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HMRC, business and the tax profession -- an uneasy relationship

HMRC's Relationship With Business And The Tax Profession

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Donald Drysdale canvasses opinion among senior tax professionals and finds that widespread concerns remain

Few would dispute the fact that the UK tax regime is unacceptably complicated. The Government is ultimately responsible for this, and for giving HM Revenue & Customs the virtually impossible tasks of collection and management.

Conversations with leading tax figures identify widespread concerns about the current state of the relationship between HMRC and other tax professionals. Much of the blame is rightly attributed to the Government as distinct from its hard pressed public servants in HMRC, many of whom work in an exemplary professional manner.

There is a general perception that the working relationship between HMRC and the tax profession at large has been at a low ebb. Many involved in front line tax work speak of a serious deterioration in their relationship with HMRC, and some identify the 2005 merger of the Inland Revenue and HM Customs & Excise as a particularly low point.

Speaking of her general concerns about this relationship, Heather Self, tax partner at Grant Thornton, spoke of the 'inevitable "navel gazing" following any large merger'. She added that HMRC spent a lot of time focusing on internal structures and reporting lines, and 'somewhat neglected the needs of taxpayers'.

A respectable activity

Many reasons can be quoted for stresses and strains in what is, after all, a naturally adversarial relationship. The tax authority's aggressive attitude to perceived avoidance is attributed to the apparent dominance of the culture inherited from Customs, and the occupation by Customs staff of many key posts within the newly merged body. However, both sides to the merger have played their part, and the blitz on tax avoidance spearheaded by the Revenue's Dave Hartnett and Customs' Chris Tailby is cited by many as a major contributing factor. Government claims of an immorality in tax planning have been misguided and corrosive. It is the duty of government to legislate clearly against behaviour that it considers wrong. It is HMRC's task to ensure that taxpayers pay the right amount of tax, and the duty of tax compliance staff and advisers to ensure that those they represent do not overpay. Many tax professionals performing such work are bound by strict rules and ethics of professional bodies to which they belong.

Minimising tax by legal means is a respectable activity, in many cases endorsed or even actively encouraged by government. Official messages can therefore be confusing. Many recall the enthusiasm with which small businesses were urged by a prominent government minister in 2002 to incorporate to enjoy the £10,000 nil rate corporation tax band, only to discover in 2004 that they were regarded as having participated in unacceptable tax avoidance.

The relatively new regime for early disclosure of tax avoidance schemes has changed the rules of engagement, and organisations involved in sophisticated tax planning have had to alter their *modus operandi* to comply. In spite of this reporting requirement, tax planning remains a legitimate activity. At times HMRC has sought, somewhat disingenuously, to blur the line between tax avoidance and evasion, and this has served no useful purpose.

The Government has a duty to stamp out tax evasion. The 'black economy' is widespread; cheating on tax, which Britons used to consider a southern European trait, is becoming more socially acceptable here and too little is being done to reverse this trend. A worrying feature of evasion has been the huge growth of attempted Missing Trader Intra-Community (MTIC) fraud, involving the criminal misappropriation of vast amounts of VAT; for too long the task of countering MTIC fraud appears to have been defeating the ingenuity of HMRC. This is a failure for which UK taxpayers collectively have been paying a heavy price.

An obscure tax system is unfair to law-abiding citizens and businesses. This government has heaped extra complexity on taxpayers and agents to discourage tax planning, and introduced significant elements of uncertainty for the same reason. Although many of the more complicated provisions in tax legislation have been introduced by the Government to combat tax planning, they can have the effect of opening up new tax avoidance opportunities or even breeding evasion and are often counter-productive.

Describing the general deterioration in working relationships between HMRC and tax professionals, Ian Brimicombe, Director of Group Tax at Astra Zeneca, referred to 'a distinct slump, with focus on anti-avoidance and the related disclosure regime, and increased tension with more threats of litigation'.

Inevitably, the HMRC merger forced cultural changes on staff formerly employed by the predecessor bodies, and this may have had a detrimental effect on the attitudes of individuals. For example, there are concerns about HMRC's internal performance measures. The former Inland Revenue ethos was to collect the right amount of tax, and tax officials were credited with making appropriate adjustments in either direction in the course of enquiries. Now there seems much greater pressure to maximise tax revenues and penalties.

A widening gulf

Against this background there are some welcome signs of improvement in the relationship between HMRC and large business. These emanate primarily from the review of HMRC's links with large business, led by Sir David Varney, who held the chairmanship of HMRC for only a short period but introduced a refreshing perspective from his experience in the private sector. In Ian Brimicombe's words, 'a more sensible approach seems to be emerging'. There is little evidence yet of any such improvement in the relationship between HMRC and the tax agent community. This has led to the perception of a widening gulf between large corporates, who are seen to get special attention from HMRC and (in some respects) favoured treatment, and the rest of the business world and the taxpaying public.

Across the board there are fears that the ongoing review of HMRC's powers will not take into account how difficult it is for taxpayers to comply, and will penalise those who make innocent errors.

