Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study

Judith Freedman, Oxford University Law Faculty and Oxford University Centre for Business Taxation; Geoffrey Loomer, Dalhousie University Law School and Oxford University Centre for Business Taxation; and John Vella, Oxford University Centre for Business Taxation

---

Corporate taxpayers sometimes engage in what the revenue authorities consider to be "aggressive" revenue reducing avoidance behavior. The Organization for Economic Co-operation and Development (OECD) has defined this as "planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences," as well as "taking a tax position that is favorable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law."[1] Revenue authorities around the world are concerned to manage the risks of reduced revenue collection resulting from such behavior. At the same time, the behavior so described may well be perfectly legal and not subject to any penalty. There are practical management and resource allocation questions, as well as rule of law issues about management of risk in this area. The current paper focuses on the results of a survey of attitudes of tax directors to the response by the United Kingdom (U.K.) revenue authorities to the management of tax risk. Further discussion by the authors of the difficult definitional issues and general analysis of tax avoidance questions can be found elsewhere.[2]

In recent years, a number of countries, including the United States (U.S.), the U.K., Australia, and the Netherlands, have been experimenting with innovative risk management techniques based on fostering a trusting and co-operative relationship with taxpayers. The goals of these initiatives are to improve resource allocation by revenue authorities, to reduce compliance costs for co-operative taxpayers, and to reduce incentives to participate in the behavior described above, even in cases where it is legal. These risk management techniques have been endorsed in a study by the OECD.[3]

The U.K. revenue authority, Her Majesty's Revenue and Customs (HMRC), has recently adopted the Risk Rating Approach (RRA) for taxpayers within its Large Business Service (LBS). This program has been described by the Inland Revenue Service Advisory Council (IRSAC) as "a novel and fairly bold approach to managing taxpayer compliance risk".[4, 5] The IRSAC Report for 2008 explains that the present focus of the IRS Large and Midsize Business Division (LMSB) is on improving current programs rather than creating new ones. Despite this, the IRSAC recommends:

> "… that LMSB management should monitor closely the progress and results of the LBS Initiative—with a view toward considering whether, at least, certain elements of that program might be useful to LMSB in its ongoing efforts to develop new and improved approaches for identifying and managing large taxpayer compliance risks and incentivizing those LMSB taxpayers who are especially cooperative in facilitating such efforts. Such consideration would be particularly germane, we believe, to LMSB's continuing evaluation and modification of its Compliance Assurance Program ("CAP") and Limited Issue Focus Examination Program ("LIFE"), both of which similarly seek to ease the burden of tax audits as the result of enhanced cooperative relationships with participating taxpayers."[6]

The primary aim of this paper is to provide both an early assessment of the RRA on the basis of empirical work undertaken by the authors, as well as commentary on further U.K. initiatives designed to address tax risk. It is hoped that this paper will be of assistance if the IRS decides to consider an approach akin to the RRA or at least certain elements of it. This assessment of the RRA is largely based on views the authors gathered from tax directors. The views of tax directors are only one factor in judging the success of these developments, but, given that one aim of current tax policy is an enhanced relationship with corporate taxpayers, directors' views are significant in assessing the progress being made.

It is important to note that the RRA is in its early stages. Indeed, the IRSAC Report comments that a "few years' actual experience under the LBS Initiative … will of course be necessary before any reasonable assessment can be made as to its overall effectiveness from the perspective of HMRC and participating U.K. companies." This is undoubtedly true. However, it is already possible to learn something about the apparent strengths, weaknesses, and design of the RRA, and, indeed, there have been modifications to the system in the U.K. since the survey discussed here was completed, as described below.

Between 2007 and 2008, the authors carried out a qualitative research project examining a number of issues relating to tax risk and tax risk management, avoidance, and the relationship between large corporates and HMRC. The core part of this paper presents the findings on the two main issues examined in the research project, namely the RRA as part of a wider enhanced relationship model, and two new legislative approaches adopted by HMRC to deal with avoidance. The two legislative approaches are targeted anti-avoidance rules (TAARs), which are purpose-based avoidance rules akin to a general anti-avoidance rule, though confined to one area of the tax code, and principles-based legislation (PBL). Together, the RRA, as part of the broader enhanced relationship program, and these new legislative approaches can be seen as constituting HMRC's multi-pronged approach to dealing with tax risk. The primary focus of this paper is the RRA, although the findings on new legislative approaches are also mentioned. A third, and very important, prong of the program is the requirement to disclose certain tax schemes in advance. The U.K. disclosure regime is now well established and was not discussed as part of this research project, although it forms an important backdrop. A brief explanation of the disclosure regime is given below.[7]

The research project was carried out by means of a survey of views of large businesses undertaken by the authors (referred to herein as the Main Survey).[8] The Main Survey examined the views of tax directors obtained from in-depth interviews conducted in spring 2008 with tax directors of 30 corporate groups. In summary, the authors found that the RRA and the enhanced relationship program on the whole have been successful in achieving some aims but not others. Thus, for example, while the RRA has led to a perceived better allocation of resources within HMRC, it seems to be less convincing as a means of moderating the tax planning of certain types of corporate taxpayer. With respect to the two new legislative approaches, the authors found that there was some support for the view that they could advance the simplicity and coherence of the tax system and possibly enhance competitiveness. However, it was also clear that there remain serious concerns about certainty of application and resistance by some to modifying behavior beyond what they perceived to be required by law. The fact that these new regimes are co-existing with the RRA approach did not necessarily moderate these concerns.

The rest of this paper is structured as follows. It provides a brief comparative review of risk management initiatives based on co-operation. It provides information on the survey, in particular the methodology employed in carrying it out and analyzing its results. It provides an analysis of the main findings of the survey. It describes and provides commentary on developments since the survey, and then concludes.

Brief comparative review

OECD

In January 2008, the OECD published a study on the role of tax intermediaries, a study which went considerably further than its title suggests in attempting to form the basis for an agreed approach to the management of tax risk by revenue authorities.[9] The study concluded that "risk management is an important tool enabling revenue bodies to prioritize risk and allocate resources effectively."[10] As risk management depends on the information available to revenue bodies, the study recommended, among other things, that revenue bodies establish a "more collaborative, trust based relationship…between revenue bodies and large corporate taxpayers who abide by the law and go beyond statutory obligations to work together co-operatively."[11] Such an enhanced relationship should lead to a better flow of information from taxpayers through early disclosure and greater transparency and thus allow for a better allocation of resource according to risk. Taxpayers also benefit from such a relationship through, among other things, lower compliance costs and enhanced certainty.[12] The study team noted the existence of a number of mechanisms that can and have been adopted to build this enhanced relationship, some of which will be discussed below. It also suggested that, if taxpayers do not wish to enter the enhanced relationship, revenue bodies should risk-assess such taxpayers on the basis of information available and respond accordingly.[13]

As noted, some countries had been experimenting with initiatives based on co-operation even prior to the OECD report. Before looking at the initiatives introduced in the U.S. and the U.K., it is worth noting the developments in Australia and the Netherlands.

Australia

The Australian Taxation Office (ATO) has been a pioneer in developing wide-ranging programs espousing "responsive regulation" rather than "command-and-control regulation." As early as 1998, in fact, the ATO adopted a pyramidal model of responsive regulation as a means of improving its management of taxpayer compliance, and this Compliance Model, briefly described here, has been used ever since to develop enforcement strategies.[14]

The Compliance Model espouses responsive regulation in that it requires the authorities to select an enforcement strategy on the basis of the specific taxpayer's behavior. Following the Compliance Model, authorities are expected to commence their engagement with taxpayers by being co-operative, through education, understanding, and service delivery, but they are to use increasingly stronger methods, such as audits and penalties, should compliance not be forthcoming. Responsive regulation is said to differ from the command and control style of regulation previously espoused by the ATO, in that, under the latter approach, they would quickly escalate their enforcement strategies when problems arose.[15] It is also said to combine the best of the deterrence and accommodative models of regulation, in that it does not ask whether to punish or to persuade, but when to punish and when to persuade.[16]

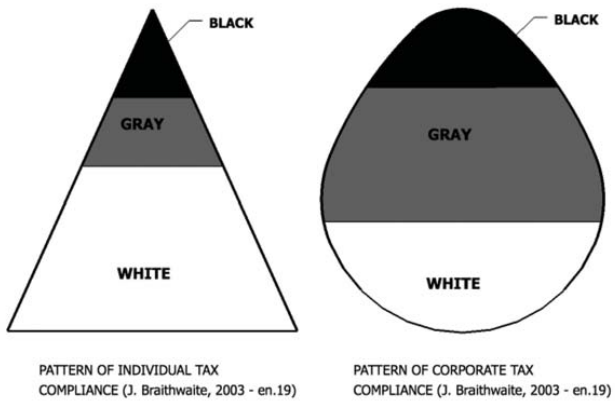
The Compliance Model was "significantly influenced" by the work of Ian Ayres, John Braithwaite and Valerie Braithwaite in regulatory and psychological theory.[17] It appears to find backing partly in the "considerable research literature [which] supports the failings of command and control regulation when applied indiscriminately in areas where compliance and non-compliance are multifaceted and complex phenomena."[18]

John Braithwaite notes that, when the Compliance Model was proposed in 1998 by the Cash Economy Task Force, there were some doubts as to whether it was relevant for large businesses. Writing in 2003, Braithwaite argued that the Compliance Model has relevance to large business, though a different kind of relevance than in the case of the cash economy.[19]

Braithwaite helpfully represents different patterns of compliance for individuals and large corporates graphically. Adapted versions of his representations are reproduced in Figure 1.

The individual Compliance Model works on the basis that the majority of taxpayers want to comply. Braithwaite's work suggests that more than two thirds of individual taxpayers fall into this category, as shown in the first diagram: the pyramid. As one moves up the pyramid through the gray area (which we equate with tax avoidance) to the black area of unwillingness to comply, in which tax evasion occurs, the number of taxpayers will become smaller and smaller. According to Braithwaite, the majority of large corporations, however, appear to want to comply with the letter but not necessarily with what the revenue authorities regard as the "policy purposes of the parliament's tax laws," thus making them "gamers" or "avoiders." This makes the pattern of large business compliance egg-shaped rather than pyramidical as is the case with individuals, with large numbers of corporate taxpayers falling into the gray area of tax avoidance, as shown in the second diagram in Figure 1. Braithwaite notes that this makes the creation of compliance strategies harder, and, thus, among other strategies, work should be carried out to move the egg-shaped compliance pattern closer to a pyramidical shape. One key way to do this is by law reform which reduces the size of the gray area.[20]

Figure 1. Compliance Model



In Australia, a number of initiatives have been taken, in fact, with regard to large corporates, including the Priority Rulings Process (PRR), the Forward Compliance Arrangements (FCA), and the Annual Compliance Arrangements (ACA). The PRR, a process for handling complex private rulings, was introduced in March 2005 and has been generally limited to large transactions.[21] The FCA, which was also introduced in 2005, entails a voluntary arrangement between a large business and the ATO, which sets up an agreed way of working together in the future. In particular, the FCA is a commitment in writing to make a joint effort to focus on complying with current tax requirements and anticipate future tax needs, especially when major transactions affecting tax are likely. A high standard of corporate governance (and a corresponding "low" tax risk profile) is a prerequisite for entry into the program, and a demonstrated commitment to continuous disclosure is also required.[22] Finally, the ACA, which was launched in 2008, is designed to provide practical certainty by jointly assessing tax risks in real time or at the time that the tax return is lodged. The ACA is currently available only to the top 50 companies, based on turnover. To enter an ACA, a company must have sound tax risk management processes and a commitment to full and true disclosure of all relevant and material facts.[23]

