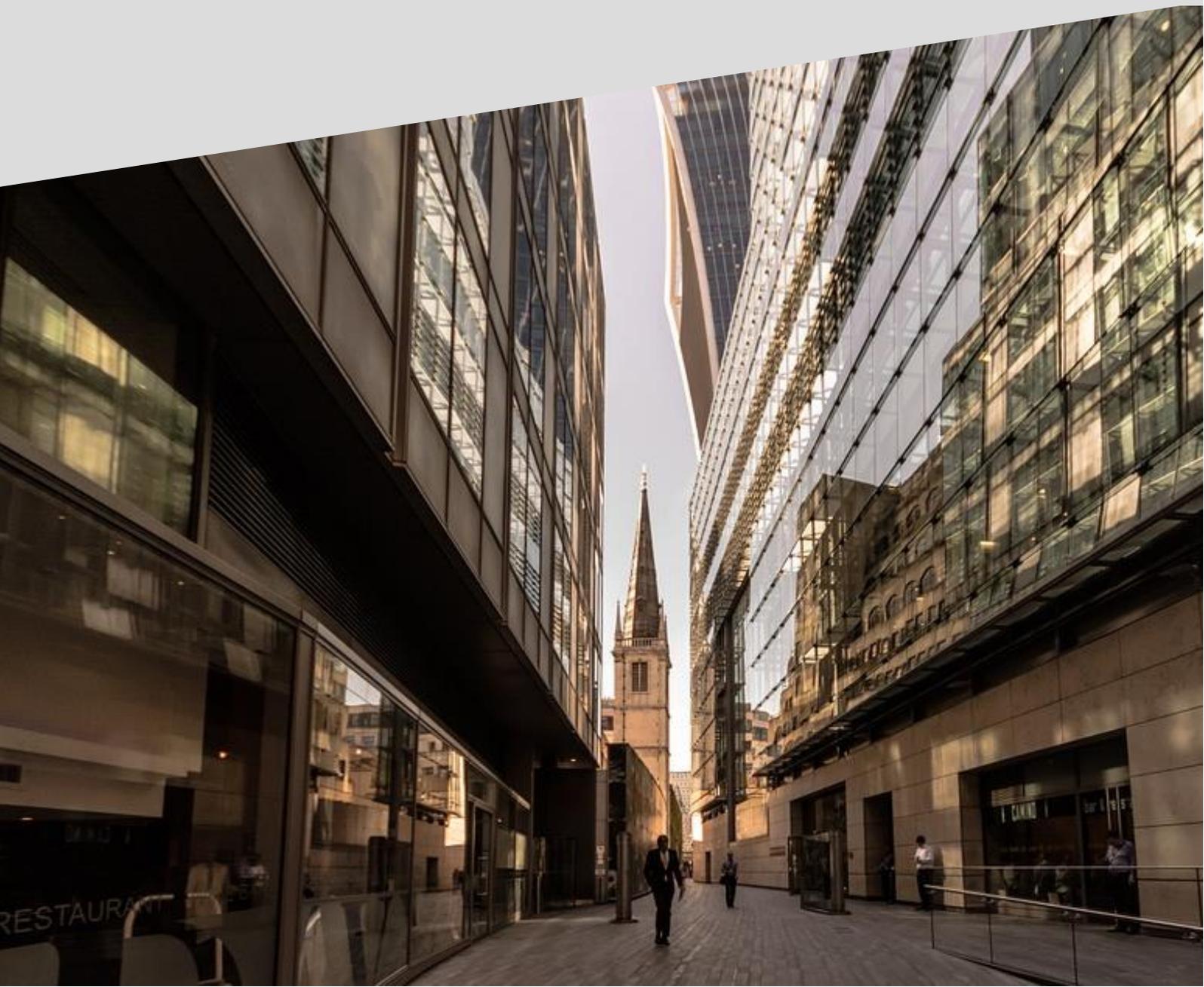


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# In need of a reset

*HMRC's relationship with large business*

December 2018



## Executive summary

The tax affairs of large businesses are inherently complex, requiring more interaction with HMRC than is usually the case for other taxpayers. But, when business and HMRC work collaboratively on a real-time basis it delivers significant benefits for both parties.

