

# **International corporation tax: a review of HMRC's relationship with customers and their advisers**

## **Chapter 1 - Introduction**

### ***Background and context of the review***

1.1 This review was commissioned to look at customer and stakeholder views on HM Revenue & Customs (HMRC) handling of international corporation tax (CT) issues. The focus was primarily on the large business customer base, as that is where the most complex and significant international issues arise. The commissioning of the report reflects the rising importance of international issues for business customers and the importance of international risks in the context of the tax gap.

### ***How the review was conducted***

1.2 The review was undertaken by Melissa Tatton (HMRC) who obtained views directly from large businesses, their advisers (accountants and lawyers) and others with an interest in the review. The analysis and recommendations draw on the face-to-face discussions with these stakeholders. Melissa also spoke with a number of colleagues engaged on international work in HMRC including in CT&VAT, Large Business Service (LBS) and Local Compliance (LC).

1.3 The purpose of the review was explained and customers were asked for their views on international CT work under three main themes: the nature and tone of HMRC's engagement; how well HMRC builds trust and transparency and whether HMRC has the right professional skills and commercial understanding. In her discussions Melissa made clear that the focus of the review was HMRC's technical/operational work rather than issues arising from HM Treasury (HMT) tax policy. Where feedback covered a mix of HMRC and HMT led work Melissa reflected this in her analysis.

### ***Structure of the report***

1.4 Chapter 2 of the report outlines what is meant by international CT work and how it is organised in HMRC. Chapter 3 explains the key challenges it poses for HMRC and for customers. Chapter 4 sets out the themes from the feedback from large corporates and advisers on their relationship with HMRC, and Chapter 5 recommends the way forward. Annex A sets out the terms of reference and Annex B the timetable for implementation of the recommendations.

### ***Key themes***

1.6 HMRC needs to develop a constructive relationship with large businesses in order to meet its twin objectives of closing the tax gap and improving both the customer experience and the UK business environment, consistently with HMRC's vision and its large business strategy. In the large business context, given the complexity of international tax issues and the inevitable involvement of specialists (as described in chapter 2), it is vital that

this constructive relationship encompasses not only the case teams in LBS but the specialists within CT&VAT and Business International.

1.7 The key themes emerging are, perhaps unsurprisingly, similar to those of Sir David Varney's 2006 Review of Links with Large Business and of subsequent research in this area – including the importance of speedy resolution of issues and certainty, the need to improve commercial understanding and to have a joined-up approach across HMRC. But these themes are of even more critical importance, both to HMRC's objective of closing the tax gap and to the competitive position of the UK as a location for business and for investment in the context of international CT work.

1.8 International CT is at the leading edge of HMRC's large business work, with the stakes frequently very high both for HMRC and for customers, and the impact of taxation highly visible at senior and even Board level within the large corporate community. Customers compare HMRC's approach favourably with that of other countries' tax authorities and when the relationship works well they feel that the UK deserves the reputation of being among the best tax authorities in the world. However, when customers encounter difficulties with HMRC's administration of their tax matters, the reputational damage is perceived to hinder the UK's competitive position.

1.9 The findings of the report, based on feedback from customers and their advisers, suggest that HMRC has been travelling in the right direction following the 2006 Review of Links with Large Business, but that there is more to do – specifically in the context of international CT work – to embed this way of working. While HMRC sometimes provides a first class service, at other times – even in the same business area - we fall short of customer expectation. It is clear that HMRC is capable of excellent performance but that the customer relationship that HMRC needs to develop and maintain is not yet consistently the norm and there is scope for raising overall performance to that of the best.

## Chapter 2 - What is international CT work and how is it organised within HMRC?

### *What do we mean by international CT work?*

2.1 Corporation tax is, broadly, a tax on the profits of UK resident companies and the profits attributable to UK permanent establishments of non-resident companies. International issues immediately arise even in giving this broad definition of the tax – what is a UK resident company, what is a UK permanent establishment and what are its profits? And in the tax affairs of most large businesses, operating through a wide network of corporate entities across the world, international issues may be critical to quantifying the profits attributable to UK companies within the group.

2.2 To protect the CT base, particularly in relation to highly mobile profits which could easily be moved offshore, the UK introduced a Controlled Foreign Companies (CFC) regime in 1984. Broadly, this provides a framework for taxing UK-resident parent companies in relation to the profits of their overseas subsidiaries provided certain conditions (including a motive test) are met. The system has developed into a complex body of rules and exemptions. In the 2008 Pre Budget Report (PBR) Ministers committed to consultation on the modernisation of the CFC regime through 2009.

