

Response to Consultation Document
“Improving Large Business Tax Compliance”
published by HMRC on July 22, 2015.

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This paper is based on the text of the document dated 22 July 2015 and represents views conveyed orally to HMRC as part of the consultation process. Some aspects of the proposals may now have changed as a result of the consultation process.

BACKGROUND

- On July 22, 2015 HMRC published a consultation document which set out three proposals to deal with perceived challenges posed by the tax practices of some large businesses.¹ The proposals are:

(1) A legislative requirement for all large businesses to publish their tax strategy, enabling public scrutiny of their approach towards tax planning and tax compliance;

(2) A voluntary ‘Code of Practice on Taxation for Large Business’ (the Code) which sets out the behaviours which HMRC expects from its large business customers;

(3) A narrowly targeted ‘Special Measures’ regime to tackle the small number of large businesses that persistently undertake aggressive tax planning, or refuse to engage with HMRC in an open and collaborative manner.

- The Consultation Document has been presented as part of the fight against tax avoidance, incentivizing the ‘right behaviour’ and ensuring that ‘aggressive tax planners’ are tackled in order to create and maintain a level playing field for the vast majority of businesses.² It is put forward as a continuation of the **co-operative compliance** mode of working.
- These objectives chime with the current political climate and have been presented carefully in such a way as to appear beneficial both to the public and to the majority of businesses. It is necessary, however, to examine the detail of the proposals to ensure that they do contribute to good tax governance and achieve their objectives in the long term. A system based on trust, such as the co-operative compliance programme, can be undermined by the introduction of certain types and levels of sanction: the balance and

¹ HMRC, “Improving Large Business Tax Compliance”, July 22, 2015 (Consultation Document).

² David Gauke, Introduction to Consultation Document and <https://www.gov.uk/government/speeches/david-gaukes-speech-at-hmracs-annual-stakeholder-conference>

dynamic is a complex one.³ Tax morale amongst business, but also more generally, could suffer in the long run from taking a short-term view. It is on good tax morale that all tax systems rely to achieve high levels of voluntary compliance from the vast majority of taxpayers, so that threats to that relationship would be to the detriment of long-term revenue collection.

- There is an overriding need for any tax system to be governed by the rule of law if it is to gain and maintain the confidence of taxpayers and the public.⁴ Tax authorities undoubtedly require discretion to run a modern, complex tax system. However, if the discretion given to officials goes beyond what is required to run the tax system fairly, efficiently and effectively, the system will ultimately run into difficulties. Furthermore, and critically, officials must be careful not to exceed the discretion granted to them and adequate controls must be in place to ensure this. Authority for all actions and decisions must come from a proper source and, in the case of taxation, this should be the legislature. This is the case whether discretion is exercised by officials too heavily in favour of taxpayers (perceived ‘sweetheart deals’) or too heavily against taxpayers (attempts to go beyond the proper interpretation of the law as enacted by the legislature and interpreted by the courts). This takes us to another aspect of the rule of law- ‘the law must be capable of guiding the behaviour of its subjects’.⁵ Taxpayers are entitled to expect that they can rely on the law in the books when making their decisions in what can be very complex commercial situations, where precise costing is vital in assessing the viability of a transaction or arrangement.
- This analysis of the Consultation Document considers the need to balance the necessary use of discretion under the powers of care and management bestowed by the Taxes Acts on HMRC against the need for the application of the tax system to be at all times subject to a clear legal framework. This is not an argument for literal interpretation of tax law- the UK courts have long ago moved away from this in any event, and HMRC’s armoury includes many forms of anti-avoidance provisions, including the General Anti-abuse Rule, which should re-enforce the ability to defeat attempts at twisting the meaning of legislation.⁶ Many examples of taxpayers avoiding tax are old and

³ Gangl, Hofmann, Pollai and Kirchler, “The Dynamics of Power and Trust in the ‘Slippery Slope Framework’ and its Impact on the Tax Climate” (2012)

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2024946

⁴ The term ‘rule of law’ is often defined to mean that government should govern by known rules rather than by whim or discretion (Dicey and others). A more modern manifestation is, as put forward by Tomkins, that the executive may do nothing without clear legal authority permitting its actions - an authority that in the case of taxation we would expect to see coming from the legislature. For further discussion see Freedman and Vella, ‘HMRC’s Management of the U.K. Tax System: The Boundaries of Legitimate Discretion’ in C Evans, J Freedman and R Krever (eds), *The Delicate Balance: Revenue Authority Discretions and the Rule of Law*, IBFD, (2011).