Commenting on behalf of the Institute of Chartered Accountants of Scotland in response to stringent new penalties proposed by HMRC, Robin Hume of Deloitte said: 'We support higher penalties when taxpayers deliberately understate their liability. Our concern is with the difficult grey area when it is unclear whether a mistake arose from confusion over dealing with an excessively complex system or failing to take "reasonable care".'

In the words of Paul Aplin, partner at AC Mole & Sons and newly-elected chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales, 'the relationship between the UK tax authorities and practitioners has become steadily more impersonal over the last decade'.

He went on to lament the lack of trust between HMRC and tax agents: 'How do you reintroduce the personal element that is essential to narrowing the trust gap when you have been told to shed thousands of jobs? One way might be to reappraise the criteria for deciding which jobs should go, as many of those who are leaving HMRC seem to be the very ones who have the knowledge, expertise and credibility on which practitioners could rely.'

Professional bodies representing tax agents welcomed Paul Gray's recent appointment as HMRC chairman. Indications are that he is committed to improving HMRC's relationship with tax professionals. Consultations have been taking place on a wide range of matters that concern the work of tax agents and advisers, and there is hope that some beneficial changes will emerge. Nonetheless there are fears that further deterioration is inevitable as a result of large scale shedding of jobs at HMRC and the progressive de-skilling of many that remain.

In-house corporate tax departments

The 15,000 largest businesses pay or collect more than half of the total UK tax revenues, so it is understandable that HMRC should pay particular attention to its working relationship with those organisations. Some very large businesses employ their own in-house tax professionals, often supplemented by tax advisory support from 'Big Four' or other large accountancy firms.

Careful handling of these large taxpayers helps maintain the competitiveness of the UK as a place to do business. Such businesses have faced particular uncertainties, and opportunities, as a result of globalisation and, more particularly, from specific challenges to UK tax legislation under EU treaties. Some complex anti-avoidance measures, by their nature, impact only on large or multinational organisations.

Judgements at the European Court of Justice have required the UK and other member states to ensure their tax laws comply with EU treaties. However, even when over-ruled at the ECJ, the UK Government has been loath to modify its tax laws sufficiently to comply, leading inevitably to further challenges. This leads to uncertainty and distrust, and damages the UK's competitive position.

Battles between HMRC and large corporations can last for years. Until recently HMRC had appeared particularly litigious on contentious issues and reluctant to 'do deals'. However, a recent announcement by BT that they had settled a large number of open years, resulting in a repayment of around £1bn, sent out a strong signal of changing attitudes in HMRC.

As Heather Self commented, 'it is surely in the interests of HMRC, as well as taxpayers, to be pragmatic and to seek to resolve disputes rather than litigate whenever possible'.

What might at first seem a brave new world of agreement and compromise may be misleading. HMRC may simply be trying to clear the decks of existing disputes before starting to flex its muscles with a fresh zeal. With wider powers for HMRC, and in some cases less robust safeguards for taxpayers, the new regime may prove harsh in reality.

The Varney Review of Links with Large Business, published last November at www.hmrc.gov.uk/large-business/review-report.pdf, offers an olive branch to large businesses. It seeks to develop a spirit of trust, promising a new system of advance rulings and an extension of existing clearances to give earlier certainty about the tax treatment of transactions, implementation of a new audit approach to enquiries based on improved risk assessment, a greater focus on speedy resolution of transfer pricing enquiries and contentious issues, and improved clarity through consultation.

HMRC published at the time of the March 2007 Budget a paper setting out its approach to compliance risk management for large business. This is a key part of HMRC's new strategy and draws on the former Customs' 'intelligence-led, risk-based approach to tackling non-compliance, based on improved analysis of the patterns of non-compliance, and targeting of resources on high-risk sectors of the economy' (set out in the 2002 Pre-Budget Report).

The new paper explains the role of HMRC's new customer relationship management (CRM) philosophy for liaising with each of the largest businesses, and signals that appropriate CRM proposals will be developed for all other large businesses. It also defines the key tax risks that concern the tax authority, and explains the process by which businesses will be assessed as high or low risk.

In-house tax departments are coming under a new degree of scrutiny. HMRC is interested in whether a business has strong governance, with a clear tax strategy and principles set by its board, and whether it has a clear understanding of its tax obligations and responsibilities. HMRC wants to know that the business has robust systems and processes that:

- rely on accredited software;
- deal correctly with the transactions and issues whose tax treatment is clear; and

- identify those whose tax treatment is complex or uncertain or requires use of judgment.

This brings new challenges to finance directors and tax directors needing to convince their boards that their tax computational and tax reporting systems are fit for purpose. They are reviewing their working methods, and may need to turn to specialist software solutions that bridge the gap between accounting systems and tax computations -- creating a structure and audit trail for tax adjustments outside the accounts which have traditionally been the preserve of *ad hoc* spreadsheets. For many companies this is not unlike the new burdens already imposed by compliance with stringent tax reporting requirements such as those of FIN 48 (Accounting for Uncertainty in Income Taxes) under US GAAP.

