ICAS response to the HMRC consultation document
‘Improving Large Business Tax Compliance’

14 October 2015
About ICAS

1. The Institute of Chartered Accountants of Scotland (“ICAS”) is the oldest professional body of accountants. We represent around 20,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK and in almost 100 countries around the world. Nearly two thirds of our members work in business, whilst a third work in accountancy practices. ICAS members play leading roles in around 80% of FTSE 100 companies. ICAS is also a public interest body.

General Comments

2. ICAS welcomes the opportunity to comment on the HMRC consultation document ‘Improving Large Business Tax Compliance’ issued by HMRC on 22 July 2015. We have canvassed views from our members specialising in tax as well as those in business with board and corporate governance experience.

Key Tax Messages

3. ICAS is supportive of HMRC’s aim to promote collaborative professional working with HMRC to build an open, transparent and trusted relationship with large companies. However we believe that this must be a two way process whilst the proposals are currently very one-sided. Large businesses are being asked to publish their tax strategies and to commit to a code of practice: we believe that these commitments should be matched by HMRC undertakings as discussed in Q8.

4. ICAS is concerned that the proposals relating to the tax strategy and code of practice (as currently framed) will impose an additional compliance burden on many companies. This is particularly the case for multinational and foreign owned companies and unless the proposals are amended could make the UK a less attractive place to do business. We would therefore like to see adjustments to take account of different corporate structures and to reduce the potential compliance burden.

5. In relation to the special measures regime, further evidence is needed from HMRC to demonstrate the need for additional powers. ICAS is not convinced that these companies cannot be dealt with using HMRC’s existing powers. The proposals appear to be a disproportionate response to the behaviour of a small number of businesses. If the proposal is nevertheless implemented it is important that the majority of large businesses should have certainty that they will be unaffected. ICAS would therefore like to see additional clarification and safeguards in relation to the entry thresholds.

Key Corporate Governance and Company Law Messages

6. This HMRC consultation paper includes cross-cutting proposals which overlap into the realm of corporate governance and company law led by the Department of Business, Innovation and Skills (BIS) and in some instances, delegated to the Financial Reporting Council (FRC).

7. Under the proposals the published tax strategy is to be a UK tax strategy. This is not reflective of the governance of listed multinational companies who use global rather than UK specific tax strategies. If these companies are expected to produce a separate UK tax strategy this will impose an additional compliance burden which will make the UK a less attractive place to do business. A purely UK strategy would also be incomplete and potentially misleading for investors. Many international companies have already adopted, or are considering adopting, the BIAC ‘Statement of Tax Principles for International Business’ in their global tax strategies. Where this is the case we believe this should be sufficient to meet the requirement rather than having to produce an additional UK tax strategy. ICAS is supportive of this approach and of the principles outlined by BIAC.

8. Different government departments may introduce new requirements without necessarily being aware of the overall burden on companies or the market’s preference for a ‘principles’ versus ‘rules-based’ approach to regulation. In order to maintain consistency with overarching deregulatory priorities and to maximise effectiveness of regulation, it is
important to ensure a holistic, joined up approach on areas of overlap and common objectives.

9. Specific inconsistencies in relation to company law and corporate governance include non-compliance with the unitary board principle enshrined in the Companies Act 2006 (as detailed in our response to Q2 which points out that having a named individual responsible for the strategy is inconsistent with this principle) and differences in regulatory approach. The HMRC approach is legislative, whereas BIS and the FRC support a more proportionate and targeted non-regulatory approach for corporate governance.

10. A core component of this is the ‘comply or explain’ method of adherence which has achieved a high level of compliance with the Corporate Governance Code\(^1\). ICAS strongly supports this non-regulatory approach for corporate governance matters. A proportionate approach is also more consistent with the Better Regulation agenda.

11. We would welcome greater visibility of a co-ordinated approach by government when designing consultation proposals on cross-cutting topics. Our strong preference is for policy relating to corporate governance and company law to be designed by BIS and the FRC as the competent authorities for these specialisms. We would welcome further consideration of non-legislative and proportionate options to achieve the policy objectives in matters which relate to corporate governance, building on the success of ‘comply or explain’.

Specific questions

Scope

Q1. Do you agree that the threshold above (£200 million/£2 billion) is appropriate for these measures? What other thresholds might we use?

12. Yes, subject to our comments about special measures. It makes sense to use the threshold which is used for deciding those businesses administered by HMRC’s Large Business Directorate and for the SAO requirement. The proposals on tax strategy and the Code of Practice will be unworkable for businesses which do not have a CRM so having a CRM must be a basic requirement.

Transparency

Q2. Do you agree there should be a named individual at Executive Board level with accountability for a business’s published tax strategy? If so, do you have any views on who should this be?