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2174946

⁵ Raz, , *The Authority of Law: Essays on Law and Morality* (OUP, 2nd ed., 2009), ch. 11 (“The Rule of Law and its Virtue”).

⁶ See for example Lord Steyn’s discussion about this shift from literal interpretation in the tax context in *IRC v McGuckian* [1997] STC 908.

would not succeed under current law. What is argued here is simply that the law to be applied is that created by parliament and interpreted by the courts. This is not to deny that tax law is frequently hard to interpret and they may be a range of possible answers. It is also clear that, if the Government is not happy that the law is as it wishes it to be, it can and should go through proper legislative processes to change it. But recent anti-avoidance legislation already in place should reduce the need to play cat and mouse with tax legislation.

- Much good work has been done to establish the existing co-operative compliance regime and this is a positive development for business, HMRC and the wider public, in that it increases the ability of the tax administration to collect revenue efficiently. Surveys and analysis undertaken by the Oxford University Centre for Business Taxation (CBT) suggest that this regime has on the whole worked well to improve, transparency, speed of resolution and understanding of commercial issues amongst the population covered by the Large Business Service.⁷ There is a risk that some of the current proposals would undermine the concept of relationships based on trust and actually reduce the amount of information coming to HMRC.
- **Overall, the authors have reservations about Proposal 1 and concerns about the direction in which Proposals 2 and 3 take the relationship between HMRC and Large Business. Proposals 2 and 3 appear to be at odds with the basic tenets of the UK cooperative compliance programme. Also, they appear to be yet further measures designed to move from the boundary drawn by law to a boundary drawn by HMRC. The fact that this latter boundary drawn by HMRC may equate with the views of some politicians, or a perceived view of the public and the media, does not make this an appropriate boundary for the operation of a tax system within the rule of law.**

PROPOSAL 1

A legislative requirement for all large businesses to publish their tax strategy, enabling public scrutiny of their approach towards tax planning and tax compliance.

- i. Benefits and disadvantages of adopting a tax strategy
- There could be some benefits in companies adopting a formal tax strategy. In a survey undertaken by CBT researchers in 2008⁸ a number of tax directors

⁷ See J Freedman, F Ng and J Vella, 'HMRC's relationship with large business', (2014) Oxford University Centre for Business Taxation Report http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/HMRCs-relationship-with-business.pdf

⁸ J Freedman, G Loomer and J Vella, 'Corporate Tax Risk and Tax Avoidance: New Approaches', (2009) *British Tax Review*, 74.

expressed the view that such strategies could focus the mind on how tax and tax risk is managed within a company. Clearly, such strategies, if approved by the board of directors, could also ensure that tax issues are discussed at the highest governance levels within the company.

- This discussion of strategy does not, of course, determine the outcome of those deliberations. In the current climate one would expect some directors to be keen to avoid reputational risk, but this will depend on the type of firm concerned. In our 2008 survey we reported that "... a few interviewees noted that board engagement can have the opposite effect [ie can encourage tax minimization attempts] as a result of the so-called 'golf course syndrome'". In other words, in some cases the board of directors has been keener to minimize tax than the tax advisers and directors were. This could be partly driven by investor preference on these issues. A recent survey by Allen & Overy in fact explained that "[w]hile some investors are most focused on transparency, reputation and ensuring stability of the tax position, for many it is simply a question of minimising leakage on their returns."⁹
- It may be that the process of discussing the strategy is helpful, and revealing it to HMRC could then be a requirement to ensure that this discussion had taken place, but this does not of itself demand publication to the public. It is not clear that such a requirement will result in the development of a serious strategy rather than a public relations document. Thus the publication requirement could reduce the usefulness of this document.
- The Consultation Document sets out the underlying thinking behind this proposal and the reputational channel through which it is hoped this change in behaviour will be achieved:

"Our most recent research into large businesses (also published today) tells us that the degree of codification and content of a tax strategy are 'clear indicators of aggressiveness' in tax planning. The research found that 'businesses with a greater appetite for risk tend[ed] not to have written (or published) tax strategies, while those with lower risk-appetite tended to have more formalised strategies.' This research also shows that reputational concerns can influence the attitudes of large businesses and encourage them to pursue less aggressive tax planning arrangements."¹⁰

