

# Reforming HMRC:

## Making it fit for the twenty-first century

Prem Sikka, Michele Christensen, John Christensen, Christine Cooper,  
Tom Hadden, Deborah Hargreaves, Colin Haslam, Paddy Ireland,  
Glenn Morgan, Martin Parker, Gordon Pearson, Sol Picciotto,  
Jeroen Veldman, Hugh Willmott



HM Revenue  
& Customs



**REFORMING HMRC:  
MAKING IT FIT FOR THE TWENTY-FIRST CENTURY  
FIRST STAGE REPORT**

Prem Sikka,  
Michele Christensen  
John Christensen  
Christine Cooper  
Tom Hadden  
Deborah Hargreaves  
Colin Haslam,  
Paddy Ireland  
Glenn Morgan  
Martin Parker  
Gordon Pearson  
Sol Picciotto  
Jeroen Veldman  
Hugh Willmott

This review was commissioned by the Shadow Chancellor of the Exchequer, John McDonnell MP, and conducted independently by Professor Prem Sikka and others.

The contents of this document form a submission to Labour's policy making process; they do not constitute Labour Party policy nor should the inclusion of conclusions and recommendations be taken to signify Labour Party endorsement for them.

## **EXECUTIVE SUMMARY**

Her Majesty's Revenue & Customs (HMRC) performs a vital task in collecting taxes, enforcing tax laws and delivering services to taxpayers. Against a background of reductions in resources, it has experienced considerable difficulties in meeting the service expectation of taxpayers and challenging organised tax avoidance. This policy paper investigates the difficulties and makes recommendations to strengthen HMRC and its public accountability. The reforms include the following:

1. The formation of a Supervisory Board, consisting of stakeholders, to watch over HMRC Board to give it direction and enhance its public accountability. The Board shall act as a bulwark against corporate capture and inertia and be accountable to parliamentary committees.
2. The Supervisory Board should support and protect tax whistleblowers.
3. Additional investment in HMRC resources and staffing.
4. HMRC needs local knowledge and must respond to citizens' concerns. This is best achieved through a network of local offices and staff with local knowledge.
5. HMRC should have a well resourced internal investigation and prosecution unit. This would strengthen its in-house institutional knowledge base.
6. HMRC should offer competitive financial rewards to its staff.
7. Stronger parliamentary oversight.
8. The tax returns, related computations and documents of all large companies must be made publicly available. The public availability of corporate tax information will improve the quality of information available to parliamentary committees to scrutinise the effectiveness of HMRC in meeting its objectives.
9. Parliamentary committees should be empowered to examine any tax information, no matter how sensitive. It would be up to the relevant parliamentary committee to decide whether scrutiny of any documents and practices should be conducted in private or closed meetings.
10. The backlog of tax cases creates uncertainties and anxieties. This is also unfair to taxpayers. The judicial capacity to hear cases should be expanded.
11. Various reports published by HMRC should contain information that enhances transparency and accountability.

12. Public pressure is a vital ingredient in transforming HMRC. It should not be diluted by the introduction of fees to challenge tax assessments.
13. HMRC needs effective tools to combat sham. We recommend a rewrite of the General Anti Abuse Rule (GAAR). HMRC should be guided by the Department of Justice and/or a panel of retired judges, rather than by corporate elites.

## **CHAPTER 1 INTRODUCTION**

Her Majesty's Revenue & Customs (HMRC) performs a vital task in collecting taxes which enable the state to redistribute wealth, finance social investment and provide resources for the day-to-day operations of government departments. In 2015-16, it collected £536.8 billion from UK taxpayers, compared to £517.7 billion in 2014-15. It interacted with 45 million individuals, more than 5.4 million businesses, and paid tax credits to 4.4 million families and Child Benefit to 7.4 million families. These are commendable achievements; especially as HMRC staffing and resources have been substantially cut in real terms.

HMRC efficiency and accountability is a key factor in the administration of tax collection, and is of national interest. In recent years, HMRC has been seen to be failing to provide an efficient service to taxpayers. Often taxpayers have to wait for long periods for an answer to telephone calls. Despite the anxieties of parliamentary committees, there is a dearth of test cases against multinational corporations avoiding taxes through profit shifting and a variety of intragroup transactions. Consequently, parliament is unable to enact stronger legislation to curb organised tax avoidance. HMRC is too close to the interests of big business and too distant from the concerns of ordinary taxpayers. Parliamentary committees have sought to examine some of the settlements of prolonged tax disputes with major corporations, but have been thwarted by claims of 'confidentiality'. All in all, HMRC's public accountability needs to be strengthened and it needs additional resources.

In assessing the steps necessary for strengthening HMRC, this report adopts the objectives currently used by the government. The government currently requires HMRC to:

- Maximise tax revenues,
- Make sustainable cost savings
- Improve the service to what the government calls "customers".

The above three objectives overlap. A gain in one could be to the detriment of the rest. For example, cost savings can be made by reducing staff, but can result in poor service to taxpayers. The remainder of this report uses the above three objectives to assess how well HMRC is meeting its objectives. As the attainment of objectives is enmeshed with the governance and accountability of HMRC, this report pays particular attention to that, and makes recommendations for strengthening HMRC.

In order to draft this report, we discussed matters with a number of current and former HMRC staff (including senior staff), business advisors, accountants, lawyers, institutional investors and small businesses. We have been greatly assisted by discussions with representatives of the Association of Revenue and Customs (ARC) and the Public and Commercial Services Union (PCS). The PCS also assisted us with a random survey sample of 10,000 HMRC staff which yielded a 21% response

rate. These were extremely helpful in identifying a number of issues vital to the long-term success of HMRC.

## **CHAPTER 2**

### **MAXIMISING TAX REVENUES**

Tax revenues can be maximised by reducing the tax gap<sup>1</sup> and by mounting more and effective prosecutions. HMRC has been found wanting in both.

#### **Tax Gap**

The persistence of the tax gap shows that HMRC is not maximising tax collection.

The most recent statistics published by HMRC<sup>2</sup> put the 2013-14 UK tax gap at £34 billion, which is 6.4% per cent of total theoretical tax liabilities, compared to 8.4% in 2005-06. HMRC claims that small and medium-sized enterprises account for the largest portion of the overall tax gap (just under half), followed by large businesses (just over a quarter).

The exact details of the HMRC model for estimating the tax gap are not publicly available. The estimate depends on the policies and practices that HMRC is willing to accept or challenge. For example, a large number of multinational corporations use a variety of transfer pricing practices, royalty payments, management fees, interest payments on intragroup loans and other schemes to shift profits from the UK to low/no tax jurisdictions. The published accounts of companies such as Google, Facebook, Microsoft, Amazon, Starbucks, Boots, BHS, Caffè Nero and others show an effective tax rate considerably lower than the headline rate. One reason for this is that HMRC has not challenged their tax practices, whereas other countries have shown greater willingness to challenge the same. For example, in 2012 the Canadian tax authorities challenged GlaxoSmithKline's transfer practices and the case was settled in 2015. Previously, the US had also challenged the same company's transfer pricing practices. As HMRC does not consider the same to be tax avoidance or evasion, its estimate of the tax gap does not include the amounts shifted through transfer pricing techniques. In view of the challenges in other countries and corporate acceptance that there is a case to answer, it would appear that the UK estimates of the tax gap and tax avoidance/evasion are understated. Alternative models,

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<sup>1</sup> The Tax Gap is the difference between the amount of tax HMRC should theoretically be able to collect and what it actually collects. Tax Gap broadly consists of three elements - tax avoidance, tax evasion and uncollected taxes/tax arrears.

<sup>2</sup> HMRC, Measuring tax gaps 2015 edition Tax gap estimates for 2013-14, London: HMRC, October 2015 ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/470540/HMRC-measuring-tax-gaps-2015-1.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470540/HMRC-measuring-tax-gaps-2015-1.pdf)).



contested by HMRC, estimate the UK tax gap to be anything up to around £120 billion a year<sup>3</sup>.

## Prosecutions

A deterrent effect leading to higher tax revenues could be achieved by signalling zero tolerance for tax avoidance and evasion. This would require more test cases and legal challenges. It was announced<sup>4</sup> that between “2010 and 2014 HMRC secured more than 2,650 criminal prosecutions and 2,718 years of prison sentences for tax crimes”. Under pressure from the House of Commons Public Accounts Committee (PAC), HMRC agreed a target to increase prosecutions by 1,000 a year by 2014-15. However, this seems to be met by targeting less complex cases and a quarter of all prosecutions related to sums less than £10,000. A December 2015 report by the National Audit Office (NAO) noted that

*“Although HMRC cannot demonstrate that this was the right number, the target had the effect of prompting it to change its processes and make its investigations more efficient. This led it to focus on less complex cases, in particular a large number of prosecutions for evading income tax, VAT and tobacco duty, and lower-value cases<sup>5</sup>”.*

HMRC’s claim that it has increased tax revenues through prosecutions is not quite what it seems. The NAO stated<sup>6</sup> that

*“HMRC claimed £295 million in yield from the deterrent effect of its additional 1,000 prosecutions. However, in 2015 HMRC evaluated the deterrent effect of these prosecutions and found it could not verify their monetary value. The deterrence effect is inherently difficult to evidence. HMRC has therefore commissioned a range of research methods including surveys, interviews and data analysis. HMRC’s surveys found an increased awareness of prosecutions, but it proved difficult to evidence changes in behaviour or increases in tax revenues from prosecutions”.*

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<sup>3</sup> Richard Murphy, £119.4bn Tax Gap, London: PCS, 2014 (<http://www.taxresearch.org.uk/Documents/PCSTaxGap2014.pdf>)

<sup>4</sup> HMRC press release, Statement by HMRC on tax evasion and the HSBC Suisse data leak, 14 February 2015 (<https://www.gov.uk/government/news/statement-by-hmrc-on-tax-evasion-and-the-hsbc-suisse-data-leak>).

