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Witnesses: Patrick Stevens, Bill Dodwell and Richard Murphy

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Members present

Lord MacGregor of Pulham Market (Chairman)
Lord Bilimoria
Lord Hollick
Baroness Kramer
Lord Rowe-Beddoe
Lord Tugendhat
Lord Wakeham
Baroness Wheatcroft

Examination of Witnesses

Patrick Stevens, President, Chartered Institute of Taxation (CIOT), **Bill Dodwell**, Chairman of Technical Committee, CIOT, and **Richard Murphy**, Director, Tax Research LLP.

Q25 The Chairman: Good afternoon, and welcome to the second public meeting of the Economic Affair Committee's Finance Bill Sub-Committee 2013. Welcome to Mr Stevens, Mr Dodwell and Mr Murphy. I was saying earlier that they are probably old hands at this business, having been in front of us before. We have three topics. I think we will be spending most of the time on the general anti-abuse rule and then, after that, the annual residential property tax and, if there is time, we would like to have a few brief questions on the cap on income tax reliefs. Do any of you want to make a statement?

Richard Murphy: No.

The Chairman: Then we shall go straight into questions. On the general anti-abuse rule, as you know, we have already had evidence from Mr Aaronson, which I assume you have been able to see. The scope and target of the proposed GAAR measure in the draft Finance Bill follows the recommendations of that study group. We see from the evidence that the Chartered Institute of Taxation takes the view that this approach is broadly correct. In contrast, Mr Murphy has a different view—a wider spectrum GAAR with a comprehensive

clearance system to deal with the resulting uncertainty. Previous attempts to introduce a GAAR have foundered on the resource consequences of introducing a clearance system. Mr Murphy, how would you deal with this problem?

Richard Murphy: Oh, simple: charge for a clearance. It is as straightforward as that. I do not see why the Revenue should provide somebody with certainty in their affairs without charging them for the privilege. After all, at the moment, if a taxpayer wants some degree of certainty with their affairs, if they are undertaking a complex transaction they will go to counsel and pay for the advice that they get. They would get a much higher degree of certainty if they went to the Revenue and asked for a clearance. So, in the Bill that I referred to, which is before the Commons at the moment, which I drafted for Michael Meacher, I suggested that a fee should be paid based upon the estimated taxation value of the transaction for which a clearance was being sought. I think that that would inevitably provide the resources to solve this problem. If we are to have a modern, competitive economy which provides business with certainty, which is what the Government say they want, I do not think anything could do the job better than actually telling people, as soon as is possible, whether the transactions that they are undertaking are acceptable or not to HMRC. It solves a great many problems.

Q26 The Chairman: Any comment from our other witnesses on that proposal?

Bill Dodwell: To be honest, I think it starts from the wrong premise. In our view tax should be levied clearly by law, enforced by the tax administration and then disputes about its application resolved by the judiciary. But to impose the sort of question of whether something should or should not be taxable to the tax authority is moving the role of Parliament into the role of an executive agency and not likely to create a satisfactory outcome for anyone. The other point I would just make on the breadth or otherwise of the general anti-abuse rule is that the UK starts with a great deal of legislation, a great deal of

which sets out in pretty prescriptive terms how Parliament thinks the law should apply in particular circumstances. Applying some general rule over such a detailed body of law would really be quite unhelpful and not at all clear as to how it would apply. Whereas by contrast the anti-abuse rule proposed here would deal simply with completely unintended consequences when somehow those prescriptive pieces of legislation have not quite achieved the result that everyone in Parliament thought they were due to achieve.

Patrick Stevens: Only to extend it just by two sentences: the wider concept of a GAAR, which I think you are coming on to later, would probably mean that such a clearance system was huge. It would cover such a huge number of transactions, it would mean that much tax law would be administered through such a clearance system. I am just saying that that takes you back even more firmly to the point that Mr Dodwell was making.

Q27 Lord Wakeham: I was just going to ask a supplementary on Mr Murphy's view that the fee that should be charged under his system would be based upon the amount of tax paid. I can see the argument for that but surely there ought to be some notice of the complexity of the scheme that is put forward or it seems to me that there will be a good deal of cross-subsidisation between one fee payer and another. Where something was complicated but relatively little tax was involved, a very small fee would be paid, whereas where something was enormous but simple, an enormous fee would be expected to be paid. Do you really think that what you propose is the fairest way of doing it?

