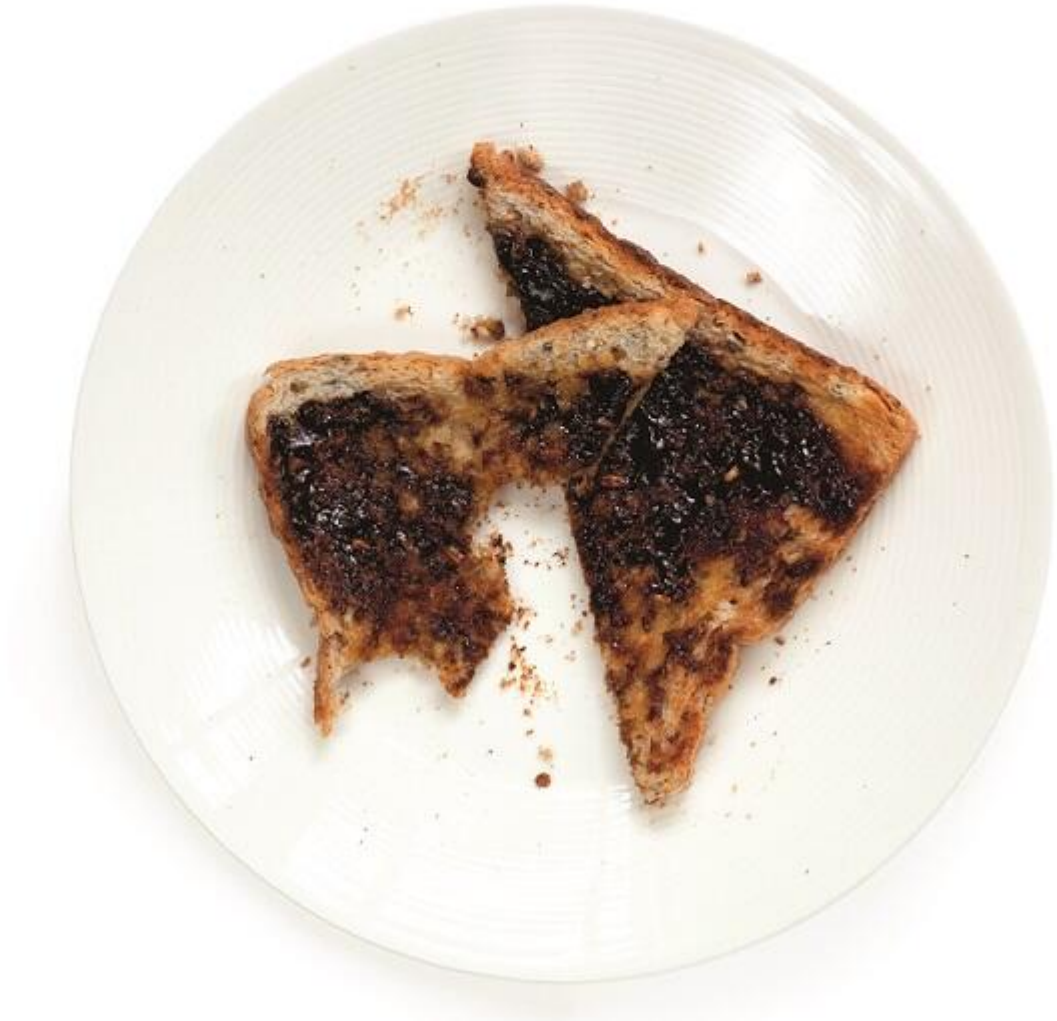
# Love it or hate it

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Ray McCann believes that the ‘rules is rules’ culture within HMRC needs to go

We are now several months past what must have rung alarm bells within HMRC, namely, the pre-election promise by Ed Miliband, then leader of the opposition, that a future Labour government would carry out a root and branch review of the department’s operations and management. The election result means that no such a review will take place, or at least no obvious review of the sort promised. But what precisely is wrong with HMRC and how does it move forward under the new government?

## HMRC criticism

It has been a remarkable ten years since HMRC were set up. It is easy to criticise the Revenue – it is, after all, a very large government department – and whether you love or hate it, you cannot ignore it. So much has their remit been expanded that HMRC are now responsible for almost every feature of life in the UK from cradle to grave.

In 2005 the department employed one-fifth of the entire civil service, since when it has appeared somewhat accident prone. Early on there was the enormous loss of data when some compact discs went missing; there was trouble over the ‘PAYE reconciliation’; the ‘scandal’ of thousands of coding errors; and a senior leadership that appeared out of touch or not to care about the difficulties ‘ordinary’ taxpayers had. This was compounded by concerns at the other end of the scale over alleged ‘sweetheart’ deals with large corporates and the tax planning of the super wealthy. There was the HSBC affair and, of course, Goldman Sachs and the controversy stoked by the Public Accounts Committee (PAC).