⁹ Allen & Overy 'Negotiating the minefield: challenges facing the corporate tax function'. http://www.allenoverly.com/SiteCollectionDocuments/Global_Tax_Challenges%20facing%20the%20corporate%20tax%20function.pdf

¹⁰ 'Exploring Large Business Tax Strategy Behaviour' TNS BMRB Final Report HMRC Research Report 363 July 2015. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/444898/HMRC_Research_Report_363_-_Exploring_Large_Business_Tax_Behaviours.pdf. This was a survey from a sample drawn by HMRC of 35 individuals with a strategic decision making role in tax in large companies from the LBS population. 12 were higher risk, 7 medium risk and 16 lower risk. This is small and not necessarily representative sample upon which to base a new legislative requirement.

- This appears to confuse correlation with causation. It may be true that companies that have a lower risk appetite tend to have formalized tax strategies, however, it does not follow, as a matter of logic, that requiring companies with a higher risk appetite to adopt formal tax strategies, without more, will induce them to reduce their risk appetite.
- Tax strategies can be drafted in carefully selected vague language that is open to interpretation. Statements such as “we pay all taxes due under the law”, “we do not undertake artificial tax planning which is devoid of commercial reality”, and “we respect both the letter and the spirit of the law” can allow behaviour of varying degrees of aggressiveness depending on the interpreter’s particular understanding of these statements. Companies adopting such loosely worded statements need not feel constrained in their tax planning behaviour. For this reason, a formal requirement to adopt such strategies may well not produce its desired effect with the most recalcitrant firms, which are those the Government is concerned to target.

ii. The content of the tax strategy

- The final point above assumes that the content of tax strategies will not be prescribed by HMRC. This is implied in the current Consultation Document, as it currently only provides “suggested elements” (para. 2.2).
- Clearly, if the required tax strategy were to have a prescribed content the proposal would be of a different nature. If, for example, companies were required by law to include statements as to whether they aim to comply with the “spirit of the law” as defined by HMRC and discussed below, this might be thought to be a stronger version of Proposal 2. However, companies might be prepared to state this to be the case on the basis that in their view following the law covers following the spirit of the law. Since all companies must abide by the law in any event, this would not add anything.
- A requirement to include such matters as target effective tax rates (ETR) would be very problematic, since such targets, where they exist, are likely to be global and in any event there may be many different reasons for the ETR in any given year. Therefore this is unlikely to be workable or useful.
- A requirement to state whether the taxpayer had signed up to the Code would remove the Code from the realms of the voluntary, as discussed below, and would be likely to lead to demands for more information about the operation of the Code.

iii. Publication of the tax strategy

- The Consultation Document places this proposal in the context of other recent proposed measures to increase transparency. A critical design feature of these measures is whether disclosure is made to revenue authorities or the public at large. Current proposals by the OECD for country-by-country reporting and disclosure of tax rulings have been limited to the former. The Consultation Document does not explain why this proposal adopts a different approach, and requires disclosure to the public at large.
- One possible reason is that such tax strategies contain less sensitive information than that found in country-by-country reports and tax rulings. Indeed, this follows from their potentially vague and anodyne nature. Also for this reason, objections to public disclosure may be less compelling here.
- Equally, one has to question what is being achieved by placing information of this kind in the hands of the public and the NGOs. It could lead to misunderstandings and will certainly add cost for companies, which will have to employ experts to advise on content and presentation. The benefits to the public are unclear particularly if there is no requirement to publish specific information, although that would in turn bring about the issues discussed above. If reputational pressures were to arise from varying presentations of tax strategy, there is a strong likelihood that they would apply differentially across the body of taxpayers partly depending on their exposure to the retail market.
- It seems that the most likely outcome of this requirement may be to create work for tax advisers and PR firms rather than increasing the amount of tax collected.
- This proposal is projected to raise £65m by 2017, but it is not clear how this figure could have been reached- it seems speculative.
- If, after discussion and consultation, it is thought that any particular piece of information should be published, this should be specified in legislation, so that a level playing field is created.

iv. Accountability for the tax strategy

The Consultation Document explains that a member of the Board of Directors will be “responsible for owning and signing off the tax strategy.” It is not clear whether HMRC envisages that a breach of the strategy will carry consequences for the director and what those consequences would be.

v. Where is this intended to lead?