<sup>5</sup> National Audit Office, Tackling tax fraud: how HMRC responds to tax evasion, the hidden economy and criminal attacks, London: TSO, 2015, para 16 (<https://www.nao.org.uk/wp-content/uploads/2015/12/Tackling-tax-fraud-how-HMRC-responds-to-tax-evasion-the-hidden-economy-and-criminal-attacks-Summary.pdf>).

<sup>6</sup> Para 17, NAO, 2015, op cit.

HMRC's 2014-15 annual report states that it prosecuted 1,289 cases of tax-related crimes and secured a collective total of 407 years in prison sentences, but the report does not provide information about who is prosecuted and for what? How many relate to wealthy individuals, ordinary taxpayers, small businesses or large corporations?

The Financial Times reported that the amount of tax at stake in cases that were successfully prosecuted last year ranged from £250 to an organised crime case worth £160m<sup>7</sup>. More than two-thirds of cases concerned less than £100,000 of tax and were together, less than 1 per cent of all cases by value. HMRC states that evasion of tobacco duty accounted for 13 per cent of all tax fraud risks, but was the subject of nearly a third of all prosecutions.

There is a dearth of legal test cases even though in 2012 HMRC was aware<sup>8</sup> of 41,000 marketed schemes used by small businesses and individuals alone. HMRC estimates there are 30,000 users of partnership loss schemes. The House of Lords Economic Affairs Committee noted that

*“we remain concerned by the evidence we received that HMRC’s approach to multinationals was not assertive enough, and the Commons Public Accounts Committee’s critical findings of HMRC that the tax collector is not “sufficiently challenging” of multinationals<sup>9</sup>”.*

The number of prosecutions for offshore tax evasion has been described by the PAC as “woefully inadequate<sup>10</sup>”. Between 2010 and 2015, there have been only 11 prosecutions in relation to offshore tax evasion resulting in 15 years of jail time collectively (also see below). The Committee noted that

*“In December 2013, we argued that HMRC needed to demonstrate that it deals robustly with individuals and companies who deliberately mislead it and that HMRC should be more willing to pursue prosecutions against both*

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<sup>7</sup> Financial Times, HMRC focuses on low-value tax prosecutions, 17 December 2015 (<http://www.ft.com/cms/s/0/a890ddf6-a3fd-11e5-873f-68411a84f346.html#axzz42mEoinsR> ).

<sup>8</sup> National Audit Office, Tax avoidance: tackling marketed avoidance schemes, London: NAO (<https://www.nao.org.uk/wp-content/uploads/2012/11/1213730.pdf>).

<sup>9</sup> House of Lords Select Committee on Economic, Tackling corporate tax avoidance in a global economy: is a new approach needed? London: TSO, July 2013, para 118. (<http://www.publications.parliament.uk/pa/ld201314/ldselect/ldeconaf/48/48.pdf>).

<sup>10</sup> House of Commons Committee of Public Accounts, HM Revenue & Customs performance in 2014-15, London: TSO, 2015 (<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/393/393.pdf>).

*individuals and businesses. Regrettably, since then HMRC appears either to have ignored our recommendation or to have made little progress<sup>11</sup>”.*

The information provided by whistle-blower Hervé Daniel Marcel Falciani (former HSBC employee) showed that HSBC’s Swiss operations turned a blind eye to illegal activities of arms dealers and helped wealthy people evade taxes. Only one individual from the Falciani list of some 3,600 potential UK tax evaders has been prosecuted. In January 2016, HMRC told the PAC that it had abandoned its criminal investigation into the role of HSBC in alleged illegal activities.

In April 2016, a leak relating to Panama law firm Mossack Fonseca<sup>12</sup> revealed organised tax avoidance and evasion. The leaked information consists of some 11.5 million documents and 2.6 terabytes of information relating to over 300,000 companies. HMRC claims that some 70 staff<sup>13</sup> are examining the data. This may well suffer the same fate as the HSBC inquiry (see above), especially as the Office for Budget Responsibility (OBR) acknowledges that due to cuts in staffing HMRC has been less effective in handling data about previous disclosures of tax avoidance. For example, in relation to a tax disclosure facility related to Jersey, Guernsey, and Isle of Man, the OBR<sup>14</sup> noted:

*“Budget 2013 measures announced a disclosure facility with the crown dependencies and was originally costed to raise £1,050 million from 2013-14 to 2017-18. ... We lowered our forecast of the total yield to £800 million in November. ... The disclosure facility closed on 31 December 2015 and HMRC has informed us that there were far fewer disclosures than expected. They believe this is due to a number of factors, including HMRC campaigns being less effective and with less coverage than expected and a perceived lack of awareness from those targeted. HMRC is also now less optimistic about how much of the lost yield can be recouped through additional compliance activity, on the basis that they are unlikely to be able to work the higher number of additional cases on top of existing workloads. Taking both factors into account, we have lowered the costing for this measure by a further £530 million”.*

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<sup>11</sup> House of Commons Committee of Public Accounts, HM Revenue & Customs performance in 2014–15, London: TSO, 2015, page 6.

<sup>12</sup> The Guardian, What are the Panama Papers? A guide to history's biggest data leak, 5 April 2016 (<http://www.theguardian.com/news/2016/apr/03/what-you-need-to-know-about-the-panama-papers>).

<sup>13</sup> See Q32 of the House of Commons Committee of Public Accounts Report, Quality service to personal taxpayers and replacing the Aspire contract, July 2016 (<http://www.publications.parliament.uk/pa/cm201617/cmselect/cmpubacc/78/78.pdf>).

<sup>14</sup> Office for Budget Responsibility, Economic and Fiscal Outlook, March 2016, page 223 (<http://cdn.budgetresponsibility.org.uk/March2016EFO.pdf>).

HMRC offers voluntary disclosure facilities to tax evaders to settle their tax affairs and claims that some of the individuals settled their affairs by using such a facility in return for reduced penalties of up to 30% of the tax due compared to a maximum penalty of 200% where a voluntary disclosure is not made. So criminal prosecutions can be avoided by voluntary disclosures and this begs questions about any deterrent strategy used by HMRC.

HMRC executives<sup>15</sup> told the PAC that its investigations into transfer pricing arrangements take 22 months on average, and that only about 35 wealthy individuals are investigated for tax evasion each year. Consequently, it is unable to maximise tax revenues by checking tax avoidance and evasion.

HMRC claims to increase tax revenues by settling long-standing tax disputes. Good examples of this are the settlement of disputes with Vodafone, Goldman Sachs<sup>16</sup>, and Google<sup>17</sup>. However, there are questions about whether the settlements are reasonable. Parliamentary committees have not been able to reach any meaningful conclusions as HMRC has sheltered behind claims of confidentiality of information and refused to provide the relevant documents to the committees. A disturbing aspect of these episodes is that HMRC appears to be held to ransom by some companies. For example the case of *UK Uncut Legal Action Ltd v HM Revenue and Customs & Anor* [2013] EWHC 1283 (Admin) (16 May 2013) showed that in November 2010 Goldman Sachs had secured concessions from HMRC and to prevent HMRC from renegotiating, it

*“threatened to withdraw from the Code if HMRC withdrew from the November settlement”.*

A withdrawal would have embarrassed the Chancellor, who had announced that major banks had signed up to a voluntary code of taxation (soft law). The case suggests that companies may use voluntary codes to secure economic advantages.

There have been no prosecutions by HMRC or HM Treasury against the designers of tax avoidance schemes. In 2005, an internal HMRC study<sup>18</sup> concluded that the UK-

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<sup>15</sup> House of Commons Committee of Public Accounts, Tackling Tax Fraud, March 2016 (<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/674/674.pdf/>)

<sup>16</sup> House of Commons Committee of Public Accounts, HM Revenue & Customs 2010–11 Accounts: tax disputes, London: TSO, 2011 (<http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1531/1531.pdf>).

<sup>17</sup> House of Commons Committee of Public Accounts, Corporate tax settlements. TSO: London, 24 February 2016 (<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/788.pdf>).

<sup>18</sup> The Guardian, Gilt-edged profits for profession's 'big four', 7 February 2009 (<https://www.theguardian.com/business/2009/feb/07/tax-gap-avoidance-schemes>).

based Big Four accounting firms (KPMG, Deloitte, Ernst & Young and PricewaterhouseCoopers) generated around £1 billion in fees each year from "commercial tax planning" and "artificial avoidance schemes". There are a number of court cases in which the judges have declared the schemes designed, marketed and implemented by the big four firms to be unlawful. In the case of *Revenue and Customs v Pendragon plc & Ors (Rev 1) [2015] UKSC 37 (10 June 2015)*, the UK Supreme Court rejected a tax avoidance scheme designed by KPMG and the presiding judge said: "In my opinion the KPMG scheme was an abuse of law". This abuse has a long history. For example, a tax avoidance scheme designed by Ernst & Young and used by Debenhams and 70 other major high street retailers was thrown out by the Court of Appeal (*HM Revenue & Customs v Debenhams Retail Plc [2005] EWCA Civ 892*). About £300 million of tax revenues were at stake in this one scheme alone and a Treasury spokesperson said that

*"This was one of the most blatantly abusive avoidance scams of recent years, and the court's decision to quash it is very welcome<sup>19</sup>".*

Despite public statements, successive governments have been unable or unwilling to prosecute or fine any of the enablers and designers of avoidance schemes. The failures mean that HMRC's deterrents are weak and as a result tax revenues are not collected. After years of inertia, in August 2016, the government announced proposals<sup>20</sup> which if enacted could see accountants, lawyers and other enablers of avoidance schemes face fines if up to 100 percent of tax that is unpaid as a result of their advice. For such proposals to have any teeth, HMRC would need staff, resources, stronger public accountability and independence from corporate interests.

