

# Mandatory tax strategies, a code of practice and "special measures" – a new era for corporates?

The Government yesterday published a [consultation document](#) proposing that large businesses be required to publish a "tax strategy", introducing a voluntary Code of Practice on taxation for corporates, and creating a "special measures" regime for companies HMRC regards as engaging in unacceptable tax avoidance. We ask how these proposals are likely to work, what they mean in practice for UK business, and whether the Code of Practice will really be "voluntary".

## What is a "tax strategy"?

HMRC believe that requiring large businesses to have a "tax strategy", and to make it publicly available, will make them less likely to engage in aggressive tax planning.

The tax strategy would set out:

- internal governance arrangements with respect to tax;
- the general approach to risk management;
- the attitude to tax planning and appetite for tax risk, and whether the company seeks to work in accordance with the spirit, as well as the letter of the law;
- the attitude to their relationship with HMRC; and
- whether the business has a target effective tax rate in the UK, what it is, and what measures the business is taking to reach it.

Any company failing to publish a tax strategy would face a financial penalty. A company submitting tax returns that appear "materially inconsistent" with its published tax strategy would be treated by HMRC as a high risk company.

## What will the tax strategy proposal achieve?

In our experience, most large businesses already have a tax strategy, do not engage in aggressive tax avoidance, have a transparent relationship with HMRC, and seek to follow the spirit of the law where it can be discerned. So we are not sure this proposal will have much effect.

HMRC of course believe the proposal will change taxpayer behaviour. This follows [research](#) published by HMRC yesterday which suggests that businesses with a published tax strategy are less likely to engage in

aggressive tax avoidance, and that those with a target effective tax rate are more likely to engage in aggressive tax avoidance. However, we would query whether this research is really rigorous enough to drive tax policy, given that it relies upon a small sample of only 35 businesses, and that that sample was selected by HMRC.

## What is the Code of Practice?

The central principle of the Code is that companies signing up to it will agree to comply with the spirit, as well as the letter, of tax law. In particular, they will commit to:

- not undertake tax planning that aims to achieve a tax result that is inconsistent with the underlying economic consequences (save where there is specific legislation designed to give that result);
- not enter into transactions structured in a way that gives a tax result that is contrary to the intentions of Parliament;
- maintain a transparent relationship with HMRC, and seek to resolve disagreements by agreement where possible;
- comply fully with all their tax obligations;
- engage in open early dialogue with HMRC to discuss tax planning, strategy, risk, significant transactions, and to fully disclose any areas of significant uncertainty; and
- provide HMRC with evidence that decisions with tax implications have been approved by the most senior decision makers within the business.

## What are the "special measures"?

HMRC say a very small number of large businesses persist in undertaking persistent aggressive tax planning and/or persistently refuse to engage with HMRC in a collaborative and transparent way. HMRC propose a new regime where such businesses are warned to change their behaviour. If they do not do so, they may enter "special measures".

For those businesses that have failed to transparently engage with HMRC, sanctions could include:

- a requirement to provide all documentation related to tax (including third party tax advice not protected by legal professional privilege);
- refusal to provide non-statutory clearances; and
- being publicly named as being subject to special measures.

For those businesses that enter into what HMRC views as "persistent aggressive tax planning", the special measures could be:

- automatic 100% penalties where any tax planning is found to be ineffective by a Court or Tribunal; and
- being publicly named as being subject to special measures.

The "special measures" regime would continue to apply to a company for two years, and would then be subject to review.

## What does all this mean in practice?

The practical impact of these proposals will be that companies may feel obliged to discuss tax planning and potential sources of uncertainty and tax risk with HMRC before entering into an arrangement or transaction, as part of the "early dialogue" they'll be committing to if they sign the Code.

This would, we expect, have little impact on most companies' ordinary course activities, where the tax treatment is usually clear and settled. And few if any companies are presently willing to enter into aggressive and artificial tax avoidance schemes.

The real impact will therefore be on the "grey area" where either there is an uncertain tax result, or there are numerous possible ways of structuring the arrangements, each with a different tax result. The complexity of the

tax code means that these are fairly common occurrences. The Code may in practice require such "grey areas" to be agreed with HMRC in advance of the company entering into the transaction (albeit that HMRC will not usually provide a formal opinion). This is not just a matter of persuading HMRC that the proposed approach complies with tax law – HMRC would have to agree it accords with the spirit of the law and the intent of Parliament.