2.3 International CT work can be broken down into the following broad categories, most of which will be of relevance to the tax affairs of a large multinational group:

- *Corporate residence* – what is a UK resident company? In practice, the main impact of UK residence will frequently be to determine whether a company's subsidiaries fall within the controlled foreign companies rules.
- *Permanent establishment* – what is a UK permanent establishment and what are the profits attributable to it?
- *Controlled foreign companies rules* – which overseas subsidiaries are potentially or actually within the scope of these rules, and what profits are chargeable? A key issue here is interaction with European law, with cases currently going through the courts.
- *Transfer pricing rules* – to determine the amount of profits attributable to the UK companies (and permanent establishments) within a corporate group. The UK works within the international framework established by the OECD, with profits attributed according to the “arm's length principle” (i.e. what would parties at arm's length have done?).
- *Rules on financial transactions* – in the main, the rules on financial transactions (loans, derivatives) fall within the general principles of transfer pricing, but there are some specific rules to prevent the use of artificial cross-border arbitrage to create a UK tax advantage. There are some specific rules relating to international activities in the financial services sector (for example, the Investment Managers' Exemption).
- *Double taxation relief* – for overseas tax paid on profits taxable in the UK (for example, this can arise under the provisions of a treaty giving

primary taxing rights to the source country for a particular type of income). A key issue here has been the “underlying tax” attributable to dividends received from overseas subsidiaries – but this is due to change in April 2009 following the announcement at PBR 2008 of a move to an exemption system for foreign dividends.

2.4 Much of this work is underpinned by the UK’s wide network of bilateral tax treaties. While not specific to corporation tax, this treaty network and the work to support it are a critical part of the international CT picture.

2.5 Another important dimension of international CT work is HMRC’s work with overseas fiscal authorities. This includes:

- negotiation of double taxation treaties with other fiscal administrations
- representation of the UK at OECD committees, working parties and other groups such as the OECD Forum on Tax Administration
- work with the European Commission, with other EU member states and in EU groups such as the EU Joint Transfer Pricing Forum
- participation in other international bodies such as G5 and G6
- collaboration with other fiscal authorities – for example through JITSIC, FISCALIS and Multilateral Controls (MLCs).
- interaction under our tax treaties with the “competent authorities” of other fiscal administrations on a range of issues affecting individual corporates (for example, on transfer pricing through the Mutual Agreement Procedure and Advance Pricing Agreements, and on double taxation relief).

#### ***What is HMRC’s role in relation to international CT work?***

2.6 HMRC’s role can be described under three broad headings, though there are interactions between them:

- administration of the current tax system. This includes interaction with corporate customers (and their advisers) to agree the tax liabilities of individual companies, but an important aspect of the work is to ensure consistency of treatment between taxpayers.
- policy partnership work with HMT. Following the O’Donnell reforms of 2004, HMRC is responsible for “policy maintenance” – ensuring the tax system operates as intended within the current policy framework – and for supporting HMT on policy development. This also involves direct interaction with corporates and their advisers, as part of formal and informal consultation.
- the international representative work described in paragraph 2.5 above.

#### ***How is international work organised within HMRC?***

##### *Administration of the current tax system*

2.7 The primary responsibility for agreeing the tax liabilities of corporate taxpayers lies with the Large Business Service (LBS) (top 800 corporate groups) and Local Compliance (other corporate groups, including around 14,000 large businesses). The LBS now has a well-established structure of Customer Relationship Managers for each of its large corporates, with teams (including specialists) within LBS to support them. Local Compliance

introduced, this year, Customer Relationship Managers for approximately its largest 1,500 businesses.

2.8 Because of the importance and difficulty of international CT issues in the context of large corporates, LBS and Local Compliance have their own cadre of transfer pricing specialists and international issues managers who are available to support CRMs in dealing with these issues.

2.9 Where an issue is of wider significance, or is of particular technical complexity, it will be referred to central specialists (within CT&VAT until January 2009) for advice, and there is mandatory referral in certain instances (for example, where the size or technical issue requires HMRC Board's approval, where the case team proposes to seek a penalty, or where a customer requests an Advance Pricing Agreement (APA)). Depending on the size and significance of the issue, and its interaction with other issues affecting the customer, the central specialists may become part of a wider project team involving LBS/Local Compliance and possibly other technical specialists. In addition, a small number of cases have been worked directly by central specialists.

