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UK institutions for tax governance: reviewing tax settlements

In a current note in this *Review* in 2013, the writer examined some problems with our tax institutions in the UK.¹ The focus in that note was on The Office of Tax Simplification (OTS) and the General Anti-abuse Rule (GAAR) Panel. The saga continues in relation to both of these institutions. The OTS is to be given statutory footing in the Finance Act 2016 (FA 2016), but is very far from independence.² The GAAR Panel is as yet untested, but is acquiring potential new duties that, arguably, it was not designed to fulfil.³ Both these developments will be covered in the FA 2016 issue of this *Review*.

The writer's 2013 note concluded with a brief reference to the Tax Assurance Commissioner. This was a role established in 2012, following criticisms by the National Audit Office (NAO)

¹ J. Freedman, "Creating new UK institutions for tax governance and policy making: progress or confusion?" [2013] BTR 373.

² HMRC Policy Paper, *Office of Tax Simplification: permanent establishment* (9 December 2015), available at: <https://www.gov.uk/government/publications/office-of-tax-simplification-permanent-establishment/office-of-tax-simplification-permanent-establishment> [Accessed 25 February 2016].

³ HMRC Policy Paper, *Penalties for the General Anti-Abuse Rule* (9 December 2015), available at: <https://www.gov.uk/government/publications/penalties-for-the-general-anti-abuse-rule/penalties-for-the-general-anti-abuse-rule> [Accessed 25 February 2016].

and the Public Accounts Committee (PAC) in 2011, and again in 2012.⁴ Allegations of “sweetheart deals” made at that time were found by the NAO not to be substantiated, but some criticisms were made. A sample of settlements was found by Sir Andrew Park, a retired High Court judge and leading tax expert, to be reasonable, but recommendations resulted for improving the processes for reaching settlements, including amending HMRC’s Litigation and Settlement Strategy.⁵ HMRC also changed their governance arrangements. A Tax Assurance Commissioner (Edward Troup) and Tax Disputes Resolution Board (TDRB) were appointed to scrutinise settlements with taxpayers in sensitive cases and those with more than £100 million in tax under consideration.⁶

We might have expected this governance structure to have been in the spotlight at the beginning of this year, given the criticisms of HMRC’s settlement with Google announced in January 2016.⁷ Concerns that this arrangement was a “sweetheart deal”⁸ should surely have been swiftly allayed by the new governance structure designed precisely to provide assurance that the settlements HMRC reach are appropriate.⁹ Edward Troup commented in his 2015 report that the Commissioner is

“responsible for seeing that tax disputes are resolved appropriately with greater transparency about our processes and a strengthened decision-making model for our largest and most sensitive disputes”.¹⁰

This should have been what was at issue here and the new procedures set up in 2012 should have provided the public and politicians with the reassurance they needed that there would have been no settlement other than one within the stated Litigation and Settlement Strategy.

When the Google settlement was announced, however, most of the media and political comments completely ignored the existence of the Tax Assurance Commissioner. Following what were, perhaps, rather unwise remarks from the Chancellor, George Osborne, who seems

⁴ Comptroller and Auditor General (C &AG), *HM Revenue & Customs Annual Report and Accounts 2010–11*, Session 2010–2012, HC 981, 7 July 2011, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/89199/annual-report-accounts-1011.pdf [Accessed 25 February 2016]; Committee of Public Accounts, *HM Revenue & Customs 2010-11 Accounts: tax disputes*, Sixty-first Report of Session 2010–12, HC 1531, 20 December 2011, available at: <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1531/1531.pdf> [Accessed 25 February 2016]; C &AG, HM Revenue & Customs, *Settling large tax disputes*, HC 188, Session 2012–13, 14 June 2012, available at: <https://www.nao.org.uk/wp-content/uploads/2012/06/1213188.pdf> [Accessed 25 February 2016].

⁵ HMRC, *Resolving Tax Disputes: Commentary on the litigation and settlement strategy* (November 2013), available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/387770/Commentary_on_litigation.pdf [Accessed 25 February 2016].

⁶ See HMRC, *How we resolve Tax Disputes: The Tax Assurance Commissioner’s annual report 2012–13* (2 July 2013), available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210246/3741_Tax_Assurance_AR_accessible.pdf [Accessed 25 February 2016], 4–5.

⁷ K. Rawlinson, “Google agrees to pay British authorities £130m in back taxes”, *Guardian*, 23 January 2016, available at: <http://www.theguardian.com/technology/2016/jan/22/google-agrees-to-pay-hmrc-130m-in-back-taxes> [Accessed 25 February 2016].

⁸ e.g. from the Shadow Chancellor, John McDonnell, “Google tax deal labelled ‘derisive’, as criticism grows”, *BBC News*, 23 January 2016, available at: <http://www.bbc.co.uk/news/uk-35390692> [Accessed 25 February 2016].

⁹ C &AG, *Settling large tax disputes*, above fn.4, Summary para.4.

