taken in this case to: the fact that relatively novel issues arose from examining a digital company; and that Google's exponential growth in the UK and changes to its business model and customers' behaviour over the course of the investigation meant that HMRC had to look at each year individually. HMRC noted that it had been "painstaking to get to the bottom of things"[19] and that "ideally corporates would take a lower-risk approach to their tax affairs and would deal with us in real time, and we would not have to do six-year audits into tax."[20] HMRC agreed with us that a lower-risk approach would also be less damaging for large businesses' reputations.[21]

6. The previous Committee highlighted the disparity in the number of specialists employed by HMRC compared to those hired by the large accountancy firms, who advise multinational companies. HMRC told us that it employs 81 transfer pricing specialists, an increase from the 65 employed when the previous Committee asked about this in 2012.[22] At any one time between 10 and 30 HMRC staff worked on the Google investigation. Not all of these were transfer pricing specialists; the team also included specialists in law, economics and data analysis.[23]

7. HMRC confirmed that no penalty had been applied to Google, despite the settlement clearly showing that Google did not pay enough tax in the UK for a decade.[24] HMRC told us that the current penalty legislation does not work in relation to large businesses in the way that it should. In order to attach a penalty HMRC has to demonstrate firstly, that the tax return was wrong—which it clearly was in this case—and secondly, that insufficient care was taken in producing the self-assessment, which is very difficult to establish given the complexity of tax law on transfer pricing. HMRC noted that large businesses engaged in transfer pricing can take "a lot of expert advice and opinion" to establish they have taken a "reasonable position in relation to a complex area of law."[25] HMRC told us that it has published draft legislation in the Finance Bill 2016 to remove the reasonable

14 Q 58
15 Q 58
16 *Report and financial statements, period ended 31 December 2013*, Google UK Limited
17 Q183
18 Q 184
19 Qq 183, 185
20 Q 185
21 Q 213
22 Qq 221, 225, 258; *HM Revenue & Customs: Annual Report and Accounts 2011–12*, 19th Report, Committee of Public Accounts, HC 716, 3 December 2012; *Tax avoidance: the role of large accountancy firms*, 44th Report, Committee of Public Accounts, HC 870, 26 April 2013.
23 Q 229
24 Qq 195–196
25 Q 196

care defence from large businesses. This will enable HMRC to apply penalties to large businesses that are “habitually aggressive tax planners and habitually understate their profits as a result” and have ignored warnings. HMRC only expects to apply penalties to “a very small number” of large businesses as they are already changing their behaviour.[26]

8. In conducting investigations of multinational firms, HMRC told us that “ultimately what we are looking to do is tax at full value the activities carried on here and not, for example, police their global tax compliance”.[27] HMRC stated that the conclusion of the enquiry in January 2016 settled the tax position as “provided for by law”. [28] HMRC and HM Treasury are working with other countries to take forward the Organisation for Economic Co-operation and Development’s (OECD’s) Action Plan on Base Erosion and Profit Shifting.[29] HMRC is also working with five other tax authorities as part an ‘E6’ project to share information about digital multinationals to get a better understanding of how these companies operate in different countries. HMRC hopes this will build its understanding of the tax issues and arguments used by large businesses in other countries.[30]

9. HMRC maintained that under the law it is obliged to keep taxpayers’ information confidential.[31] However, HMRC agreed that there was an issue with the public not having confidence in the tax system and accepted that “it is very important that every single taxpayer believes that we are treating each of them fairly and under the same rules.”[32] HMRC stated that small companies are treated in the same way as large businesses, and that the same processes and rules are followed for everyone. HMRC claimed that in this settlement it received the “full tax that is due” and that of the £196.4 million charge that Google has taken for corporation tax between 2005 and 2015, £130 million was as a result of the settlement. HMRC told us that this was a “significant uplift in their liability” and that Google had acknowledged that it is going to have to pay more in the future. Google told us that the settlement includes an element of the size of sales to UK customers in each of the 10 years between 2005 and 2015 and that it would continue to pay on that basis in the future.[33]

10. We asked HMRC what issues were considered in reaching this settlement with Google. HMRC told us that once the facts had been established, discussions centred on: what value-added is created by activities; what remuneration those activities get on an arm’s length basis in the market; and which transfer pricing methodologies were the relevant ones to apply. Furthermore, while there is clearly a UK company to which HMRC could attach a tax charge, there was also the question of whether there was a permanent establishment of some other Google company in the UK. [34] HMRC told us that it was “confident” it had got the full tax due based on the evidence[35], but it accepted that, particularly in transfer pricing cases, issues were not absolute but a matter of judgement.[36] Google noted that there was a range of views that could be taken on the profit amounts shown by comparable companies