For HMRC, the resolution of issues before tax returns are filed ensures the right amount of tax is paid at the right time, improving cash flow for the funding of vital public services, and avoiding costly post-filed return investigations. For businesses, real-time working provides greater clarity over their tax position, reducing the risk of unpleasant surprises later down the line. It also frees resource from lengthy and administratively burdensome investigations, so that firms can get on with the business of contributing to the UK's economic growth.

There is a range of views on the current state of the relationship between large businesses and HMRC, some businesses are very positive about their relationship with HMRC and would not want to change it. However, in recent years a growing number of businesses are reporting a steady breakdown in their relationships with HMRC. Many now say that collaborative working has become a one-way street, where firms submit information and receive little back. With this breakdown in relationship, the benefits to both sides diminish.

It is important to consider that this decline in satisfaction among some businesses is from a very high starting level. The international business community has long recognised HMRC as a world-class, well respected tax authority which maintains excellent relationships with business taxpayers. This is driven by its reputation for integrity and reliability meaning business can trust that their tax affairs are being treated with confidence and in a fair way. But the veil of fog that seems to have appeared for some businesses means that, for the UK to remain open for business and to retain its reputation as a well administered tax system, HMRC now needs to press the reset button on the commitment to co-operative compliance. We are grateful to HMRC for their openness and willingness to listen and understand business concerns on this issue so far. Going forward, businesses are keen to focus on solutions and have identified three main areas for improvement:

1. **HMRC should use the Business Risk Review ('BRR') pilot to ensure the right incentives are in place for firms to be transparent and work collaboratively with HMRC.** The new version of the BRR should prioritise the following characteristics:
  - a. A robust, objective, transparent, consistent and auditable methodology for determining risk areas.
  - b. Greater clarity around the benefits to business of being a lower-risk taxpayer.
  - c. The revised model's fit with other major tax initiatives must avoid unnecessary additional compliance burdens.
  
2. **The dedicated Customer Compliance Manager ('CCM') regime should be an opportunity for honest business relationships.** The CCM should represent HMRC's position while at the same time bring HMRC along to reach a sensible, reasonable and acceptable position for both the taxpayer and HMRC. The following areas should be improved to achieve this:
  - a. A re-commitment to a transparent project-type engagement between CCMs and a taxpayer to resolve issues. There should be increased openness regarding decision-making, the drivers behind those decisions, internal governance and timeframes etc.
  - b. As part of the CCM Development Programme, CCMs' commercial awareness should be improved through:
    - i. work shadowing opportunities at large businesses;
    - ii. secondments into tax/operations functions at large business;
    - iii. training events and a wider education programme run in collaboration with large business.

- c. Without risking compromising the rigour of internal HMRC decision making processes, levels of CCM discretion should be increased and there should be a clear steer from HMRC senior governance boards for CCMs to exercise more judgement.
- d. Allowing relevant people in business, e.g. tax managers, a high-level direct access to HMRC specialists to expedite technical queries.
- e. Introduction of knowledge handover packs with a checklist of information which has been pre-agreed (to the extent possible) with a taxpayer.

3. **The publication of annual metrics on HMRC's co-operative compliance performance would increase awareness of the benefits it brings.** The assumption that all businesses are actively trying to avoid paying the right amount of tax must change. This could be done by shifting the focus onto 'achievements' before the tax return is submitted which in return could boost confidence in the UK's tax administration. To achieve this HMRC should publish annual metrics on their performance across a series of indicators, including the following:

- a. Average time for enquiries to be resolved;
- b. Average response time to queries raised by business to be answered;
- c. Amount of tax at stake on open issues, and length of time those issues have been open;
- d. Feedback from annual business survey commenting on standard of key tenets of the Cooperative Compliance Framework: collaborative relationship; real-time working; commercial awareness by CCMs;
- e. Number of issues resolved before returns filed, and number of issues opened after returns filed;
- f. Aggregate value of tax paid associated with the issues resolved;
- g. Number of voluntary disclosures;
- h. Turnover of CCMs;
- i. Completion of handover packs.

