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INSIGHT: Changing U.K. Tax Environment—Impact on Corporates' Approach to Tax Risk

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Kate Ison and Jessica Hocking, of Bryan Cave Leighton Paisner LLP, surveyed senior tax professionals at 27 large corporate organizations to gain insight into how the changing landscape of U.K. tax is impacting businesses' approach to tax risk. They discuss their findings below and set out practical steps to mitigate against the more interventionist approach of the U.K. tax authority.

The U.K. tax landscape has changed significantly in the last few years. Since 2010–11, the U.K. government has introduced over 100 measures to regulate and tackle tax non-compliance and has set the U.K. tax authority, HM Revenue & Customs (HMRC), a target of raising an additional 5 billion pounds ($6.3 billion) per year by the end of 2020 by tackling all forms of tax non-compliance.

In parallel with the increased efforts of HMRC to tackle tax non-compliance, the last few years have seen increasing attention being given by the media, politicians and tax activists to tax avoidance, tax evasion and, more generally, the tax affairs of businesses and wealthy individuals in the U.K.

The common mantra is that everybody should pay their "fair share" of taxes in the U.K. and tax has become a regular headline feature in the media. In March 2019, MPs wrote to Theresa May MP urging more efforts to prosecute large corporations for economic crimes, including tax evasion. HMRC has appeared to welcome the increasing attention on tax because it hopes to change tax behavior.

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The changing climate clearly presents a number of challenges for taxpayers. Against this backdrop, the Tax Advice and Controversy team at Bryan Cave Leighton Paisner LLP conducted a survey of senior tax professionals in a wide range of industries, including real estate, financial services and utilities, about the impact of HMRC's continued focus on tax non-compliance on their businesses.

The feedback from respondents is summarized below and provides a valuable insight into the issues that U.K. corporates currently face in relation to tax risk, and how the tax landscape is impacting on corporates' approach to tax risk and disputes with HMRC in practice.

Changes to Tax Regulation

Corporates must navigate an ever-increasing volume of regulations introduced by tax authorities across the globe. Many new measures have been introduced in the U.K. to tackle tax avoidance, tax evasion and other forms of non-compliance, some of which are summarized in a Briefing Paper, Tax Avoidance and Tax Evasion, published by the House of Commons Library in May 2019.

This is compounded by the fact that governance and tax behavior of multinationals and large corporates has become subject to acute scrutiny by HMRC, the media and politicians alike. Morality has crept into the debate and, arguably, tax is no longer just a question of law.

In this context, it is unsurprising that 67% of respondents say that the increase in tax regulation has had a significant impact on their businesses.

The practical consequences of HMRC's more interventionist approach are that corporate taxpayers are allocating more resource and incurring more expenditure to deal with tax risk and disputes, including through seeking professional advice.

Furthermore, the increasing burden of tax regulation means that many corporates now have a lower appetite for risk. 57% of respondents say that the most important factor driving the change in their approach was the risk of increased scrutiny from HMRC, with 38% attributing their change in appetite to concerns over reputational risk.

Given the popular support for governments taking a robust approach towards tax non-compliance, and the increasing collaboration and information sharing between international tax authorities, there is little sign of the heavy burden of tax regulation on corporates relenting.

Relationships with Customer Compliance Managers

In the U.K., HMRC has adopted a particular approach towards its dealing with large businesses, aimed at promoting tax compliance by this category of taxpayer. One aspect of HMRC's policy is to assign a senior tax expert, known as a Customer Compliance Manager (CCM), to each of the 2,000 largest businesses in the U.K., to work closely with the business to make sure it pays the correct amount of tax.

Where applicable, we asked respondents to evaluate their relationships with their CCMs at HMRC. While the relationship between large corporates and their CCMs is generally positive, as CCMs can facilitate an open chain of communication, a common theme raised by respondents is that CCMs have their limitations as they do not have the authority to make decisions.

As the weight of the tax regulatory and compliance burden for taxpayers continues, effective relationships with CCMs will become all the more important.

HMRC's Interventionist Approach

Tax disputes have increased in frequency and complexity in the last few years. Through increased cooperation and information exchange between international tax authorities, HMRC has access to more data from U.K. and non-U.K. sources than at any time prior.

For example, in its Policy Paper, No Safe Havens 2019, published in March 2019, HMRC stated that it received information about around 3 million U.K. taxpayers who have offshore financial interests from overseas tax authorities during 2018. This extra data, combined with the increased powers available to HMRC, mean it is inevitable that taxpayers from across the spectrum will see more inquiries from HMRC.

In fact, in HMRC's Policy Paper, Tackling Tax Avoidance and Other Forms of Non-compliance, also published in March 2019, HMRC states that, at any one time, it has around half of the U.K.'s largest businesses under investigation and, in 2017–18, such investigations into large businesses secured over 9 billion pounds in additional tax revenue. Against this backdrop, it is unsurprising that 50% of respondents say that the number of inquiries and/or information requests issued by HMRC has increased over the past few years.