26 Qq 196, 213–215
27 Q 245
28 HMRC written evidence, CTX0004
29 OECD, ‘Base Erosion and Profit Shifting’
30 Q 246; *“Government ramps up efforts to tackle digital multinational tax risks”*, HMRC press release, 25 March 2015
31 Q 190
32 Q278
33 Q58
34 Q188
35 Q251
36 Q259

and that the answer arrived at was a matter of interpretation between the company and the tax authority.[37]

11. The previous Committee recommended that HMRC should consider increasing transparency in large and complex cases to assure Parliament and the public that it is following due process. In response HMRC put in place a new governance structure, including the appointment of a Tax Assurance Commissioner who reports annually on the settlement of tax disputes.[38] Disappointingly, the Tax Assurance Commissioner told us that "I don't think that within the rules of confidentiality I can discuss anything to do with Google's affairs beyond the material which we have now shared with the Committee, which they agreed that we should share."[39] HMRC recognised that transparency could be improved.[40] There is a proposal in place for large businesses to publish their tax strategies, but there is more that HMRC can do. We have not, for example, seen any evidence to prove that confidentiality results in more tax being raised than would otherwise be the case.[41] HMRC told us that confidentiality was the norm for tax administrations throughout the world.[42]

12. There are reports that the French and Italian tax authorities have ongoing investigations into the amount of tax owed by Google. The French tax authorities are reportedly seeking around £380 million in back taxes from Google.[43] The Italian tax authorities are reported to have asked for £150 million in back taxes, and that Google is also suspected of evading £173 million of tax in Italy between 2009 and 2013.[44] These amounts are larger than the UK tax settlement, despite the UK being the most significant market for Google outside of the US.[45] We were told that some European tax jurisdictions begin their investigations with police action and the seizure of documents. For example, in 2011, French authorities raided Google's offices in Paris.[46] Google would not comment on the press reports, but told us that the UK settlement was the largest so far outside of the US.[47]

13. HMRC told us that it could re-open its investigation into Google if new evidence came to light from the investigations by other authorities.[48] HMRC said that it collaborated regularly with other tax authorities and had a good understanding of what they were doing. While HMRC does not receive information on tax settlements outside of the UK routinely, there is sharing of information on particular taxpayers.[49]

37 Qq 54, 78
38 Q 192; *Increasing the effectiveness of tax collection: a stocktake of progress since 2010*, Comptroller & Auditor General, HC 1029, 6 February 2015
39 Q232
40 Qq 254–255
41 Qq 284–285
42 Q 285
43 Q 39; '*France demanding 3 times UK payout*' Daily Mail, 27 January 2016
44 '*Now Italy is demanding Google payback over €227m in unpaid tax following HMRC settlement in UK*', International Business Times, 28 January 2016
45 Qq 41
46 Q 252
47 Q 43
48 Q 247
49 Q 251

2 Google's approach to tax

14. Google told us that the tax affairs of companies that operate across more than one country are complicated but it wanted "to pay the right amount [of tax] and be seen to pay the right amount".[50] In an article for *The Telegraph* that was published on the day we took evidence Google was quoted as saying that it had "long been in favour of simpler, clear rules" and that the "international tax system needs reform." Google also wrote in a letter to the *Financial Times* that "governments make tax law, the tax authorities independently enforce the law, and Google complies with the law."[51]

15. Google made no mention in that article or letter of the complex set of arrangements it has chosen to set up which involves sending its money to a tax haven in Bermuda, via a series of royalty payments between Ireland and the Netherlands.[52] Google confirmed to us that it employs no staff in Bermuda.[53] The rules do not say that Google has to operate in the way it does and Google's actions stand in sharp contrast to its apparent desire for a more transparent system.[54]

16. We heard that Google bases its European operations in Ireland. It is widely reported that the disparity between definitions of tax residency between the Irish and US tax codes allows multinational companies to make royalty payments to companies in tax havens that largely go untaxed.[55] We asked why Google chose to base its operations in Ireland. Google told us that it did this for business reasons, not tax reasons, although Google acknowledged that a lower tax rate was one of the factors that had led it to base its European headquarters and sales operation in Dublin.[56] Google maintained that one of these business reasons was the linguistic skills available in Ireland where 40 languages are spoken by its employees. [57]