The Netherlands

The Netherlands is another frontrunner in developing approaches based on co-operation between the tax authority (the Tax and Customs Administration—TCA) and taxpayers. Indeed, this appears to reflect a broader and deeper culture of dialogue between government and major civil organizations aimed at consensus within Dutch society, known as the Dutch Polder model of dialogue. Underpinning this model is the belief that "[t]he Dutch Government and its citizens are well aware of the fact that they depend on each other to accomplish great things."[24]

In the tax field this culture has manifested itself in a program of "horizontal monitoring" introduced in 2005. This programme "entail[s] mutual trust between the taxpayer and the TCA, clearer articulation of each other's responsibilities and means of enforcing the law, and the establishment of and compliance with reciprocal agreements."[25] The TCA started off by launching a pilot project for 20 very large companies, most of them listed, followed by another group of 20 companies in 2006.[26]

Under this program individual companies and the TCA conclude so-called "supervision agreements" (or "enforcement agreements"). On conclusion of such agreements, steps are taken to settle existing open issues, thus clearing the way for the relationship between the two to be governed by the principles and processes agreed on and embodied in the agreement. The board of the TCA demands from the company at board level to commit itself to full transparency on current tax issues, and, in return, the TCA will give its binding opinion on issues that arise expediently. Companies should benefit from legal certainty and significantly reduced vertical supervision which translates into reduced administrative burdens. The TCA, on the other hand, should benefit from avoiding devices normally combated through vertical supervision, and also from spare capacity from the reduced vertical supervision which can then be directed toward less compliant taxpayers.[27] In 2007, the first part of the pilot was evaluated, and, as the results were positive, the Netherlands is reported to be encouraged to move forward along this road.[28]

As can be seen, this program is based on trust, co-operation, and reciprocity. This brief overview should be enough for one to note that the Dutch enforcement arrangements and the Australian FCAs "in general … are based on the same premises."[29] The two approaches differ, however, in one important respect. As noted, to enter the FCA program, the Australian authorities must be satisfied that the company in question has sound tax risk management processes and a commitment to full and true disclosure. Also, due diligence is carried out to determine the relevant tax risks.

In the Netherlands, no such conditions are imposed, and the emphasis, therefore, is even more firmly placed on trust. Happé concludes that the enforcement agreement is more akin to a "co-operation pact," while the FCA is more akin to a "legal agreement."[30] On the other hand, the Dutch system is not devoid of any monitoring. The TCA requires the company to set out a tax control framework, and this is the main vehicle for monitoring by checking on internal risk control models. In interviews with large corporates, the TCA has used Simon's "levers of control" to provide a structure within which to discuss core values and norms and the way in which these are built into internal control systems.[31]

The U.S.

There is considerable interest in co-operative approaches in the U.S. too. The LMSB Commissioner Frank Ng asked the IRSAC, LMSB Subgroup when preparing its Annual Report for 2008 "to focus its efforts … on (a) improving identification and management of tax compliance risks, and (b) improving transparency through the development of an enhanced relationship between LMSB and taxpayers." The IRS has adopted, in fact, a number of compliance risk management strategies over the years based on a co-operative model including the Compliance Assurance Program (CAP), the Limited Issue Focus Examination (LIFE), the Prefiling Agreement Strategy (PFA), the Fast Track Settlement Strategy (FTS), and the Joint Auditing Planning Process (JPP). As noted, the present focus of the LMSB is on improving current programs rather than creating new ones.

CAP and LIFE are discussed here briefly, given that they were singled out by the IRSAC as having parallels with the RRA. CAP, which currently has about 100 participants, was used in the OECD Study as an example of a business model aimed at improving the tax system through greater co-operation. It was described in IRS Announcement 2005–87 in the following terms:

> "The CAP requires extensive cooperation between the Service and participating taxpayers. Throughout the tax year, these taxpayers are expected to engage in full disclosure of information concerning their completed business transactions and their proposed return treatment of all material issues. Participating taxpayers that resolve all material issues will be assured, prior to the filing of the tax return, that the Service will accept their tax returns, if filed consistent with the resolutions…, and that no post-filing examination will be required. If all issues cannot be resolved prior to the filing of the return, the program will identify the remaining items that will need to be resolved through traditional examination processes."[32]

The introduction of LIFE was announced in 2002, by means of IRS Announcement 2002–133:

> "This initiative will involve a formal agreement, a Memorandum of Understanding (MOU), between the IRS and taxpayer to govern key aspects of the examination. The MOU will contain dollar-limit thresholds, established on a case-by-case basis, below which the IRS will agree not to raise issues and the taxpayer will agree not to file claims. This will create, with the taxpayer's assistance, an atmosphere where the examination process is less difficult, less time-consuming, less expensive, and less contentious for all involved. Working together, both the IRS and the taxpayer will focus their resources and time on the issues most significant to the return under examination."

The U.K.

In November 2006, HMRC launched its Review of Links with Large Business project, known as the Varney Review, which aimed at creating a relationship based on trust and understanding between large corporate taxpayers and HMRC.[33] More specifically, HMRC put forward proposals designed to achieve four desired outcomes: greater certainty, an efficient risk-based approach to dealing with tax matters, speedy resolution of issues, and clarity through effective consultation and dialogue. The proposals, which all sought to contribute toward the enhanced relationship, included the introduction of a system of advance rulings, the extension of the then current clearance system, a new approach to transfer pricing enquiries, a clear process for the quick and efficient resolution of issues, a new consultation framework, improved guidance, and the RRA.

The stated aim of the RRA is achieving a "more cost effective use of resources and efficient resolution of issues."[34] Under the RRA, each company within the LBS is awarded a risk rating, which determines the volume of HMRC's interventions in the company's affairs and the nature of the working relationship between the two. In essence, a light touch is adopted for low risk companies, thus releasing resources that can be directed toward higher risk companies.[35] Risk here is "compliance risk," defined by HMRC as "the likelihood of failure to pay the right tax at the right time, or of not understanding what the right position might be."[36]

The practicalities of the enhanced relationship are set out in HMRC guidance. The version in use during the time covered by the Main Survey was published in December 2007.[37] Since completion of the Main Survey, revised guidance has been published in May 2009.[38]

Methodology

Overview of Surveys and Related HMRC Research

The Main Survey, which is the primary foundation of this article, collected the views of tax directors by way of in-depth, face-to-face interviews conducted in the spring of 2008 with representatives of 30 corporate groups, comprising FTSE 100, FTSE 250, and unlisted companies. The interviews focused on the workings of the Large Business Service (LBS), which manages the affairs of the largest U.K. businesses.[39] The questions were designed to elicit the experiences and opinions of large business representatives with respect to the Risk Rating Approach (RRA), a key feature of the Varney Review, as well as the status of relationships between HMRC and large business more generally. The survey next sought respondents' views on the practical implications of two developing legislative approaches—targeted anti-avoidance rules (TAARs) and principles-based legislation (PBL)—and how these approaches impact on and are influenced by relationships between HMRC and large businesses. The primary, but not exclusive, focus of this paper is the portion of the Main Survey that explored the RRA.

Brief reference is also made herein to two pieces of research commissioned by HMRC and carried out in 2007 by market research firms on the experience of large business customers, including key aspects of the Varney Review. Summary results were published by HMRC in January 2008.[40] A full report on one of the two pieces of research was published after the Main Survey interviews had been completed.[41] The authors understand that the other research results will not be published.

Survey Design

The Main Survey was designed in early 2008, the goal being to interview tax directors from a robust sample of U.K. based companies of sufficient size to be covered by the LBS. Formal approval from the University of Oxford's Research Ethics Committee was obtained in March 2008, and interviews were carried out in April–June 2008. The Main Survey followed from and built on the smaller Pilot Survey, which was designed and implemented in 2007.[42]

A key feature of both surveys was the use of detailed, hypothetical tax planning scenarios, around which a series of semi-structured questions were asked by two of the present authors, bringing practical and academic experience on various aspects of tax law, corporate law, and corporate governance. In addition to asking more general questions regarding firms' risk ratings, the relevant risk criteria, and the perceived effectiveness of the RRA, the authors used the scenarios as a foundation for obtaining detailed, practical views on the respondents' approaches to tax planning—and, accordingly, a key element of each respondent's risk profile. The use of detailed legal scenarios distinguishes this work from the research carried out by HMRC and, indeed, from any other research of which the authors are aware and defines the methodological approach to this qualitative survey.

In both the Pilot Survey and the Main Survey, two tax planning scenarios were sent to each interviewee a few days in advance of his or her interview. These scenarios had been designed earlier by the authors, vetted separately with tax experts from our steering committee (two tax directors and a chartered accountant specializing in tax), and subsequently revised for use in the interviews. In addition, a catalogue of standard questions was prepared and tested with the same three experts and with one tax solicitor.

The two scenarios used in the Pilot Survey are not discussed in this paper. The two scenarios used in the Main Survey are summarized only briefly here.[43] Each scenario involved some element of tax planning the effectiveness of which could have been affected by recent or proposed anti-avoidance legislation in the U.K. Each was based on examples discussed in HMRC publications, with additional details provided in order to make the scenarios more realistic. The goal was to move beyond generalities in order to understand how businesses might assess and react to specific tax planning opportunities and to compare such assessments and reactions to the academic and policy commentary on tax avoidance and tax risk. A further goal was to draw connections between these results and the conclusions regarding firms' risk ratings and relationships with HMRC.

Sampling, Implementation, and Analysis

Pilot Survey Sample

One purpose of the Pilot Survey was to test the use of detailed legal scenarios as the basis of discussions with tax directors, and to determine whether active, in-depth interviews on these subjects would elicit responses that could reasonably be quantified or generalized. As such, a rigorous sampling methodology was not pursued in the Pilot Survey. A letter was sent to the "Hundred Group," comprising FTSE 100 companies only, and interviews were carried out with tax directors from the nine companies which volunteered.

Main Survey Sample

Although the results of the Pilot Survey were interesting, the reliability of the research was hindered by selection bias and by the small sample size. For the Main Survey, the authors assembled a larger and more varied pool of survey respondents using a combination of random and "purposeful" sampling. As observed by Patton:

> "The logic and power of purposeful sampling derive from the emphasis on in-depth understanding. This leads to selecting *information-rich* cases for study in-depth."[44]

The respondents consisted of tax directors from eight of the nine companies that participated in the Pilot Survey, 21 other companies from a short list selected randomly from the FTSE 350 list, and one unlisted company.[45, 46] The companies short-listed randomly received a letter. Seventeen companies responded and agreed to be interviewed. Others from the random sample did not respond to the initial letter but were contacted by telephone and then agreed to be interviewed. In all, 19 companies from the FTSE 100, 10 from the FTSE 250, and one unlisted company were interviewed. Twenty-seven of the companies interviewed are dealt with by the LBS.[47] Of the remaining three companies, two had been informed that they would be moved into the LBS soon. One of the 27 companies in the LBS at the time of the interview had been informed that it was being moved out. One high-level LBS official was interviewed in order to clarify some points of fact and obtain a balancing view.