13. No. This proposal is inconsistent with the principle of collective responsibility and a unitary board which is enshrined in the Companies Act 2006. We would welcome greater demonstration of a joined up approach with BIS and the FRC on shaping proposals which affect corporate governance and company law to reduce inconsistency and support better regulation.

14. The proposal also fails to take account of different corporate governance structures, particularly those of multinational and foreign owned companies. It is essential that there is flexibility in the approach and recognition that there will be different ways of achieving HMRC’s desire for board oversight. In some companies tax strategy may be delegated and discussed in detail with appropriate committees (which include some board members) with key elements or transactions escalated to the main board.

\(^1\) FRC press release July 2015
Q3. Do you think the areas above are the right areas for a published tax strategy to include? If not, what other aspects of tax strategy are more relevant? Equally, what aspects do you think are less relevant?

15. The published tax strategy is to be a UK tax strategy. This is not reflective of the governance of listed multinational companies who use global rather than UK specific tax strategies. If these companies are expected to produce a separate UK tax strategy this will impose an additional compliance burden which will make the UK a less attractive place to do business. A purely UK strategy would also be incomplete and potentially misleading for investors.

16. Many international companies have already adopted, or are considering adopting, the BIAC ‘Statement of Tax Principles for International Business’ in their global tax strategies. Where this is the case we believe this should be sufficient to meet the requirement rather than having to produce an additional UK tax strategy.

17. In addition to companies which are already using the BIAC Statement, some multinationals are (or will be) required to produce different information for various transparency initiatives such as Country by Country reporting and the Extractive Industry Transparency Initiative, although currently not all of these require publication. It would be helpful if HMRC could consider the information required under other initiatives and whether this could be used to meet their requirements rather than imposing additional burdens by creating a completely separate regime.

18. There will be specific issues for joint ventures. ICAS would welcome clarification on which tax strategy they should publish. Would it be a strategy for the joint venture itself or the strategy of one of the joint venture companies/groups?

19. Subject to the points above relating to multinationals, many companies/groups would be able to cover the first four bullets in para 2.28 with the exception of the reference to the ‘spirit of the law’. The ‘spirit of the law’ is open to differing interpretations and reference to it should not be required unless there is a public statement which companies and HMRC can both refer to: see also our comments in Q10 on the ‘intentions of parliament’. The BIAC Statement referred to above (and the CBI’s Seven Tax Principles for UK Business) include statements on tax planning which do not refer to the ‘spirit of the law’ or the ‘intentions of parliament’ and we believe that these would be reasonable alternatives for companies to use.

20. The fifth bullet in para 2.28 – target UK Effective Tax Rate (ETR) - would present significant difficulties for many companies and is unlikely to be useful to HMRC. Some global companies may not have a target UK ETR. Target ETRs would also be open to misinterpretation where companies had, for example, taken advantage of tax reliefs. A target ETR might involve price sensitive information which companies should not be obliged to publish.

21. Some examples of difficulties with the publication of target ETR include:

- If an impairment is being considered a target ETR might take this into account but circumstances might change. If the target ETR had been included in a published strategy this would lead to questions even though it had nothing to do with tax avoidance.
- A UK based business deriving say 70% of its income from the US might have a target ETR based on this. However if the trade mix changed the ETR would also change – potentially significantly due to US tax rates. Again this would have nothing to do with tax avoidance.
- Oil companies are subject to special tax regimes in some countries. This would affect their target ETR and it would also be affected by any changes in the split between the different countries.
- A company considering expansion might factor this into target ETR but would not want to give this information to the market.
Q4. Should the tax strategy be supported by publication of factual information on how it has been applied in practice? If so, what information would be most relevant to demonstrate the application of the strategy?

22. No. As noted above the publication of a tax strategy is likely to impose an additional compliance burden on many companies, particularly multinationals. Additional information should be kept to a minimum. Companies should also not be required to publish commercially sensitive information.

Q5. Do you think that businesses should be required to publish whether they are or are not a signatory to the ‘Code of Practice on Taxation for Large Business’ as part of this measure?

23. If the Code of Practice is voluntary it is hard to see why it should be mandatory to state whether the company is a signatory. This seems to be an attempt to make the code mandatory. In practice it is likely that peer pressure will mean that companies will feel obliged to publish that they are signatories if others in their sector do.

Q6. What is the right medium for publication of a tax strategy? Where do you think a business’s tax strategy should be published?

24. We do not support publication of a tax strategy in the annual report as this is inconsistent with the direction of travel to streamline and reduce the volume of annual reports. There may also be audit implications depending on where the material sits, for example, as required by International Standard on Auditing (ISA) 720 on the auditor’s responsibilities for other information beyond the financial statements. It would also increase compliance costs.