## Where we are now

Business welcomes HM Treasury's move to a single fiscal event and the new timetable for legislating tax changes. This should bring more predictability and certainty for business. Business also values a strong relationship with HMRC, a core asset of the UK tax regime for a number of years. There is a range of experiences among large businesses: some are positive of their CCM relationship and would not want to lose it.

### *Business experience No.1*

I have to say that despite an ongoing historic dispute, our relationship with our CCM is very positive and we have the continuity, at least at a senior level, that we need.

However, there is a growing concern that HMRC is becoming more difficult to deal with and in many cases collaborative working has become a one-way process of submitting information and receiving little back.

A significant amount of new and complex legislation, additional reporting burdens that HMRC and business are working with, reduced resources within HMRC, tightened public finances and potentially other factors have prompted a change in culture at HMRC. There is a perceived risk that we are moving away from co-operative compliance - a relationship management model which is meant to govern HMRC's interaction with the largest and most complex businesses. The top concerns cited by business are:

- Response times to resolve issues are slower than previously.
- Some inability of CCMs to provide timely or definitive decisions, including when areas are being revisited on submission of tax returns when they were discussed on a "real-time" basis ahead of submission and were considered agreed.
- Some reduction in the willingness of some CCMs to develop and apply knowledge of the industry.
- A relatively high turnover of staff.
- A frequent tendency not to take a risk-based approach.
- A regression towards dogmatic approaches to issues. For example, HMRC's recent approach to disputes has become much more legalistic in applying the letter of, but not necessarily the principle underlying, the tax law. In a limited number of cases, this can result in the taxpayer having an unfair tax result, or an unnecessarily onerous compliance burden.

### *Business experience No.2*

*Our experience of HMRC over the last few years has suggested a change in their approach to the co-operative compliance relationship:*

- *HMRC has become more adversarial and more opaque regarding governance and agreement of tax positions.*
- *Their response times are poor, frequently hiding behind governance processes or policy sign offs. These timing issues are often measured in years.*
- *Meanwhile, a taxpayer is expected to respond to complicated issues within weeks which is clearly a very imbalanced approach.*
- *We have had information notices and penalties being threatened as a matter of course.*

*The above approach is prevalent in the negotiation of tax deductions for recurring (every year) energy infrastructure capital expenditure, which are not artificial or contrived tax deductions.*

Co-operative compliance was first introduced in the UK in 2006. In 2017, HMRC published a Framework for Cooperative Compliance designed to reset the relationship. The framework includes both parties:

- Working collaboratively, pro-actively and transparently.
- Engaging in open and timely dialogue to discuss tax planning, strategy and significant transactions, on a real-time basis.
- Responding to queries, information and clearance requests in a timely fashion and keeping each other updated on progress.
- Resolving issues before returns are filed.

Business now wants to see HMRC live up to their side of the framework. Business is keen to protect and enhance the co-operative compliance experience as it brings benefits to both HMRC and business.

## Why it matters

A competitive and well administered tax system is something that has always been a distinguishing feature of the UK in the past and business does not want to lose this.

Large businesses make large investment decisions on a regular basis. They aim to make these decisions quickly and with certainty. The co-operative compliance relationship increases assurances regarding any likely tax outcomes at the point of entering into transactions, either because issues are specifically discussed, or because the business can bring its tax affairs up-to-date quickly. Furthermore, where the Government has introduced specific incentives to encourage investment, e.g. R&D tax credits or patent box, these are unlikely to be effective if there is any significant uncertainty over how they work, and the business is unable to reach an understanding with HMRC. Hence, UK competitiveness is a key tenet of co-operative compliance, as the predictability of the tax regime as well as quality of the tax authority are important considerations for businesses making investment decisions.