2.10 Since April 2008, and following proposals in the 2006 Review of Links with Large Business, a new process has been introduced to oversee transfer pricing work within HMRC:

- Transfer pricing enquiries cannot be opened without approval from either the LBS or Local Compliance Transfer Pricing Panel, comprising senior transfer pricing specialists from across the relevant directorates.
- Once the enquiry is opened it is project managed through a series of Stage Gates which monitor the progress of the enquiry and ensures key decisions are referred to the relevant Transfer Pricing Panel.
- The Panel may refer particularly difficult decisions to the Transfer Pricing Board of senior managers from across the relevant directorates. The Transfer Pricing Board also makes the decisions on the highest risk transfer pricing enquiries.
- Transfer pricing specialisation in HMRC has been enhanced by the creation of an internal cross-directorate group of Transfer Pricing Specialists (the Transfer Pricing Group). A new enhanced training programme is being given to all of the Transfer Pricing Specialists and the Transfer Pricing Group share expertise and working methods to improve the effectiveness of HMRC's transfer pricing work.

2.11 Another important element of international CT administration is the facility for advance agreements and clearances. There are arrangements for obtaining advance clearance of varying degrees of formality, including the following (all of which are dealt with centrally by specialists apart from the last):

- Informal clearances on specific international issues such as CFC motive test, arbitrage rules and Investment Managers' Exemption

- Treasury consent (to be replaced by an information power from April 2009)
- Advance Pricing Agreements – a statutory process to obtain formal agreement to transfer pricing methodology (with involvement of other fiscal authorities where appropriate)
- Advance Agreements Unit – set up following 2006 Review of Links with Large Business to provide dedicated service for the largest corporate reconstructions and inward investments
- General business clearances under the extended Code Of Practice 10 following the 2006 Review of Links with Large Business – administered largely by LBS or Local Compliance with reference to specialists where necessary and available for any transaction where there is uncertainty on the tax treatment of a commercially significant transaction.

#### *Policy partnership*

2.12 Policy partnership work with HM Treasury is generally carried out by central specialists (in CT&VAT until Jan 2009). Occasionally LBS or other specialist staff may be involved in particular policy projects, where they have particular expertise or experience.

#### *Representational work /interaction with other fiscal authorities*

2.13 Representational work and interaction with other fiscal authorities is generally carried out by central specialists (in CT&VAT until Jan 2009).

2.14 Exceptions are:

- UK participation in JITSIC, which is run from Anti-Avoidance Group
- Competent authority for oil and gas taxation issues, which sits within LBS
- The treaty team, which (until Jan 2009) has been part of Customs & International.

#### *Creation of new directorate*

2.15 From Jan 2009, a new Business International Directorate has been created in recognition of the critical importance of international CT issues both to closing the tax gap and to UK competitiveness. The new directorate will sharpen HMRC's focus on the issues described earlier in this chapter and will increase the dedicated senior leadership resource in this area. The new director, Judith Knott, will be charged with taking forward the work flowing from this report.

## Chapter 3 - What are the key challenges of international CT work?

### *A balanced approach*

3.1 The over-arching challenge for international CT work is to balance the twin objectives of closing the tax gap (ensuring that the right amount of tax is paid under the law) and improving both the customer experience and the UK business environment, consistently with HMRC's vision. This need for balance is fundamental to HMRC's large business strategy, but is particularly acute, and difficult to achieve, in the international CT context. There are a number of reasons for this, outlined below, but the key point is that today's multinationals - whether headquartered in the UK or elsewhere - operate on a truly global scale, with genuine choices of location for each of their activities, and organise themselves along lines which cut across the "legal entity" boundaries traditionally envisaged by the international tax framework.

3.2 A global business will generally adopt a global approach in organising its tax planning (that term being used neutrally, to include normal commercial tax planning that a corporate will undertake). Consequently, a one-sided focus on closing the tax gap - without regard to the customer experience and the UK business environment - has the potential to impact directly on UK competitiveness, as business can choose not to locate activities and investment in the UK and can in some circumstances re-locate existing activities and investment from the UK. From an overall governmental perspective, focussing only on the tax gap would also be ultimately fruitless or even counter-productive for the Exchequer, the tax gap might theoretically become narrower, but the result of re-locating genuine activities would be to reduce the UK tax base (as well as having knock-on effects on UK productivity, jobs etc) – a Pyrrhic victory.

3.3 The customer experience on international issues can be particularly important to perceptions of UK competitiveness. By their very nature these issues are particularly relevant to commercial decisions on location and can be highly visible, both to potential inward investors and to boards of UK-headquartered groups considering the impact of outward investment and group financing decisions:

- inward investment – transfer pricing (including thin capitalisation) will typically be a critical issue for location of underlying business activities, together with the possible existence of a UK permanent establishment of overseas companies
- holding company location – controlled foreign companies rules may well be relevant, as will (up to April 2009) the taxation of funds repatriated as dividends; and for inward investors there may be thin capitalisation issues to consider
- outward investment – again the controlled foreign companies rules, dividend taxation and transfer pricing may be relevant
- group financing – once again the controlled foreign companies rules may be in point, together with the arbitrage rules and the anti-avoidance provisions within the loan relationships regime.