25. Moreover, publication in the annual report will not be an option for many companies. Companies subject to SEC requirements are unlikely to be able to include a tax strategy in their annual reports.

26. We would prefer the option of publication of the tax strategy on the company’s website.

Q7. What would you see as an effective sanction for non-publication? To whom should this apply?

27. ICAS does not support financial penalties for non-publication because it believes that most companies will wish to comply for reputational reasons. This approach is also inconsistent with the FRC’s ‘comply or explain’ regime which, as noted above, has been successful in achieving a high level of compliance with the Corporate Governance Code; companies are keen to comply as they see the reputational benefit. Non-compliance could potentially be addressed by publishing details of companies which do not publish a strategy.

**Code of Practice on Taxation for Large Business**

Q8. Do you agree that the openness and relationship behaviours contained within the Code of Practice are appropriate for large businesses? Are there any other behaviours you would expect to see?

28. ICAS is concerned that the proposed approach is very one sided with companies being required to make commitments without any matching undertakings from HMRC. An open, transparent and trusted relationship has to be two way.

29. The requirements include companies providing information and answers promptly and seeking to resolve issues in real-time. ICAS would like to see this matched by similar commitments from HMRC. Currently many companies are finding that they cannot obtain HMRC responses for months. Companies would like to resolve matters in real time but find they cannot do so because HMRC resources are not available. They also find that having provided large amounts of information to a CRM and in some cases having developed an effective working relationship, the CRM is abruptly moved on so that they have to start again. Some companies have had four or five CRMs in periods of five or six
years which makes the kind of relationship envisaged in the consultation document impossible to achieve.

30. The proposed code also requires companies to engage in open, early dialogue with HMRC to discuss tax strategy, risks etc and fully disclose any significant uncertainty in relation to tax matters. Again ICAS would like to see similar HMRC commitments: meaningful dialogue relies on both parties being available and committed to it. HMRC should also undertake to disclose areas of uncertainty in their position.

31. Mixed messages have been given about whether HMRC believes that all large businesses can be rated as ‘low risk’. It has been suggested that if businesses comply with the proposed Code of Practice and adopt an appropriate tax strategy it should be possible for any business to be ‘low risk’. However others in HMRC, including some CRMs, have given the message that some businesses will be rated as ‘high risk’ whatever they do because of the sector they operate in or the complexity of their business. It would be helpful to have some clarification from HMRC on whether it will be possible for all businesses to achieve a ‘low risk’ rating or whether some will always be automatically excluded regardless of their behaviour in relation to tax strategy and the Code of Practice. We would also welcome a consistent approach from all CRMs.

Q9. Do you agree that the governance behaviours contained within the Code of Practice are appropriate for large businesses? Are there any other behaviours you would expect to see?

32. As noted in our response to Q8 HMRC should also make commitments on behaviour.

33. Many companies would have problems providing the type of evidence of ‘governance in action’ which seem to be envisaged in the draft code. Board minutes include price sensitive information and confidential information entirely unrelated to tax. Most companies would reasonably not wish to provide these to HMRC and foreign owned companies might find it impossible. Would HMRC be prepared to accept extracts dealing solely with tax matters and excluding price sensitive information? Additionally as noted in our response to Q2 there are different governance structures so appropriate evidence might vary from company to company.

Q10. Do you agree that the tax planning behaviour contained within the Code of Practice is appropriate for large businesses? Are there any other behaviours you would expect to see?

34. Reference to the ‘intentions of parliament’ should not be required unless the word ‘public’ is inserted before intentions. This is only workable if both companies and HMRC can refer to a public statement of the intentions of parliament; we understand that HMRC has some internal guidance which it could consider publishing as a first step. ICAS has also already called for better, simpler legislation which includes clear and unambiguous drafting of parliament’s intentions; this would help to address the issue in future.

35. As noted in our response to Q3 the BIAC ‘Statement of Tax Principles for International Business’ and the CBI’s ‘Seven Tax Principles for UK Business’ include statements on tax planning which do not refer to the ‘intentions of parliament’ or the ‘spirit of the law’. We believe that HMRC should accept that these provide reasonable alternatives for companies to use.

36. It is important that companies which sign up to the Code of Practice do not feel pressurised into not challenging or testing those areas of tax legislation where there are genuinely differing views on interpretation. There should be recognition from HMRC that Boards have to manage their tax affairs in accordance with their view of the law and that shareholders will expect them to do this: from time to time Boards will hold views which differ from those of HMRC and will pay tax on that basis. Unnecessarily overpaying tax would lead to an inefficient cost of capital for companies with a UK presence, negatively affecting the attractiveness of the UK as a place to do business.
Special measures

Q11. Do you agree with the initial/preliminary framework for entry into special measures? If not what framework do you think would be appropriate?