The main disadvantages of using this partly purposeful sample are, first, that not all participants were randomly selected, and, second, that there was a disproportionate representation of very large companies (those from the FTSE 100) compared to the population covered by the LBS. The overwhelming advantage of this sample is that most of the respondents had practical experience or general awareness of the issues which our interviews sought to explore. Although the authors cannot be absolutely certain that the Main Survey sample was representative, it is comforting that the distribution of responses regarding firms' risk ratings was in line with HMRC expectations and with official figures published in July 2008.[48]

Regarding firm size, the authors found it difficult to obtain participation from any companies in the FTSE 250, let alone companies below this level of market capitalization. Most such companies indicated that they were not aware of or interested in HMRC's enhanced relationship model or novel approaches to anti-avoidance legislation. It is notable that the research commissioned by HMRC similarly found that "[i]n practice, the extent of awareness and understanding of the Review of Links among participants prior to the research was limited."[49] Moreover, companies having a market capitalization below that of the FTSE 250 are unlikely to have internal tax departments and, therefore, tend to rely on external tax advisers.[50] The authors decided to restrict this research to the views of tax directors operating within large corporate groups, although the approach used here could be extended to external tax advisers as well.[51]

Conduct of Interviews

The authors' primary goal in conducting these interviews was "to generate data which give an authentic insight into people's experiences."[52] It was decided that the only way to achieve this was to conduct face-to-face, semi-structured interviews with individual respondents. The other obvious options—focus group interviews and telephone or postal surveys—were discounted at an early stage. The use of focus groups almost certainly would have resulted in a lack of candor and completeness, given the sensitivity around corporate tax risk profiles and avoidance activities.[53] Respondents would have been concerned to protect their firms' legal positions vis-à-vis HMRC and competitive positions vis-à-vis other participating firms. The use of telephone or postal surveys, on the other hand, would have demanded short and quantifiable answers that would have revealed none of the nuance and controversy surrounding the meaning of "tax compliance," "tax aggressiveness," and "tax reputation." As these shades of meaning were precisely what the research was designed to explore, in-depth interviews were seen as the best choice.

The survey was carried out by means of interviews of about 1 hour conducted by two of the present authors. There was an interview schedule and a catalogue of standard questions, but the interviews were semi-structured, allowing the interviewees to focus on matters of importance to their companies. This flexibility permitted the interviewers to steer the interviews away from broad generalizations to a more meaningful and concrete exchange. It also facilitated the attainment of a satisfactory depth of discussion. On the other hand, it meant that not all issues were discussed for the same length of time and in the same amount of detail with all interviewees.

One further feature of the interviews was that the questions asked, and the issues discussed, often did not lend themselves to an easy "yes" or "no" answer. This again led to very engaging discussions. Yet this meant that some respondents did not always provide direct answers to the questions asked. These interviewees at times responded by providing examples, recounting an anecdote, or speculating about the general view of tax directors. In the light of all this, the authors note the difficulty at times encountered in determining the exact view of an interviewee on a particular issue. The authors have erred on the side of caution, by, for example, not attributing any specific views to the interviewees unless this was clearly stated or implied in the answers given. If a respondent's answers only provide vague support for a view, then that is what is stated in the paper.

Analysis of Interviews

The authors concede that it is impossible to create a "pure" interview that would provide an exact reflection of reality in this or any other area. However, the authors were satisfied that active, in-depth interviews could and would elicit "authentic accounts of subjective experience" regarding tax risk, tax avoidance, and the other matters discussed.[54] Interviews were not electronically recorded—again to encourage candor from participants—but the two interviewers took extensive notes which they transcribed and cross-checked as soon as possible following each interview. The transcribed interviews were then coded for particular views in respect of particular themes, following typical procedures, although, given the highly nuanced and active nature of the interviews, no attempt was made to force respondents' answers into rigid categories.[55, 56] The authors coded the interviews independently, and any discrepancies were resolved by consensus following re-examination of the original interview notes.

Therefore, while the authors attempted to put order to the answers given, to aggregate views, and to draw out some main and subsidiary themes, this research remains very much of a qualitative and not a quantitative nature.

Summary and Analysis of Main Survey Results

Risk Rating and the Relationship Between HMRC and Large Businesses

Overview of the RRA and Note on Disclosure Regime

As mentioned above, one of the four desired outcomes of the Varney Review is "an efficient risk based approach to dealing with tax matters," which now exists in the form of the RRA.[57] Under the RRA, each company within the LBS is assigned a risk rating on various specified criteria, as well as an overall risk rating. That overall rating determines the volume of HMRC's interventions in the company's affairs and the nature of the working relationship between the two. Risk here is "compliance risk," defined by HMRC as "the likelihood of failure to pay the right tax at the right time, or of not understanding what the right position might be."[58]

The stated aim of the RRA is achieving a "more cost effective use of resources and efficient resolution of issues."[59] It is clear from the published documentation, however, that HMRC also view the RRA as a means of incentivizing companies to alter their behavior in terms of transparency, governance, and tax planning. It can thus be characterized in part as an administrative route to control tax avoidance. For example, HMRC's documentation speaks about having "encouraged businesses to consider their positions by defining the benefits of being low risk."[60] The theory, at least, is that each company is free to behave in the way it chooses, which will result in a particular position on the risk rating spectrum. If it makes choices that result in it remaining on the higher end, it will simply forfeit the benefits of being low risk.

The RRA, in conjunction with new legislative approaches for controlling tax avoidance, contains two aspects of HMRC's multi-pronged approach to dealing with tax risk. They need to be seen against a background of a third prong: namely, the U.K. disclosure regime. That regime was introduced in 2004 with limited scope and was widened in 2006 to cover the whole of income tax, corporation tax, and capital gain tax. It takes some characteristics from U.S. disclosure requirements but differs in some respects.

Under the disclosure rules, a tax arrangement must be disclosed when it will, or might be expected to, enable any person to obtain a tax advantage, and that tax advantage is, or might be expected to be, the main benefit or one of the main benefits of the arrangement, and it is a tax arrangement that falls within hallmarks prescribed in the relevant regulations.[61] In most situations where a disclosure is required, it must be made by the scheme promoter (a defined term) within 5 days of it being made available. However, the scheme user must make the disclosure where the promoter is based outside the U.K., the promoter is a lawyer and legal privilege applies, or there is no promoter. A person who designs and implements his or her own scheme must disclose it within 30 days of implementation.

The hallmarks are: a wish to keep the arrangements confidential from a competitor and/or HMRC; arrangements for which a premium fee could reasonably be obtained; arrangements that include offmarket terms; arrangements that are off-the-shelf products; loss schemes; and certain leasing arrangements.

Disclosed schemes are given a number by HMRC, and this number must then be included on the tax return of each user. Thus, it can be seen that a considerable measure of transparency is required by the law—further transparency requirements discussed as part of the RRA go beyond this.

Summary of Views

The respondents in the Pilot Survey agreed with the RRA in principle, but a large majority raised serious questions about its details and practical operation.[62] These reservations primarily concerned the risk rating criteria and the purported benefits of being low risk. The details of the RRA, however, had not been fully developed at the time of that survey. For the purposes of the Main Survey, the authors were interested in finding out whether the uncertainties had been overcome and how the approach was translating into practice. Initial implementation of the RRA for companies within the LBS was largely complete at the time of the Main Survey interviews.[63]

The Main Survey indicated that the respondent firms were split fairly evenly between those that are low (or lower) risk and those that are high (or higher) risk. The Main Survey revealed modest improvement in respondents' comprehension of the risk rating criteria and their relative weight, yet some confusion and scepticism remained. Most importantly, the results supported the view that the RRA should lead to a better allocation of resources within HMRC, and possibly a change in taxpayer behavior in terms of transparency and openness, but also indicated that the RRA is unlikely to change the attitude of specific corporate taxpayers toward tax avoidance.[64] The results also suggested that, while firms have wider reputational concerns associated with public perceptions of their tax planning activities, the extent to which reputational concerns limit a given company's tax planning behavior is far from obvious. The possible lack of incentives for some large businesses to do what is necessary to become low risk under the RRA has serious implications for the success of the Varney Review. Each of these results is discussed in more detail below.

Reported Risk Ratings

As noted above, companies are given a risk rating on specific criteria as well as an overall rating under the RRA. A high-ranking official from the LBS explained to the authors that there are only two overall ratings a company can obtain—“low risk” and “higher risk”—but, as explained below, there was some confusion about this among respondents.[65] Guidance published more recently by HMRC (well after the interviews were completed) has changed the risk terminology to “low risk” and “non-low risk” and endeavors to make clearer the fact that a company may be assigned only one of these overall risk ratings.[66]

The responses given in the Main Survey showed that the firms interviewed were spread quite evenly along the risk rating spectrum. A small number of the companies interviewed were, at the time, still to undergo a risk rating assessment. Of those that had received a risk rating, some reported a single overall risk rating—these were divided almost equally between low and higher risk. Some interviewees spoke of different gradations within the “higher risk” category, such as “moderate risk,” although there is no recognition of such gradations in the HMRC guidance. The remaining respondents merely said that they obtained different ratings on the different criteria. They again split quite evenly between those that seemed to lie closer to the lower end of the spectrum and those that seemed to lie closer to the higher end.[67]

These findings are in line with HMRC’s stated expectation that, by March 2008, nearly 40 percent of risk-rated companies would be low risk.[68] Interestingly, most interviewees were not surprised by this 40 percent figure, tending to relate it to the relatively “small” size of many companies covered by the LBS. There appeared to be a belief among some of the respondents that there is a correlation between high risk and large, complex companies. This is despite the fact that HMRC claim that large, complex companies may be low risk and that, even within the sample, a number of large, complex companies are in fact low risk or on the lower end of the scale. It remains to be seen whether the Guidance published more recently by HMRC will affect the views of large businesses with respect to this issue. The authors submit that, in view of the apparent concern of some firms that there is a correlation between size and risk and HMRC’s contrary position, it would be useful if HMRC could provide a breakdown of risk ratings by size of company.

Risk Rating Criteria

The criteria used for assessing compliance risk under the RRA can be divided into two general groups: structural or inherent and behavioral.[69] Inherent risks consist of change, complexity, and "boundary issues" (by which HMRC mean issues arising from international relationships and transactions), while behavioral risks include corporate governance, delivery, and tax strategy.[70] A final, overarching risk criterion is "contribution."[71]

The results of the Pilot Survey suggested that it was unclear whether the existence of structural issues or their management was more important and thus whether companies of a certain size and complexity could ever be low risk.[72] Most of the interviewees assumed that inherent factors were more important to the risk rating process. Following recommendations made by the authors and others, HMRC have attempted to convey more clearly the message that behavioral factors carry greater weight than inherent factors, which they maintain has always been the case.[73]

A majority of the Main Survey interviewees seemed to believe there had been a change, with some expressly noting the evolution of the approach.[74] Other respondents were less clear in their answers regarding the risk rating criteria, simply observing that both structural and behavioral issues are important.[75] The remaining few interviewees, all from large and complex companies, and all higher risk, acknowledged that HMRC assert that large multinationals can be low risk but remain skeptical. Two further interviewees believed that large multinationals cannot be low risk because they were told so by HMRC staff. This brings to light a problem noted by some other respondents, namely, that the attitude regarding the RRA may not have filtered down from the top at HMRC. Evidently, the success or otherwise of risk rating will depend critically on the extent to which HMRC personnel having direct contact with large businesses understand and adopt the elements of the approach.