3.4 Tax is unlikely to be the prime factor in these decisions: research generally puts it at number 5 or 6 in decisions on location, after factors such as the sophisticated legal environment and business infrastructure, ease of communication/travel and attractiveness as a place for executives to live. But tax does have an important part to play (hence the importance of UK competitiveness as a driver in the recent PBR announcements) and tax administration and policy go hand in hand in fostering an environment that is attractive to business.

3.5 Having said that, it is equally important that the balance does not tip too strongly in the opposite direction. HMRC's fundamental role is to collect the right amount of tax and our vires determine that we can only operate within the law. Both the rule of law and wider government objectives, such as fairness, dictate that HMRC should ensure a level playing field, both within the large business segment and between that segment and other parts of the tax-paying community.

### ***Obstacles to achieving a balanced approach***

3.6 Balance, then, is key – but can be particularly difficult to achieve because the stakes are so high, both for HMRC and for the customer. Amounts involved on large business CT issues are generally very significant both in absolute and relative terms, and can easily run into several £hundred millions, or even billions; and they can frequently involve points of principle which are relevant over a number of years.

3.7 They are also among the most technically complex. Transfer pricing demands (from HMRC, from corporate tax departments and from their advisers) a high level of commercial understanding across a range of industries and involves the application of economic principles in determining how and what to tax. The controlled foreign companies rules are among the most complex to apply, having had to adapt over the last 25 years to keep pace with sophisticated tax planning, emerging jurisprudence from the European Courts of Justice (ECJ), and business practice that has become increasingly complex and global (indeed the need to maintain the UK's competitiveness in a global economy is a key reason behind the decision to modernise the CFC regime).

3.8 As a result of these factors, it is not unusual for international issues to take years to resolve. Following the 2006 Review of Links with Business, the aim is to work with business to resolve issues more speedily; for example, transfer pricing enquiries to be resolved where possible within 18 months, and within 3 years for the most complex. This will be challenging to achieve, both for HMRC and for customers.

3.9 One reason for protracted length can be that both sides become entrenched in their positions, sometimes working towards litigation or awaiting the resolution of litigation on another case. In fact, actual litigation in the international field is relatively rare on transfer pricing which raises its own challenges. Under the Litigation and Settlement Strategy, HMRC will aim to

take an early view on the prospects of success in litigation, to inform the decision whether to proceed with enquiries. In the context of international CT work, it will be important that this decision is informed by direct evidence of the nature and scale of business activities, which will typically involve meeting key personnel within the global business.

***Importance of the relationship between HMRC, customers and advisers***

3.10 In order to meet these challenges, a constructive relationship between HMRC, its large business customers and their advisers is essential. A constructive relationship allows issues to be resolved with maximum speed and minimum fuss, while enabling robust conversations where necessary, thus facilitating the balanced approach described above.

3.11 The specialised and complex nature of international CT work inevitably requires a significant degree of specialist input on individual cases in addition to the LBS/Local Compliance CRM and case team, as described in chapter 2. Central specialists also interact directly with customers and advisers in their policy role, as part of formal and informal consultation. The constructive relationship described above therefore needs to encompass HMRC's central specialists as well as the LBS/Local Compliance Customer Relationship Manager (CRM) and case team.

## **Chapter 4 - What do customers/HMRC need from the relationship?**

4.1 Customers were asked for details of what, in their experience, they felt went well and to explain what they saw as our strengths. Where they were less satisfied customers were asked for their views on what HMRC could have done differently and on the root causes. The meetings began with these open questions and follow up questions were used as required to draw out more detailed feedback.

4.2 As themes began to emerge which clustered around a number of key issues Melissa was able to test these in later discussions. The feedback in this chapter reflects those views given by a number of stakeholders. Discussions internally with colleagues on cases, issues and organisation of work within HMRC enabled Melissa to understand the context of the responses received, to explore issues more deeply and to support her analysis of the feedback. This was an iterative process in the course of the review.

4.3 Customer feedback suggests a number of recurring themes in what businesses need from their relationship with HMRC on CT international operational matters. Meeting those needs should enable HMRC to achieve the balanced approach discussed in chapter 3, resulting in a more effective approach to closing the tax gap and making a positive contribution to UK competitiveness. This is discussed further in chapter 5, together with the proposed way forward to address the issues identified here.

