Finance Bill
2016

# Large business tax compliance

## New measures applicable from April or July 2016

## A package of measures to drive behavioural change

Details of HMRC's new large business tax compliance package were published on 9 December 2015, in the form of a summary of responses to the consultation which ran from July to October and draft Finance Bill 2016 legislation.

The measures, now confirmed, cover three separate but inter-dependent strands:

- A requirement for large businesses to publish their tax strategy as it relates to UK taxation
- A framework for co-operative compliance (in place of the voluntary Code of Practice previously proposed)
- A series of 'special measures' designed to discourage persistently high risk behaviour

HMRC has explained that the measures are driven by the need to address businesses that represent a significant risk to the Exchequer, but much of what is being introduced will be relevant to all businesses. HMRC's thinking is that the existing large business strategy has worked well for the majority of businesses, but that this needs to be reinforced to deal with those businesses who; have yet to adopt the best practice in tax compliance exhibited by the majority, who persist with aggressive tax planning, and/or who resist full and open engagement with HMRC.

In publishing the outcome of the consultation, HMRC has taken on board a number of the key representations made concerning the one-sidedness of its proposed Code of Practice, with changes to the proposed tax strategy requirements which remove some of the unnecessary compliance burdens of what was previously proposed. The new draft Framework for Co-operative Compliance highlights a set of principles that both large businesses and HMRC should adopt. It commits HMRC to working collaboratively, openly and with resource prioritised to the business uncertainty, commercial urgency or risk involved, in return for business similarly adopting a collaborative, open and low risk approach. HMRC has also dropped requirements for business to publish their ETR and measures being taken to achieve that, and for a single executive to be responsible for a business's published tax strategy.

The requirement to publish a tax strategy will however add a new layer of compliance obligations to all large businesses, including the vast majority that meet their responsibilities in respect of taxation, and it remains to be seen how meaningful such a strategy will be in terms of helping HMRC to encourage tax compliance and effectively identify and tackle tax compliance risk.

## Scope of measures

HMRC has confirmed that businesses in scope for these measures are broadly those businesses administered by HMRC's Large Business Directorate. Specifically, the measures will apply to all businesses that have a UK turnover of more than £200mn and/or a relevant balance sheet total of more than £2bn for the preceding financial year. This is the same threshold set for the Senior Accounting Officer (SAO) requirement. In addition, businesses within the scope of Country by Country Reporting (global turnover of more than €750mn) are also included.

## Requirement for large businesses to publish their tax strategy

The draft Finance Bill 2016 legislation sets out a mandatory requirement that large businesses publish (and report to HMRC that they have published) their tax strategy as it relates to or affects UK taxation. For multinationals (including foreign-owned) groups, there is no requirement for a separate UK tax strategy to be produced and published, provided that what is published applies to UK tax matters. The legislation applies from Royal Assent (expected July 2016) for financial years of the head of the relevant group or sub-group beginning after that date.

The strategy must be published on the internet, on an annual basis, for the period covered by the business's annual report or accounts and before the end of each current financial year. There is no requirement that the strategy be published with or as part of the group's financial statements.

The strategy must be owned by the executive board. The rationale behind this comes from research commissioned by HMRC, which states that increased scrutiny of an organisation's approach to tax matters by the board discourages aggressive behaviours. However this is a change from the consultation proposal which would have required ownership by a single executive board member.

The legislation stipulates that the published tax strategy must cover:

- Approach of the UK group to risk management and governance arrangements in relation to UK taxation
- Attitude of the group to tax planning (so far as affecting UK taxation)
- Level of risk in relation to UK taxation that the group is prepared to accept
- Approach toward dealings with HMRC

It may also cover other information relating to taxation.

In response to representations made in the consultation, HMRC has dropped its requirement that the strategy must cover any Effective Tax Rate target and measures taken to deliver that. This proposal raised questions around workability, as well as commercial and pricing sensitivity and potentially adverse behavioural effects from the incentive for businesses to meet a target once published.

HMRC will not require publication of evidence that the strategy is being applied, but will consider whether the tax returns and claims received from a business over the period covered by the strategy are in line with it. If the returns appear materially inconsistent with the published tax strategy, HMRC plans to take account of this as part of its regular risk reviews.

There will be a penalty for non-publication, aligned with penalties for non-filing at Companies House, i.e. £7,500, and this will apply to the company at the head of the UK group (i.e. not a personal penalty as for SAO).