One of the main problems in the current febrile atmosphere surrounding tax matters is that any form of tax planning – however benign – can be misrepresented if it gets into the public domain. No public official wishes to have to justify their decisions before bodies like the Public Accounts Committee. So in practice a business seeking to agree with HMRC that a piece of uncontroversial tax planning is not in breach of the Code may find it hard to get the required confirmation. There is no benefit for an HMRC official who gives that confirmation, but an obvious risk for the official if the confirmation is given and subsequently criticised.

Any business signing up to the Code will therefore need to consider HMRC's likely reaction to proposed transactions and arrangements at the earliest possible stage.

The "special measures" regime is likely to be relatively uncontroversial if it is reserved for companies engaging in egregious artificial and aggressive tax avoidance schemes. However we are conscious that HMRC's view of what is avoidance is not always the same as taxpayers' views. We would be very concerned if HMRC start using "special measures" as a threat to resolve disputes over areas of legitimate technical uncertainty.

## What businesses will be particularly affected?

HMRC suggest that the threshold for application of the new rules could be the same as for the existing Senior Accounting Officer rules – a turnover of more than £200m and/or a balance sheet total of more than £2bn.

We see two scenarios where the new rules will be particularly difficult for companies.

First, where a business is entering into a complex corporate or financing transaction – they are then at particular risk of running into one of the "grey areas" mentioned above. They may also be under time constraints which make it difficult to reach up-front agreement with HMRC.

Second, some businesses' ordinary course operations benefit from specific, and highly complex, reliefs and incentives created by Parliament. These would include, for example, IP development and holding structures, real estate and leasing businesses claiming capital allowances, and companies with share schemes and other types of employee remuneration arrangements. In all of these areas Parliament clearly intended to facilitate tax relief, and so the tax result often departs significantly from the economic result. However determining the precise intent and effect of the reliefs is often less than straightforward.

The Code is unlikely to "grandfather" historic arrangements. Any business signing up to the Code will therefore need to be ready to defend its existing structures to HMRC.

## What are the likely effects on governance?

HMRC's general policy is that a company's tax policy should be raised to the highest level within large companies' management structures. The Code suggests HMRC will be holding Board members as well as senior tax personnel accountable for any decisions on tax with which HMRC disagrees.

## How "voluntary" will the Code be in reality?

FTSE 100 and other large companies are likely to come under a significant degree of pressure from the Press and NGOs to sign up to the Code. Those companies that are less in the public eye may in practice have more freedom of action in choosing whether or not to sign.

It is also possible that the Government will extend their [existing policy](#) on procurement and tax compliance so as to exclude companies that haven't signed the Code from government procurement processes.

The code of practice on taxation for banks took some time to become widely adopted. That code was introduced in July 2009, but by October 2010 only four of the major banks had signed up. There was then a concerted campaign by HMRC and the Treasury, which resulted in each of the largest 15 banks operating in the UK signing the code. As of today there are almost three hundred banks and building societies signed up to the code.

Legislation was enacted in 2014 which put the banking code on a statutory footing. HMRC was required to publish an annual report, listing both those banks which have not signed up to the code, and those banks (if any) who signed up to the code but breached it. Before HMRC could list a bank for being in breach, HMRC and the affected bank could make representations to an independent adjudicator, whose decision would be binding.

The consultation document states explicitly that it will not publicly name companies that don't sign the Code, although this may be a required element of the tax strategy report. HMRC also say they won't name companies that sign the Code and then breach it, but it would not be surprising if that policy changes over time.

## What should businesses be doing now?

We would suggest the immediate steps are:

- responding to the consultation where a business believes it has issues of practicality or principle that should be brought to the Government's attention;
- start thinking through its governance arrangements and considering whether any of its historic arrangements and structures are not compliant with the Code;
- ensuring that it has a group tax strategy and, if it already has one, reviewing it in light of the HMRC proposals; and
- ensuring the business has a press strategy in place when journalists, shareholders or other stakeholders ask whether it plans to sign up to the Code.

If you would like further information, please call or email your usual Clifford Chance contact, or one of those listed overleaf.

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