4.4 While many of the points made could apply more generally to technically complex large business work, customers and advisers were commenting specifically on their interaction with HMRC on international CT issues, and it was clear that they felt their comments were particularly relevant to that area of HMRC's large business work. This, together with the critical importance of international CT work both for closing the tax gap and for UK competitiveness, indicates a clear need for focussed effort to embed the changes heralded by the 2006 Review of Links with Large Business in this area of work.

### ***A single customer relationship***

4.5 Businesses strongly welcome the LBS Customer Relationship Manager (CRM) model and many examples have been given of good relationships built with individual CRMs. Businesses value the trust and the deeper understanding of a business that can be developed as part of an ongoing relationship as well as the opportunity to discuss issues in real time. Customers also welcome the introduction of the CRM model for the largest cases in Local Compliance so that these businesses can also benefit from building relationships.

*“At CRM level we are building trust – that needs to filter through HMRC more widely but HMRC is definitely moving in the right direction”*

4.6 Feedback from the LBS suggests a number of benefits for HMRC in building strong relationships. Colleagues feel that more issues are brought to us in real time for early resolution and that a strong and robust relationship enables HMRC to discuss and agree significant tax adjustments rather than putting difficult issues to one side.

4.7 The CRM is seen as a key role as it sets the tone for the whole HMRC relationship. However, businesses believe that CRMs add most value when they demonstrate strong leadership and interpersonal skills as well as technical competence and there is a perception that this level of performance is not consistent. Customers consider that the CRM role on international issues lacks clarity and questioned whether the CRM exerts sufficient authority as a technical leader on specialist international issues. Customer perception is that an experienced CRM with the right skill set enables productive involvement of specialists and effective decision making.

4.8 Customers recognise that the CRM needs to refer some issues and clearances to specialists and they value the consistency that such an approach brings. However, irrespective of HMRC's internal processes for decision making, customers would like those with whom they engage to be empowered and confident enough to take decisions on behalf of HMRC and to be able to present a single joined-up HMRC view.

*“Where the CRM is only a co-ordinator role it doesn't add value – you need someone who can make decisions and can navigate the tensions between specialists and case workers and can balance the need for pragmatism and consistency/precedence.”*

4.9 Customers consider that time spent at meetings explaining complex issues and their commercial context with those who are decision makers is a good investment of their time. On the other hand, customers feel frustrated if the issue is referred to specialists to whom they need to repeat their explanations, or if the specialists subsequently make decisions without the full benefit of the background explanation.

4.10 Whilst customers expect there to be a level of healthy debate within HMRC on complex issues requiring difficult judgements, exposure to customers of internal differences between specialists and CRMs is unwelcome. It creates uncertainty for the customer and risks undermining the value of the respective strengths of both the CRM and specialist roles.

4.11 The new transfer pricing process has provided greatly improved planning and project management of transfer pricing work. The rigour it imposes, for example, around stage gates and timescales, is very much welcomed by business. However, it is still early days and business is keen to see how the process develops in practice and customers remain concerned that despite the new governance arrangements HMRC still does not always present a single joined-up response.

4.12 Greater clarity is required around the impact of a “low risk” designation. In particular, it is unclear to customers and advisers what that means for the way international work is done and how far international specialist work is tailored according to the risk status of a group.

4.13 Internal feedback on international work within Local Compliance stressed the importance of ongoing well resourced training provided by specialist technical advisers to those within Local Compliance specialising on international issues in order to provide a consistent HMRC approach on technical issues. Presentations, surgeries and workshops give practical examples of effective ways to share not only technical information with Local Compliance but also best practice in ways of working. Feedback also emphasised the value of readily available advisory support to Local Compliance international specialists to ensure HMRC consistency.

***Relationship management – constructive ways of working***

4.14 Customers consider that a well managed relationship with HMRC impacts constructively on the handling of their tax affairs. It does not mean that HMRC will always agree with the customer but it does mean that discussions are productive and can focus on the real risks and move quickly to a debate of the technical issues.

4.15 Customers consider that constructive relationships are created and strengthened by particular HMRC ways of working. Many positive examples were given of these approaches and the mutually beneficial impact that they have for HMRC and customers. Customers want, however, a greater consistency in ways of working international issues in order to provide certainty and predictability and feel that HMRC still has further work to do in ensuring this. The constructive ways of working identified by customers fall into a number of broad themes:

- Understanding business
- Transparency
- Speed of resolution
- Certainty
- Objectivity

*Understanding business*

4.16 Listening and understanding large business customers and their commercial drivers builds strong relationships which encourage trust and transparency. It also ensures that HMRC has the right commercial understanding essential to an objective and accurate assessment of tax risk and enables HMRC to distinguish those issues that it needs to pursue relentlessly from those it does not. Where there is no commercial driver to a transaction it is right that HMRC spots that quickly and tackles the risk. In order to do that HMRC must be able to understand the commercial context.

