

Improving large business tax compliance

Engaging with HMRC

A package of measures to drive behavioural change

On 22 July 2015, HMRC published its consultation document setting out proposals for a new strategy for its engagement with large businesses. The consultation covers three separate strands, being:

- ▶ A legislative requirement for large businesses to publish their tax strategy
- ▶ A voluntary Code of Practice on Taxation setting out the standards HMRC applies in its risk assessment and inviting businesses to adopt the same standards. Entities governed by the existing 'Code of Practice on Taxation for Banks' will not be affected by this part of the proposals
- ▶ A series of 'special measures' designed to discourage the 'unrepentant' behaviours described

The proposals are driven by the need to address businesses that represent a significant risk to the Exchequer but elements in the proposals will be relevant to all businesses. It seems that HMRC believes that the existing large business strategy has worked well for the majority of businesses but that some businesses:

- ▶ Have yet to adopt the best practice in tax compliance exhibited by the majority;
- ▶ Persist with aggressive tax planning; and/or
- ▶ Resist full and open engagement with HMRC.

In his foreword, the Financial Secretary, David Gauke reinforced the Government's commitment to the UK being the most competitive tax regime in the G20, while expecting businesses to pay those taxes. For some time, HMRC's large business strategy has been built on the twin track of both encouraging transparency and discouraging tax avoidance, thus reducing risk. This consultation document contains proposals for further incentives and sanctions for both elements.

The starting point for the consultation document is the relationship between the taxpayer and HMRC, though the relationship between the taxpayer and its stakeholders will be just as, or even more important. We look at the impact on a taxpayer's management of reputational risk separately in our alert 'Corporate Governance Code meets Tax Code of Practice'.

This alert looks at what the proposals may mean for businesses in their dealings with HMRC.

Consultation proposals

In the Summer Budget, the Government confirmed its intention to consult on measures intended to improve large business tax compliance.

HMRC has now published its consultation document, seeking responses by 14 October 2015. The document contains three proposals which aim to embed positive tax behaviours across all large businesses, drive further behavioural change, and equip HMRC with additional tools to tackle what it sees as 'unrepentant' conduct by some large businesses.

The businesses intended to be in scope for these measures are broadly those businesses administered by HMRC's Large Business Directorate. However, HMRC will identify an objective threshold for a business to be in scope. A possible threshold would be that the measures apply to all businesses that have a turnover of more than £200mn and/or a relevant balance sheet total of more than £2bn for the preceding financial year. This is the same threshold set for the Senior Accounting Officer (SAO) requirement.

A legislative requirement for large businesses to publish their tax strategy

Under the first proposed measure, large businesses will be required to publish (and report to HMRC that they have published) a tax strategy on an annual basis, for the period covered by the business's annual report or accounts. The strategy must be owned by an executive member of the board. It should cover the business's attitude to tax risk, its appetite for tax planning, and its approach to its relationship with HMRC.

HMRC suggests the following areas could be covered when articulating the tax strategy:

- ▶ Overview of internal governance
- ▶ Approach to risk management
- ▶ Attitude to tax planning and appetite for risk in tax planning (e.g. whether they seek to work in accordance with the spirit - in addition to the letter of the law)
- ▶ Attitude to their relationship with HMRC

- ▶ Whether the UK Group has a target Effective Tax Rate (ETR), what this is, and what measures the business is taking to maintain or reach this target ETR

There is a requirement for an executive director to be named as having responsibility for signing off an organisation's tax strategy. The rationale behind this comes from research commissioned by HMRC, which is said to show that increased scrutiny of an organisation's approach to tax matters by the board discourages aggressive behaviours.

HMRC will consider whether the tax returns and claims received from a business over the period covered by the strategy are in line with it. If the returns appear materially inconsistent with the published tax strategy, HMRC plans to take account of this as part of its regular risk reviews.

The proposed requirement to publish a tax strategy is a significant shift in encouragement for further transparency and the document indicates this could include not only publication of attitude to tax risk but also more granular disclosure of what measures a group is taking to apply the strategy and achieve any target ETR. As with the existing SAO regime, a named officer of the group responsible for the tax strategy is required.