## Summary

This chapter has identified continued weaknesses in maximising tax revenues. Revenues could be maximised through the deterrent effect of prosecutions and test cases, but that is low. Little effective action has been taken to tackle the tax avoidance industry or big companies.

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<sup>19</sup> The Daily Telegraph, Debenhams lose VAT case, 19 July 2005 (<http://www.telegraph.co.uk/finance/2919204/Debenhams-loses-VAT-case.html>).

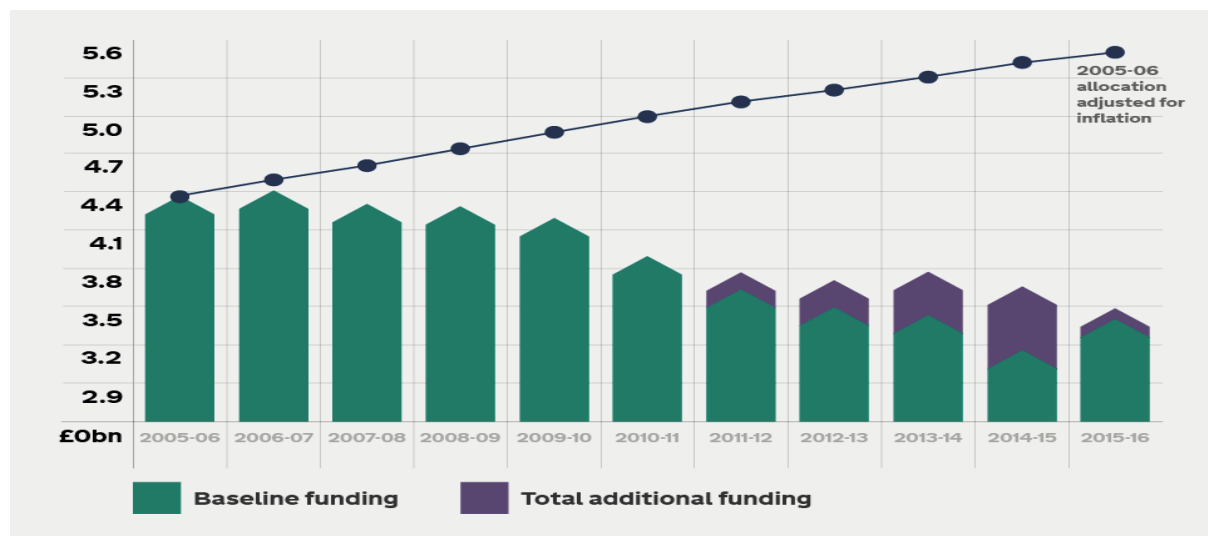
<sup>20</sup> HMRC, [Strengthening Tax Avoidance Sanctions and Deterrents: A discussion document](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/546589/Strengthening_Tax_Avoidance_Sanctions_and_Deterrents-discussion_document.pdf) ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/546589/Strengthening\\_Tax\\_Avoidance\\_Sanctions\\_and\\_Deterrents-discussion\\_document.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/546589/Strengthening_Tax_Avoidance_Sanctions_and_Deterrents-discussion_document.pdf)), 17 August 2016.

## CHAPTER 3 SUSTAINABLE COST SAVINGS

Cuts in resources and staffing have reduced HMRC's capacity to provide an efficient service to taxpayers, investigate cases of tax avoidance and take legal action against avoiders and evaders.

### Cuts in Resources

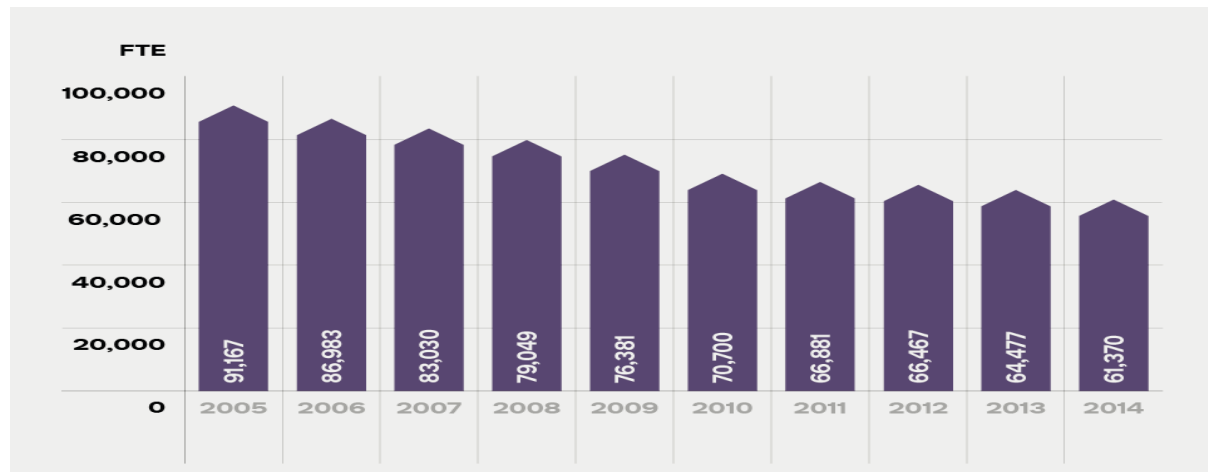
Information technology and efficient work practices can reduce the cost of tax collection and improve the quality of service to taxpayers, but the government's emphasis on '*cost savings*' has become a euphemism for cuts and privatisation. Economic globalisation and mobility of capital have increased opportunities for tax avoidance, but successive governments have reduced HMRC's budget and staffing levels. The chart below shows that HMRC's budget has decreased<sup>21</sup> in real terms despite the recent so-called additional funding provided for large business investigations. HMRC's 2015-16 budget was £3.2 billion, a small increase over the previous year, but the general trend is unmistakably downwards.



The financial cuts have resulted in lower capacity for dealing with enforcement issues and has affected HMRC's ability to respond to run of the mill enquiries from customers.

<sup>21</sup> HMRC business plan: 2014 to 2016 (<https://www.gov.uk/government/publications/hmrcs-business-plan-2014-to-2016/hmrc-business-plan-2014-to-2016>).

In 2004, at the time of the merger, the Inland Revenue and HM Customs & Excise had a combined staff of 100,000, almost immediately reduced to 90,000. The chart below shows that nearly 30,000 jobs have disappeared between 2005 and 2014.



HMRC's 2015-16 annual reports shows that by March 2016 its headcount stood at 59,857, an increase of 2,700 over the previous year, mainly to meet the pressure on phone lines. However, HMRC has plans to reduce staff to below 50,000, and possibly as low as 41,000<sup>22</sup>. The staff reductions come from the November 2015 announcement termed "Building Our Future" which proposed to reduce the HMRC estate from 170 locations to 13 regional hubs and four specialist sites. By 2021, 137 sites will be closed<sup>23</sup>. HMRC has already closed its entire office enquiry network removing the option of face-to-face services for approximately 2.5 million members of the public even though multinational companies, such as Google, Vodafone and Goldman Sachs, can be assured of one-to-one assistance. This has intensified pressures on its telephone services. HMRC handles about 60 million telephone calls a year and because of the shortage of staff at least 25% of calls go either unanswered or are not answered within HMRC's own time targets. Every £1 saved by HMRC on its telephone services results in an estimated £4 in additional costs to customers.

Cost savings made via prolonged wage freezes have been counterproductive and have caused problems in recruitment and retention of staff. The knock-on effect has been to increase costs due to over-time payments in order to process work in the absence of sufficient staff. Approximately £5 million is spent each month on overtime payments to plug the gaps. Lack of competitive financial rewards fuels increased

<sup>22</sup>Hansard, House of commons Debates, Adjournment Debate – HMRC: Building Our Future Plan, 28 April 2016 (<https://hansard.parliament.uk/commons/2016-04-28/debates/16042848000002/HMRCBuildingOurFuturePlan>)

<sup>23</sup> Page 26, National Audit Office, HM Revenue & Customs 2015-16 Accounts, 2016 (<https://www.nao.org.uk/wp-content/uploads/2016/07/HMRC-Annual-Report-and-Accounts-2015-16.pdf>)

staff turnover and poor morale makes it difficult to retain experienced staff who are often poached by big accountancy, law and financial service companies. One effect of the HMRC budget cuts is that it lacks resources for investigations and prosecutions. In February 2016, HMRC had 81 transfer pricing specialists. An investigation into just one major company (e.g. Google, Goldman Sachs) used up between 10 and 30 specialists, leaving little time for others. In contrast, the big four accounting firms alone had four times as many transfer pricing specialists<sup>24</sup>.

HMRC does not appear to have properly resourced internal prosecution units. It routinely hires external lawyers to argue its case in courts. The extensive reliance on external experts results in a weak institutional knowledge base. Unsurprisingly, HMRC is often unwilling or unable to tackle tax avoidance and evasion by large and comparatively well-resourced companies.

## **Privatisation**

The government has sought cost savings through privatisation and Private Finance Initiative (PFI) deals, but the outcomes have been problematical. In April 2001, HM Customs & Excise and the Inland Revenue (predecessors to HMRC) transferred the ownership and management of 415 leasehold and 159 freehold buildings and offices to Mapeley, a private sector consortium in a 20-year PFI deal. HMRC continued to occupy the buildings. Mapeley paid the government £220 million for the estate and a further £150 million over the first ten years of the contract, through reductions in the annual charges paid by HMRC. On signing the contract, Mapeley transferred the freehold and long leasehold properties to a company based in Bermuda. By 2012/13, the group was thought to be headquartered in Guernsey. The PFI deal enabled Mapeley to avoid capital gains and corporate tax on its activities on the properties formerly owned by the government. The company's shareholders were also based offshore and therefore unlikely to have paid income tax and National Insurance Contributions (NIC) on profits generated in the UK.