Richard Murphy: There might be another way of doing it. I am not pretending that I have the answers to all the problems. It seems to me to be quite a fair way of dealing with it. I have to say that I do not think there would be that many clearances. First, the vast majority of cases that would require to be addressed would be capable of being dealt with in a very small number of clearances. Most people's tax affairs are not complicated. Most people do not run into any problems with the law in terms of interpreting what is going on. Most

people steer well clear of the risk of a dispute with the Revenue, and so, mostly, do councils if they have any sense, because inevitably they do not make much money out of them. So the vast majority of people would not wish to go near this.

However, as I know from my career as a practitioner, which I was before I did this, there are now occasions when you need clearances. I am sure that both the other witnesses are well aware of the fact that part of the life of the practitioner still involves asking for clearances, upon which we rely. There is nothing unusual about clearances. Nor is there anything unusual about presuming that the Revenue administers tax in this country. Some 99.99% of all tax returns and tax disputes are resolved without ever being referred to a commissioner, let alone to a court. So I do not think that this is extending the parameters of taxation administration beyond anything that already exists.

Q28 Lord Hollick: Mr Dodwell, the DOTAS rules provide a useful certainty to individuals who might or might not wish to invest in a tax minimisation arrangement or scheme. They do so with a degree of certainty if it is passed, as I understand it.

Bill Dodwell: I do not think so, no. The tax disclosure rules simply require promoters of schemes to notify them, and HMRC are then almost bound to issue a reference number. HMRC are not expressing an opinion as to whether they think that the scheme succeeds or fails in its intended objectives. They simply have to give notice.

Lord Hollick: If they feel that it is, let us say, an abusive scheme, they would presumably take steps for legislation to deal with it.

Bill Dodwell: Yes.

Lord Hollick: So a wise, sensible or prudent investor might say, "Well, I'll wait and see what's going to happen on that".

Bill Dodwell: Yes.

Patrick Stevens: Yes.

Lord Hollick: That seems to go somewhat down the path that is being suggested here. It is largely corporations that will be most concerned about this. Recalling my days as a chief executive, our tax advisers came in with a rather interesting new piece of technology to minimise taxation, and our greatest concern was whether this would pass muster. So having certainty would be of enormous value to corporates. Taking Mr Murphy's point, once that particular door is closed, or indeed remains open, then people will either go through it or not as the case may be. So I should have thought that there would be a relatively small number of cases which would then establish whether or not a particular piece of tax planning was acceptable.

Bill Dodwell: I would agree in relation to the general anti-abuse rule that we have got proposed. It is a narrow thing. I agree that clearances should not be needed but, in relation to the much broader thing that Mr Murphy was discussing, I think there would be many more clearance applications. While I completely understand the point about charging for them, one of the difficulties that that does not deal with is the actual use of experienced HMRC officers who may be diverted from enforcing the tax law to the more complex question of giving a clearance. They have not got so many free high-quality inspectors.

Lord Hollick: Which would, of course, save a lot of enforcement down the line?

Bill Dodwell: Yes, possibly.

Richard Murphy: My point.

Q29 Lord Wakeham: We will come a bit later on to some of the fundamental problems that Mr Murphy sees with the general anti-avoidance rule. I wonder if both of you could give us an overview of the tax arrangements that you see will be captured by the proposed rule and which ones you see will be outside its scope.

Bill Dodwell: I think that if an individual in particular tries to enter into an arrangement with little if any commercial or economic consequence beyond a tax saving, then I think they will

find themselves straight in the compass of the GAAR, of this limited anti-abuse rule. I will have to exclude inheritance tax from that because, obviously, giving one's assets away is a more complex thing to put in that commercial context. But, if you are dealing with business life, the loss generation schemes that we have seen, I would expect, in many cases would be caught by an anti-abuse rule once it is enacted.

Richard Murphy: I think that that is about as far as this GAAR is going to go. It is what this GAAR is meant to do. Very specifically it says that this does not relate to normal commercial transactions whether they are abusive or not. What we do know with absolute certainty is that this GAAR would not, for example, tackle any of the abuse that is being discussed with regard to Google, Amazon and Starbucks, which the Public Accounts Committee looked at, and which is clearly seen to be common-place in its structuring. It is not intended to challenge a whole host of other arrangements which are now normal in business but which, none the less, to most people on the Clapham omnibus, would appear abusive. But this is not going anywhere near those. It is basically targeted at pre-packaged and planned tax abuse schemes which involve a degree of artificialness, which are designed specifically to look at very particular opportunities to construct abuse through a series of steps which are designed to exploit a loophole in the law. So, it is a very narrow piece of work.