Introduce a voluntary Code of Practice on Taxation

A draft voluntary Code of Practice on Taxation is included in the consultation document. The Code represents HMRC's views of the best practice behaviours that large businesses should adopt. Signing it would be open to all businesses within the scope of the proposal for the mandatory publication of a tax strategy. The draft Code commits signatories to an open and collaborative relationship with HMRC; to have open and transparent governance in place for tax issues; and only to engage in tax planning where the business reasonably believes that transactions are structured in a way that gives a tax result which is not contrary to the intentions of Parliament.

The Code aims to:

- ▶ Promote positive and responsible ways of working between large businesses in the UK and HMRC, and promote openness and transparency within this relationship.

- ▶ Promote best practice in a business's approach to governing its tax affairs.
- ▶ Formalise the standards which large businesses should adopt in structuring their approach to tax planning.

Unlike the Code of Practice on Taxation for Banks, HMRC will not be publishing a list of signatories to the Code. It will also not regularly opine of whether particular planning is 'Code-compliant'. However, the consultation document does ask whether signing up to the Code should be included in a business' tax strategy which must be disclosed.

Banks themselves will continue to be governed by the Code of Practice on Taxation for Banks and be outside the new voluntary Code of Practice (though not the other measures proposed in the consultation document). Signing and adhering to it would be seen by HMRC as an indicator of lower risk behaviour.

The proposed voluntary Code codifies many of the factors which HMRC already takes into account in assessing whether or not a business is low risk, but in some respects, it goes further in seeking to raise the bar for a business to be classed as low risk. Specifically, the draft Code suggests that a low risk business should have early dialogue with HMRC on tax planning generally (not just aggressive tax planning avoidance), and would require businesses to demonstrate not just that there are clear accountabilities in place for tax risk decisions but that transactions with a significant tax impact have actually been seen and agreed by senior decision makers within the business.

Special measures

A special measures regime is proposed for businesses that lack the required level of transparency with HMRC and/or persist with aggressive planning. These special measures are to be distinguished from the measures in the consultation document on Strengthening Sanctions for Tax Avoidance which deals with those who repeatedly engage in avoidance such as unsuccessful DOTAS schemes and the introduction of specific penalties where the General Anti-Abuse Rule (GAAR) applies. There may well be areas of commonality and overlap between the two consultations which will need to be considered as both sets of proposals are progressed.

Special measures are intended for large businesses that represent a significant risk to the Exchequer. They will first be put in an initial notice period for 12 months and given the opportunity to change their behaviour. After 12 months, HMRC will carry out a review which may lead to the business entering special measures. Sanctions are divided into strands A and B and will depend on whether HMRC perceives the business to be failing on transparency or tax planning respectively.

Strand A sanctions on transparency are:

- ▶ Increased reporting and disclosure requirements between HMRC and the business.
- ▶ Withdrawing or limiting the extent to which HMRC provides certainty to businesses – for example, non-statutory clearances or informal opinions on the level of risk attached to proposed transactions.
- ▶ Being named publicly by HMRC as being subject to special measures.

Strand B sanctions on tax planning are:

- ▶ An inability to rely on the defence of 'reasonable care' within Schedule 24 of Finance Act 2007, and therefore, the charging of any penalties on the basis that the behaviour was at least careless, if not deliberate.
- ▶ Being named publicly by HMRC as being subject to special measures.

Businesses will remain in special measures for a minimum of two years, at which point HMRC will perform an exit review. At that point, the business may leave the regime and HMRC will publically announce that the business has left the regime. Alternatively, the business may remain in the regime for a further two years before its next exit review.

The proposed special measures regime is a significant tightening of current sanctions for non-compliance, albeit that it is said to be reserved for a very small number of persistent high risk businesses.

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The special measures could include public naming and shaming as well as a requirement to routinely provide additional information or documents (e.g. all non-privileged third party tax advice) without specific request, the withdrawal of the non-statutory clearance service, and (in the case of incorrect returns) a withdrawal of the defence of 'reasonable care' such that penalties are automatically based on a presumption of either careless or deliberate behaviour, even where the planning in question has a positive Counsel's opinion.

It is proposed that a business may enter into the special measures regime as a result of an assessment of its tax compliance risk (without necessarily any finding that its returns have been incorrect as a result). Given the substantial consequences of the special measures regime, it is important that appropriate governance and safeguards – not covered in any detail in the consultation – are clear and robust. This will be one of the key areas to discuss with HMRC in the course of the consultation.

Further information

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