Tax Strategy and the Centrality of Tax Planning

One of the three behavioral criteria noted above is a company's "tax strategy." An important aspect of this criterion is a company's attitude to tax planning and avoidance, as made clear in the HMRC Guidance.[76] If large multinationals are to be low risk, then tax planning could be the most important risk criterion in a considerable number of cases. These firms can never be fully low risk on inherent factors, and can thus only bring down their overall ratings by becoming low risk on behavioral factors: governance, delivery, and tax strategy. None of the interviewees in either the Pilot Survey or the

Main Survey said that they wanted to be anything other than low risk on corporate governance and delivery. Indeed, becoming transparent and putting good internal systems in place are aspects of the Varney Review that most, if not all, the interviewees seemed to agree with. It follows that, if companies manage to bring down their risk ratings on the other behavioral factors, their overall risk ratings will hinge on their attitudes to tax planning.

The correlation between risk rating and tax planning behavior is evident from the Main Survey, in that most of the FTSE 100 respondents reporting a broadly low risk rating appeared to eschew activity that they described as "aggressive tax planning." Several other respondents stated that, while they aspire to transparency and real-time disclosure, they also want to be free to engage in tax planning that is legal and believed to be technically effective—even if HMRC may dislike it. Thus, transparency, disclosure, and robust compliance systems were seen to be reasonable requirements, but engaging in tax planning was seen by a number of the interviewees as something the company has a right to do and purely a matter of cost/benefit analysis. Some of these interviewees made it clear that, although they knew that they could reduce the company's risk rating by altering its tax planning behavior, they were resolutely unwilling to do so. This important conclusion is broadly supported by the research carried out on behalf of HMRC.[77]

Other factors taken into account by HMRC when assessing the tax strategy criterion are whether the company's strategy is documented, the extent to which tax planning is articulated in it, and the board's awareness of it.[78] HMRC view a board approved tax policy, as well as board engagement on tax matters, as features of good corporate governance.[79] The Risk Management Report states that a business that is successfully managing tax risk will have, among other things, "strong governance, with a clear tax strategy and principles set by its Board, and well-defined accountabilities, roles, and responsibilities that are understood throughout the business."[80]

A great majority of the interviewees stated that their companies had a tax policy or a tax strategy, almost all approved by their boards.[81] While tax policies and strategies are common, it would seem that the former can often be too vague and general to have much practical significance. All but one of the high risk companies in the sample had a tax policy or strategy.[82] Also, all but one of these companies claimed to have formal or informal decision making/review processes which involved the board or board members.[83] A few described the view that their boards might not be aware of the tax planning undertaken by their tax departments as "naive." These results indicate that companies engaging in non-conservative tax planning may nevertheless have corporate governance procedures in relation to tax matters.[84] The survey, however, did not investigate the adequacy and robustness of such processes, in particular the ones of an informal nature. With that caveat, the findings of the Main Survey support the view that tax planning behavior could be the paramount risk rating criterion in a significant majority of cases involving large, complex multinationals.

Benefits of a Low Risk Rating

HMRC set out their view of the benefits of being low risk in the *Risk Management Report* and again in considerable detail in the December 2007 Guidance. In essence, low risk companies are to benefit from a light touch approach, while higher risk companies will be the subject of "more intensive scrutiny."[85] A majority of respondents in the Pilot Survey could not see the benefits of being designated low as opposed to higher risk. Some observed that low risk companies are meant to enjoy a light touch approach but were sceptical about that happening in practice.

In contrast, about half of the interviewees in the Main Survey affirmed the benefits of being designated low risk.[86] The identified benefits included being subject to fewer inquiries, obtaining formal and informal clearances with greater ease, being approached by HMRC with less suspicion, a real-time working relationship, and quicker resolution of disputes. Only two respondents said that they were unclear about the benefits of being low risk. The remaining interviewees were aware of the benefits, but did not think they were sufficient to induce them to alter their tax planning behaviors and thus become low risk.[87] Some of these respondents said that the benefits are "intangible"; others said that they could be tangible but still would not justify altering their behaviors. All of these interviewees were rated higher risk, apart from one whose company was yet to be risk rated. They observed that one has to weigh the costs against the benefits of becoming low risk. If the benefits do not outweigh the costs, then they would not undertake the necessary changes to become low risk. Obviously, this has repercussions for the fulfillment of some of the goals of the RRA.

Reputational Risk and Related Concerns

Another issue discussed with some interviewees was whether the influence of shareholders, investors, or even the wider community makes a difference to tax planning behavior. A number of reports have elaborated on the way in which efforts by companies to understand and manage tax risk can enhance shareholder value.[88] Others have suggested that a company's approach to taxpaying and tax planning are relevant to its broader Corporate Social Responsibility (CSR).[89] HMRC's effort to bring tax into the boardroom could thus be seen, in part, as an attempt to encourage directors to consider what their duties to shareholders and stakeholders at large, require of them in terms of tax and tax planning.

These issues were investigated in the Pilot Survey and were revisited with some of the Main Survey respondents, although this was not a focus of the Main Survey.[90] The limited number of interviewees with whom these issues were discussed means that the results must be assessed with caution. With that caveat, the results seem to confirm that companies do not see tax as a CSR matter in the broad sense, that is, as defined by the European Commission: "enterprises deciding to go beyond minimum legal requirements and obligations stemming from collective agreements in order to address societal needs."[91]

Nevertheless, the Main Survey provided some indication that tax matters can give rise to reputational concerns. For the minority of interviewees with whom this issue was discussed, CSR seemed to be on the agenda in the narrow sense, that is, in the sense of a director's duty to take into account wider interests to the extent that this furthers the maximization of shareholder value over time.[92] In particular, a majority of respondents who discussed this point seemed concerned about reputational repercussions if their tax planning were subject to negative press coverage.[93] It is notable that some of the respondents who expressed concern about negative press coverage did not fully articulate how this could be damaging. One reason could be that there is a general lack of knowledge and research on the effect of negative press on corporate profits and share price. In addition, respondents' views could have been influenced by negative (and in fact incorrect) press coverage of some tax planning undertaken by a large corporation and a subsequent libel action, which was continuing at the time the interviews were carried out.[94]

Given that the coverage was subsequently corrected, an apology issued, and the libel action settled, this may have been a temporary effect. Indeed, the editor of the national newspaper concerned has argued that the company's willingness to litigate may have made it harder for the media to investigate such issues.[95] Reputational concerns are therefore often relevant, but the public reaction to engagement in legal tax planning is unlikely to be clear cut, given that attitudes to tax are wide-ranging and also given that the media may have considerable difficulties understanding and reporting complex tax issues. All this makes the impact of reputational risk far from straightforward. Further research is needed on the question of the impact of negative press coverage regarding a company's tax planning on its profits, share price, and general reputation, but such research is likely to be difficult to structure and conduct.[96]

Relationship with HMRC

The RRA is only one of the desired outcomes of the Varney Review, the other three being certainty, speedy resolution of issues, and clarity through consultation. All four contribute to the ultimate aim of the Varney Review, namely, improving the relationship between HMRC and large business. One cannot assess the effect of one without at least considering the others.

One of the more positive findings of the Main Survey was that most of the interviewees said either that they enjoy a good relationship with HMRC or that the relationship between the two has improved recently.[97] Critical to this positive relationship was the competence of the firm's "Customer Relationship Manager" (CRM), who acts as a first point of contact with HMRC.[98] Respondents from both low and higher risk companies noted an improvement in the openness of the relationship, in the speed with which issues are resolved, and in the focus on the more important issues.[99] The focus on important issues, in particular, marks a clear difference from the past. Interviewees in the Pilot Survey had complained about HMRC being indiscriminate, often demanding voluminous documentation in areas where the risk and the amount of tax in question were low. In the Main Survey, both low and higher risk companies commented on an improvement in this respect. This is, of course, to be expected for low risk companies. However, HMRC are committed to speedier resolution and focusing their interventions on areas of significant risk even for higher risk companies.[100]

The relationship between HMRC and large businesses thus seems to be moving in the right direction, but there is a need for further work. A few interviewees first noted the improvement, then hastened to add that there is still some way to go. One respondent commented that HMRC still tended to react aggressively when challenged. Another observed that, while HMRC have been very good at dealing with small, less significant issues, it remains to be seen how they act when dealing with the larger, more significant issues.

Evaluation and Conclusions

The goals of the RRA are more cost-effective use of resources, more efficient resolution of issues, and more incentivizing of companies to alter behavior with respect to transparency, governance, and tax planning. The Main Survey results support the view that the RRA should lead to a better allocation of HMRC resources and possibly an improvement in taxpayer transparency and disclosure, but also indicate that it is unlikely to change the attitudes of some large businesses toward tax planning.

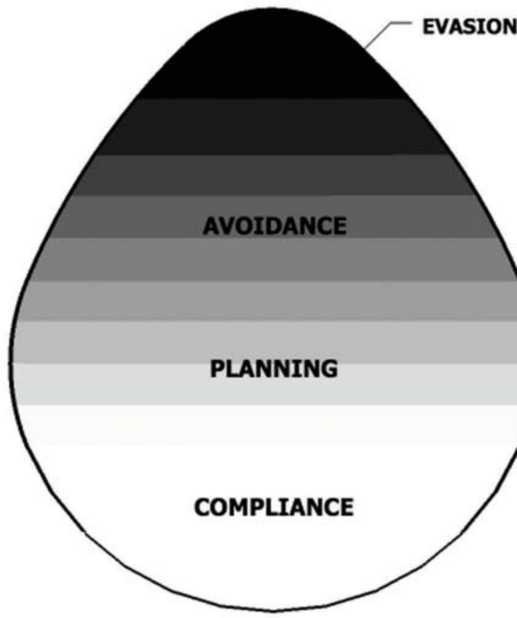
Two features must be present for an alteration of tax planning behavior to occur. First, all types of company, whatever their size and complexity, must be able to become low risk. Whether this was possible was still uncertain at the time of the Pilot Survey, but HMRC have gone some way in clarifying the ability of large multinationals to be low risk, both before and since the Main Survey. Second, the incentives to make the necessary behavioral changes must exist. HMRC have clarified the benefits of being low risk, yet a number of interviewees from higher risk companies stated either that they cannot see what the benefits are, or that these benefits are not substantial enough to justify altering their planning activities, even when taking reputational concerns into account.

Company management ultimately applies a cost/benefit analysis to this question. If the benefit of being low risk (savings made through certainty and lighter engagement with HMRC) do not outweigh the costs (foregoing the savings made from tax planning), then companies will simply not have sufficient incentives to make the necessary changes to become low risk. This is particularly so when the question of where the boundary of the law lies is still, often, very indeterminate.

As noted earlier, Braithwaite has described the pattern of large business compliance as being egg-shaped rather than pyramidical as is the case with individuals. This is due to the large numbers of corporate taxpayers falling into the gray area of tax avoidance. Clearly, for companies positioning themselves in this area, the costs do not as yet outweigh the benefits of engaging in such behavior. Again, however, one should not forget that the category of behavior Braithwaite labels as gray is neither homogenous, nor are its boundaries clear cut.

The diagram in Figure 2, adapted from Braithwaite's by the authors, is intended to reflect the different gradations within the gray area, which we take to cover the whole range of what may be generically termed "avoidance." Taxpayers can lie along a whole spectrum of positions between those who will not take any risk of not being compliant to those prepared to engage in aggressive, highly artificial avoidance. Transactions can move away from clear compliance to a position that takes a "reasonably arguable position" through to highly artificial transactions which involve non-commercial steps and are less and less acceptable to the revenue authorities.