**Our view**

The requirement to publish a tax strategy is a significant shift in HMRC mandating further transparency, and on a unilateral basis which differs from the requirements multinationals will face in other countries. Even with the changes to what was proposed in July, this will add a new layer of compliance burdens to all large business, with questionable value to HMRC in tax compliance terms.

## Framework for co-operative compliance

In its consultation document, HMRC included a draft voluntary Code of Practice on Taxation, representing HMRC's views of the best practice behaviours that large businesses should adopt.

Responses to the consultation highlighted the lack of any reciprocal benefit for business in signing up to such a Code, and the missed opportunity for HMRC to further entrench the benefits of collaborative working practices among its own staff as well as across the business population. In the light of these representations, HMRC has replaced the proposed Code with a draft Framework for Co-operative Compliance, which it is proposed will be introduced in April 2016.

This draft Framework highlights a set of principles that both large businesses and HMRC should engage and work within, recognising the value of mutuality between both parties.

Specifically, the Framework encourages both parties to:

- adopt an open and collaborative professional relationship;
- engage in open and early dialogue to discuss tax planning, strategy, risks and significant transactions;
- respond to queries, information and clearance requests in a timely fashion;
- seek to resolve issues in real time and before returns are filed if possible;
- where disagreements arise, work together to resolve issues by agreement (where possible).

Businesses are in addition encouraged to:

- be open and transparent about decision making, governance and tax planning in their business;
- reasonably believe that transactions are structured to give a tax result which is not contrary to the intentions of Parliament;
- interpret the relevant laws in a reasonable way, and ensure transactions are structured consistently with a co-operative relationship;
- where a reasonable solution cannot be reached, escalate issues through to the HMRC Deputy Director.

HMRC commits to:

- apply an "Openness and Early Dialogue" approach which sets out the specific tax risk identified and avoids opening unnecessarily wide-ranging enquiries;
- prioritise resource in areas of genuine uncertainty, commercial urgency and/or absolute risk.
- use the Framework as part of its existing risk management approach.

HMRC proposes to consult further on the content of its draft Framework in the next few months.

**Our view**

The draft Framework codifies many of the factors which HMRC already takes into account in assessing whether or not a business is low risk, while helpfully setting out more clearly than it has before what business can expect in return. HMRC commitments to respond to queries etc in a timely fashion, to prioritise work where there is real uncertainty, commercial urgency or absolute risk, and to avoid unnecessarily wide-ranging enquiries are very welcome. A written commitment to an escalation mechanism within HMRC where issues cannot readily be resolved is also valued. As the Framework is finalised, it would be useful to see an endorsement of the detailed blueprint for collaborative working in HMRC's Litigation and Settlement Strategy, as well as a commitment for HMRC as well as business to interpret relevant tax laws in a reasonable way.

## Special measures

The draft Finance Bill 2016 legislation provides for a special measures regime for a small number of businesses that persistently engage in 'aggressive' tax planning or refuse to engage with HMRC in an open and collaborative manner. The draft Finance Bill legislation sets out a number of factors as indicating such behaviour – including the use by HMRC of formal information powers, number and seriousness of inaccuracies within returns, and reliance on 'speculative' interpretations of legislation. HMRC has indicated that clear and objective *de minimis* thresholds will be set as part of finalising the operational design of the special measures regime.

Businesses which HMRC regards as meeting the conditions will first be put in an initial notice period for 12 months and given the opportunity to change their behaviour. After 12 months, HMRC will carry out a review which may lead to the business entering special measures and facing potential sanctions.

The sanctions HMRC may apply to businesses entering special measures are:

- Removing access to non-statutory clearances.
- Removing the ability of the business to rely on the defence of 'reasonable care' within Schedule 24 of Finance Act 2007, and therefore, charging any penalties on the basis that the behaviour was at least careless, if not deliberate.
- If the special measures status is confirmed after a further 24 month period, naming the business publicly as being subject to special measures.

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

**Our view**

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

The legislation would allow HMRC to bring a business into the special measures regime as a result of an assessment of its tax compliance risk (without necessarily any finding that its returns have been incorrect as a result). Given the significant consequences, it is important that as the detailed operational design of the regime is worked up there are appropriate governance arrangements and safeguards.

## Further information

For further information, please contact one of the following or your usual EY contact:


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