Mapeley properties are soon due for rent renewals. Many of the Mapeley properties are in desirable city centre locations and have lucrative alternative uses (hotels, shops, clubs, and offices) and can generate higher rental income for its owners. So HMRC is facing higher rental costs, but its budget is being cut in real terms. The large scale closure of HMRC offices (see above) is partly influenced by the fallout from the previous privatisation deals<sup>25</sup>.

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<sup>24</sup> House of Commons Committee of Public Accounts, Corporate Tax Settlements, London: TSO, February 2016, page 9 (<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/788.pdf>).

<sup>25</sup> HMRC press release, HMRC announces next step in its ten-year modernisation programme to become a tax authority fit for the future, 12 November 2015 (<https://www.gov.uk/government/news/hmrc-announces-next-step-in-its-ten-year-modernisation-programme-to-become-a-tax-authority-fit-for-the-future>).



The public has obtained poor value in other privatisations too. For example, in relation to the Aspire contract (an acronym for 'Acquiring Strategic Partners for the Inland Revenue') which provides for a variety of computer hardware and software services, the PAC wrote<sup>26</sup>: "HMRC has been outmanoeuvred by suppliers at key moments in the Aspire contract, hindering its ability to get long term value for money. The contract, which cost £7.9 billion from July 2004 to March 2014, has generated a combined profit for Capgemini and Fujitsu of £1.2 billion, equivalent to 16% of the contract value paid to these suppliers. HMRC considers the contract to have been expensive, and pressure to find cost savings in the short-term led it to trade away important value for money controls". On 30 March 2016, HMRC announced that it has reached a final agreement with its major IT suppliers on the phased exit of the £10 billion Aspire IT contract<sup>27</sup>. The House of Commons Committee of Public Accounts concluded that "HMRC demonstrated little appreciation of the scale of the challenge it faced in replacing its Aspire IT contract<sup>28</sup>". The Committee will revisit the matter as HMRC develops a replacement project.

A number of services, such as cleaning, mailing and security, have been privatised and/or subcontracted. Often staff have been put on inferior employment contracts<sup>29</sup>. In 2007, it came to light that sensitive data relating to millions of individuals sent via internal post, run by the courier firm TNT went missing<sup>30</sup>. The government<sup>31</sup> has announced further privatisation of HMRC services, including the use of private sector debt collection agencies and private companies to carry out fraud and error checks.

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<sup>26</sup>House of Commons Committee of Public Accounts, Managing and replacing the Aspire contract, London: TSO (<http://www.publications.parliament.uk/pa/cm201415/cmselect/cmpubacc/705/705.pdf>)

<sup>27</sup> HMRC press release, HMRC announces agreement to exit its £10 billion IT contract, 30 March 2016 (<http://www.mynewsdesk.com/uk/hm-revenue-customs-hmrc/pressreleases/hmrc-announces-agreement-to-exit-its-ps10-billion-it-contract-1356780>).

<sup>28</sup> House of Commons Committee of Public Accounts, Quality of service to personal taxpayers and replacing the Aspire contract, July 2016, p. 3.

<sup>29</sup> The Guardian, Whitehall cleaners gather outside HMRC to campaign for living wage, 17 October 2014, (<http://www.theguardian.com/society/2014/oct/17/whitehall-cleaner-hmrc-campaign-living-wage>).

<sup>30</sup> BBC News, Six more data discs 'are missing', 24 November 2007 ([http://news.bbc.co.uk/1/hi/uk\\_politics/7111056.stm](http://news.bbc.co.uk/1/hi/uk_politics/7111056.stm))

<sup>31</sup> HM Treasury, Autumn Statement 2013 ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/263942/35062\\_Autumn\\_Statement\\_2013.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263942/35062_Autumn_Statement_2013.pdf)).

In 2013, HMRC signed a £20 million contract with CDMS Ltd<sup>32</sup> (trading as Transactis) and Bosch Security Systems Ltd to outsource much of the Benefits & Credits directorate. In 2014, HMRC's post handling services<sup>33</sup> were privatised by signing a contract with the EDM Group. The company scans incoming post and provides HMRC with a digital version within 48 hours of receipt. The computer system for tax credits was outsourced to US business services giant Concentrix<sup>34</sup> on a £75 million, three-year deal but had many problems. The ad hoc privatisation raises serious concerns about efficiency and effectiveness. There is little publicly available information about value for money, efficiency, security, privacy, exploitation of data and public accountability of such changes. Much of the tender information remains confidential.

## **Summary**

HMRC has faced considerable reduction in staffing and resources. Some services have been privatised and outsourced. The cost reductions have eroded efficiency and effectiveness of HMRC. Privatisation has not delivered the promised savings or increases in efficiency and effectiveness.

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<sup>32</sup>HMRC, Benefits and Credits: Tax Credits Error and Fraud Additional Capacity Trial, May 2014 ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/308696/Tax\\_Credits\\_Error\\_and\\_Fraud\\_Additional\\_Capacity\\_Trial\\_-\\_Final\\_Evaluation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/308696/Tax_Credits_Error_and_Fraud_Additional_Capacity_Trial_-_Final_Evaluation.pdf)).

<sup>33</sup><http://www.accountingweb.co.uk/article/hmrc-privatise-post-handling/557295>; 23 April 2014.

<sup>34</sup> Accountancy Age, Staff paid to go home as outsourced HMRC IT system fails, 27 February 2015 ([http://www.accountancyage.com/aa/news/2397321/exclusive-staff-paid-to-go-home-as-hmrc-it-system-fails?utm\\_source=twitterfeed&utm\\_medium=twitter](http://www.accountancyage.com/aa/news/2397321/exclusive-staff-paid-to-go-home-as-hmrc-it-system-fails?utm_source=twitterfeed&utm_medium=twitter)).

## **CHAPTER 4**

### **SERVICE TO CUSTOMERS**

There is considerable dissatisfaction with the quality of service provided by HMRC to customers.

#### **Poor Service to Customers**

The pursuit of short-term cost savings, loss of staff, wage freezes and poor value from a number of IT projects has had a negative impact on services to taxpayers or what are sometimes called customers. These problems are deeply rooted and have persisted over a number of years. The 2014-15 report of the PAC noted<sup>35</sup> that around £1.2 billion was wrongly paid by HMRC in tax credits due to fraud and error; HMRC failed to answer a quarter of the approximately 60 million calls it receives a year.

HMRC call centres are poorly resourced and Citizens Advice has stated that thousands of people were waiting 47 minutes to get their calls answered<sup>36</sup>. The PAC concluded that

*“HMRC is still failing to provide an acceptable service to customers and could not tell us when it would be able to do so. In March 2013, the previous Committee concluded that HMRC had “an abysmal record on customer service”, having only answered 74% of telephone calls received by its contact centres during 2011-12. In 2014-15, HMRC responded to just 72.5% of calls and over the first half of 2015 this had fallen to 50%. The previous Committee considered that HMRC’s target of answering 80% of telephone calls within five minutes was “woefully inadequate and unambitious” and recommended that HMRC should set a more challenging short-term target for call-waiting times and a long-term target that is much closer to industry standards”.*

There have been marginal improvements and the 2016 NAO report noted that only 58% of the “customers” considered HMRC’s service to be good or excellent<sup>37</sup>.

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<sup>35</sup> House of Commons Committee of Public Accounts, HM Revenue & Customs performance in 2014-15, London: TSO, 2015 (<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/393/393.pdf>)

<sup>36</sup> BBC News, HMRC defends call waiting times of 47 minutes, 9 September 2015 (<http://www.bbc.co.uk/news/business-34195843>).

<sup>37</sup> National Audit Office, HM Revenue and Customs: The quality of service for personal taxpayers. London, NAO, May 2016.

HMRC has a history of poorly managing its computer systems and millions of taxpayers have received erroneous statements<sup>38</sup>. In March 2016, the House of Lords Economic Affairs Committee<sup>39</sup> criticised HMRC for failure to communicate important changes in tax rules to the public. The Forum of Private Business said:

“We represent over 20,000 small and medium-sized businesses throughout the UK. In this submission we have collected together information and evidence from our members which highlight the problems with HMRC. From the evidence provided by our members it is clear that HMRC is not fulfilling its aims as an organisation. It is slow and inefficient, with many of its online systems too complicated for our members to use<sup>40</sup>”.

Public pressure is an essential element in persuading HMRC to improve the quality, efficiency and effectiveness of its services. However, it is likely to be stifled as the government is contemplating fees for access to courts, including fees for challenging assessments raised by HMRC<sup>41</sup>. A 2015 consultation paper by the Ministry of Justice proposed fees of between £50 and £200 for referring cases to the first-tier tax tribunal, with hearing fees to range from £200 to £1,000 depending on their complexity. Appeals to the upper tribunal would incur an initial fee of £100, plus up to £2,000 for a hearing. Such a policy, if enacted, would further commodify access to the legal system and ensure that only the wealthy can challenge tax authorities. Such a policy is likely to reduce the number of complaints against HMRC and would reduce the pressures on HMRC to improve the quality of its service.

## **Summary**

There is considerable public dissatisfaction with the quality of service delivered by HMRC. This increases public frustration and costs to taxpayers, and reduces confidence in HMRC.

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<sup>38</sup> House of Commons Committee of Public Accounts, HM Revenue and Customs' 2009 – 10 Accounts, February 2011 (<http://www.parliament.uk/pagefiles/54525/CRC%20Final.pdf>).

<sup>39</sup> <http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-finance-bill-sub-committee/news-parliament-2015/draft-finance-bill-2016-report/>

<sup>40</sup> <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/memo/hmrc/05.htm>

<sup>41</sup> Ministry of Justice, Court and Tribunal Fees: The government response to consultation on enhanced fees for divorce proceedings, possession claims, and general applications in civil proceedings and Consultation on further fees proposals, August 2015.