Figure 2. Compliance Diagram with Gradations



LBS TAX COMPLIANCE
(OUCBT Survey, 2008)

The diagram in Figure 2 reflects the view of the authors that the distinction between evasion and avoidance remains, and should remain, a firm one. The boundary between avoidance and compliance is less clear at times because the law can be uncertain. To complicate matters, and to show the frequently porous nature of these categories, transactions that revenue authorities, and indeed other observers, may classify as aggressive avoidance may be declared perfectly valid, and thus compliant, by courts.

Targeted Anti-avoidance Rules (TAARs) Principles-Based Legislation (PBL)

Objectives

As discussed in the preceding sections, a major part of the Main Survey concerned the application and import of the RRA. Given the importance of a firm's tax planning to its perceived risk profile, the authors see the issues surrounding the RRA as being related to the manner in which relevant anti-avoidance legislation is conceived, drafted, and applied. TAARs and PBL provide more scope for revenue discretion than prescriptive legislation does, and, accordingly, if they are to work in the context of a low risk relationship, they demand greater trust from businesses that revenue interpretations will be generally consistent with their own. This hypothesis was corroborated in the Main Survey interviews. Detailed tax planning scenarios were used in order to understand how large businesses would assess and react to TAARs and PBL as a practical matter and to draw connections between these results and the conclusions regarding tax risk and relationships. This aspect of the Main Survey is discussed only briefly here.

General Comments on the Nature and Impact of TAARs

The targeted approach to curtailing unacceptable tax avoidance represents a middle route between the application of a general anti-avoidance rule (GAAR) (whether legislated or judicially created) and the use of detailed technical measures to counter every transaction that is considered unacceptable. HMRC has stated that "TAARs aim to strike a balance between generality and specificity."[101] The TAAR concept is not new, but it appears that the terminology has only recently been adopted by HMRC and Treasury.[102] Unlike detailed prescriptive legislation, TAARs and GAARs usually place significance on the main purpose or purposes for carrying out a transaction.

Tax directors in the Main Survey were asked which TAARs they had encountered in practice and whether they viewed the introduction of new TAARs positively. While not every respondent had dealt with the actual application of TAARs to transactions carried out by his or her firm, all agreed that existing TAARs could potentially affect a variety of transactions that they undertake. The degree of concern regarding TAARs varied. A majority of interviewees emphasized that some TAARs are too general, too vague, or too opaque, such that they threaten what these interviewees often described as "legitimate commercial transactions."[103] A minority felt that there was always a risk of TAARs applying to transactions they undertake.[104] Yet they do not worry much about that risk because they are confident in the commerciality of their activities. It is notable that most of the tax directors in the last group were from companies that have been rated by HMRC as low risk, companies on the lower end of the risk spectrum, or smaller firms without much knowledge about the scope of TAARs.

Most interviewees also commented on the complexity and uncertainty of U.K. tax legislation, with TAARS and detailed anti-avoidance rules being illustrations of such problems. Interviewees identified various causes of legislative complexity and instability, including a constant thirst for tax reform by HMRC and Treasury, often described as legislative "tinkering"; an increasingly global and sophisticated business environment; and a keen desire for tax law to be precise. Twenty-three respondents expressed exasperation with the complexity and unpredictability of current anti-avoidance rules, all but one asserting that this was a phenomenon hindering the competitiveness of the U.K. economy.[105] However, seven other respondents expressly recognized that the responsibility for legislative complexity and change may lie as much with business as it does with government. They conceded that the exploitation of tax minimization opportunities and the demand for legal certainty by businesses have contributed to the current legislative framework. These respondents insisted that complexity in itself has little effect on the competitiveness of the U.K., arguing that legislative complexity follows from the complexity of modern international commerce.

Interpretations of Purpose Rules Used in TAARs

Most TAARs define tax liability by reference in part to the taxpayer's purposes for carrying out a transaction. This is illustrated by the two provisions that were under consideration in the hypothetical tax planning scenarios discussed in the interviews, which in broad terms disallow a tax benefit where the main purpose, or one of the main purposes, of a particular transaction or arrangement is to obtain that tax benefit.[106]

Two key results emerged from the interviews with respect to TAARs purpose tests. First, there was a preference among the interviewees for the use of common language across the various purpose tests. No interviewee could identify the practical difference between a primary purpose and a main purpose, nor could any interviewee explain how he or she would distinguish among a purported multiplicity of "main purposes." Some interviewees simply referred to the *Duke of Westminster* principle, which they took to support the proposition that a taxpayer is entitled to arrange his or her commercial affairs in the most tax-effective manner, and, in doing so, effectively ignored the nuances of purpose tests.[107] Having said that, within the current framework, a large majority of respondents stated that they preferred a single legal test that focuses solely on a taxpayer's "main," "primary," "underlying," or "overwhelming" purpose behind a transaction.

A key issue raised by a majority of interviewees was the need to preserve a taxpayer's ability to structure commercial transactions in a tax-efficient manner. Most respondents argued that virtually any commercial arrangement will be structured in a tax-advantaged manner, often stating that it would be “irrational” or “foolish” to ignore tax considerations. A few respondents asserted that a test based on “one of the main purposes” gives scope to HMRC to insist that taxpayers implement the highest tax comparator transaction.

It was noted that the freedom to structure transactions in a tax efficient way depends not only on the text of relevant TAARs but also on HMRC’s interpretation and application of those provisions. Half of the respondents indicated that they had disagreed with HMRC about the main purpose or purposes of a transaction, or expected imminently to have such a disagreement. Most said that the question whether the presence of some tax purpose takes a transaction offside of TAARs depends on whether HMRC personnel analyzing the transaction apply the rule “sensibly.”[108] They felt that appropriate application of TAARs by HMRC personnel requires a strong appreciation of the business perspective.

Nature of PBL

Various commentators have argued that the ever-increasing spiral of detailed tax legislation, and its attendant lack of certainty, can only be resolved by shifting to an entirely new legislative approach, variously styled as “purposive drafting” or “principles-based drafting.”[109] A purposive rule is still a rule, whereas a principle is something external to the rules, which explains how the relevant rules should be construed. There is an appetite for PBL among policymakers who have grown frustrated with the failures of prescriptive legislation. This appetite is illustrated by various Australian efforts and, more recently, by draft U.K. legislation regarding tax avoidance associated with financial products.[110, 111]

The PBL Consultation Document was issued in December 2007 along with draft legislation, which was revised in February 2008 in response to a series of open day discussions and written representations. At the time of the interviews, the consultations were continuing. After the interviews had been concluded, in December 2008, HMRC published a further consultation document containing further amended draft clauses which take on board some of the points made by the interviewees and others. As the PBL Consultation Document and revised draft legislation on financial products avoidance represent the first express attempt by HMRC and Treasury to enact purposive or principles-based legislation, the survey questions were focused on those proposals. Comments were also welcomed from respondents regarding the merits and challenges of PBL more generally.

Comments on PBL Generally

The PBL Consultation Document stressed that a principles-based approach would further the goals of simplicity, certainty, and revenue protection in the U.K. tax system.[112] It also stated that such an approach would promote fairness and consistency in tax treatment. The Main Survey interviews suggested that there is some theoretical interest in a principles-based approach as a means of improving the simplicity of the UK tax system. A majority felt that PBL is a way forward and is worth exploring as an alternative to overly specific prescriptive legislation and overly broad TAARs.[113] They generally agreed that a principles-based approach would further the objectives of simplicity and revenue protection.

These respondents' enthusiasm was tempered, however, by concerns about the need for certainty and appreciation of the business perspective. It was often said that any legislated principles should be "meaningful," "focused," and "clear," and should only be enacted following extensive consultation with stakeholders. Only four of these respondents were optimistic that a principles-based approach could enhance commercial certainty. It is notable that three of these four respondents were from companies that have been rated as low risk by HMRC. The remaining interviewees feared that a move toward PBL would reduce certainty, but they were nonetheless in favor of exploring the approach.

A further five interviewees expressed the opinion that a principles-based approach is, as a policy matter, undesirable. These respondents stated that they preferred explicit legislation and were wary of "legislation by guidance." A few of those opposed to PBL stated that they simply did not trust HMRC personnel to apply broad principles with an appropriate focus or with a consistent view of which planning activities are and are not acceptable. Interestingly, there was no obvious correlation between this view and a firm's risk rating. The remaining five tax directors were agnostic about the merits of PBL or did not express a clear opinion either way.

Comments on the Draft PBL

In contrast to the broadly positive comments received about PBL as a new legislative approach, none of the interviewees was happy with the 2007 draft or February 2008 revised draft legislation on financial products avoidance. Most of the concerns from the 22 respondents who had analyzed the legislation fell into two categories: the lack of precision in the stated principle and the lack of effective consultation in the development of the principle.

First, aside from one respondent who felt that the draft legislation was not “ambitious” enough in its scope, most interviewees argued that the draft legislation suffered from a lack of clarity and was, thus, excessively broad and vague. Specifically, nine respondents believed that the way the provisions were drafted—or the way that the draft guidance indicated they would be interpreted—meant that the legislation threatened a variety of “commercial transactions,” which in their view should not be so affected. The remaining interviewees seemed to agree with this view without saying so expressly.

The second and related concern expressed by some respondents (seven) was that there had been a lack of “real” or “effective” consultation regarding the draft legislation.[114] There was a common feeling among these respondents that the push to implement the draft PBL in Budget 2008 was too rushed. Some felt that the consultations only happened after the substantial issues had been decided within HMRC and Treasury. A few respondents suggested that more thorough consultation would result in greater refinement of the stated principle, perhaps to exclude further “commercial transactions” from its scope.

Reactions to Scenarios[115]

The first scenario, for which interviewees were asked to consider both the current TAAR and the draft PBL on disguised interest involved an intercorporate investment in cumulative redeemable preferred shares. The target company was in a long-term loss position, and, accordingly, it was indifferent about paying dividends on equity financing and paying interest on debt financing. Thus, it was willing to offer a preferred share dividend which exceeded what comparable companies might offer and which approached a commercial interest rate. The key questions were whether the investor’s purpose in acquiring the shares would be treated as an “unallowable purpose” under Finance Act 1996 section 91D, or whether the dividends would be considered “economically equivalent” to a loan at interest under the draft PBL.

A substantial majority of respondents stated that this transaction should be permitted as a policy matter. Specifically, 22 respondents said that the “main,” “primary,” or “overwhelming” objective of this transaction was investment.

They felt that this commercial objective was sufficient to make the transaction legitimate. The eight remaining interviewees were ambivalent or equivocal, suggesting that this transaction was probably acceptable but depended on the relative weight of the commercial and tax motivations.

Notably, no respondents said unequivocally that this transaction should be considered unacceptable. Virtually all interviewees tended to apply a main or primary purpose test when assessing the transaction, consistent with the responses summarized above. It is interesting that respondents were generally in favor of this transaction regardless of whether their respective firms had been rated as low risk or higher risk by HMRC.