The Consultation Document suggests that failure to adopt and publish a tax strategy will be met with a penalty. As we have explained, we think this could lead to great cost without much, if any, gain. However, failure to comply to

HMRC's satisfaction with an adopted tax strategy will only be considered for the purposes of risk rating. No further consequence is currently envisaged. If further sanctions were to be introduced (and there is evidence from the Code of Practice for Banks that this kind of development can take place), it would be important to be more precise about the requirements, as suggested above.

PROPOSAL 2

A voluntary 'Code of Practice on Taxation for Large Business', which sets out the behaviours which HMRC expects from its large business customers.

The Code of Practice on Taxation for Large Business (the Code) covers three broad areas of large business behaviour:

- Openness and the relationship of the business with HMRC
- Internal Governance
- The approach of the business to tax planning.

We focus here on the third area, "the approach of the business to tax planning", although many of our general points about the discretion any such Code envisages HMRC exercising hold for all three.

i. Beyond the boundary of the law.

- The Code requires companies to:
"Avoid structuring transactions in a way which will have tax results that are inconsistent with the underlying economic consequences unless there exists specific legislation designed to give that result. In all cases, the business should reasonably believe that transactions are structured in a way that gives a tax result which is not contrary to the intentions of Parliament."
HMRC's understanding of the phrase "intentions of Parliament" is explained in the following definition of tax avoidance and aggressive tax planning accompanying the Code:
"In arriving at a view as to whether the transaction is contrary to the intentions of Parliament, HMRC will consider a purposive construction of the legislation, and will also consider whether Parliament can realistically have intended to give the proposed result in circumstances that are very different from those that prevailed at the time (e.g. re loopholes being used to arrive at an unexpected result)."¹¹
- An identical provision is found in the Code of Practice for Banks (the Bank Code). It assumed that the identically phrased provisions are intended to have the same

¹¹ Consultation Document, p. 38.

meaning. HMRC have explained the meaning of the provision in the Bank Code in the following terms:

“In arriving at a view as to whether the transaction is contrary to the intentions of Parliament, the bank should *not only consider a purposive construction* of the legislation but should also consider whether Parliament can realistically have intended to give the proposed result in circumstances that are very different from those that existed at the time (e.g. are loopholes being used to arrive at an unexpected result). The question of whether the tax results are contrary to the intentions of Parliament can be answered in practice by asking whether the tax consequences of a proposed transaction are too good to be true. The Government has a track record of acting to close avoidance opportunities of which it becomes aware.”¹²

“...we will suggest banks answer the question of whether the transaction is contrary to the “intentions of Parliament” in practice by asking whether the tax consequences of a proposed transaction are too good to be true, so that the tax consequences would be a surprise to HMRC. This is because a tax result contrary to the “intentions of Parliament” would not be what HMRC would expect.”¹³

- By requiring banks to comply with this understanding of the intention of Parliament the Code and the Bank Code (the Codes) appear to require companies to go beyond the requirements of the law.¹⁴ In a sense, this can be seen as a matter of simple logic. The Codes would have very little purpose if all they did was to commit companies to comply with the law when planning their tax affairs.
- That the Codes commit companies to go beyond the requirements of the law emerges from the definition given to the “intention of Parliament”. This differs from the meaning used generally in law. This proper constitutional usage of the phrase “intention of Parliament” makes the intention of Parliament a matter for the Courts to decide.¹⁵ In reaching their decision, the Courts in the UK, as in most other jurisdictions, already follow a purposive interpretation of statutes, meaning that they do not merely follow the letter of the law, but they also look at the context of the particular provision in terms of the purpose of the statute as a whole. The proposed Code encompasses that, but that adds nothing, as companies are already required to adopt such an interpretation and any lawyer advising them should do so.

¹² HMRC, *A Code of Practice on Taxation for banks - Supplementary Guidance Note*, 9 December 2009, pp. 4-5 (emphasis added).

¹³ HMRC, *A Code of Practice on Taxation for banks – Consultation Response Document*, 9 December 2009, p. 9.

¹⁴ For further discussion of the Bank Code see R. Collier, ‘Intentions, banks, Politics and the Law: The UK Code of Practice on Taxation for Banks’ [2014] BTR 478.