## **CHAPTER 5**

### **HMRC GOVERNANCE STRUCTURE**

HMRC successes and failures are the outcome of its governance structures. HMRC Board is responsible for good governance. Amongst other things it must investigate violations of tax laws and consider appropriate responses. For it to be effective and seen to be effective there must be some distance between HMRC and corporate interests subject to its jurisdictions. However, increasingly that distance has been eroded and HMRC is perceived to attach too great a weight to the interests of large corporations. Such concerns could be addressed by robust public accountability mechanisms which give voice to the concerns of other stakeholders, but they are weak. Parliamentary Committees have not been able to scrutinise some aspects of HMRC operations.

#### **Corporate Influence**

HMRC is a non-ministerial department and is different from most other government departments which work under the direct day-to-day control of a minister. The Queen appoints Commissioners of HMRC who are responsible for providing leadership to the department and for managing its resources efficiently and effectively and for delivering the objectives and targets set by the Chancellor of the Exchequer. The Commissioners meet formally and make decisions within HMRC's Board and Executive Committees.

Currently, the HMRC Board consists of seven Commissioners and five non-executive directors. The Commissioners are:

1. Jon Thompson, Chief Executive and Permanent Secretary;
2. Edward Troup, Executive Chair and Permanent Secretary;
3. Jennie Granger, Director General Enforcement and Compliance;
4. Jim Harra, Director General Business Tax;
5. Justin Holliday, Chief Finance Officer;
6. Ruth Owen, Director General Personal Tax; and
7. Nick Lodge, Director General Benefits & Credits.

Commissioners are responsible for the collection and management of revenue, the enforcement of prohibitions and restrictions and other functions, such as the payment of tax credits.

The Executive Chair leads the Board and has ultimate responsibility for the department's strategy, safeguarding of its reputation and supporting the executive team who are responsible for the department's performance. The Executive Chair also leads on providing tax policy advice to ministers and overseeing the relationship with HM Treasury. The current Executive Chair is Edward Troup. Since 2012, he has also been in charge of scrutinising tax settlements for HMRC. Previously, he ran the corporate tax practice of City law firm Simmons & Simmons. He has been a vocal

opponent of the attempts to clamp down on tax avoidance and in 1999 said<sup>42</sup> that “Taxation is legalised extortion and is valid only to the extent of the law”. He has been a known defender of tax havens and an opponent of the General Anti-Avoidance Rule (GAAR)<sup>43</sup>.

The non-executive directors are appointed by HM Treasury, normally for a three year term. These are:

1. Ian Barlow, HMRC lead non-executive director and chair (former senior partner KPMG; former chairman of WSP Group plc; former member of CBI Tax Committee; former director, Racing Enterprises Limited, London Development Agency; non executive director Smith & Nephew, Brunner Investment Trust, chairman of The Racecourse Association), HMRC Lead Non-Executive Director;
2. Joanna Baldwin (Non-Executive Director and Member of the Strategy Committee for Aviva France<sup>44</sup>);
3. John Whiting (former PricewaterhouseCoopers partner and Tax Director of the Office of Tax Simplification) Chair, HMRC Audit and Risk Committee;
4. Mervyn Walker (former director at Anglo American<sup>45</sup> and British Airways);
5. Simon Ricketts (former director at Rolls Royce and a non-executive director with the National Savings and Investment Bank; also held senior positions at Scottish and Newcastle, Cadbury Schweppes and British Steel).

The HMRC Board consists of nine men and three women. It is assisted by three further non-executive directors who serve on the Board’s committees.

1. Leslie Ferrar (former tax partner at KPMG, Treasurer to Charles, Prince of Wales from 2005 to 2012; and subsequently non-executive director of Penna Consulting, Secure Income REIT plc, Risk Advisory Group and The Rothschild Foundation);

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<sup>42</sup> Cited in the House of Common Library Briefing Number 02956: Tax avoidance: a General Anti-Avoidance Rule - background history (1997- 2010), 15 May 2015. (<http://researchbriefings.files.parliament.uk/documents/SN02956/SN02956.pdf>).

<sup>43</sup> Private Eye, New Troup movements at HMRC, Issue 1413 (<http://www.private-eye.co.uk/news/>).

<sup>44</sup> Aviva is one of a number of financial institutions names in the Luxembourg leaks which enjoyed the benefits of secret tax deals in Luxembourg, according to the documents leaked to the International Consortium of Investigative Journalism (<http://www.thelocal.fr/20141106/luxembourg-france-tax-avoidance-fight>).

<sup>45</sup> Anglo American is a heavy user of offshore subsidiaries ([https://www.actionaid.org.uk/sites/default/files/doc\\_lib/collateral\\_damage.pdf](https://www.actionaid.org.uk/sites/default/files/doc_lib/collateral_damage.pdf)).

2. Diane Herbert (present and past links<sup>46</sup> with Mindshift Ltd, Housing for Women, Channel 4 and The Walt Disney Company);
3. Paul Smith (former Finance Director of Ford UK)

Within HMRC there are numerous specialist and focus groups and subgroups<sup>47</sup>. The HMRC Board has individuals previously connected with major corporations, tax avoidance industry (e.g. KPMG, PricewaterhouseCoopers), but none from civil society, HMRC employees, small businesses, ordinary taxpayers or anyone representing citizens on social security benefits. This is unhealthy and does not enable HMRC to see poor service, policies and practices from the perspective of various stakeholders.

HMRC's closeness to big business gives corporations and accountancy firms an 'insider' status. Representatives of large businesses enjoy considerable privileges in drafting tax laws and shaping the enforcement practices. They also exploit their inside knowledge to make private profits. For example, a working group consisting entirely of representatives from GlaxoSmithKline, Rolls-Royce, Eisai, Syngenta, Shell, Dyson, Arm, Fusion IP, Vectura, and Technology Research Ltd drafted what eventually became known as the Patent Box legislation<sup>48</sup>. It had no representatives from any other section of society. Corporate representatives also designed the Controlled Foreign Company (CFC) legislation. Both laws gave corporations tax concessions. It was not long before the tax avoidance industry was exploiting the opportunities offered by its insider status. The PAC wrote that it was

*“very concerned by the way that the four firms appear to use their insider knowledge of legislation to sell clients advice on how to use those rules to pay less tax. KPMG seconded staff to advise government on tax legislation, including the development of the ‘Controlled Foreign Company’ and ‘Patent Box’ rules. It then produced marketing brochures relating to both sets of rules highlighting the role its staff had in advising government. The brochure ‘Patent Box: what’s in it for you’, suggests that the legislation is a business opportunity to reduce UK tax and that KPMG can help clients in the ‘preparation of defendable expense allocation’. KPMG denied that it was advising its clients on how to use those laws in ways that Parliament did not intend, but we are*

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<sup>46</sup> As per <https://www.linkedin.com/in/diane-herbert-0a8b345>

<sup>47</sup> For some details see the Assurance Commissioner's 2014 - 15 report, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/444911/How\\_we\\_resolve\\_tax\\_disputes.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/444911/How_we_resolve_tax_disputes.pdf)

<sup>48</sup> As per <https://www.gov.uk/government/consultations/the-patent-box>.

*not convinced by its insistence that all the advice it offers to clients seeks to fulfil the purpose of the legislation<sup>49</sup>”.*

## **HMRC Public Accountability**

HMRC publishes an annual report highlighting key aspects of its performance during the year. Such reports are subject to scrutiny by the National Audit Office (NAO) and hearings by the Public Accounts Committee (PAC). Depending on the issues, other parliamentary committees may also hold hearings and question HMRC staff.

Since 2013, and following pressure from the PAC, the annual report has been supplemented by a “How we resolve Tax Disputes” report from the newly designated Assurance Commissioner<sup>50</sup> (Edward Troup). This development came after public concern that HMRC may have reached special tax deals/settlements with Vodafone and Goldman Sachs<sup>51</sup>. The background is that due to the complexity of the tax affairs of major corporations, the parties may reach an impasse and may be willing to reach a negotiated tax settlement. The question is whether the settlement is fair and reasonable for taxpayers. The PAC sought access to the hard documentation relating to the settlements with Vodafone, Goldman Sachs and others, but HMRC sheltered behind the cloak of taxpayer confidentiality and refused to provide the relevant documents. The PAC hearing was followed by a NAO report which noted that

*“The Department intends to appoint an assurance Commissioner, who will have to approve all settlement proposals over £100 million. The assurance Commissioner will have no role in individual taxpayer’s affairs, so that their role as an independent check on settlements is not compromised. The assurance Commissioner will also review future settlements to check whether internal governance processes have been followed<sup>52</sup>”.*

The PAC holds one or more annual hearings to examine HMRC report(s). In recent years, HMRC Commissioners have also attended additional hearings relating to tax avoidance by companies. Depending on the issues, other parliamentary committees (e.g. House of Lords Economic Affairs Committee) can also hold hearings. However,

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<sup>49</sup> House of Commons Committee of Public Accounts, Tax avoidance: the role of large accountancy firms, London: TSO, 2013 (<http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/870/870.pdf>)

<sup>50</sup> The first report is available here: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/210246/3741\\_Tax\\_Assurance\\_AR\\_accessible.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210246/3741_Tax_Assurance_AR_accessible.pdf)

<sup>51</sup> House of Commons Committee of Public Accounts, HM Revenue & Customs 2010–11 Accounts: tax disputes, London: TSO, 2011 (<http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1531/1531.pdf>).