¹⁰ HMRC, *How we resolve Tax Disputes. The Tax Assurance Commissioner’s Annual Report 2014–15* (July 2015), available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/444911/How_we_resolve_tax_disputes.pdf [Accessed 25 February 2016].

to have somewhat inaccurately linked the settlement with the Diverted Profits Tax,¹¹ the debate veered off into a discussion of what commentators thought Google had paid and should have paid under some non-existent ideal tax system, despite the fact that, clearly, HMRC can only collect tax due under current law. There was also an over simplistic view widely expressed that there was a “correct” amount of tax that should have been paid, showing a lack of understanding of the inherent uncertainty surrounding transfer pricing valuations, which, rightly or wrongly, under current law makes discussion and negotiation part of the normal process of collecting tax in such cases. The politicians piled in, with criticisms of Google and of HMRC. Given the rules on confidentiality of arrangements with taxpayers, HMRC were in a difficult position and could not easily defend themselves, but surprisingly the organisation made no statement about the role of the Tax Assurance Commissioner until they issued a “Fact Sheet” just before a hearing of the PAC.¹² By this time much harm had already been done. The PAC hearing on 11 February 2016, at which Dame Lin Homer, Chief Executive and Permanent Secretary of HMRC, Jim Harra, Director General Business Tax, HMRC and Edward Troup, the Tax Assurance Commissioner, appeared, did not seem to reassure the members of that Committee, who appeared to have decided that the settlement was for a derisory amount and to be determined to blame HMRC, despite all attempts to explain the process to them.

At the time of writing this note, the PAC has just issued its written report.¹³ This states that:

“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. ... 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.”

As a result of this conclusion, the PAC has recommended that HMRC should argue for greater transparency and that

“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

¹¹ R. Kwong, “Osborne hails Google tax deal as ‘major success’”, *Financial Times*, 23 January 2016, available at: <http://www.ft.com/cms/s/0/c8a11c10-c1c5-11e5-808f-8231cd71622e.html#axzz412QgmTH6> [Accessed 25 February 2016].

¹² HMRC, *Factsheet on HMRC and multinational corporations* (9 February 2016), available at: <https://www.gov.uk/government/news/factsheet-on-hmrc-and-multinational-corporations> [Accessed 25 February 2016]. See also the attempts of the writer to explain the role of the Tax Assurance Commissioner in the press: J. Freedman, “We should create a tax system that reassures the public”, *Financial Times*, 9 February 2016, available at: <http://www.ft.com/cms/s/0/12e5ea38-cf10-11e5-831d-09f7778e7377.html#axzz412QgmTH6> [Accessed 25 February 2016].

¹³ PAC, *Corporate tax settlements*, Twenty-fifth Report of Session, HC 788, 24 February 2016, available at: <http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/788.pdf> [Accessed 25 February 2016].

for Parliament and interested parties to judge whether tax settlements reached are reasonable.”¹⁴

This needs to be considered carefully in the context of the role of the PAC, as described on its own website. This is described as follows:

“The Committee’s remit

This Committee scrutinises the value for money - the economy, efficiency and effectiveness - of public spending and generally holds the government and its civil servants to account for the delivery of public services. ...

What the Committee does not do

The Committee looks at how rather than why public money has been spent and does not examine the merits of Government policy. That role is performed by the relevant Departmental Select Committee.”¹⁵

So, the question for the PAC is not whether a particular settlement is for the “right amount of tax”, but the efficiency and effectiveness of the process followed by HMRC to come to the result they have reached. It is reasonable to ask about the role of the Tax Assurance Commissioner and about how long the process took, but it is not the role of the PAC to decide how much tax should have been paid, either under existing law or under the law as it would like it to be.

We have a system for judging whether tax settlements are reasonable. If that is not providing the reassurance that is needed we may need to change that, but the answer does not lie in having every settlement open to the PAC, or, indeed, any other Parliamentary Committee. This is not elitism, or mystification of expertise, but common sense.

It is inconceivable that the Google settlement would not have gone through the rigorous procedures set up in 2012 and there will have been awareness of the sensitivity of the issues when approving the settlement. The amount of tax paid may seem small relative to global profits, but there has been no concrete evidence produced that the tax paid in the UK was not based on the facts and the law at the relevant time. Nevertheless, the fact that this issue has erupted less than four years after the introduction of the new HMRC governance process and Tax Assurance Commissioner, which was supposed to be a definitive procedure designed to prevent just this occurrence, suggests that the new structure has not achieved its objective of providing reassurance.¹⁶

In 2013, this writer stated of the appointment of the Tax Assurance Commissioner:

¹⁴ PAC, above, fn.13, 5.

¹⁵ *Public Accounts Committee - our role*, available at: <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/role/> [Accessed 25 February 2016].