Most but not all respondents, despite believing that this transaction should be permitted as a policy matter, said that they would be worried about HMRC challenging it under the relevant legislation. Regarding the current TAAR, none felt that the legislation was inapplicable to this transaction, meaning that the different opinions were based on different views of how HMRC would apply the rules. Similarly, most respondents who were familiar with the draft legislation and guidance stated that they would be worried about HMRC challenging this transaction under the proposed PBL. Thirteen interviewees said that they would be more uncomfortable about proceeding with this transaction under the draft PBL than under the current TAAR. A further nine felt it made no difference to the analysis whether one applied the draft PBL or the current TAAR. None of the interviewees said that they would be more comfortable proceeding with this transaction under the proposed PBL, which is perhaps not surprising. An interesting observation made by four respondents was that HMRC routinely used to allow transactions of this nature. They nevertheless conceded that the draft PBL on disguised interest (and, to a lesser extent, the current rules) mandated a different result.

The second scenario, for which only the existing TAAR were in issue, involved a group restructuring. Briefly, the parent company caused a subsidiary to dispose of a variety of shares and assets, some with an accrued gain and some with an accrued loss. The parties negotiated an option for another subsidiary in the group to acquire certain of the transferred shares within 60 days, provided that the market value thereof had not risen or fallen more than a nominal amount. This had the effect of recognizing a capital loss on shares without a permanent change in the ultimate economic ownership of the shares. The question was whether this loss was disqualified as an "allowable loss" under TCGA 1992 section 16A.

Most of the respondents had a more negative view of this transaction compared to the previous scenario, although opinions were not unanimous. Specifically, 18 interviewees felt that this transaction should not be permitted as a policy matter, often describing it as "artificial" or "contrived," This group invariably said that the main or primary purpose of the arrangement was loss crystallization rather than commercial divestment. Some said that the presence of the "repurchase" option meant there was no "real disposal" or no "genuine intention" to dispose. Only five interviewees believed that this transaction should be considered acceptable. They emphasized that the latent loss on the shares was a real economic loss. The seven remaining interviewees were ambivalent or equivocal, suggesting that the legitimacy of the transaction depended on the relative weight of the commercial and tax motivations. Interviewees who had a negative view of this transaction were from a mixture of low risk and higher risk firms, while four of the five who expressed favorable views were from higher risk firms. All interviewees, whatever their policy views of this transaction, said that they would be worried about HMRC challenging it under the relevant legislation.

Evaluation and Conclusions

Various commentators have argued that massive increases in the volume and detail of tax legislation have not enhanced legal certainty. Rather, they have achieved the reverse.[116] There is no doubt that some of the difficulty stems from the courts' traditional insistence on predominantly textual interpretation of taxing statutes, but the attitude of the courts is changing, and much of the responsibility for difficulties in giving legislation a purposive interpretation has been argued to lie with the legislative designers and draftsmen.[117] One way to ameliorate this problem may be to enact further purpose-based TAARs, as they depend less on the technical details of a transaction and more on a taxpayer's purposes in carrying it out. It is far from obvious, however, that the business community views such rules as enhancing commercial certainty. The Main Survey interviews indicated that there is significant concern about the generality and potential vagueness of such rules, particularly the uncertainty regarding how HMRC would apply these rules to what many respondents characterized as legitimate commercial transactions.

As for the principles-based approach, the interviews indicated that there is considerable interest in at least exploring it as a means of improving the simplicity of the U.K. tax system. Most respondents agreed that a principles-based approach would further the objectives of simplicity and revenue protection. Yet opinions were unfavorable when applied to specific draft legislation. Most respondents' enthusiasm for PBL was tempered by concerns about the need for certainty/clarity and consistency in application, and appreciation of the business perspective. The draft PBL on disguised interest, along with its expected application by HMRC, were considered to fail all three of these criteria.

The desire for certainty/clarity in commercial transactions is understandable. Yet there may be a (perhaps unfounded) belief that such certainty is best obtained via a traditional system of detailed prescriptive legislation. Appreciation of the business perspective by the tax authorities is also important, although one should be careful to distinguish between appreciating the business perspective and agreeing with the business perspective. The desire for consistent application of legislated principles is also fully understandable. It is not surprising that changing policy views on the part of Treasury and HMRC, reflected in frequent amendments to legislation or in altered application of purpose-based TAARs, have led some businesses to lack trust in the tax administration. Without improving such trust, it will be very difficult to gain acceptance of a principles-based system, which evidently relies on administrative discretion to a greater extent than a system of prescriptive rules.

Despite the fact that there was some indication in the interviews that better relationships brought about by the Varney Review have improved commercial awareness within HMRC, the interviews suggest that taxpayer trust has not been enhanced to the point where all large businesses feel comfortable to work with the discretion afforded to HMRC by TAARs and PBL. The negative feedback on current and proposed anti-avoidance legislation suggests that the RRA framework cannot replace the guidance afforded by good statutory provisions.

New Developments

May 2009 Guidance

As noted above, since the completion of the Main Survey, the May 2009 Guidance has been issued, replacing the earlier 2007 Guidance.[118, 119] The May 2009 Guidance states that it has been substantially changed from its predecessor and that the risk assessment indicators have been altered to distinguish more clearly between inherent and behavioral factors. This is portrayed as a presentational difference, a clarification rather than a change of stance. There are indeed presentational differences, but the extent to which there is real change is not clear.

It is clearly stated at the head of the assessment indicators in the new Annex B that:

> "A customer may have inherent factors that increase tax compliance risk; however, the customer can still be Low Risk if the behavior, governance, tax strategy, and delivery effectively manage these inherent risks."

In fact, there was a similar statement in the 2007 Guidance, but it was contained within one of the risk factors rather than stated upfront. This statement and the changes are generally a response to HMRC's own consultations, which reached similar conclusions to those in both the Pilot Survey and the Main Survey on the need to reassure taxpayers that a low risk rating is possible despite their size and complexity. If this were not so, there would be very little incentive for large businesses to moderate their tax planning behavior so that this is critical to the RRA method.

Processes and transparency, however, are still not sufficient to achieve a low risk rating. For example, the fact that a taxpayer is involved in "a high degree of complex issues" will indicate a major risk, and such a taxpayer will need very strong processes to negate that factor. Tax strategy continues to play an important part in that negation exercise. The wording with respect to the tax strategy criterion has changed slightly, but the thrust seems to be much the same as in the 2007 Guidance.

As one might expect, a taxpayer "heavily involved in tax planning with no commercial context" will have an increased risk. This does not seem contentious, but other indicators listed in the May 2009 Guidance are more so. "Frequent tax planning that requires disclosure to HMRC" or "innovative interpretation of tax law" are perhaps debatable factors. A company's risk rating could be negatively affected by undertaking transactions that a court might conclude are perfectly legitimate. Even more debatable is the indicator that consists of regularly submitting requests for clearance or making voluntary disclosures which are not in accordance with HMRC guidance, given that there are statutory provisions which permit such applications for clearances, and that the HMRC Web site advertises a clearance service for businesses that is said to "provide certainty for businesses operating in the U.K., as a useful practical service at a level whereby speed of response from HMRC can be reasonably assured."[120]

It seems odd that businesses can be penalized for relying on such a service. If the law is unclear so that clearances are needed, is this not arguably sometimes due to the failure of government to provide adequate guidance in the legislation? It also seems likely that large and complex businesses with innovative transactions will be more in need of clearances and guidance on new legislation than will smaller simpler businesses. Therefore, it remains unclear just how accessible a low risk rating is to some very large firms in certain sectors.

Finance Act 2009

Another new development has emerged in the Finance Act 2009 which seems to be intended to impact on just such firms.[121] Under this provision, the senior accounting officer (as defined) of a qualifying company must take reasonable steps to ensure that the company and each of its subsidiaries (if any) establishes and maintains appropriate tax accounting arrangements.[122] This legislation has caused some concern to directors, who will be personally liable for any breach, and is being likened to section 404 of the *Sarbanes Oxley Act* by some. The fact that it is believed to be necessary suggests that the RRA regime alone is not having the desired effect on the modification of the tax planning behaviors of large corporates.

The HMRC guidance published on this provision links it very firmly into the risk review process, suggesting that some companies currently do not have robust enough systems and processes to ensure that the "right" amount of tax is being paid. Although the legislation refers to process, the guidance states that HMRC consider that the "judgment around tax sensitive decisions is part of "appropriate tax accounting arrangements" in so far as companies are expected to ensure that those making the decisions base them on reasonable interpretation of accurate information in full knowledge of tax law and having taken appropriate advice." It is acknowledged that the fact that this judgment may differ from that made by HMRC does not mean that the tax accounting arrangements are inappropriate, but the objective is clearly to give decisions about entering into tax "avoidance" arrangements a higher profile and to deter companies from using them.

Conclusions

The results of the surveys discussed here suggest that the RRA has resulted in a substantial improvement in the relationships between many large corporations and HMRC and that the development of the CRM role is particularly positive. From that point of view, it would appear to be a development worthy of further examination as a way of improving resource allocation and reducing compliance and administrative costs. It is less clear that this approach will result in corporate taxpayers becoming more accepting of widely drawn anti-avoidance legislation giving considerable discretion to the revenue authorities. This is not to say that such forms of legislation have no place in the armory of revenue authorities, but other methods of management may be needed to make them acceptable and workable.[123] These could include, for example, greater use of legislative clearances than currently exist in the U.K. This idea, however, runs counter to the apparent distrust of a clearances system expressed in the May 2009 Guidance.

The underlying problem remains that the boundary between effective and acceptable tax planning and what is referred to in the OECD Study as aggressive tax planning is one which cannot be expressed in definitive terms.[124] Were this to be attempted, manipulation would be made very simple. Taxpayers are entitled to a measure of clarity, however, as a fundamental tenet of the rule of law. As the OECD Study states:

> "Taxpayers have a reasonable expectation that revenue bodies will act consistently, objectively, and fairly. It would seriously undermine trust and confidence for a revenue body to seek to extract as much tax from the taxpayer as possible regardless of whether it is due under the law, using whatever commercial or other leverage can be brought to bear."[125]

This view is reflected in the IRSAC report, which takes the view that:

> "While the core "risk review" feature of the LBS Initiative should surely be a focal point for LMSB as well, the weight properly assignable to the "tax planning strategy" factor of that analysis should be driven by rules, principles, and attitudes reflecting the evolving state of U.S. law—including especially the application of nonstatutory doctrines (e.g., business purpose; substance v. form; step-transaction; sham transaction)—with respect to the fine line that often can exist between legitimate and abusive or otherwise overly aggressive tax planning strategies."[126]

HMRC seem to be using the RRA to induce large corporate taxpayers to stay on the right side of the acceptable/unacceptable boundary as drawn by them, even if this might not be where a court would draw the boundary. This could be one reason why the RRA has not been as successful in altering the tax planning behaviors of certain taxpayers as it has in achieving other goals.

In sum, the RRA in the U.K. and other similar developments elsewhere are well worth monitoring and considering, but this approach cannot itself define what is due under the law nor should it be relied on to attempt to override that central question.

Endnotes

1 Definition taken from *OECD Study into the Role of Tax Intermediaries* (OECD, 2008) ("OECD Study"), available at: www.oecd.org/dataoecd/28/34/39882938.pdf (accessed May 29, 2009) pp. 10–11, 87.

2 J. Freedman, G. Loomer and J. Vella, "Corporate Tax Risk and Tax Avoidance: New Approaches" [2009] *British Tax Review* 74, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1385042 ("Main Survey Report"); J. Freedman, "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 122 *Law Quarterly Review* 52; J. Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle" [2004] *British Tax Review* 332, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=900043.