Lord Wakeham: I do not get the impression that any of you think this thing is really worth having at all—I shall finish the sentence—except as a signal.

Bill Dodwell: Yes.

Patrick Stevens: The description given by my colleagues here was really quite close to each other as to what it will do. In my terms, it is where we as tax professionals would look at something and say, "That's ridiculous. How do you get that result? That cannot be how a tax system is supposed to work". Just for what it is worth, I think having it is worthwhile to stop

that because, if we have a tax system where people can do things, using my phrase, that is ridiculous, it brings the system into disrepute. Whether there should be more is something which we are not probably going to agree on, but let us not just throw away what there is there.

Q30 Lord Bilimoria: Given what Mr Murphy has just said about the fact that GAAR will not address the high-profile public situation such as Starbucks—and you mentioned Google—the perception is that this is being brought in specifically to address all forms of tax avoidance, whereas really it is about tax abuse. There is a distinction between tax abuse and tax avoidance, but tax avoidance is still going to carry on in spite of this GAAR. Could you comment on that?

Richard Murphy: I am astonished—if I just stand back and watch the comments that have been made by the Chancellor and the Prime Minister on tax avoidance—that they think this is going to satisfy anyone that, politically, this fills the gap that they say they are trying to plug because it will not. It goes nowhere near those things that have attracted the headlines, which every day I get another journalist commenting about. There was another story on *Bloomberg* this morning on Yahoo! and Dell doing much the same sort of arrangement. These things are almost daily occurrences at the moment and there appears to be an unquenchable appetite in the press for them. I therefore think there is going to be an enormous, sudden realisation that this part of the Finance Bill will fail in its objectives. I imagine that there will be a great deal of debate on that in the House of Commons as it goes through its passage there.

Lord Bilimoria: Sorry, I should have declared my interest, in particular as an alumnus of Ernst & Young as well.

Patrick Stevens: Sorry, maybe I should have done that as well. It was not intentional.

Bill Dodwell: Could I just add one point to that? The National Audit Office is reporting on about £10 billion of tax being claimed by 41,000 individuals, if I remember the figure right, in relation to tax schemes of this sort. If the general anti-abuse rule stops those things coming into being in the first place, stops promoters who are mainly very small boutiques from inventing them, stops HMRC wasting its time and gives a signal to potential investors that they should just not go there, that is surely a pretty helpful thing to do.

Richard Murphy: The Exchequer Secretary was surprised that I welcomed Graham Aaronson's report in November 2011, I think. But I pointed out that if you are campaigning for street lighting for a whole street, if you at least get the first light you will welcome it, even if you are a long way from achieving your whole objective. So of course I welcomed this but it is a long way from being the lighting for the whole street that I would like.

Q31 Lord Wakeham: Were the Government to say in response to what you are saying that they cannot do some of the things that you clearly would like them to do—and I suspect they would like to do as well—because of OECD and EU agreements, is that an inhibition or should it be?

Richard Murphy: If you actually look at what the OECD and EU say—I have checked that in some detail—the OECD are quite specific in their guidance on, for example, the abuse of residence and permanent establishment. Any country may take action against the artificial use of those rules and therefore it is within the scope of national sovereignty to challenge those particular abuses, which I think was quite key to what we have been saying. If you look at the EU, which is clearly very influential in this area, it also says—and last said in December 2012—that there is a need for a broader general anti-abuse rule than we are going to get. A general anti-avoidance principle is what they have certainly talked about. They said one would have to use it with care but none the less it should be used against schemes that are

an obvious abuse, even if they have international backing. So both organisations have said we can do it.

Patrick Stevens: Just to take it back for one moment, I think that we are all agreed or have tried to describe what the GAAR is intended to do, and which we think it will probably just about do. We have moved on to say, "But should it be aimed at a much wider range of things?". There we have used the term "tax avoidance" to describe that. I suggest the term tax avoidance then gets us into a whole lot of definition problems as to what one thinks is acceptable and what is not. To a large extent, certainly over the last year or two, that has changed very much daily with the newspapers and various committee inquiries and so forth. It has not stopped yet. Simply using the term tax avoidance, can we think of a rule to cover all tax avoidance? Just to be really silly, and I am not trying to play games, but there is whether I put my money into a bank account on which I pay tax or an ISA. You could claim that I am avoiding tax by putting it into an ISA.