<sup>52</sup> National Audit Office, Settling Large Tax Disputes, London: NAO, 2012 (<https://www.nao.org.uk/wp-content/uploads/2012/06/1213188.pdf>).



the Committees have not always been able to secure the information necessary for its effective scrutiny. The same shroud of confidentiality has also prevented the PAC from an effective evaluation of matters relating to privatisation and outsourcing of some of the HMRC's activities

In December 2011, after attempts to secure information about what appeared to be a special settlement with Vodafone and Goldman Sachs, the PAC wrote<sup>53</sup>:

*“The Department has insisted on keeping confidential the details of specific settlements with large companies, even where there have been legitimate concerns about the handling of cases. Details of some cases only reached the public domain because the press secured the details. We recognise the general intention of the legislation is to keep taxpayers’ details confidential, but there is a provision which allows the Commissioners to authorise disclosure in certain circumstances. Furthermore, HMRC has a clear duty to assist Parliament in its work to establish value for money and detailed information can be necessary if Parliament is to properly meet its obligations. Given the public interest in these very large settlements, it is not unreasonable that they should be subject to more specific scrutiny. As it stands, the Department’s decision to withhold details from us reduces transparency and makes it impossible for Parliament to hold Commissioners to account. This situation is entirely unacceptable”.*

The issues about confidentiality arose again in 2016 when it became known that with a payment of £130 million Google had settled approximately ten years’ disputed UK tax liabilities. Once again, the PAC could not secure any meaningful information to make assessment of HMRC diligence and efficiency. The PAC wrote<sup>54</sup> that

*“The lack of transparency about tax settlements makes it impossible to judge whether HMRC has settled this case for the right amount of tax”.*

It may be argued that the Assurance Commissioner publishes an annual report on settlement of tax disputes to reassure parliament and the public that all good and legal processes have been followed to settle disputes and collect the appropriate tax revenues. Such a report is, however, not a substitute for detailed parliamentary scrutiny. The tone of the Assurance Commissioner reports is often self-congratulatory and disclosures are inadequate. There are no details about any specific cases, the total amount of tax in dispute, the number of disputes outstanding for more than one, five, or ten years; the reasons for the delay, the nature of the dispute, involvement of third parties (e.g. other tax authorities), the expected period of settlement, etc. There

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<sup>53</sup> House of Commons Committee of Public Accounts, HM Revenue & Customs 2010–11 Accounts: tax disputes, London: TSO, 2011

<sup>54</sup> House of Commons Committee of Public Accounts, Corporate tax settlements, February 2016, London: TSO (<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/788.pdf> )

is still the thorny question of private settlements. The taxpayer making the settlement (e.g. Google, Vodafone, Goldman Sachs) is aware of the particular limitations and interpretations of laws and the nature of the settlement, which can then become a precedent for future liabilities. However, other taxpayers are not aware of the precedents and thus cannot take advantage of the rules. As long as the interpretations of law remain private then parliament is not in a position to consider making revisions to those laws.

## **Summary**

HMRC is too close to organised corporate interests. Its board and various committees and working parties are colonised by representatives from big business, many of whom are directly implicated in tax avoidance or designing, marketing and implementing tax avoidance schemes. There is virtually no representation from other sections of society who might express counter views or raise uncomfortable questions about service to customers, quality of proposed laws, levels of enforcement or corporate capture of HMRC. Various reports are a good means of communicating information, but they do not deliver adequate accountability to taxpayers or confer rights on taxpayers to question HMRC. Parliamentary Committees are a crucial means of public accountability, but they have been unable to examine some aspects of HMRC's operations. Thus, there is a considerable public accountability deficit.

## **CHAPTER 6**

### **AN EVALUATION OF HMRC GOVERNANCE**

This report has sought to examine HMRC's fitness to deliver its mission, which is to maximise tax revenues, make sustainable cost savings, and improve service to taxpayers. Despite considerable achievements, the tax gap has persisted though HMRC claims that it has marginally declined. The data produced by HMRC cannot easily be independently corroborated. HMRC does not report on the scale of aggressive tax avoidance, or profit shifting. Consequently, HMRC's estimate of the tax gap is likely to be understated.

Tax revenues can be increased by a greater willingness to investigate and/or prosecute tax avoiders and evaders. This can help to clarify the law and enable parliament to enact more effective legislation to achieve the desired goals. At the very least, this can send a strong signal and act as a deterrent. However, HMRC does not have a good record. HMRC claims that prosecutions have resulted in additional revenues, but the NAO has noted that such claims are not always easy to verify. HMRC has increased prosecutions, but has primarily targeted less complex cases with lower financial values. It has been "woeful" in tackling offshore tax evasion and even when handed a massive dossier on tax evasion facilitated by HSBC it failed to act decisively.

Offshore tax evasion may be one of the toughest areas to prosecute as the perpetrators deliberately disguise their activities, but that requires resources, strategies and determination. Major transnational corporations (e.g. Google, Facebook, Microsoft, Starbucks) have become very adept at shifting profits, but HMRC has not brought any test cases. The failure to mount legal challenges and prosecutions means that HMRC is not able to maximise tax collection. This also means that the weaknesses of the existing legislation are not identified and parliament cannot easily introduce tighter laws. It sends a signal to corporations and individuals that as things stand, tax avoidance/evasion can be a risk worth taking.

Whilst we accept there is no simple linear relationship between the number of HMRC staff and taxes collected, the data suggests that a compliance officer paid a salary of approximately £30k per annum can bring in a tax yield of approximately £1m per annum. HMRC has lost over 40,000 jobs since 2005. The continuous job erosion and wage freezes have resulted in low staff morale. HMRC lacks adequate resources to discharge its obligations effectively, resulting in poor service to taxpayers, tax collection and prosecutions. Taxpayers are concerned about the long wait for a reply to telephone enquiries. HMRC needs to go through a period of consolidation.

The loss of local offices means that taxpayers are no longer able to access face to face services and the person at the end of the phone is not always the person available again for any follow-up enquiries. This is disruptive and time consuming. Reliance on call centres is also problematic as taxpayers are not standardised units but individuals with their own particular concerns. Most of the people contacting

HMRC are lay persons, often without the relevant tax or legal knowledge and concerned about incorrect tax assessments or personal tax codes.

Waiting in long telephone queues only adds to taxpayer anxiety and frustration. The absence of a local presence means that HMRC is not able to build local expertise and intelligence. For example, oil, fisheries, software, manufacturing and other businesses have their own peculiarities which are embedded in particular local environments. All business advisers that we met (over one hundred) complained that HMRC staff were too divorced from the local environment and often lacked detailed knowledge of local businesses. HMRC have tried to save some costs by centralising its operations, but the impact on businesses has been detrimental.

A major reason for HMRC's failure to maximise tax revenues is its closeness to big business. Seemingly, to appease big corporations, the government has virtually privatised tax policymaking and enforcement. HMRC board is dominated by corporate interests and has no representation from other stakeholders, including normal taxpayers and employees. It is a matter of concern that HMRC is being run by individuals with a publicly declared aversion to clampdown on tax avoidance. As we highlighted above, Edward Troup, the recently appointed Executive Chair of HMRC, has been a defender of tax havens, an opponent of clampdown on tax avoidance and has indeed described taxation, which pays his salary, as "*legalised extortion*".

Unsurprisingly, HMRC is soft on big corporations and rarely takes effective action against big corporations. The task of HMRC is to apply the law, collect tax revenues, and litigate where necessary. The tax commissioners need not be hostile to big corporations, but there needs to be considerable distance between the HMRC board and big business. In principle, non-executive directors should provide some checks and balances and challenge the dominant views but they come entirely from big corporations and accountancy firms, often with a record of aggressive tax avoidance and engagement in avoidance schemes declared to be unlawful by the courts.

In addition to the Board level, corporations also exercise undue influence in designing policies and legislation. We noted earlier that KPMG exploited that position to make private profits. Of course, this is not the only example. In 2013, the government sought to expand HMRC's armoury by introducing an anti-avoidance measure known as the General Anti Abuse Rule<sup>55</sup> (GAAR). However, HMRC is shackled and cannot on its own initiative pursue "abusive" practices. It needs permission from a Panel, which entirely consists of business people and has no representation from other stakeholders. The Panel<sup>56</sup> is chaired by Patrick Mears, a senior tax partner at law firm Allen and Overy. Other members are Michael Hardwick,

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<sup>55</sup>[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/399270/2\\_\\_HMRC\\_GAAR\\_Guidance\\_Parts\\_A-C\\_with\\_effect\\_from\\_30\\_January\\_2015\\_AD\\_V6.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/399270/2__HMRC_GAAR_Guidance_Parts_A-C_with_effect_from_30_January_2015_AD_V6.pdf)

<sup>56</sup> As per <https://www.gov.uk/government/groups/general-anti-abuse-rule-advisory-panel>

a consultant at law firm Linklaters; Brian Jackson, vice-president for group tax at Burberry<sup>57</sup> group plc and previously tax partner at KPMG<sup>58</sup>; Sue Laing, a partner at law firm Boodle Hatfield; Gary Shiels, a business consultant; and Bob Wheatcroft, a partner in accountancy firm Armstrong Watson<sup>59</sup>. One of the initial appointees to the GAAR Panel was David Heaton, a partner in accountancy firms Baker Tilly and a recent chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW). In September 2013, Heaton was secretly filmed offering tips on how to keep money "out of the chancellor's grubby mitts"<sup>60</sup>. He advised an audience on how they could exploit maternity pay rules "to get the government to pay your bonuses". Subsequently, David Heaton resigned from the GAAR Panel.

The issues are captured by the House of Lords Economic Affairs Committee<sup>61</sup> which noted that

*"The use of staff seconded from the Big Four accountants by HM Treasury and HMRC to help design taxes is counterproductive. The risks are two-fold: that those on secondment will not have any incentive to design robust, hard-to-avoid taxes and that when they return to private practice they will be better placed to advise how to exploit loopholes. We recommend that the Treasury and HMRC should be better resourced to design and implement taxes, without undue dependence on short-term professional advisers".*

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<sup>57</sup> 28,000 pages of leaked tax agreements known as Luxembourg Leaks (LuxLeaks) showed that Burberry has used complex transactions to avoid taxes (<http://www.theguardian.com/business/2014/nov/05/-sp-luxembourg-tax-files-tax-avoidance-industrial-scale>); Burberry chairman has attacked the government for attacks on tax avoidance and told the prime minister to "stop moralising and rein in his rhetoric on tax avoidance" (<http://www.theguardian.com/business/2013/may/20/david-cameron-tax-avoidance-multinationals>).