¹⁵ See J Freedman, ‘Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament’ (2007) 123 LQR 53 at p72 and Devereux, Freedman and Vella, “Tax Avoidance”, (2012) http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/TA_3_12_12.pdf

- The proposed Code then requires companies to go beyond this and “also consider whether Parliament can realistically have intended to give the proposed result in circumstances that are very different from those that prevailed at the time (e.g. re loopholes being used to arrive at an unexpected result)”. This further step is not undertaken by the Courts when interpreting statutes and, therefore, the proposed Code is committing companies to go beyond the demands of the law. It commits companies to refrain from a transaction even in a case where the company believes that there is a good argument that it is compliant with the law (an argument which a court might well accept). In other words, the proposed Code would require companies to arrange their affairs in line with the law as interpreted by HMRC or as HMRC would like it to be, rather than as it is.
- There is an interesting contrast with the legislative General Anti-abuse Rule (GAAR) here. The GAAR does allow the courts to look at shortcomings in the legislation, but only in certain prescribed circumstances, and subject to safeguards. These safeguards were set out as a matter of policy to protect taxpayers. It would seem strange if taxpayers were expected to go further than this carefully delineated boundary. We would have no problem with a code that required companies to consider whether the GAAR would apply, since that is required by law in any event, but a requirement that companies consider what Parliament would have intended in different circumstances, without the various safeguards deemed necessary for the GAAR, clearly goes beyond what was thought appropriate by Parliament after considerable discussion and consultation, in 2013.
- Some of the wider concerns of the general public and politicians over what are seen as deficiencies in international taxation can clearly be dealt with only by changing the specific rules, as is happening in co-operation with other jurisdictions through the OECD’s Base Erosion and Profit Shifting (BEPS) process. The Code might give the public a misleading impression that these issues can be dealt with more easily. A voluntary Code would clearly not be an effective way of dealing with matters which have been in place for many years - only changes to legislation and treaties can be expected to achieve that result.

ii. Consequences for failing to sign or breaching the Code.

- The Consultation Document is very careful in differentiating the Code from the Bank Code (see para. 3.7 et seq). Whilst both Codes are “voluntary” failure to adopt or comply with the Bank Code can result in the bank being named and shamed, but no such consequences are foreseen for a failure to adopt or comply with the Code. Non-adoption or breach of the Code would be used only in the context of the existing risk management approach. These statements must be read in the context of the rest of the document, however, and in the light of the development of the Bank Code.

- Too much attention can be given to the term “voluntary”. HMRC have defended the use of the term “voluntary” to describe the Bank Code despite the fact that the 15 largest banks operating in the UK were given a deadline by the Chancellor of the Exchequer within which to sign up to it and despite the introduction of legislation which allows HMRC, following a set of procedures, to name and shame banks which do not adopt or breach it. One can clearly take issue with the use of “voluntary” to describe such a measure, however the label used to describe either of the two Codes is ultimately less important than whether and what type of consequences flow from the non-adoption or breach of these Codes.
- HMRC explain that the non-adoption or breach of the Code would be “considered indicators of higher-risk behaviour.”¹⁶ HMRC explain that “unlike the Bank Code, HMRC does not intend to name (or otherwise publish information on) signatories to, or compliance with, the Code, or otherwise identify which businesses are or are not signatories.”¹⁷ However, when HMRC introduced the Bank Code it also did not intend naming and shaming non-signatories or banks which breached the code. The gradual strengthening of consequences for the non-adoption or breach of the Bank Code justify concerns that the same trajectory will be followed with the Code.
- The Code behaviours are those which HMRC already expects from its large business customers - “the Code simply provides a formal avenue for businesses to commit to meeting this standard”.¹⁸ In this case it is hard to see what is added by the Code. The introduction of the Code may be seen as a move towards formalising co-operative compliance, as is done in the Netherlands with individual compliance agreements with each company covered by the approach. But this is done within a context where all large companies have already undergone risk rating and many are already working with HMRC in an open and transparent way.
- It is possible that the consequences attaching to the failure to sign the Code might go beyond mere indications of higher-risk behaviour. As seen, the Consultation Document also proposes a legal requirement for large businesses to publish a legal strategy. Paragraph 2.31 explains that HMRC are considering requiring business “to state in their published tax strategy whether they are a signatory to this Code.” If this were to be required legislatively, it would be tantamount to a name and shame approach for companies who do not sign the Code.
- Failure to comply with the standards set out in the Code could have significant consequences, whether or not the company is a signatory to the Code.¹⁹ Under Proposal 3, a company which fails consistently to comply with these standards

¹⁶ Code para. 3.24.