3 OECD Study (en. 1).

4 The IRSAC Fact Sheet explains its function as follows: "[T]he IRSAC's primary purpose is to provide an organized public forum for senior IRS executives and representatives of the public to discuss relevant tax administration issues…, the IRSAC reviews existing tax policy and/or recommends policies with respect to emerging tax administration issues …. Membership is balanced to include representation from the taxpaying public, the tax professional community, small and large businesses, State tax administration, and the payroll community." See www.irs.gov/taxpros/article/0,,id=167596,00.html (accessed May 29, 2009).

5 IRSAC, *Large and Mid-Size Business Subgroup Report* (2008), Attachment B, available at: www.irs.gov/taxpros/article/0,,id=188491,00.html (accessed May 29, 2009) ("IRSAC Report 2008").

6 Ibid.

7 See text following en. 59.

8 Main Survey Report (en. 2).

9 OECD Study (en. 1).

10 Ibid. p. 53.

11 Ibid. p. 39.

12 Ibid. pp. 40–41.

13 Ibid. p. 45.

14 See V. Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate Publishing, 2003); V. Braithwaite, "Responsive Regulation and Taxation" (2007) 29 *Law and Policy* 3; K. Murphy, "Moving towards a

more effective model of regulatory enforcement in the Australian Tax Office" [2004] *British Tax Review* 603.

15 Murphy (en. 14) at p. 605.

16 Ibid. pp. 612–615.

17 Ibid. p. 605.

18 V. Braithwaite 2007 (en. 14) p. 4.

19 J. Braithwaite, "Large Business and the Compliance Model" in V. Braithwaite 2003 (en. 14) p. 177.

20 Ibid. Reducing the gray area through law reform is of course easier said than done because of the difficulties involved in drawing the line between different types of tax avoidance, from tax planning that would be sanctioned by the courts as being within the purpose of the law on the one hand and artificial tax avoidance schemes that would ultimately fail to be effective if taken before the courts on the other. There might also be schemes that would be sanctioned by the courts but which the tax administration would think were contrary to the purposes of the legislation as they understand it. Some would think that such schemes are clearly in the white area of the egg, while others would place them in the gray area. Because of these difficulties, Braithwaite suggests a three-pronged approach to the problem. In addition to law reform, he argues for the use of what he calls democratic and international tools. By a democratic approach, he means a public debate which will influence the approach of the judges to interpretation and the corporate taxpayer and the tax administration to tax risk and corporate responsibility—what he calls "escalated responsive enforcement." Much of what he argues for is what revenue authorities are indeed attempting to do with their enhanced relationship approaches.

21 See www.ato.gov.au/corporate/content.asp?doc=/content/74928.htm.

22 See www.ato.gov.au/corporate/content.asp?doc=/content/00110436.htm.

23 See www.ato.gov.au/corporate/content.asp?doc=/content/00167346.htm.

24 R. Happé, "Multinationals, Enforcement Covenants, and Fair Share" in J. Freedman (ed), *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management* (Oxford University Centre for Business Taxation, 2008) ("Beyond Boundaries") 157 at p. 165, first printed in (2007) 35 *Intertax* 537.

25 Ibid. p. 166. See also Netherlands Tax and Customs Administration Coordination group on the treatment of very large businesses, *Tax Control Framework* (March 2008), available at: http://ec.europa.eu/taxation_customs/

resources/documents/taxation/vat/vat_conferences/tax_control_framework_en.pdf (accessed May 31, 2009).

[26] The OECD Study (en. 1) likens this to the U.S. CAP.

[27] Happé (en. 24) p. 165 et seq.

[28] OECD Study (en. 1) p. 81.

[29] Happé (en. 24) p. 170.

[30] Ibid. p. 171.

[31] R. Simons, *Levers of Control: How managers use innovative control systems to drive strategic renewal* (Harvard Business School Press, 1995), cited in *Tax Control Framework* (en. 25).

[32] IRSAC 2008 Report (en. 5).

[33] For the HMRC publications setting out the details of this program, see *Review of Links with Large Business* (HMRC, November 2006) ("Varney Review"); *Making a Difference: Delivering the Review of Links with Large Business* (HMRC, March 2007) ("Varney Delivery Plan"); *HMRC Approach to Compliance Risk Management for Large Business* (HMRC, March 2007) ("Risk Management Report"). A summary and update are available in HMRC, *The framework for a better relationship* (Budget 2008) ("2008 Framework"), available at: www.hmrc.gov.uk/budget2008/supplementary.htm (accessed May 31, 2009).

[34] *Varney Review* (en. 33) p. 16.

[35] By basing its enforcement program on risk assessment, HMRC are moving into line with the government's wider approach to better regulation, as recommended by the Hampton Review: *Risk Management Report* (en. 33) para 1.6. See also P. Hampton, *Reducing Administrative Burdens: Effective Inspection and Enforcement* (HM Treasury, March 2005).

[36] *Risk Management Report* (en. 33) para 3.2.

[37] HMRC, *Tax compliance risk management: Guidance for LBS customers and staff* (December 2007) ("December 2007 Guidance"), now removed from the HMRC Web Site, copy available from the authors.

[38] HMRC, *Tax Compliance Risk Management Process* (May 2009) ("May 2009 Guidance"), available at: www.hmrc.gov.uk/manuals/tcrmanual/index.htm (accessed May 25, 2009).

[39] The LBS deals with the affairs of around 700 companies, based on factors including turnover, assets threshold, and sector. There is some flexibility as to

inclusion depending on a variety of circumstances. (Source: interview with LBS senior official).

40 HMRC, *Update on Review of Links with Large Business: research summary* (January 2008), available at: www.hmrc.gov.uk/large-business/lb-summary.pdf (accessed May 25, 2009).

41 HMRC Research Report 58, *Research to support the implementation of proposals in the Review of Links with Large Business* (December 2007) ("HMRC Research Report 58"), available at: www.hmrc.gov.uk/research/report58.pdf (accessed May 25, 2009).

42 For a summary, see J. Freedman; G. Loomer; and J. Vella, "Moving Beyond Avoidance? Tax Risk and the Relationship between Large Business and HMRC" in *Beyond Boundaries* (en. 24) 81. For the full report, see: www.sbs.ox.ac.uk/Tax/publications/reports/Reports.htm ("Pilot Survey Full Report").

43 The scenarios are described fully in the Main Survey Report (en. 2) Appendix II.

44 M.Q. Patton, *Qualitative Research and Evaluation Methods* (3rd edition, Sage Publications, 2002) 46. There are differing views about the importance of sample selection when a qualitative methodology is used: M. McKerchar, "Philosophical Paradigms, Inquiry Strategies, and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation" *eJournal of Tax Research* [2008] 5. Whatever the sample used, it is important not to overgeneralize from the results of a qualitative survey, and the authors of this paper have paid respect to this principle. Nevertheless, the authors take the view that the more representative the sample, the greater its value, and that careful sample selection was therefore important.

45 One of the 9 companies that participated in the Pilot Survey was unable to participate in the Main Survey.

46 The 21 companies from the FTSE 350 were selected by means of the following process. The authors randomly selected 118 companies from the FTSE 350 Index as of March 6, 2008. This was done by selecting every third company on the alphabetical list. A small number of the companies that were selected following this process formed part of the sample from the Pilot Survey; in such cases, that company was deselected, and the next company on the list was selected. The authors also randomly selected 20 companies from the FTSE Small Cap Index as of March 6, 2008, by selecting every twentieth company on the alphabetical list, but no company contacted from the FTSE Small Cap Index was willing to participate in the research.

47 The then-current HMRC documentation indicated that the LBS was composed of "approximately" 1000 companies, so that the authors proceeded on the

assumption that most of the companies in the FTSE 350 and perhaps even the FTSE Small Cap Index would be within the LBS. That assumption was later proven to be incorrect.

48 See en. 67 and en. 68 below.

49 HMRC Research Report 58 (en. 41) p. 8.

50 Even some FTSE 250 companies that were contacted indicated that they do not have internal tax departments.

51 There is a small literature that analyzes the views of tax accountants with respect to ethics, risk management, and tax avoidance, including: K. Kadous and A.M. Magro, "The Effects of Exposure To Practice Risk on Tax Professionals' Judgements and Recommendations" (2001) 18 *Contemporary Accounting Research* 451; E.M. Doyle; J.F. Hughes; and K.W. Glaister, "Linking Ethics and Risk Management in Taxation: Evidence from an Exploratory Study in Ireland and the U.K." (2009) 86 *Journal of Business Ethics* 177.

52 D. Silverman, *Interpreting Qualitative Data: Methods for Analysing Talk, Text, and Interaction* (2nd edn, Sage Publications, 2001) p. 87.

53 The authors do not dispute that focus group interviewing can be entirely appropriate in other circumstances. See D.L. Morgan, "Focus Group Interviewing" in J.F. Gubrium and J.A. Holstein (eds), *Handbook of Interview Research: Context and Method* (Sage Publications, 2001) 141.

54 J. Miller and B. Glassner, "The 'Inside' and the 'Outside': Finding Realities in Interviews" in D. Silverman (ed), *Qualitative Research: Theory, Method, and Practice* (2nd edn, Sage Publications, 2004) 125.

55 On coding procedures see, for example, A. Strauss and J. Corbin, *Basics of Qualitative Research: Techniques and Procedures for Developing Grounded Theory* (2nd edn, Sage Publications, 1998) pt. II.

56 K. Charmaz, "Qualitative Interviewing and Grounded Theory Analysis" in Gubrium and Holstein (en. 53) 675; J.A. Holstein and J.F. Gubrium, "The Active Interview" in Silverman 2004 (en. 54) 140.

57 *Varney Review* (en. 33) para 1.7. See also para 1.6 and the Chairman's forward at p. 1.

58 *Risk Management Report* (en. 33) para 3.2.

59 *Varney Review* (en. 33) p. 16.

[60] 2008 Framework (en. 33) p. 4. See also HMRC, *Making a difference: Certainty and clarity* (October 2007) p. 11; *Risk Management Report* (en. 33) para 1.4; *Varney Delivery Plan* (en. 33) para 3.3 and p. 16; 2008 Framework (en. 33) p. 10; December 2007 Guidance (en. 37) pp. 8, 16, and 18.

[61] Description taken from HMRC Web Site, www.hmrc.gov.uk/aiu/summary-disclosure-rules.htm (accessed May 31, 2009).

[62] Pilot Survey Full Report (en. 42) p. 9.

[63] In the 2008 Budget, HMRC reported that 97 percent of LBS customers had been reviewed using the new risk review template: 2008 Framework (en. 33) p. 10.

[64] See also Pilot Survey Full Report (en. 42) pp. 17–18.

[65] The high ranking official from the LBS explained that there are only two overall ratings a company can obtain during the above-mentioned interview with the authors (en.39). See also text following endnote 47.

[66] May 2009 Guidance (en. 38). See in particular TCRM2100, 2200, and 2400.

[67] The detailed responses were as follows:

> 4 companies had not had a risk rating assessment yet—all FTSE 250;
>
> 16 gave a single overall risk rating: 7 of these said they were low risk (4 FTSE 100, 2 FTSE 250, 1 unlisted); 2 said they were moderate risk (FTSE 250); 7 said they were high risk (FTSE 100);
>
> 10 did not give an overall risk rating: 2 of these said they were on the lower end of the scale (1 FTSE 100, 1 FTSE 250); 8 said they were low on some criteria and moderate or high on others. Of these 8, 3 were clearly on the lower end of the spectrum and could possibly be overall low risk (2 FTSE 100, 1 FTSE 250), while the remaining 5 seemed to the authors to be situated somewhere on the mid-high end of the scale, possible closer to the high end (FTSE 100).