37. ICAS understands that the special measures regime is intended to apply to a very small number of companies (‘a handful’ according to HMRC representatives at the consultation meetings). ICAS is not convinced that these companies cannot be dealt with using HMRC’s existing powers, particularly as HMRC gives details of its success in this area in the consultation document. Further evidence is needed from HMRC to demonstrate the need for these additional powers. If the proposal is nevertheless implemented it is important that the majority of large businesses should have certainty that they will be unaffected.

38. In relation to both entry strands we would like to see a clear statement from HMRC that no company assessed as being ‘low risk’ will be considered for inclusion in special measures. As noted in our response to Q8 we would also like clarification from HMRC on whether it will be possible for any business to achieve ‘low risk’ status or whether some will be excluded regardless of behaviour because of the sector they operate in or the complexity of their business. We also believe that before any company is considered for inclusion it should first have been placed in the High Risk Corporates Programme for at least two years; only if this has not been effective should special measures be considered.

Q12. At what level should thresholds (number of schemes, number of information notices issued, tax at risk, etc.) be set?

39. In relation to the strand based on lack of transparency and cooperation with HMRC, ICAS would like HMRC clarification that a company would not be considered for special measures solely because its relationship with its CRM had broken down. Companies are already reluctant to complain or give feedback about their CRM when they have difficulty obtaining responses, due to the potential adverse impact on the relationship. They will be even less likely to do so if this could result in them being considered for special measures. As noted in our response to Q8 many companies have experienced frequent changes of CRM which causes considerable difficulties. In cases which only relate to this strand ICAS would like to see provision for an independent review mechanism to consider the behaviour of both HMRC and the company.

40. In relation to the strand based on persistent and aggressive tax planning it would be helpful if HMRC could give some guidance on what it considers constitutes aggressive tax planning across all taxes.

Q13. Do you agree that HMRC should look back at a business’s recent behaviour when applying these criteria? If yes, to what extent (e.g. three years as in the ‘Promoters of Tax Avoidance Schemes’ regime)?

41. Companies should be given the opportunity to engage with HMRC to address issues prior to being considered for special measures so as noted in our response to Q11 we believe that before any company is considered for special measures it should first have been placed in the High Risk Corporates Programme for at least two years.

Q14. Is 12 months an appropriate notice period to allow businesses at risk of special measures to demonstrate a significant improvement in their behaviours and approach to tax planning? If not, what period would you propose?

42. In view of corporate governance cycles it takes time to make changes to behaviour. Once in special measures it is proposed companies should remain within them for two years so we believe the notice period should match this two year period.
Q15. Would introducing increased reporting and disclosure requirements for businesses who persistently refuse to engage with HMRC alter behaviour? If not, what other ways might we achieve this objective?

43. ICAS has no evidence on which to base any comment.

Q16. Would businesses behaviour be influenced by the withdrawal of certainty from those who refuse to work with HMRC in a transparent or collaborative way? If not, what other ways might we achieve this objective?

44. ICAS has no evidence on which to base any comment.

Q17. Would removing the defence of “reasonable care” from businesses who repeatedly engage in unacceptable tax planning be successful in changing behaviours? If not, what other ways might we achieve this objective?

45. The right to challenge HMRC’s interpretation of the law is a fundamental one. ICAS is concerned that removing the defence of ‘reasonable care’ for this small number of businesses could lead in future to more extensive erosion of this basic right. This would be unacceptable.

Q18. Would businesses behaviour and approach to tax planning be influenced by public naming by HMRC as being subject to special measures? If not, what other ways might we achieve this objective?

46. It is possible that businesses in some sectors might be influenced by public naming. However as naming in these circumstances would be based purely on an HMRC administrative decision we do not consider that this is a desirable approach.

Q19. Given the objectives of the special measures regime are there any other sanctions that you think should be considered, either in addition to, or instead of, those described above?

47. See our response to Q11. We are not convinced that this regime is necessary.

Q20. What other safeguards do you think might be required in applying sanctions within special measures?

48. See our responses to Q11 and Q12.

Q21. Do you agree that two years is a suitable length of time to remain in special measures? If not, what duration would you suggest?

49. This seems like a reasonable period. However there should be some discretion to permit an earlier exit in appropriate cases.

Q22. Do you agree the criteria for determining exit from special measures are appropriate? If not, what criteria would you suggest?

50. There should be a mechanism for a company to challenge a decision by HMRC refusing to remove it from special measures.