The U.K. government has a number of key focus areas. It has shown that it is keen to make use of the new corporate criminal offense of failure to prevent the facilitation of tax evasion, and recently announced that it has five active investigations ongoing under the Criminal Finances Act 2017. This number is expected to rise as HMRC invests more resources into investigations in this area.

Diverted profits tax and transfer pricing also remain hot topics, and this is likely to continue following the introduction of the new Profit Diversion Compliance Facility. In addition, as April 2020 approaches, the proposed changes to IR35 are proving to be a cause for considerable concern for many in the private sector, particularly in recruitment, financial services and IT.

It is clear that taxpayers across a range of sectors and of all profiles are seeing more interventions from HMRC. However, as highlighted by the House of Lords Economic Affairs Committee in its Report, The Powers of HMRC: Treating Taxpayers Fairly, published in December 2018, there are concerns about the extent to which sufficient safeguards are in place to protect taxpayers from HMRC's more interventionist approach, and the extent to which HMRC is conducting its investigations thoroughly, fairly and in accordance with due process.

Delays

Delays on the part of HMRC are a major problem facing taxpayers; 67% of respondents say that they are experiencing delays in resolving disputes with HMRC. This is despite HMRC's Litigation and Settlement Strategy encouraging HMRC to engage in early discussions with taxpayers.

Delays were identified as a major problem in the House of Lords Economic Affairs Committee Report in December 2018, and formed one of the bases on which the Committee concluded that the balance of power had tipped too far in favor of HMRC. The Report concluded that HMRC's declining resources have rendered it unable to effectively perform its dual roles of tackling avoidance and evasion, and ensuring taxpayers are treated fairly.

Despite the U.K. government's support for more intervention by HMRC to increase tax revenues and reduce the U.K. tax gap (as detailed in the House of Commons Library Briefing Paper published in May 2019), and its commitment to substantial investment to enable HMRC to tackle non-compliance, there are serious questions about whether HMRC is sufficiently resourced to adequately undertake its combined role as tax collection authority, regulator and litigator.

The House of Lords Economic Affairs Committee urged reform but, given the government's silence on the issue, there are questions regarding the extent to which it will effect any change. Further, while recent cases indicate that the Tribunals are taking account of HMRC's delays in conducting investigations in specific circumstances (for example, in cases concerning ''discovery'' and ''staleness'', such as Hargreaves v. HMRC [2019] UKFTT 0244) the harsh reality is that, at present, HMRC appears to be largely unaccountable for these delays and U.K. taxpayers can be exposed to years of uncertainty despite their best efforts to resolve inquiries.

Resolution of Disputes

Given concerns over reputational risk, and the inherent uncertainty involved in litigating, 57% of respondents say that they will always seek resolution by agreement with HMRC: 33% of respondents say that they would only litigate in exceptional circumstances.

This is unsurprising. Achieving settlements with HMRC (on favorable terms to the taxpayer) is likely to remain difficult given the government's target for collecting 2 billion pounds by 2023–24 through its most recent package of measures designed to counter tax non-compliance. In HMRC's Policy Paper, Tackling Tax Avoidance and Other Forms of Non-compliance, HMRC states that it has won 9 out of 10 cases taken to court in respect of tax avoidance and, where HMRC's tax evasion investigations result in prosecution, more than 9 out of 10 end in conviction. While these statistics relate only to tax avoidance or evasion cases (and HMRC's ''success'' rates for cases which do not involve tax avoidance or evasion are lower), it is certainly a challenging environment in which to litigate against HMRC.

Respondents named a number of specific challenges in reaching a resolution with HMRC, including that HMRC becomes entrenched in its technical position, HMRC does not fully understand the factual and/or commercial background, and HMRC is not willing to engage in settlement negotiations.

Conclusion

We are left with, on the one hand, HMRC listing the ''success'' of its measures in its recent Policy Paper and, on the other hand, the House of Lords Economic Affairs Committee highlighting real concerns about HMRC's imbalance of power and inadequate safeguards protecting taxpayers. As indicated above, lack of progress indicates that there is little political appetite to reform the shortcomings of HMRC and so taxpayers will have to continue to adapt to an environment which is not necessarily conducive to fair and reasonable settlement.

Planning Points

- Corporates are likely to continue to allocate more resource and incur more expenditure to deal with tax risk and disputes, including through seeking professional advice. This is advised given the extent and speed of changes to U.K. tax regulation.

- Corporates should be aware that international tax authorities are exchanging information about taxpayers more than ever. HMRC prides itself on being a world leader in collaboration with other tax authorities. Particular care should be taken to analyze the scope of information requests which have a cross-border element; any information disclosed to HMRC could end up in the hands of another tax authority.

- Taxpayers should expect their tax affairs to be subject to greater scrutiny as HMRC continues to work towards collecting an additional 2 billion pounds in tax revenue by 2023–24. As above, at any one time, HMRC has around half of the U.K.'s largest businesses under investigation.

- Taxpayers involved in disputes with HMRC should place great emphasis on establishing and agreeing the facts with HMRC at the outset in order to minimize delays due to misunderstandings on the part of HMRC later down the line. Similarly, taxpayers should seek to agree the parameters and timeline for any investigation at an early stage in the proceedings.

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