[68] 2008 Framework (en. 33) p. 10. By June 2008, the actual number of businesses managed by the LBS that had a low risk rating was 238 (out of around 700 possible businesses): Hansard, House of Lords, Vol. 703, col. WA70 (July 7, 2008), available at: www.publications.parliament.uk/pa/ld200708/ldhansrd/text/80707w0003.htm (accessed May 26, 2009). This equates to roughly 34 percent. More recently, HMRC has stated that it has a low risk relationship with “about 30 percent” of LBS businesses: May 2009 Guidance (en. 37) TCRM9000 (Annex G).

[69] *Risk Management Report* (en. 33) para 4.4 and Annex A. See now May 2009 Guidance (en. 37) TCRM2100 and TCRM4000 (Annex B).

[70] December 2007 Guidance (en. 37) pp. 6–7 and Annex C. See now May 2009 Guidance (en. 38) TCRM4000 (Annex B).

[71] "Contribution" in this context is the tax paid by the company in comparison with the amount HMRC might expect from the level of its economic activity and in comparison to its competitors. Obviously, this comparison involves subjective judgments and could be contentious.

[72] Pilot Survey Full Report (en. 42) pp. 9–11.

[73] December 2007 Guidance (en. 37) p. 7. See now May 2009 Guidance (en. 38) TCRM2110 and TCRM4000 (Annex B).

[74] 12 out of the 22 interviewees who answered the question believed that there had been a change.

[75] 2 out of the 22 interviewees who answered the question.

[76] December 2007 Guidance (en. 37) Annex C. See now May 2009 Guidance (en. 38) TCRM4000 (Annex B) and TCRM9000 (Annex G).

[77] "There were generally pessimistic views about whether the risk review would incentivize tax behaviour changes, other than by highlighting potential areas for improvement. This was explained as resulting both from conscious decisions about attitude toward tax risk, and the inherent risk status of businesses due to their size, structure and nature." HMRC Research Report 58 (en. 41) p. 27.

[78] December 2007 Guidance (en. 37).

[79] See HMRC, *Tax in the Boardroom,* available at: www.hmrc.gov.uk/lbo/tax-in-the-boardroom.htm (accessed May 26, 2009).

[80] *Risk Management Report* (en. 33) para 3.2. Schedule A includes these questions: "What are the reporting structures—what reports are required and made to the Board by the customer's tax team? What are the relevant accountabilities?"

[81] 28 answered this question: 10 have a tax policy; 11 have a tax strategy; 2 said that tax falls within the ambit of a broader risk policy.

[82] Tax planning falls within the ambit of a more general code of conduct/risk policy for this one company. Note that one of the companies said that its policy was unwritten and informal.

[83] The decision making and review processes were not discussed with the remaining company, so that it could, in fact, have had such processes in place.

[84] See also HMRC Research Report 58 (en. 41) p. 26.

[85] *Risk Management Report* (en. 33) para 1.10. See now May 2009 Guidance (en. 38) TCRM2210 and TCRM2420.

[86] 13 of the 25 who answered the question.

[87] 10 of the 25 who answered the question.

[88] D.F. Williams, KPMG's Tax Business School, *Developing the Concept of Tax Governance* (2007); Henderson Global Investors, *Tax, Risk, and Corporate Governance* (February 2005); Henderson Global Investors, *Responsible Tax* (October 2005).

[89] SustainAbility, *Taxing Issues—Responsible Business and Tax* (2006). For academic discussions, see R. Avi-Yonah, "Corporate Social Responsibility and Strategic Tax Behaviour" in W. Schön (ed), *Tax and Corporate Governance* (Springer, 2008); R. Avi-Yonah, "Aggressive Tax Behaviour and Corporate Social Responsibility" in *Beyond Boundaries* (en. 24); R. Fraser, "'Aggressive Tax Behaviour' and Corporate Social Responsibility: A Response" in *Beyond Boundaries* (en. 24); D. McBarnet, "Corporate Social Responsibility Beyond Law, Through Law, For Law: The New Corporate Accountability" in D. McBarnet; A. Voiculescu; and T. Campbell (eds), *The New Corporate Accountability* (CUP, 2007); J. Freedman, "The Tax Avoidance Culture: Who is Responsible? Governmental Influences and Corporate Social Responsibility" in J. Holder and C. O'Cinneide (eds), 59 *Current Legal Problems* (2006) 359. Also see the Pilot Survey Full Report (en. 42) p. 38.

[90] Pilot Survey Full Report (en. 42) pp. 38–41.

[91] European Commission Communication COM (2006) 01136.

[92] This can be described as the Enlightened Shareholder Value approach. For a discussion of this approach, see DTI, *The Strategic Framework* (London, February 1999, URN 99/654).

[93] Of the 10 interviewees who discussed this: 6 said that they were concerned about the reputational effect of negative press coverage regarding tax planning, but then suggested that the effect was minimal or unclear; 1 said there were possible reputational risks in tax planning, but these were often exaggerated; 1 thought this would be more of a concern for companies dealing directly with members of the public; the remaining 2 felt that a company's tax affairs would not affect its reputation.

[94] The first article was published in February 2008. In 2009, *The Guardian* conducted a further campaign on tax avoidance naming several further companies. See www.guardian.co.uk/business/series/tax-gap.

[95] A. Rusbridger, "A Chill on *'The Guardian'*" in *The New York Review of Books* (January 15, 2009).

[96] For commentary on research in the U.S., see M. Desai, "Corporate Governance and Taxation: The Implications for Financial Reporting" and M. Hanlon, "Analyzing the Impact of Tax Avoidance," both in *Beyond Boundaries* (en. 24), and M. Hanlon and J. Slemrod, "What Does Tax Aggressiveness Signal? Evidence from Stock Price Reactions to News about Tax Shelter Involvement" (2009) 93 *Journal of Public Economics* 126, but the U.S. research is not conclusive.

[97] 13 companies noted that the relationship has improved recently. 7 enjoy a good relationship. Interviewees were not asked directly whether their relationship with HMRC has improved or if they enjoy a good relationship with HMRC, so that the actual figures could have been higher. The authors note that the research carried out on behalf of HMRC found that "[t]here were contrasting views among participants about whether an open and transparent relationship with HMRC was a realistic goal": HMRC Research Report 58 (en. 41) p. 20.

[98] See proposal 7 of the *Varney Delivery Plan* (en. 33).

[99] The last two noted improvements also relate to another of the four desired outcomes of the *Varney Review*, namely speedy resolution of issues: *Varney Review* (en. 33) pp. 18–19. The delivery of this desired outcome is detailed in 2008 Framework (en. 33).

[100] December 2007 Guidance (en. 37) Part 5 "Handling tax issues for all customers." See also proposal 7 of the *Varney Delivery Plan* (en. 33).

[101] HMRC, *Simplifying anti-avoidance legislation* (12 March 2008) ("Simplification Progress Report") para A.10, available at: www.hmrc.gov.uk/budget2008/supplementary.htm (accessed May 26, 2009).

[102] D.F. Williams, "Avoidance through the Creation and Use of Capital Losses by Companies" [2006] *British Tax Review* 23.

[103] 17 of 30 interviewees.

[104] 10 of 30 interviewees.

[105] About half of these respondents added that, while they were concerned about the complexity and uncertainty of anti-avoidance provisions, the uncertainty surrounding the proposals for the taxation of foreign profits was more significant to them. For details of these proposals as they stood at the time of the survey, see HMT & HMRC, *Taxation of the foreign profits of companies: a discussion document* (June 2007). The government later published modified proposals which addressed the objections of business to some extent: HMT

& HMRC, *Taxation of the Foreign Profits of Companies: Draft Provisions* (December 2008). Draft legislation has been introduced recently in Finance Bill 2009. All of this material is available at: www.hm-treasury.gov.uk/consult_foreign_profits.htm.

106 Finance Act 1996 sections 91A through 91G, as amended; Taxation of Chargeable Gains Act 1992 section 16A. For readers interested in the wording of the provisions, the relevant parts are set out in the Main Survey Report (en. 2) at p. 95.

107 The Duke of Westminster principle is based on a leading tax case which established the right to minimize taxes and that economic substance could not override form: *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1. This case has been qualified by later case law developments in the U.K., but never overruled. For the current position regarding judicial anti-avoidance rules in the U.K., see Freedman, (2007) (en. 2).

108 A range of respondents (8) highlighted the CFC "motive test" contained in ICTA 1988 section 748(3), arguing that HMRC apply this provision overzealously in order to disregard the effectiveness of transactions involving foreign subsidiaries.

109 J.F. Avery Jones, "Tax Law: Rules or Principles?" [1996] *British Tax Review* 580; B. Drummond, "A Purposive Approach to the Drafting of Tax Legislation" [2006] *British Tax Review* 669; R. Krever, "Plain English Drafting, Purposive Drafting, Principles-Based Drafting: Does Any of it Matter?" in *Beyond Boundaries* (en. 24) 189.

110 For more information on the Australian efforts see G. Pinder and B. Berkeley, *Coherent Principles Approach* (Australian Treasury, 2005).

111 HMT and HMRC, *Principles-based approach to financial products avoidance: a consultation document* (December 2007) ("PBL Consultation Document"), available at: www.hmrc.gov.uk/legislation/disguised-interest-intro.htm (accessed January 9, 2009). The proposed legislation as it stood at the time of the interviews is discussed here. Revised clauses, taking on board some of the criticisms mentioned in the interviews, were published in a newer consultation document, HMT and HMRC, *Principles based approach to financial products avoidance* (December 2008), with a view to the introduction of legislation in the Finance Bill 2009.

112 PBL Consultation Document (en. 111) para 1.8. See also Simplification Progress Report (en. 101) paras A.15–A.18.

113 20 interviewees.

[114] It should be reiterated that these interviews were conducted in April and May 2008. This was prior to HMRC's announcement that they would revise the draft legislation in accordance with comments received in early 2008 and would conduct further consultations with stakeholders via invitational workshops in August 2008. Further workshops were conducted in early 2009. All of this indicates that the HMRC consultation was a genuine exercise.

[115] The scenarios are described fully in the Main Survey Report (en. 2) Appendix II.

[116] Avery Jones (en. 109); R. Vann, "Improving Tax Law Improvement: An International Perspective" [1995] *Australian Tax Forum* 193; D. McBarnet and C. Whelan, "The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control" (1991) 54 *Modern Law Review* 848; Freedman 2004 (en. 2).

[117] Lord Hoffmann, "Tax Avoidance" [2005] *British Tax Review* 197.

[118] May 2009 Guidance (en. 38).

[119] December 2007 Guidance (en. 37).

[120] See www.hmrc.gov.uk/cap/index.htm.

[121] Finance Act 2009, section 93 and Schedule 46 and HMRC Guidance Note 17 August 2009.

[122] The definition of a 'qualifying company' includes only the largest companies, generally with a turnover of more than £200 million and/or a balance sheet total of more than £2 billion, Schedule 46 ibid.

[123] One of the current authors has argued strongly for a statutory general anti-avoidance provision in the U.K., but with appropriate safeguards and clearances: Freedman, (2007) (en. 2).

[124] OECD Study (en. 1).

[125] OECD Study (en. 1) at Annex 7.2.

[126] IRSAC 2008 Report (en. 5).