It was all great stuff for journalists, but it must have been hugely depressing for HMRC staff when the hysteria over the department’s performance standards reached extraordinary levels, so much so that a judicial review was launched into HMRC’s handling of NIC avoidance schemes. There was an urgent need for balance in the debate which did not come. The resulting low morale within HMRC should be a concern to us all, as should the fact that this is in large part caused by the fact that pay in HMRC and the civil service generally has stood still for years. Telling HMRC staff that they do have at least a great pension is of little consolation since pension

rights have been affected too. There is little the profession can do on these issues since they are a matter for government, but the profession and taxpayers need an effective HMRC that can manage the tax system efficiently and HMRC need motivated staff to achieve that.

It is not all gloom within HMRC, however, and those parts that have benefited from the coalition's determination to crack down on tax avoidance and tax evasion are buoyant. But how much of the promoted extra cash to crack down on avoidance and evasion was recycled money, meaning that there is less resource to other just as important, but not as high profile, parts of HMRC, eg customer service?

## Culture change

But there is an awareness within HMRC that the significant culture change brought about by the merger of Revenue and Customs has not had wholly positive outcomes. Whether intended or not, it has encouraged too many inspectors to view taxpayers as 'an enemy' to be punished for the most routine failing. As a result, inspectors have pursued issues that are of little interest to anyone other than the taxpayer concerned and in many instances, as matters have dragged on, even they lost interest as the layer upon layer of added governance rendered their efforts uneconomic.

Ten years on we have a tax system that is less user (customer) friendly, a tax administration that seems to struggle to connect with taxpayers and more discontent, whatever side of the tax avoidance debate you inhabit.

Despite this, HMRC can justifiably hold out example after example of success. On tax avoidance, it is beyond doubt that HMRC has brought under control the worst excesses of the tax scheme promoters. There may still be 65,000 open cases but there was probably a similar number in April 2005, although perhaps it is better to regard them as undiscovered cases. On tax evasion it is difficult to say that HMRC have been particularly effective but look at the scale of the task. HMRC's tax gap number is enormous, no matter how it is broken down, since they produce an annual estimate that does not include tax evaded in previous years; much of which will probably never be collected.

## The tax gap

But that tax gap involves an estimate of evasion by thousands, perhaps millions, of individual taxpayers, so the scale of the task was beyond HMRC from the outset and, despite the demands of the ‘hawks’, prosecution is not the answer. If it were, we would not have thousands of benefit and other cheats being prosecuted each year. Until there is wholescale change in the attitudes of all of us, there is little hope of reducing the tax lost through evasion; much of which is probably not worth HMRC pursuing in any event. Do we really care whether the window cleaner gives a receipt, or the taxi driver hands out a bundle of blank slips? We probably do, but not enough to always make our disapproval clear, and the adverse media attention towards the large companies and the wealthy probably means that many care little about a small amount of tax when ‘the rich and big corporates get away with millions’.

The huge criticism heaped on HMRC over its handling of HSBC Switzerland, which prompted Miliband’s comments, made clear that few outside HMRC and the tax profession understood the ‘rules of engagement’ that applied to cases of tax evasion. That HMRC allowed most to settle matters through voluntary disclosure would seem, on balance, the best that could have been done unless the government was willing to change the prosecution policy. And this is the important point: it’s not HMRC policy, it is government policy (and has been since the 1920s) not to prosecute a tax evader who makes a full disclosure, and there are significant difficulties in simply changing this approach.

The criticism of HMRC relied too much on an assumption that all Swiss bank accounts were stuffed with the fruits of tax evasion. Such an assumption is as ridiculous as assuming that they are all clean, but the point is how would HMRC be expected to decide who should be prosecuted, given that whatever they received was probably insufficient to prove guilt beyond reasonable doubt and there were thousands of individuals involved, many of whom had committed no offence at all. I expect that some were more clear-cut but you have to justify deviating from the policy, and that is fraught with difficulty. But on the positive, HMRC played a leading international role in opening up the secret world of offshore banking and tax havens.

## Tax crime

All tax evasion is a crime of some level although some cases are clearly more aggravated than others. But, without carrying out a detailed criminal investigation, how do HMRC determine whether it is a small case or the tip of the iceberg? And, if

HMRC take up from the outset more cases as possible tax crime and the Code 9 process is washed away, how do we manage the large number of criminal cases that could follow and what do we do with them once a conviction is secured? Bearing in mind that the burden of proof is ‘beyond reasonable doubt’ would risk turning one of HMRC’s most cost-effective investigative ‘tools’ into a loss-making venture!

## Where do we go from here?

First, HMRC need a clearer strategy. The threats that seem to be a mainstay of HMRC strategy must go; they don’t work, or at least they don’t work on a sufficiently widespread scale to make them worthwhile.

At a recent conference, a large number of delegates were worried about a client being caught up in a costly investigation; a much smaller number were worried that they would be caught! Kneejerk reactions need to be controlled and existing HMRC structures need time to settle in and recover from the merry-go-round of staff moves. Above all, HMRC need a clearer and more deliverable strategy for its relationship with agents and taxpayers and in how they achieve their objectives, which, crucially, must be realistic. Too often the rhetoric has set an over-ambitious agenda and then failed to deliver (or allowed a perception of failure to exist) resulting in criticism and dismay in parliament and among professional bodies.