*“ We’re not arguing against HMRC’s right to reach a different viewpoint – you just don’t need all the information you ask for – your request didn’t show a commercial perspective.”*

4.17 Customers want HMRC to understand what makes a business tick, how it plans strategically, how it is impacted by regulation, what drives profit and how and by whom decisions are taken in an increasingly globalised business environment. Whilst some customers noted a real improvement in HMRC's development of this understanding, others consider that HMRC needs to be far more willing to listen rather than make assumptions.

4.18 Reflecting on how HMRC could improve their commercial understanding, customers expressed a preference for informal joint training events of the kind that already take place, an increased use of non-tax specialists (including economists) and greater movement between the public and private sector. However, the most important factor cited as improving HMRC's understanding of business was a willingness to engage with and listen to the customer.

4.19 Positive examples were given where HMRC has, through listening to the customer, undertaking background research and using accountancy specialists, become very knowledgeable about an industry sector and a particular business. The result has been more meaningful discussion and greater focus on the key risks.

*"HMRC has made good efforts to understand us – we've been surprised by what you've quoted back to us including from your research – you've become very knowledgeable and that makes a difference."*

4.20 In contrast there remains a perception that HMRC at times displays an unhealthy level of scepticism and a degree of suspicion which can lead it to make incorrect and unhelpful assumptions.

4.21 If HMRC listens to customers before looking for supporting information it gets a fuller picture than one built up, for example from e-mail exchanges alone. Looking at these in isolation risks HMRC drawing incorrect conclusions, as staff in most organisations can and do send e-mails that are carelessly worded.

4.22 A number of very good examples were given of HMRC's willingness to meet with business for wider discussion and to consult and engage with customers on policy issues. However, it was felt that HMRC could use the whole range of its customer understanding, not just its operational experience of avoidance, to evaluate more proactively the impact on business of existing legislation and in initiating discussions about legislative sustainability with policy partners.

#### *Transparency*

4.23 Customers consider that enquiries progress more quickly and constructively when HMRC articulates its concerns at the outset and discusses openly what information the customer could provide to satisfy HMRC. Customers perceive this requires not only an objective approach but

also a degree of confidence that is gained from a sound understanding of the business context and a high level of technical skills and knowledge.

*“If HMRC doesn’t put its cards on the table early enough and we don’t have the technical debate we will end up in court when we shouldn’t.”*

4.24 A number of positive examples were provided including an HMRC team beginning enquiries by discussing notes on all the issues at a meeting before writing more formally. This meant that correspondence was more meaningful and the enquiry progressed more quickly. Also where HMRC discussed with the business how best they could check the underlying facts in support of an issue in a way that avoided non-productive work for HMRC and businesses. What works less well is where HMRC asks for information before articulating concerns and the request for information does not demonstrate a commercial perspective. The result is that it is not clear to the customer where HMRC’s concerns lie and the information obtained does not provide HMRC with what it needs.

4.25 Customers perceive that insufficient transparency at an early stage can slow down enquiries creating a number of difficulties. If debate about the facts is unnecessarily prolonged it becomes very difficult to obtain information from staff who had first hand experience of the issues. And less time is then spent debating application of the law which risks the wrong cases getting to court.

4.26 The need for increased transparency and better guidance was highlighted by a number of customers who consider that regular updating and more use of illustrative examples helps provide greater certainty and transparency.

#### *Speed of resolution*

4.27 Customers perceive that HMRC can be reluctant to take decisions on issues to which it objects and instead of progressing and resolving such issues, HMRC simply asks more questions. Some customers felt that in these circumstances HMRC lacked the confidence to make decisions, whilst others felt that HMRC was delaying because it recognised its own argument as weak.

4.28 Customers consider that good commercial understanding provides HMRC with the confidence to use judgements to make decisions and move from fact finding to a debate around the application of the law.

4.29 Concerns were expressed about the risk of cases backing up behind lead litigation cases even where the facts and circumstances are sufficiently different for judgement to be used to take decisions. More generally customers who raised this as an issue felt there was a lack of clarity around the scope for flexibility under the Litigation and Settlement Strategy and want a more consistent HMRC message.

*“HMRC at times seems to have taken the approach that ‘we take a line on this issue, divorced from your case and regardless of its facts’.”*

### *Certainty*

4.30 Customers value the availability of statutory and non-statutory advance clearances on international issues. While many customers commented positively on their experiences in this area, others expressed concerns. Customers recognise the level of skill and therefore training required for HMRC staff in order to be able to deal with advance clearances quickly. Resourcing of clearance activity is also considered a priority by customers.