17. Google told us that it had "looked at our structures to make them simpler and clearer," but admitted that nothing of substance had changed in how it organises its tax affairs as a result of HMRC's investigation. The overall substance of Google Ireland invoicing customers in the UK remained unchanged.[58] In 2012, when the previous Committee took evidence, Google was unapologetic about its tax structure. Google continues to have an international tax structure that delivers a low overall tax rate.[59] Google stated that the structures it has adopted are normal for US technology firms.[60]

18. Google told us that despite its very complicated corporate structure, it pays a fair amount of tax worldwide, although it recognised that its structure allows it to avoid its profits being taxed at "very high US rates."[61] Google noted that its effective global tax rate

50 Q 84
51 '*Governments make tax law, Google complies*', Financial Times, 27 January 2016
52 Qq 32, 38, 48, 58, 88, 131, 133
53 Q 137
54 Q 91
55 '*Tax specialists criticise Google deal as opaque*', Financial Times, 26 January 2016
56 Qq 91, 94
57 Qq 26, 91, 92
58 Q 49
59 Qq 149, 173; *HM Revenue & Customs: Annual Report and Accounts 2011–12*, 19th Report, Committee of Public Accounts, HC 716, 3 December 2012
60 Qq 32, 38, 91, 133
61 Qq 95, 145, 149

for the last 5 years was 19% and that it considered this to be a fair rate.[62] Following the evidence session Google sent us further information about this figure and on what basis it was calculated.[63] We note that Google's latest figures for its global business indicate that it paid an effective worldwide rate of 17%, and that this is lower than the corporation tax rates in its two largest markets, the US and the UK.[64]

62 Qq 87, 97, 144
63 Evidence on inquiry page
64 *Alphabet Inc. and Google Inc. Form 10-K for the fiscal year ended December 31, 2015*, Alphabet,

Formal Minutes

Tuesday 23 February 2016

Members present:

Meg Hillier, in the Chair

Mr Richard Bacon	David Mowat
Caroline Flint	John Pugh
Mr Stewart Jackson	Karin Smyth
Nigel Mills	

Draft Report (*Corporate tax settlements*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 18 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

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

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

[Adjourned till Thursday 25 February 2016 at 9.30am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page.

Thursday 11 February 2016

Question number

Matt Brittin, President, Google Europe, Middle East and Africa, and **Tom Hutchinson**, Vice President Finance, Google Inc.	Q1–174
Dame Lin Homer, Chief Executive and Permanent Secretary, **Jim Harra**, Director General Business Tax and **Edward Troup**, Tax Assurance Commissioner, HM Revenue and Customs	Q175–286

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry page. CTX numbers are generated by the evidence processing system and so may not be complete.

1 HM Revenue and Customs (CTX0003)

2 HM Revenue and Customs (CTX0004)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at www.parliament.uk/pac.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2015–16

First Report	Financial sustainability of police forces in England and Wales	HC 288 (Cm 9170)
Second Report	Disposal of public land for new homes	HC 289 (Cm 9170)
Third Report	Funding for disadvantaged pupils	HC 327 (Cm 9170)
Fourth Report	Fraud and Error Stocktake	HC 394 (Cm 9190)
Fifth Report	Care leavers' transition to adulthood	HC 411 (Cm 9190)
Sixth Report	HM Revenue & Customs performance 2014–15	HC 393 (Cm 9190)
Seventh Report	Devolving responsibilities to cities in England: Wave 1 City Deals	HC 395 (Cm 9190)
Eighth Report	The Government's funding of Kids Company	HC 504 (Cm 9190)
Ninth Report	Network Rail's: 2014–2019 investment programme	HC 473
Tenth Report	Care Act first-phase reforms and local government new burdens	HC 412
Eleventh Report	Strategic financial management of the Ministry of Defence and Military flying training	HC 391
Twelfth Report	Care Quality Commission	HC 501
Thirteenth Report	Overseeing financial sustainability in the further education sector	HC 414
Fourteenth Report	General Practice Extraction Service	HC 503
Fifteenth Report	Economic regulation in the water sector	HC 505
Sixteenth Report	Sale of Eurostar	HC 564
Seventeenth Report	Management of adult diabetes services in the NHS: progress review	HC 563

Eighteenth Report	Automatic enrolment to workplace pensions	HC 581
Nineteenth Report	Universal Credit: progress update	HC 601
Twentieth Report	Cancer Drugs Fund	HC 583
Twenty-first Report	Reform of the rail franchising programme	HC 600
Twenty-second Report	Excess Votes 2014–15	HC 787
Twenty-third Report	Financial sustainability of fire and rescue services	HC 582
Twenty-fourth Report	Services to people with neurological conditions: progress review	HC 502
First Special Report	Unauthorised disclosure of draft Report in the previous Parliament	HC 539