Although large businesses are being treated with respect by HMRC, and those assessed as low risk are promised that enquiries and challenges to returns and declarations will be the exception rather than the norm, the prying eyes of the tax authority will not be far away. And there will be worse to come.

HMRC is participating in OECD talks with other tax authorities worldwide on the development of direct online access to business records for fiscal audit purposes -- already the norm in some overseas jurisdictions. HMRC seems coy about mentioning this in public.

Also, the EU is moving closer to introducing a common consolidated corporate tax base, in spite of opposition from the UK. While this may promise long term administrative improvements for companies operating in multiple member states, it is likely to place extra demands on corporate tax departments.

Tax practitioners

Tax agents, ranging from international firms to sole practitioners, represent a significant number of large companies, the majority of small and medium sized enterprises and a large proportion of personal taxpayers. Without their painstaking efforts the UK tax system would collapse. However, the way in which HMRC interfaces with them has been a source of grave concern to such agents.

For several years, tax agents in general have been at the receiving end of unfair criticism in the Government's search for scapegoats on whom to blame the success of the tax avoidance industry. However, the Government itself has fanned the flames by creating the demand for this industry. Legitimate tax planning activity is endemic in the developed world, thriving on high tax rates and complex fiscal rules involving a plethora of allowances and reliefs.

In a new and apparently enlightened approach, HMRC acknowledges the importance of tax agents in its paper 'Delivering a new relationship with business' published in November 2006 (and updated last month). This said:

'Many businesses choose to deal with HMRC through an agent or tax adviser. Agents are therefore key to the smooth and effective operation of the tax system, with an important role in helping their clients get their tax affairs right. HMRC needs to build and maintain a positive relationship with the agent community, based on professionalism, trust and the delivery of services that are designed for ease of use by agents as well as business. Getting things right with and for agents will reduce the impact of administrative burdens on business. And, of course, agents and tax advisers are businesses in their own right.'

A recent innovative step by HMRC to improve relations is the publication on its website of a four-minute 'Fresh Start' podcast in which Dave Hartnett explains how important tax agents are to HMRC, and suggests that HMRC interventions on tax returns could be cut from around a year to a matter of days or weeks. These are good sentiments, but delivering a better relationship needs more than words.

Many agents used to have excellent face-to-face working relationships with local inspectors of taxes, who were trained professionals with a good understanding of tax law. However, the majority of agents' dealings are now by telephone with impersonal 'contact centres' where they must deal with junior HMRC staff who have limited technical training. Speaking of HMRC's relationship with agents, John Cullinane, tax partner at Deloitte and president of the Chartered Institute of Taxation, said: 'The biggest cause of the deterioration is the move away from the Inland Revenue's local organisational structures, so that on day-to-day matters tax advisers are less aware of whom they can contact within HMRC.'

Local problems may get worse. HMRC's new Change Programme is examining its future shape and direction across the UK in the hope of consolidating office usage and co-locating Revenue and Customs staff. While aiming to deliver a more effective service to businesses and individuals, there are clear signs that it may have the opposite effect by degrading the quality of service available, especially to taxpayers and agents in remote locations.

HMRC claims to value the professionalism of tax agents. However, by reducing its own staff numbers and de-skilling many posts it is failing to match that professionalism. It holds itself out as an organisation that takes customer care seriously, but fails to employ sufficient staff with adequate training to provide such care.

Changes in working methods are inevitable, and most tax agents have been enthusiastic in their adoption of new technology. Their poor initial experience of HMRC's systems for online filing of tax returns resulted in concerted lobbying from the professional bodies (both individually, and collectively through the Working Together initiative) and substantial improvements are being achieved. Nonetheless, HMRC's inadequate IT systems and insufficient staff resources have led to repeated processing errors, many of them on a large scale, and it is usually agents who are left with the effort and cost of clearing up after these -- a task which becomes especially difficult when the right contacts and skills are inaccessible at HMRC.

As Paul Aplin said: 'Fundamentally, technology can de-skill the compliance process, but the technical tax side needs well trained, experienced people, not impersonal help-lines.'

Under pressure to reduce staff numbers still further, HMRC is expected to extend its new risk-based methodology to all its dealings with agents. Taxpayers' returns are already subject to computerised risk assessment processes, exact details of which are a closely guarded secret. Conscientious agents help to keep the system afloat by reviewing their clients' accounts and tax returns for reasonableness, thus ensuring that any obvious errors are spotted and corrected before submission. Increasingly we can expect HMRC to collate risk assessment data by agent to identify those whose work warrants closer attention.

Conclusions

The changes HMRC is making for large business seem to be in the right direction. If a risk-based approach and improved customer relations could be applied evenly across the board to all taxpayers, we would have a better world. Unfortunately HMRC staff cuts seem likely to prevent this from happening. That is not to say that tax professionals would wish to see more staff at HMRC. It would be infinitely preferable to have a simpler tax system.

Paradoxically, a new alignment of income tax and national insurance contributions in Gordon Brown's controversial take-away cash-back Budget this year suggests that the Government might countenance some steps towards tax simplification. However, if it takes ten years in the job to develop the courage to make a start, it remains to be seen whether any chancellor has the political guts to follow this through.