¹⁶ Interestingly, in a survey undertaken by the writer together with colleagues at Oxford University Centre for Business Taxation, 64% of large business respondents said that oversight of the settlement process by a body independent of HMRC would be helpful (although a number of points were also raised against this by our interviewees): J. Freedman, F. Ng and J. Vella, *Cooperative compliance and the Litigation and Settlement Strategy; results from a survey* (15 May 2014), available at: https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/2014/tax-risk/freedmanvella-slides.pdf [Accessed 26 February 2016].

“This is a good development in many ways but does it address all the underlying needs? Is it sufficiently independent and transparent to quiet the concerns that led to its establishment? In addition, there is an argument that we need to review the role of the PAC itself and that of the National Audit Office, in informing the PAC.”¹⁷

Recent events seem to bear out this caution. Once again we face suggestions that more transparency is needed, companies need to publish their tax returns and that the PAC needs greater powers to examine the tax affairs of individual companies. The Chancellor now appears to be supporting publication of country by country tax reports to the public, although this has not previously been UK policy.¹⁸ The problem with all these suggestions is that, in the end, however much information is available, HMRC must apply the law to the facts and collect the tax due. This requires not only data but also analysis. Transparency may help commentators to raise questions, but it will not provide the answers. For this we need to delegate to an expert organisation: HMRC. There is no reason to suppose that proper processes have not been followed in this case. Nevertheless, not only is there a need for robust procedures but the public has to be able to trust in those procedures. We need to change perceptions so that it is clear the procedures are watertight and that they have been followed. This is important for the public debate and also for the protection of HMRC staff against unfair criticism. One problem is that the role of the Tax Assurance Commissioner is not widely understood. Another issue may be that he is an employee of HMRC and involved in other HMRC work, though not customer work, and this may muddy his role as a scrutineer of HMRC decisions. Whilst he is independent in terms of not having been involved in tax collection work, he is not independent from HMRC, to which he clearly owes a duty as an employee and a Commissioner.

In their 2012 report,¹⁹ following the Park review, the NAO stated that:

“There should not be a need for external reviews of settlements, such as this one, to provide this assurance. The NAO will have a role in providing assurance that the Department’s arrangements are operating efficiently and will continue to have access to the details of individual settlements.”²⁰

This suggests a way forward. Currently the role of the NAO and the PAC is to review whether HMRC are operating efficiently. This is the correct role for the PAC: politicians should not be involved in the tax affairs of individual taxpayers as a matter of constitutional propriety. But there is no reason why we should not create an expert unit of the NAO to provide external scrutiny of a sample of settlements on a regular, routine basis. This would be a small extension of the current role of the NAO and would be far preferable to special inquiries emerging periodically as a response to particular events.²¹ Whatever developments take place in international tax law as a result of the Base Erosion and Profit Shifting Action Plan and as a result of increased

¹⁷ Freedman, above fn.1, 380.

¹⁸ J. Brunsten, “George Osborne voices support for tax transparency”, *Financial Times*, 12 February 2016, available at: <http://www.ft.com/cms/s/0/82950ede-d18d-11e5-92a1-c5e23ef99c77.html#axzz412QgmTH6> [Accessed 25 February 2016].

¹⁹ C &AG, *Settling large tax disputes*, above fn.4.

²⁰ C &AG, *Settling large tax disputes*, above fn.4, para.4.

²¹ Compare the US system whereby large settlements must be referred to the Joint Committee of Taxation for oversight under IRC § 6405.

transparency, ultimately the revenue authorities will need to decide how much tax is payable. An external scrutiny process will complement HMRC's own processes in order to reassure the public and politicians and also to protect HMRC officials from unfair allegations that they are not permitted to respond to fully themselves.

As the writer finalises this note, it has been announced that Edward Troup, the Tax Assurance Commissioner, has been appointed Executive Chair and First Permanent Secretary at HMRC from 5 April 2016.²² He is to be congratulated on taking up this important role at a crucial time for HMRC. The press release announcing his appointment also states that:

“The arrangements for assuring large tax settlements in HMRC will be reviewed following Edward Troup's appointment as Executive Chair.”

This is an excellent opportunity for a re-think of the 2012 arrangements. Clearly the public and the PAC want something more than the Tax Assurance Commissioner system set up in 2012, however robust that turns out to have been. Transparency alone, however many lorry loads of information are published, is not the answer. The solution lies in good tax governance with expert independent external scrutiny, in which the public can trust and which MPs will support rather than undermine. This is vital for the administration of our tax system going forward and, hopefully, the combination of events arising in 2016 will allow for the creation of a sustainable, institutional, solution. [Ⓞ]

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²² Cabinet Office, *New Executive Chair and Chief Executive Officer appointed to lead HM Revenue & Customs* (24 February 2016), available at: <https://www.gov.uk/government/news/new-executive-chair-and-chief-executive-officer-appointed-to-lead-hm-revenue-customs> [Accessed 25 February 2016].

[Ⓞ] HMRC; National Audit Office; Public accounts committee; Settlements; Tax administration; Tax authorities; Transparency

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