For the UK to keep its reputation for being open for business and to retain its international tax competitiveness HMRC needs to reset and renew their commitment to co-operative compliance. It is not about fundamental change, just a reset. A 'true' co-operative compliance must embody the following:

- Transparency and trust in both directions - open and transparent communication regarding the decision-making process including, the drivers behind decisions, internal governance and timeframes, especially bearing in mind the increasing role of large business in providing effective "tax compliance" services for the benefit of HMRC.
- A supportive, collaborative approach.
- Quick, direct access to technical experts.
- Some discretion to exercise judgement.
- Certainty to the greatest extent possible, whilst preserving HMRC's right to challenge if there is a change of facts or new information becomes available.
- A commitment on both sides to a set of minimum standards, for example speed of response.

## What could be done

The following three areas provide opportunities for improvements to the relationship between HMRC and large business taxpayers.

### A. Business Risk Review pilot

Recommendation	<ul style="list-style-type: none"> <li>• Robust, objective, transparent, consistent and auditable methodology for determining risk areas</li> <li>• Clarity around benefits of being a lower-risk taxpayer</li> <li>• Fit with other major tax initiatives</li> </ul>
Timeframe	<ul style="list-style-type: none"> <li>• Included in BRR pilot by end of 2018</li> </ul>
Measurement of success	<ul style="list-style-type: none"> <li>• Growing number of 'lower risk' businesses</li> </ul>

HMRC consulted on the Business Risk Review ("BRR") process for Large Business Compliance last year. HMRC are now working to develop a new version of the BRR with the intention of piloting it across a defined group of customers. As long as the pilot delivers the desired outcomes, the improved BRR will be rolled out in 2019 to 2020. It is important that the new version of the BRR entails the following characteristics.

#### *Robust and auditable methodology*

Business would like to see HMRC develop a methodology for identifying risk that is robust and auditable, to alleviate businesses' fear that HMRC is moving to another subjective regime.

A more holistic view of risk as part of the methodology would be appropriate, potentially encompassing the tax control framework used within the business, legislative change that may impact on a business, transactions undertaken by a business and understanding why tax and accounting results vary.

#### *More transparency in how risk areas are identified*

Business is concerned that HMRC's concept of fairness can be somewhat fluid. It is not always clear how HMRC chooses which affairs to challenge and whether it is targeted correctly, e.g. focus on hot topic or comfort zone areas. For example, where companies work with HMRC on a real-time basis this sometimes simply allows HMRC to take more, previously uncontentious points, instead of focusing on higher risk areas or higher risk taxpayers. There are examples of HMRC using risk-based approaches as the technical argument, i.e. "you are an outlier so must be wrong", rather than identifying a risk area and assessing the technical basis for that difference. Hence, more transparency and consistency are needed in how risk areas are identified.

#### *Business experience No.3*

*We see HMRC listing out many areas (scattergun style) that they would like to look at without any justification as to why they see this as a risk area or a clear timeline of when they will look at it. The problem is that if companies, through their own controls process, then identify issues and remedy them, HMRC immediately look to claim a prompted disclosure penalty.*

*We had an issue in relation to PAYE covering a very small population that was identified by the company. HMRC then pointed to a BRR document with "Expense Review" from two years prior and sought a prompted disclosure penalty.*

*Positive behaviour should be rewarded*

The aim of the BRR is to influence taxpayer behaviour, including encouraging a real-time working relationship with HMRC and early discussion of issues which as a result can prevent future disputes. To achieve this, positive behaviour should be rewarded - there should be clear benefits to being lower risk and engaging in real-time working for both HMRC and business. It could be built explicitly into the BRR process and, for example, for lower risk taxpayers could include:

- A commitment to genuine real-time working including target times for dealing with issues.
- A rebuttable presumption that penalties will not be applied for any genuine errors by lower risk businesses making every effort to comply.
- Lower risk status should not be used as a threat by HMRC. It is important that HMRC accepts that taxpayers can take a different view to HMRC - that in itself is not poor behaviour or a problem, e.g. "if you join this GLO or take this view then we will take your low risk off you...".
- A commitment to help business find simpler ways to manage the tax compliance burden, especially with the move to greater use of technology and real-time reporting.