<sup>58</sup> KPMG have a long history of marketing tax avoidance schemes. For an indication see Austin Mitchell and Prem Sikka, *The Pin-Stripe Mafia: How Accountancy Firms Destroy Societies*, Basildon: Association for Accountancy & Business Affairs, 2011. In March 2016, the courts declared another KPMG tax avoidance scheme, this time for Stagecoach plc (see <http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j8863/TC04866.pdf>).

<sup>59</sup> The firm's website states "Two things in life are certain, while we can't influence one, we love to help you save money on the other. Diversifying across all areas of taxation to maximise the opportunities we can offer you, our tax team specialise in different areas of taxation, ensuring their knowledge and expertise is always bang up to date, innovative and accurate, giving you the peace of mind that whatever it is, it's taken care of" (<http://www.armstrongwatson.co.uk/tax-planning>; accessed on 5 July 2016)

<sup>60</sup> BBC News, HMRC's David Heaton quits after offering tips on avoiding tax, 14 September 2013 (<http://www.bbc.co.uk/news/uk-24089463>).

<sup>61</sup> House of Lords Select Committee on Economic, Tackling corporate tax avoidance in a global economy: is a new approach needed? London: TSO, July 2013 (<http://www.publications.parliament.uk/pa/ld201314/ldselect/ldeconaf/48/48.pdf>).

The general point is that the government has been engaged in a privatisation of tax policymaking and administration and this encourages abuses. No doubt, it would be argued that the people from big business are neutral and seek to serve the public interest, but the difficulty is that in common with other citizens their conception of public interest is likely to be shaped by their education, business interests and availability of income and wealth. The economic elites sitting on HMRC Board are overly sympathetic to big business, especially as after their stint at HMRC the individuals return to big business. It may also be argued that tax is a technical subject and therefore HMRC needs people with the appropriate technical know-how. Such a technocratic view needs to be challenged. For example, tax abuses have frequently been highlighted by individuals who care about a good and just society and whose worldviews are not constrained by narrow technical knowledge and business interests. Such individuals can make a very effective contribution to discussion of tax problems and development of appropriate policies.

There is poor public accountability of HMRC. Parliamentary scrutiny is an important part of accountability, but as we noted the PAC has been unable to obtain any meaningful documentation about what would appear to be special tax settlements with companies such as Google, Vodafone, Goldman Sachs and others. In the absence of information, it is impossible to know whether HMRC acted diligently, legally or indeed maximised tax revenues. HMRC Commissioners have considerable discretion, but that is not accompanied by public accountability. The annual report published by the Assurance Commissioner is not an adequate vehicle for public accountability. It is a one-way passive document and without availability of the details of the tax settlements, parliamentary committees cannot check the veracity of the claims made by HMRC. It is not only tax settlements: parliamentary committees are also unable to monitor whether HMRC obtains value for money from the resources at its command. For example, it has a poor record in delivering values from computer systems, security and privatised contracts. Whilst parliamentary committees perform vital tasks they cannot invigilate the HMRC board on a regular basis or enhance its accountability to stakeholders, especially as HMRC is too close to big business and has a history of failing to meet its objectives.

## **Summary**

This chapter summarised the concerns arising out of our evidence and discussions with various stakeholders. There are considerable anxieties about poor service to taxpayers and lack of effective action against organised tax avoidance. HMRC is too close to big business and ordinary people have little opportunity to impress their concerns upon HMRC management. In particular, there is a major public accountability deficit as some of HMRC practices even escape parliamentary scrutiny. The next chapter outlines a number of reforms to address such concerns.

## **CHAPTER 7**

### **PROPOSALS FOR REFORM**

The preceding analysis shows that HMRC's difficulties are associated with a lack of financial and human resources, transparency, public accountability and enforcement. This chapter outlines a number of reforms which will enhance HMRC's public accountability, make it accountable to parliament and the people and improve its capacity for tax collection, enforcement and more responsive public services.

1. There should be a Supervisory Board to watch over HMRC Board to give it direction and enhance its public accountability. The Board shall also act as a bulwark against corporate capture and inertia. The Supervisory Board shall consist of stakeholders and meet in the open at regular intervals. The Supervisory Board shall not have any responsibility for the day-to-day running of HMRC. No stakeholder group shall be in a majority, thus ensuring that dialogue and consensus would be necessary to reach decisions. Board minutes and background papers must be publicly available.

Board members can be appointed by the Chancellor of the Exchequer for a fixed period according to a publicly declared criterion. The appointment must be approved by the Public Accounts Committee. The appointees must declare their commercial interests and avoid conflict of interests. Before each meeting, the board members must declare whether they have held any prior discussions about the subject matters under consideration with any organisation likely to be directly affected by the discussions.

The Supervisory Board must focus on HMRC's ability to meet its objectives. These are to maximise tax revenues, make sustainable cost savings, and improve the service to customers; or any other objective decided by parliament. It will not be specifically concerned about the affairs of any specific taxpayer. It must ask questions about whether HMRC has adequate resources to meet its objectives, including staffing, legal, and financial sources. It must focus on the quality of enforcement action taken to increase tax collection, including the number of prosecutions against large businesses, high net worth individuals and others. It must approve all large tax settlements relating to tax disputes. It must approve decisions to close offices or open new ones to ensure that such developments are consistent with HMRC's objectives.

The Supervisory Board shall seek explanations about the value that HMRC obtains from PFI, privatisation and outsourcing of contracts and services. It should have an unhindered right to examine any relevant documents.

The Supervisory Board must make an annual report, which can form part of the annual report published by HMRC, and comment on its activities, practices and matters of public concern.

2. The Supervisory Board should be the statutory point of contact for whistleblowers releasing information about tax avoidance and evasion. The Supervisory Board must develop policies for supporting tax related whistleblowers from within and outside HMRC. Whistleblowers should be awarded protection (protection of their job, livelihood and future employability) and a possible share of the taxes and penalties recovered as a direct result of the information provided by them. There should also be a broader legislation to protect whistleblowers.
3. The lack of resources is a major reason for continuing poor services and enforcement. HMRC needs additional resources as without them it cannot meet its objectives. The Confederation of British Industry (CBI) has recommended that

*“Adequate resources need to be provided to HMRC to ensure it can efficiently and effectively collect taxes due and strike the right balance in relationships with taxpayers that encourages co-operative compliance<sup>62</sup>”.*

The House of Lords Economic Affairs Committee<sup>63</sup> also recommended that

*“HMRC needs sufficient high quality staff with deep expertise in corporate tax to deal effectively with the tax affairs of complex and well-resourced multinationals. In order to achieve this, we recommend that HMRC should be better resourced”.*

There is a very strong economic case for increasing resources, staffing and related support. The data<sup>64</sup> released by HMRC shows that the financial returns from investigations into large businesses for 2013/14 have jumped to £97 in extra tax for every £1 invested in the last year, up from £87 during the previous year. Both the local compliance (which investigates individual taxpayers and small businesses) and high net worth units collected approximately £18 for every £1 invested in 2013/14, up from £16 over 2012/13. The returns for various compliance units are summarised below.

### **Compliance investigations: investment in relation to revenue (£)**

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<sup>62</sup> Confederation of British Industry, A Comprehensive Business Tax Roadmap: The Way Ahead, 2014 (<http://news.cbi.org.uk/cbi-prod/assets/File/Comprehensive%20Business%20Tax%20Roadmap.pdf>).

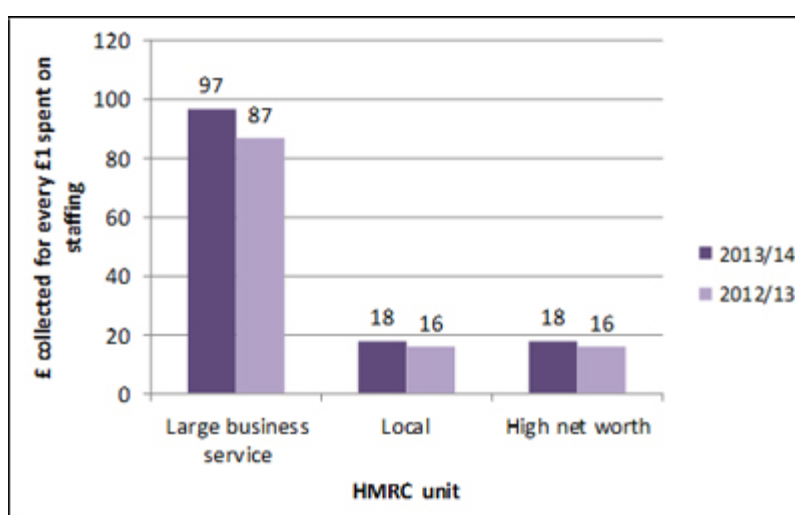
<sup>63</sup> House of Lords Select Committee on Economic, Tackling corporate tax avoidance in a global economy: is a new approach needed? London: TSO, July 2013 (<http://www.publications.parliament.uk/pa/ld201314/ldselect/ldeconaf/48/48.pdf> )

<sup>64</sup> HMRC investigations into large companies now yielding £97 for every £1 invested; <http://www.pinsentmasons.com/en/media/press-releases/2015/hmrc-investigations-into-large-companies-now-yielding-97-for-every-1-invested/>



Year	Local compliance	Large Business Service	High net worth
2011/12	1:12	1:76	1:15
2012/13	1:16	1:87	1:16
2013/14	1:18	1:97	1:18

**Amount collected from compliance investigations compared to expenditure on compliance staff 2012/13- 2013/14**



***\*Year ending March 31 2014***

In February 2016, HMRC told the PAC that it raises £75 for every £1 spent on investigating large businesses<sup>65</sup>.