4.31 Customers consider that the Advance Agreements Unit (AAU) sends very positive signals about HMRC's approach to customers but ask whether it needs further publicity in order to maximise its potential and assess the amount of focussed resource it requires.

4.32 The predictability of our decisions is seen as a critical factor in providing certainty and was highlighted by customer requests for improved, up to date guidance using illustrative examples.

### *Objectivity*

4.33 Customer feedback indicates that relationships are strengthened by an objective HMRC approach which encourages customer transparency and disclosure, rather than a judgemental or moralistic tone which can be counter productive. An objective approach also provides HMRC with a realistic approach as to what is likely to succeed in court.

*"There's no need for a moral judgement – it's not an approach that gets the tax – you would be better with a more analytical approach."*

4.34 While a number of customers commented positively on HMRC's more objective approach to dealing with international tax issues in the last few years, there are others who feel that HMRC still needs to improve in this respect.

4.35 Concerns were expressed that when HMRC displays a judgemental attitude rather than an analytical approach it alienates the customer and creates unnecessary tension which does not help progress the issues.

### ***Preventing problems and putting things right***

4.36 Customers value effective leadership on technical issues and have suggested that potentially difficult judgemental issues and differences of opinion benefit from internal escalation at a sufficiently early stage and that ensuring senior managers are better sighted at an early stage avoids difficulties later. Some comments have suggested HMRC could do more to encourage its staff to bring in senior support, recognising it as a sign of strength not weakness.

4.37 Some customers gave examples of the positive and productive impacts of good leadership and management on HMRC's approach to their tax affairs. Others felt that there was insufficient leadership and management capacity, given the growth in international work, and that more oversight was needed.

Overall, given the complex nature of the international issues that arise, customers expressed a desire for greater emphasis on quality standards and a more strategic overview of technical issues.

*“My clients used to receive extremely long standard letters which never achieved much but this approach changed dramatically following the strong steer given by the specialist – there was a definite sea change and the approach was much more productive.”*

4.38 Customers have suggested that SCS level representation of specialists when dealing with senior staff in corporates is constructive, not only in terms of relationship building, but also in terms of a high level appreciation of how organisations operate.

4.39 Feedback indicated considerable uncertainty as to how customers should best raise their concerns constructively when HMRC does not appear to recognise their business drivers or when lines of enquiry are unproductive or time-consuming to resolve. They want greater transparency of the process by which they can escalate their concerns and ensure that they are addressed.

## Chapter 5 – The way forward

### ***Importance of addressing issues raised in feedback from customers***

5.1 The feedback summarised in chapter 4, representing a broad consensus of mainstream views from our large business customers and their advisers, is an important tool in achieving the balanced approach to international work described in chapter 3. Most obviously, it is an important guide towards improving the customer experience, which in turn feeds into perceptions of UK competitiveness. Listening to customer feedback, and acting on it where possible, is also essential to building a constructive relationship between HMRC, its large business customers and their advisers. Once established, this constructive relationship allows issues to be resolved with maximum speed, and facilitates robust, mature dialogue which can also enhance the effectiveness of HMRC's work in closing the tax gap.

5.2 More specifically, many of the needs identified by customers make equally good business sense when viewed from HMRC's perspective. For example:

- *Single customer relationship* – as attested by feedback from staff, strong and robust relationships mean that more issues are brought to HMRC in real time for early resolution, and enable HMRC to discuss and agree significant tax adjustments rather than putting difficult issues to one side. HMRC cannot build the strong relationships it needs without presenting a joined-up approach to the customer.
- *Understanding business* – this is fundamental to the balanced approach of chapter 3. Understanding the commercial context of transactions (or, if the transactions are wholly artificial, the lack of commercial context) allows HMRC to identify and focus its efforts on the really significant tax risks.
- *Transparency and objectivity* – again these are critical to building the strong and robust relationships that HMRC needs; and mutual transparency is to the benefit of both parties.
- *Speed of resolution* – international tax enquiries frequently require detailed understanding of complex fact patterns. Prolonged enquiries, with the relevant facts many years in the past, benefit neither the customer nor HMRC.

5.3 The shared goal of improving the relationship between HMRC and its large business customers was at the heart of the proposals identified in the 2006 Review of Links with Large Business. As a result of that review, HMRC is already committed to delivering a number of the outcomes identified in this report:

*“1.7 The outcomes that both business and HMRC want to see as a result of this review are:*

- *greater certainty;*
- *an efficient risk based approach to dealing with tax matters;*
- *speedy resolution of issues; and*
- *clarity through effective consultation and dialogue.*

*1.8 Underpinning these proposals is a commitment for culture change within HMRC to equip staff with the range of skills, competencies and support needed to understand the perspective of large business and to deal confidently with complex matters of relevance to large business in today's rapidly changing environment."*

5.4 The feedback summarised in this report suggests that we still have some way to go towards delivering these outcomes consistently across international CT work. The recommendations which follow aim to bridge that gap.