*Business experience No.4*

*We value our relationship with HMRC which has generally been good over the years. We have however experienced a change in recent months which is disappointing. The examples of recent experiences include:*

- *HMRC setting tight deadlines for responses and then taking a long time to get back to us.*
- *We provide a technical analysis which explains our position and then get a limited response back. A fuller analysis could help us draw the matter to a quicker conclusion – saving time for both sides.*
- *HMRC is generally more adversarial in their approach and adding 'picky' points to discussions on larger matters which do not help to move things forward. Sometimes it feels like the 'old school' approach.*
- *Immediate focus on, and threat of, penalties when errors are made. This could deter some taxpayers from disclosing errors, which one would assume is not their objective. Unfortunately, a taxpayer has no similar comeback on HMRC when they make errors – which just seem to be treated as part of their learning experience.*

*But it is worth noting that the authorities in other countries can be much worse - so we should still be grateful in some ways.*

*Fit with other Government initiatives*

HMRC must consider how the BRR fits in with other major tax initiatives the Government is currently working on, e.g. Making Tax Digital, Senior Accounting Officer (SAO) regime, EU Mandatory Disclosure Regime, major legislative changes such as the corporate interest restriction and the anti-hybrid rules as well as major economic changes such as Brexit etc.

A modern tax system clearly needs to develop and deal with change, but the amount of change and complexity of that change can be controlled by HMRC. Without that control, managing change can place a high compliance burden and cost on UK businesses.

**B. CCMs**

Recommendation	<ul style="list-style-type: none"> <li>• Transparent project-type engagement to resolve issues</li> <li>• Focus on real risk areas</li> <li>• Improved CCMs’ commercial awareness via:               <ul style="list-style-type: none"> <li>○ work shadowing at large businesses</li> <li>○ secondments into tax/operations functions</li> <li>○ training events /wider education programme</li> </ul> </li> <li>• Increased levels of CCM discretion</li> <li>• Senior level steer for CCMs to exercise more judgement</li> <li>• Direct access to specialists</li> <li>• Introduction of knowledge handover packs</li> </ul>
Timeframe	By spring 2019
Measurement of success	Performance metrics statistics (see below)

CCMs manage the relationship with the 2,000 largest and most complex businesses. For these businesses, having a dedicated CCM should be an opportunity for a “relationship” and a level of trust that comes from reciprocity. That could just be about a mutual commitment to keep matters moving, or even better - a “business relationship” that does require a certain amount of honesty with each other. The CCM should represent HMRC’s position while at the same time bring HMRC along in an attempt to reach a sensible, reasonable and acceptable position for both, taxpayer and HMRC.

To improve the existing CCM-taxpayer relationship, the following areas should be considered.

*Commitment to transparency and trust*

It is important that CCMs and HMRC work from a starting point that business is being open and honest. There is a concern that some businesses are assumed to be ‘doing something wrong’. This means that a disproportionate amount of time is spent by both sides asking and answering questions that often have little bearing on the issue at hand. HMRC needs to appreciate that the starting point for most businesses is the desire to pay the right amount of tax at the right time.

*Business experience No.5*

*We would question the effectiveness of some of the CCMs’ proactively coordinating/managing the HMRC interventions with business. We were drowned in large, detailed and repetitive information requests for several years. When we eventually approached the CCM requesting that the relevance of some of the information being requested be explained, considering the draw on business resources and the cost being incurred, the CCM did not have a clear grasp of what was going on and merely informed me that the Inspector ‘probably meant well’.*

*Improved focus on real risk areas*

The vast majority of business are looking to pay the right amount of tax in the right place at the right time. In an increasingly complex tax environment, both domestically and internationally, this can be challenging. There is increasingly a presumption that any mistake is a case of wrong-doing and therefore HMRC seeks penalties. Business is also concerned that HMRC is spending a large amount of time pursuing relatively small amounts of tax which is not cost-effective. Both of these result in a more 'combative' relationship between the tax authorities and the taxpayer.