¹⁷ Code para. 3.8.

¹⁸ Code para. 3.15.

¹⁹ Code para. 4.22.

will be at risk of entering into a Special Measures regime. Once in that regime, a further trigger will result in meaningful penalties being imposed on the company.

iii. The Rule of Law

- Imposing meaningful consequences on companies which do not commit to go beyond the requirements of the law is in tension with the rule of law. Even without naming and shaming, there could be meaningful consequences as a result of not signing the Code, especially if this fact is to be published as part of a compulsorily published tax strategy. This goes further than mere allocation of resources to higher risk taxpayers, which is within the powers of HMRC in administering the tax system.
- When the Bank Code was first proposed, the Financial Market Law Committee, chaired by Lord Hoffmann, issued a note which took the view that the Bank Code was in tension with the rule of law. At the time the proposed consequences for a failure to adopt or a breach of the Code included being considered high risk and reporting the failure to the board of directors or to an outside professional body. Naming and shaming banks/companies is clearly a stronger sanction so these arguments would apply to the current version of the Bank Code (and possibly the Code) with additional force:

“The principal objection to the Code is that it appears to blur the boundaries between notifying signatories in advance of the way in which HMRC’s administrative discretion will be used and setting new (and uncertain) rules for compliance with the general law on taxation.”

The note goes on to say that to the extent that any consequence *“is intended to be—or to be experienced as—a punitive one it can be objected that HMRC is going beyond the mere exercise of an administrative discretion. In this case the Code serves as more than simply notice of how that discretion is to be used...”*

The note is particularly scathing about the reference in the Bank Code to the ‘intention of Parliament’, saying

“ It does not appear to this Committee that there are any other circumstances in which it would be considered legitimate for an agency of the executive to require citizens to comply, not just with the law as it exists, but with the law as the executive would like it to be and to police this requirement with potentially stringent sanctions. While it is recognised that tax planning and tax avoidance are currently emotive political issues, it does not appear to the FMLC that these are sufficient grounds to justify such a significant departure from well- established “rule of law” values such as: a) the law must be clear and ascertainable so that citizens can govern their conduct according to its precepts; and b) citizens are entitled to expect that administrative decisions will be applied to them on the

same basis.”²⁰

This appears to have application to the proposed Code to the extent that failure to sign it, or to abide by it, might lead to something more than a greater focus on the affairs of the company, as would fall within the risk rating regime anyway.

PROPOSAL 3

A narrowly targeted ‘Special Measures’ regime to tackle the small number of large businesses that persistently undertake aggressive tax planning, or refuse to engage with HMRC in an open and collaborative manner.

- Although it has probably received the least attention in the debates around the consultation, Proposal 3 may be the most worrying of all in concept because it involves the most serious sanctions. The Consultation Document and surrounding discussion are at pains to emphasise that this proposal is intended to affect only a very small number of companies. This is reassuring to the majority of companies, which are broadly compliant in any event. But the provisions will be on the statute book and the underlying assumptions give rise to concerns. Provisions intended to apply narrowly can be found to affect taxpayers beyond their original intended scope and can also be used more extensively in the future, when their origins might have been forgotten.
- Under the existing model of the UK cooperative compliance programme companies are free to place themselves anywhere on the risk spectrum and to have HMRC respond accordingly. However, HMRC encourage companies to move towards the lower end of the spectrum, partly by offering a number of benefits for being low risk. Proposal 3 appears to depart from the current cooperative compliance model which is based on encouragement and incentives. Under this proposal, companies which repeatedly engage in behaviour which places them in the high-risk category are placed in a Special Measures regime and if their behaviour sets off another trigger, they will be subject to sanctions. The carrot of benefits following from a low risk rating is being replaced by the special measures stick.
- This suggests, as predicted by these authors in previous work,²¹ that the benefits of being low risk would not suffice to make some of the most recalcitrant companies change their tax planning behaviour. It can be questioned, however, whether the basis of the co-operative compliance relationship should be put in jeopardy to deal with the currently targeted very small number of companies.
- The argument made above that the Code appears to be in tension with the rule of law can be made even more strongly for Proposal 3, given that under this

²⁰ Financial Markets Law Committee, Response to the June 2009 HMRC Consultation Document on a Code of Practice for Banks. October 2009.