It is reasonable to conclude that some of HMRC’s objectives were unachievable from the outset. But change is essential and, in my view, in three key areas: institutional attitude, flexibility and communication. Major projects, such as the Agent Strategy, should be moving forward, but at present, too many agents can be forgiven for not understanding what it will involve. HMRC also need to resolve what seems to be an internal struggle as to the value of agents who are vital to the smooth running of the tax system. Yet many fear that HMRC are out to get them – and with some justification – although those within HMRC have to reflect what government expects them to do.

## Glimmer of hope

There does seem to be some glimmer of hope. Since the general election we have had the suggestion from HMRC that they will be going easy on the ‘little guy’. If true, it is about time; although this may be a reflection of the huge workload that HMRC face from thousands of appeals against disputed penalties for late returns. The extra

work involved in HMRC trying to impose and collect a £100 penalty must surely be outweighed by the cost of doing so, especially in appeal cases. Then there is the cost of chasing taxpayers who don't do anything. How many of these penalties were ever collected is anyone's guess and what have HMRC learned from the enormous data gathering that they carry out as to why so many fall foul of complex rules? How much from those penalties that are collected is invested in trying to reduce the number of taxpayers who struggle to comply?

But a broader change in attitude is required. Parliament makes the law but HMRC designs it, and changes to the tax system has made compliance more difficult with too many traps set by HMRC to prevent what it sees as unintended tax breaks. Too many inspectors pay lip service to the views of the taxpayer and agents, and treat everything with suspicion. In part this is understandable, but HMRC must look seriously at how it can restore sufficient discretion to inspectors so that risks that are issues can be dealt with more effectively and less important issues disposed of quickly. This is not going soft on tax cheats, but instead, following Winston Churchill's advice that 'you will never reach your destination if you stop and throw stones at every dog that barks'! Put simply, not every taxpayer who has failed to pay 'the right tax' is a tax cheat and some of the issues that HMRC inspectors have pursued have not been worth the effort.

No one wants a free-for-all, but HMRC need to be able to clear lower-risk issues more effectively. If HMRC genuinely believe they have little or no discretion, they must persuade ministers to address this. The problem has been exacerbated by centralisation of decision-making.

A large organisation needs an effective central leadership function, but HMRC have taken centralisation too far and there is an urgent need to move the processes back to local teams and individual inspectors if, for no other reason, than the fact that, despite the various 'panels' within HMRC, similar tax issues have not always been dealt with consistently.

## HMRC governance

HMRC's governance arrangements have ensured that any issue of any size now has to be signed off by what would seem multiple layers of panels – and this has at times perfectly justified inertia. Fine, perhaps, in the context of a high value issue with complex points of law, but relatively few issues genuinely create the precedent or

consistency risks that HMRC assert justify this approach so widely. Moreover, the enormous backlog of tax scheme enquiries has resulted in the introduction of extraordinary and ground-breaking new laws to persuade thousands of individuals to give up their tax schemes. Relatively few have done so, dumping even more work on HMRC and straining governance further. To deal with tax avoidance it is clear that HMRC needed a modern Taxes Management Act more than a litigation and settlement strategy (LSS).

## Communication

Finally there is communication. HMRC should want and encourage taxpayers to contact them for help, not put obstacles in the way. For many taxpayers, HMRC should be the first point of contact and more needs to be done to improve customer service levels to reduce the 18 million unanswered calls. The digital agenda must not leave anyone behind. It is hard enough for many taxpayers to comply and harder still where, increasingly, compliance requires computer access and skills just to perform basic tasks as HMRC's local network diminishes.

The HMRC communication strategy is so poor that the tax office could be next door and you would not know. There needs to be greater use of email and inspectors should be more willing to provide clear and direct contact information to taxpayers and agents so that routine matters can be dealt with quickly. Oddly, contacting HMRC in cases of tax debt and bankruptcy seems to be a difficult process but it is not clear why this should be.

But these are just the practical aspects; a new dialogue is needed that reflects a change in attitude towards the difficulties many taxpayers face when dealing with the tax system and for HMRC to show more empathy. It is incredibly hard for HMRC and tax advisers to fully appreciate how difficult it is for taxpayers because we work with the system each day and have become hardened.

## An interesting example

The need for change and the difficulties HMRC create for themselves by a 'rules is rules' approach is clearly evident in the way HMRC have tried to impose an approach that is disconnected from the real world. To take one example, the statutory residence test (SRT). HMRC designed this and, in particular, it restricted the time that can be spent in the UK due to 'exceptional circumstances'. Example B1 on page 98 of HMRC's guidance is quite interesting in how it explains this (I shall leave you to

look it up). If you were the unfortunate individual in the example, ask yourself, would you care at all about the SRT?