It is in both businesses and HMRC's interests that attention and work is concentrated on the areas where there may be higher risks and time is not unnecessarily spent in enquiries into areas of immaterial or limited risks.

*Business experience No.6*

*We have started to notice that HMRC disregards the Litigation and Settlement Strategy ('LSS') and pursue some cases even where they do not think they have a greater than 50% likelihood of success. If HMRC believes that something might be regarded as "avoidance", then they are happy to push forward – ultimately to litigation – as they believe the costs and reputational issues around litigation are lower for HMRC than they are for the taxpayer.*

*If HMRC is changing their policy, they should be transparent about that. If the LSS policy stands, they should reinforce it and make sure it is properly applied.*

*Return to a real-time working*

To reduce business uncertainty by avoiding protracted discussions with technical specialists that are not close to businesses, often at one step removed (i.e. via CCM rather than directly), and take long periods to respond, a return to real-time resolutions is needed. Businesses welcome robust discussion, however, for a real-time working to be effective and deliver trust in the system, it needs to be conducted in good faith on both sides.

CCMs should be encouraged to prepare and share action plans for resolving issues in a timely manner and sharing with taxpayers where and how they might propose to involve specialists. This could be delivered via a CCM development programme on professional skills, including training on leadership, stakeholder management, how to progress complex issues, communicating on progress etc. An increased awareness and transparency on timetables for resolution will help taxpayers plan for assistance in such enquiries and support their timely resolution.

*Building CCMs' commercial awareness*

The lack of learning opportunities often results in a limited commercial awareness of CCMs. To improve their commercial awareness and business acumen, CCMs could be offered the following opportunities:

- work shadowing opportunities at large businesses
- secondments into tax, and/or operations functions within large businesses
- large businesses could run and/or present at training events. This could form part of a wider education programme which business could work with HMRC to help design.

### *More discretion for CCMs*

Some CCMs appear to have little power to make decisions. Set processes which CCMs have to follow (e.g. consultation with specialists) often lead to caution and a lack of ability to make decisions or use their discretion. An increased use, combined with lack of direct access to specialists by taxpayers, can result in a time-consuming and less efficient process. For example, the taxpayer communicates with the case team, the team then communicates to a series of specialists, who then respond. The information is often "lost in translation" and HMRC may decline to reassess.

Therefore, it would be worth exploring ways in which guidelines may allow CCMs more discretion, for example, to agree to a simple approach where a strict application of the law gives rise to an onerous compliance burden, but where the tax at stake is trivial. This would allow greater pragmatism, without the risk of creating an unhelpful policy precedent. It should be noted in this respect that large complex businesses face particular challenges, e.g. regarding technology, that will increase as we move towards real time reporting.

Furthermore, in the current climate where HMRC is expected to collect as much taxes as legally possible, in dispute resolution, HMRC may not be able to take a materiality or commercial view. It often has to proceed with any position that has a technical probability of winning – whether that is 49:51 or 10:90 in HMRC's favour. As a result, relatively small issues can be pursued at a significant cost or a number of similar issues with similar probabilities of success (where reasonably some would be expected to be won while others lost) cannot be considered together. This results in significant time and money being spent on issues that perhaps do not offer the best return for that spend. While clearly a framework for consistency is needed, there is perhaps a lack of discretion in the current system.

Recognising that the tax legislation does not always produce a single clear and fair outcome and allowing a CCM the ability to be pragmatic in these circumstances, could remedy this.

### *Empowering CCMs to exercise judgement*

Excessive levels of internal HMRC governance can also be problematic. Business is concerned that CCMs are sometimes working to artificial (often elongated) timelines to fit in with various HMRC senior governance boards. CCMs' workload is often dominated by "dotting all the 'i's and crossing all the 't's" and they end up spending months (and even years) preparing their case, including numerous, interminable and often duplicative information requests. As CCMs do not seem able to take two or more related points together, this stretches the process out still further.

The ability of the CCMs to exercise more judgement and more transparency about where they are in the process would help – but there is a wider problem of there often being just too much governance.