### **Recommendations**

5.5 The **overarching context** for addressing the issues identified in the report should be a **cross-directorate change programme on Pacesetter principles**, organised at Business Tax level and focussing on large business customers (including those dealt with by Local Compliance). This should aim to improve collaborative working around a common set of priorities, helping staff to achieve the **right balance between closing the tax gap and improving the customer experience**. It should involve all those engaged on specialist international work and should cover the **end-to-end process** from customer-facing delivery to policy partnership work with HMT and representational work with other fiscal administrations.

#### **1 - Accountability, governance and escalation**

That LBS, Business International, other Business Tax leaders and Local Compliance work with staff, as part of the Business Tax Pacesetter programme, to clarify the roles of the CRM and central specialists and their interaction in making decisions on complex issues - including where the **authority** for decisions lies, the **process** by which decisions are taken, and what/when **oversight** is needed at a senior level. This should be backed up by a clear escalation framework (both within and beyond LBS and Business International), which our customers understand.

#### **2 - Skills and capability**

That LBS, Local Compliance and Business International leaders should develop a skills and capability strategy across international work, covering the roles of CRMs, case teams and specialist staff. This should encompass the following areas:

- strengthening and sharing technical skills on international issues
- strengthening and sharing commercial understanding (the next step being the workshops currently being designed by a BCU-led, cross-directorate team)
- strengthening skills in communicating and interacting effectively both with each other and with customers.

The strategy should consider the right balance of skills for each role and the scope for using staff flexibly within Business Tax. It should also consider the resource impacts of strengthening skills and of the

ways of working identified in recommendation 3 below (and more generally, any resource implications for international work of the overarching Pacesetter programme).

### ***3 - Relationship Management – constructive ways of working***

Specific areas to be addressed within the Pacesetter programme should include:

- the benefits of meetings involving customers and specialist staff at an early stage of dialogue, including real-time working and enquiries
- integration of central specialist work with the risk assessment process
- objective language and tone, externally and internally, in face-to-face and written communications and in guidance
- developing transparency at all levels of the end-to-end process, including clear statements of underlying policy intentions behind international CT legislation
- using central technical specialists and operational experience proactively to identify areas where current policy is causing unforeseen difficulties
- understanding how international issues interact with other aspects of the tax system and actively reflecting how that overall impact affects UK competitiveness in our thinking about policy maintenance and development.

### ***4 - Defining and measuring success***

That the director of Business International creates a new **performance framework** for specialist international work with clear metrics for success, linking to the Large Business Strategy and to departmental objectives.

### ***5 - Setting a clear strategy***

That the director of Business International should establish a programme of work within the directorate to **review international technical issues** (including the interactions between them) and **establish strategies** to decide what should and should not be taken forward and how issues should be progressed. This should include clarification of current technical positions, to facilitate transparency, and should consider their implications for litigation and policy.

## **Annex A - Terms of reference**

### **Objective**

To explore feedback received from multinationals, law firms and advisors, identifying issues that HMRC needs to address and recommending how HMRC should respond.

### **Sponsor**

Melanie Dawes

### **Led by**

Melissa Tatton

### **Scope**

The review will look at how HMRC handles operational international issues for large businesses so that our customers pay the right tax at the right time and receive the support they need. For example, the nature and tone of our engagement with customers, how we build trust and transparency and whether we have the right professional skills and commercial understanding.

### **Methodology**

The review will gather feedback by listening to views internally and externally from

- Big Four accountants
- Lawyers
- HMRC's international customers
- HMRC staff

This will include HMRC colleagues in:  
CT&VAT; LBS; BCU; AAG, LC; C&I and CAR

### **Reporting arrangements/Timescale**

Initial findings will be available by the end of October.

## **Annex B – Timetable for implementation of recommendations**

Recommendation 1	Clarification of respective roles and creation of an escalation framework	<b>by end of May 09</b>
Recommendation 2	Development of a skills and capability strategy	<b>ongoing throughout 09/10</b>
Recommendation 3	Relationship management: addressing constructive ways of working through the Pacesetter programme	<b>by end of August 09</b>
Recommendation 4	Creation of new performance framework	<b>by end of May 09</b>
Recommendation 5	Setting a clear strategy	<b>by end of November 09</b>