²¹ Freedman, Loomer and Vella, *supra*, pp. 88-89.

proposal persistent failure to follow HMRC's understanding of the intention of Parliament could be a step towards the Special Measures regime, with penalties resulting.

- The proposed Special Measures regime has two strands to deal with
 - Lack of transparency and cooperation with HMRC (Strand A) and
 - Persistent and aggressive tax planning.²² (Strand B)
- Legislation will be used to define whether companies should be put into an 'Initial Notice Period'. This will happen if they are judged to present a 'significant risk to the Exchequer'.
- The suggested criteria for judging this include:

"That it is reasonable for HMRC to take the view that the business presents a significant risk due to:

- *the significant number of occasions on which a business has entered into tax avoidance schemes within a specified period **(whether or not they have been successful in avoiding tax)** and/or;*
 - *the nature of those schemes (for example, the extent to which they represent contrived or abnormal arrangements); ..."*
(authors' bold)
- Other criteria are also considered, but as this proposal is set out in the Consultation Document, it is the case that a company could find itself on notice for entering into a number of tax arrangements that have been upheld as effective by the courts. It should be noted that the fact that schemes are contrived or abnormal might be a factor in the courts deciding that they are ineffective, but if the courts have found the schemes to be successful notwithstanding these factors, the taxpayer should not be penalised, although it would be reasonable to change the law to meet the expectations of HMRC in the future.
 - It is true that such behaviour only puts the company in question on notice. It then has 12 months to improve its behaviour. If it has not improved by then, it will enter the special measures regime, after which it will be at risk of triggering sanctions.²³ It is not clear whether there is to be any appeal against this step being taken.

²² Consultation Document, para.4.7.

²³ Ibid, para 4.28.

- Being placed in the Special Measures regime – for a minimum of two years²⁴ – is a meaningful consequence. Once in the regime, the company will face sanctions if it sets off a trigger. The proposed triggers are somewhat unclear, but the document seems to suggest that no sanctions could follow without a judicial decision, although only where “this is part of the existing process”. That suggests that some sanctions might follow without a judicial decision, especially under Strand A.
- Leaving that question to one side, sanctions might follow on from the issuing of a Tribunal information notice leading to sanctions within Strand A or a Tribunal or court decision that a scheme had been defeated, leading to sanctions within Strand B.²⁵ The document does not make clear whether the taxpayer has to be party to the court decision in question or whether it could be argued that a similar scheme had been defeated, although we understand that the intention is that the taxpayer should itself be a party to such litigation for it to act as a trigger.
- The potential sanctions are serious. They include increased reporting and disclosure requirements and public naming by HMRC under Strand A. The potential penalties under Strand B are even greater and include one very worrying feature: not only would there be public naming but also

“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”²⁶

- The removal of a reasonable care defence shows a mistrust in the courts, which can hear all the evidence and decide whether there was reasonable care taken or not. In such cases it may seem unlikely that there was reasonable care, but this should be left to the courts to decide. The problem may be around legal professional privilege. Taxpayers can rely on legal opinions which they are not obliged to disclose. If that is the problem at the root of this then it should be tackled at source, rather than removing the entire defence from a class of taxpayers.
- Under these proposals, a company which is not in the Special Regime that enters into a transaction which is defeated will not face these sanctions in the same way. It can be seen, therefore, that non-compliance with HMRC’s interpretation of the law (and the resulting entry into the Special Regime) could have very meaningful consequences under Proposal 3.
- It would be possible for a company that falls out with HMRC over a number of schemes, and then loses in the courts on one scheme only, to lose its defence of reasonable care and to be named and shamed. We do not expect this to be a real

²⁴ Ibid, para. 4.36.

²⁵ Ibid para. 4.35.

²⁶ Ibid para 4.32.

danger at present for many companies, but we do believe that the notion that special treatment can be aimed at those entering into schemes that HMRC dislikes, but that are upheld by the courts, is in tension with the rule of law. We also consider that a defence of reasonable care, inserted into the penalty regime by Parliament for good reason, should apply equally to all taxpayers. If it is not considered robust enough for the courts to operate appropriately, then there should be changes to the penalty regime as a whole rather than removing what on the face of it seems to be a sensible defence from a particular group of taxpayers only.

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