Although it may be difficult and take a long time to reorganise HMRC governance procedures, it should be possible for the HMRC governance boards to steer CCMs towards exercising more of their own judgement. CCMs should be encouraged to take a holistic and pragmatic approach and bring issues to the governance boards where they can then allow the relevant governance body to consider the overall picture/what is worth pursuing, rather than necessarily every element of minutiae. Business, however, by no means wants this to compromise the rigour, consistency and high accountability standards of HMRC governance boards.

*Business experience No.7*

- *We have proactively engaged with HMRC before implementing a restructuring transaction. However, more than five years on, we are not any closer to a resolution, with issues around transaction charges, transfer pricing and DPT all still on the table.*
- *We have responded to multiple information requests and provided volumes of documentation. We then also arranged for HMRC to interview around 10 senior commercial people in the business. After that, we heard nothing more.*
- *It took more than 12 months after the interviews were held before HMRC responded with any questions (minor points of clarification) and longer still before they set out their position on transfer pricing.*
- *It took more than 18 months before HMRC reverted to us with their position on DPT.*
- *HMRC has also recently raised new technical points, even after they had admitted that they do not fully understand them, nor do they expect that these would give any different outcome.*
- *We have encouraged HMRC to take a step back and look at the whole issue in totality but HMRC say they are unable to do so (because of their internal governance processes), even though they agree that it would be a sensible thing to do.*

*Direct access to specialists*

If there is a question which requires a specialist answer, it is often hard to access that advice without going through the usual HMRC business contact. This can add delay to the process and in some cases prevent the query moving forward. An ability to have more dialogue with HMRC specialists directly would therefore be welcome. Consideration should be given to allowing relevant people in business, e.g. tax managers, a high-level direct access to HMRC specialists to expedite technical queries.

If direct access is not feasible, at the very least a greater effort should be made to ensure that taxpayers’ facts and positions are accurately represented when CCMs pass information to the various HMRC governance panels. For example, taxpayers should be able to see draft internal papers, perhaps redacted in places, to ensure the facts are being presented correctly. This would help speed up the review process, which would in turn increase resource efficiency.

*Better knowledge handover*

Business is concerned about high staff turnover at HMRC and in particular there being a lack of standard approach for a knowledge handover to a new CCM. To address this, there should be a clear handover pack with a checklist of information to be included which has been agreed with a taxpayer. Successful completion of such handover packs could form part of the performance metrics below.

**C. Performance metrics**

Recommendation	Publish annual metrics on HMRC’s co-operative compliance performance across a series of indicators
Timeframe	Commitment by end of 2018
Measurement of success	Increased confidence in the UK’s administrative framework around tax

Current HMRC performance metrics are primarily operational and are mainly focused on ‘what people have done wrong’, i.e. tax avoidance and evasion cases. There should be more acknowledgement of the behavioural changes made by business taxpayers in recent years – the assumption that everyone is

avoiding tax needs to change. This could be improved by shifting focus onto how many issues are agreed/discussed pre-submission (rather than number of interventions), number of voluntary disclosures etc.

It is critically important that businesses see HMRC change behaviour and practices and ultimately live up to the Co-operative Compliance Framework it published early in 2017, to boost confidence in the UK's administrative framework around tax. To show commitment to this endeavour business would encourage HMRC to publish annual metrics on their performance across a series of indicators. These indicators can then be used by business to see how their experience compares with established benchmarks. Key indicators might include:

1. Average time for enquiries to be resolved;
2. Average response time to queries raised by business to be answered;
3. Amount of tax at stake on open issues, and length of time those issues have been open;
4. Feedback from annual business survey commenting on standard of key tenets of the Cooperative Compliance Framework:
  - a. Collaborative relationship;
  - b. Real-time working;
  - c. Commercial awareness by CCMs;
5. Number of issues resolved before returns filed, and number of issues opened after returns filed;
6. Number of voluntary disclosures;
7. Turnover of CCMs;
8. Completion rate of handover packs.