The above data makes a strong economic case for additional investment in HMRC.

4. For effective and efficient service and tax collection, HMRC needs to be embedded within the community. Whilst there is a role for information technology and electronic filing of tax returns, there is also a need to build local intelligence, respond to citizens' concerns and provide continuity. This is best achieved through a network of local offices and staff with local knowledge.

<sup>65</sup> House of Commons Committee of Public Accounts, Corporate Tax Settlements, London: TSO, February 2016, page 3 (<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/788.pdf>).

5. HMRC should have a well resourced internal investigation and prosecution unit. Unlike the present reliance on external advisers, this would enable HMRC to retain the knowledge in-house and build on it. Rather than constantly relying on external lawyers it should have in-house teams of specialist lawyers to facilitate prosecutions and strengthen the deterrent effect.
6. HMRC is competing with large corporations, accountancy firms and financial services companies to attract and retain good staff. All too often, it trains staff and then due to low wages is unable to retain them. They are poached by other organisations. This is highly disruptive and costly. HMRC needs to offer competitive financial rewards.
7. Parliamentary committees perform a vital service in questioning HMRC Commissioners. They shall also be able to question members of the Supervisory Board. Any documents examined by the Supervisory Board must be made available to the committees.
8. The tax returns, related computations and documents of all large companies must be made publicly available. They can be filed at Companies House together with company accounts, annual returns and other documents. The public availability of information will help to increase the threat of naming and shaming and associated pressures on company boards not to use aggressive tax avoidance strategies, and thus increase tax revenues. The public availability of corporate tax returns will improve the quality of information available to parliamentary committees to scrutinise the effectiveness of HMRC in meeting its objectives.
9. Parliamentary committees should be empowered to examine any information, no matter how sensitive. Confidentiality should not obstruct parliamentary scrutiny of HMRC's practices. It would be up to the relevant parliamentary committee to decide whether scrutiny of any documents and practices should be conducted in private or closed meetings. There is precedence for this. For example, the Intelligence and Security Committee is able to take some evidence in private.
10. The UK lacks effective judicial capacity to resolve tax disputes. In 2009/10, the number of cases awaiting hearing at first-tier tribunals stood at 13,456<sup>66</sup>. By 2014/15, the numbers reached 29,566<sup>67</sup>. There were also 310 appeals waiting to be heard by the upper tax tribunal. A casual glance at decisions by first-tier tax tribunals and tax courts shows that many tax cases take around a decade to be

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<sup>66</sup> As per <http://www.pinsentmasons.com/en/media/press-releases/2013/record-backlog-of-disputes-between-hmrc-and-taxpayers-as-number-of-outstanding-tribunal-cases-doubles-in-four-years/>

<sup>67</sup> As per <http://www.out-law.com/en/articles/2015/august/outstanding-uk-tax-tribunal-cases-reach-record-levels/>

resolved. This is not helpful to taxpayers who may have been wronged and continue to incur costs. Excessive delay undermines confidence in HMRC and the deterrent effect of prosecutions. A speedy resolution of tax disputes would not only facilitate early tax collection, but would also enable parliament to quickly address legislative weaknesses. The delay in court hearings also adds to costs as HMRC needs to retain external lawyers and advisers.

We recommend an urgent expansion of the judicial capacity for hearing tax cases. We recommend the appointment of judges solely focused on tax matters as that can enable the development of an expert body of knowledge to resolve cases more efficiently

11. The annual “How we resolve Tax Disputes” report published by the HMRC Assurances Commissioner should be strengthened. It should provide information about the total amount of tax disputed, the amount disputed for a period of more than one year, two years, five years, ten years, or longer. The outstanding amounts should be analysed into appropriate categories, such as those relating to VAT, excise duties, income tax, taxes relating to high net worth individuals corporation tax, offshore tax avoidance/evasion, transfer pricing cases and so on. The reasons for the dispute and delay should be provided. The report should provide a summary of the outcomes together with details of the litigation costs incurred by HMRC, the time spent by HMRC staff and any costs which are recovered from the third parties. Such disclosures would increase transparency and accountability of HMRC.
12. Taxpayers should not have to pay any fees for contesting assessments raised by HMRC. Under the government proposals<sup>68</sup> taxpayers will have to pay a minimum fee of £50, which could be for contesting an assessment of only £100. The government recommends that the first tier and upper tribunals should charge up to £2,000 for contesting an HMRC decision. The creation of such a regime will further widen inequalities by ensuring that only those with wealth can dispute their tax liabilities. The introduction of such charges could mean that many less well-off people would suffer in silence and this would dilute the pressures on HMRC to improve its services. We oppose the levying of charges. Of course, judges could still declare some cases to be frivolous and award costs to HMRC.

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<sup>68</sup> [https://consult.justice.gov.uk/digital-communications/further-fees-proposal-consultation/supporting\\_documents/Government%20response%20to%20consultation%20on%20enhanced%20fees%20and%20consultation%20on%20further%20fees%20proposals%20web.pdf](https://consult.justice.gov.uk/digital-communications/further-fees-proposal-consultation/supporting_documents/Government%20response%20to%20consultation%20on%20enhanced%20fees%20and%20consultation%20on%20further%20fees%20proposals%20web.pdf)

13. HMRC's capacity to challenge abusive practices needs to be strengthened by a rewrite of the General Anti Abuse Rule<sup>69</sup> (GAAR), introduced in 2013. The principle behind GAAR should be to discourage organised tax avoidance by focusing on the economic substance rather than just the legal form of a transaction. This way, it can be argued that many of the transactions are a sham, because they have no economic substance and are merely designed to avoid taxes and should thus be ignored. Under the existing GAAR transforming income into capital through artificial transactions may not be construed as tax avoidance. Unsurprisingly, chairman of the House of Lords Economics Committee wrote<sup>70</sup>:

*"The Committee stress that because the GAAR is so narrow it will not apply to current issues of public concern about the international tax planning techniques relating to tax paid by multinational companies which limit the amount paid in the UK ... There is a misconception that GAAR will mean the likes of Starbucks and Amazon will be slapped with massive tax bills. This is wrong and the Government needs to explain that to the public. GAAR is narrowly defined and will only impact on the most abusive of tax avoidance".*

The current GAAR does not apply to any tax arrangements entered into before the legislation came into effect even though the impact of those arrangements may continue for many years. It requires HMRC to apply a "double reasonableness" test and show that the tax arrangements or schemes under scrutiny "cannot reasonably be regarded as a reasonable course of action". The net effect of the linguistic turn is that an avoidance scheme will be treated as abusive only if it would not be reasonable to hold such a view. The key test is whether what has happened is reasonable. So, if a dubious practice is well established then it may well be considered to be reasonable. Who will decide whether the state of affairs is reasonable? The procedure is that before any litigation HMRC will have to make its case to a panel of so-called independent experts who will give their opinion as to whether the arrangements in question constitute a reasonable course of action. The advisory panel consists of individuals from companies, accountancy and law firms. Thus the tax avoidance industry and companies implicated in tax avoidance are in a position to shackle HMRC. If the panel permits HMRC to bring a case then in due course the same benchmarks can apply to them and their businesses too. So there is a real conflict of interests. If the GAAR Panel does not unanimously support counteraction then HMRC need to show that it has cogent reasons for continuing the process of counteracting the tax advantage sought by the taxpayer. If the matters somehow

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<sup>69</sup>[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/399270/2\\_HMRC\\_GAAR\\_Guidance\\_Parts\\_A-C\\_with\\_effect\\_from\\_30\\_January\\_2015\\_AD\\_V6.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/399270/2_HMRC_GAAR_Guidance_Parts_A-C_with_effect_from_30_January_2015_AD_V6.pdf)

<sup>70</sup> <http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-finance-bill-sub-committee/news/fbsc-report-press-release/>

reach a court, then it may also be shackled. The guidance<sup>71</sup> issued by the government states that “the tribunal or court must also take into account the opinion, or opinions, of the GAAR Advisory Panel (in practice, the sub-panel) given to the HMRC”.

The revised GAAR must catch all sham transactions. HMRC should not be shackled by a panel of business people. Instead, it must seek guidance from the Department of Justice and/or a panel of retired judges specifically appointed to guide HMRC. To be effective HMRC must have complete independence from all business interests. This means that business interests, in common with other stakeholders, can be part of an open consultation process, but must not write laws or enforce them, or be in a position to shackle HMRC’s capacity to pursue abusive practices.

The proposals outlined here are not a panacea for deep-seated social, economic and political problems, but will help to strengthen HMRC by improving its resources, public accountability, efficiency and effectiveness.

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<sup>71</sup>HMRC’s GAAR Guidance (Approved by the Advisory Panel with effect from 15 April 2013, paragraph C8.4. ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/396179/gaar-part-abc.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/396179/gaar-part-abc.pdf)))

## **About the investigating team**

Prem Sikka, Professor of Accounting, University of Essex  
Michele Christensen, Teacher and Researcher  
John Christensen, Director, Tax Justice Network  
Christine Cooper, Professor of Accounting, University of Strathclyde  
Tom Hadden, Emeritus Professor of Law, the Queen's University, Belfast  
Deborah Hargreaves, Founding Director, High Pay Centre  
Colin Haslam, Professor of Accounting, Queen Mary, University of London  
Paddy Ireland, Professor of Law, University of Bristol  
Glenn Morgan, Professor of Management, University of Bristol  
Martin Parker, Professor of Culture and Organization, University of Leicester  
Gordon Pearson, Former company executive and a serial entrepreneur  
Sol Picciotto, Emeritus Professor of Law, Lancaster University  
Jeroen Veldman, Senior Research Fellow, City University  
Hugh Willmott, Professor of Management, City University.