Please, I am not treating you in a silly way here. The concept of what those international companies have done, I think my colleagues would agree, is nowhere near what the GAAR is aimed at. The GAAR is aimed at those taking some specific law and seeing if they can find a loophole within it, whereas most of what the multinational companies have done, it seems to me, is simply to arrange their affairs around the world to get a result out of it, without going into a specific bit of law. I do not think OECD agreements or anything like that would hold you back from doing that. Rather, you need to go back to how generally countries tax multinational groups who come within them. That is not giving you a satisfactory answer. I am simply saying it moves over to a completely different field of tax.

Richard Murphy: I would disagree with that. I think those companies are very clearly exploiting loopholes and have structured very deliberately to get round the rules that at one time made complete sense, particularly with regard to permanent establishments. I would

certainly suggest that Google and Amazon are very well aware that they are fundamentally trying to work round that and that that it is a deliberate exercise on their part to avoid tax by having an economic substance of a transaction which is not consistent with the way in which the transaction is submitted for taxation purposes. For me, that is the critical point here. When there is a mismatch between the substance and the form, then you have clearly got tax avoidance going on.

Bill Dodwell: I do not agree that there is a mismatch between the substance and the form, I am afraid, in the cases we have seen. I do not represent any of those three companies but in a globalised world where companies make commercial choices to centralise activities because that is a more efficient and effective way of delivering those activities, they will then have to choose a location for them. At that stage, they will inevitably consider a range of factors, and taxation will no doubt be one of them. The fact that somebody chooses to locate a central operation of that sort in Ireland, let us say, partly because it has a 12.5% rate, is not tax avoidance. That is a choice that it is free to that company to make. That is the end of it. What we do see, of course, is that in the modern internet world it is possible to provide some services in a wholly different manner that was not contemplated by any of those international agreements. That is a much more interesting question for future development.

Q32 Lord Rowe-Beddoe: Can I just go back to your unquenchable thirst of journalists in their search for further multinationals? This is not a new phenomenon. How long has Google been doing this, for example? I know you are writing a book on this. You have obviously done the research.

Richard Murphy: I have written it. It is out on 11 February—a little plug.

Lord Rowe-Beddoe: I would like the answer as well.

Richard Murphy: Google has been using this structure basically for as long as Google has been in Europe. In effect, we are talking since around 2000. It is quite interesting, and I should draw attention to it in the context of this, that Google is of course not alone in this arrangement. Last week in the highest Spanish court, in a case that has not yet apparently been reported in this country—you will have to get it in translation from Spain—Dell has been found, in using a structure of the sort that for example Amazon has been using, to have breached Spanish law. It is deemed to have a permanent establishment in Spain and is now being asked for tax from 2000 onwards. In other words, Spanish law looked at a fundamentally similar structure of importing from Ireland with a local commission agent who supposedly has no interest in the transaction apart from marketing advice and that is now deemed to have a permanent establishment through that marketing agent and will be taxed from the full profits arising on the transaction in Spain. As far as I know, that is the first European country that has delivered such a finding, which therefore follows that OECD principle that a local country can challenge the rules on permanent establishment and try to override them. As I say, it has happened in Spain and that was last week.

Lord Rowe-Beddoe: Thank you, so if I can just continue: this is not a new phenomenon. There is a question you have highlighted of the perception of the Clapham omnibus gentleman or woman that this is what this proposed legislation is aiming at. Obviously, they are going to be greatly disappointed if they listen to what you have said and how you have approached this. It is rather disappointing because obviously if there is this perception then why have government not already started to tackle the misperception so that people understand that this is something that will be addressed? We all know it is a practice. Multinationals have been going on for many years. It is not new. The press has just woken up to it, perhaps, but it should simply be pointed out that it is not new. I do not understand why there is this gap between the reality and the perception. Perhaps you could help me.

Bill Dodwell: HMRC has issued a bulletin called *Taxing the Profits of Multinational Corporations*. It is on the website. It sets out some of the principles that Patrick Stevens was referring to as to how the UK and other countries seek to tax multinationals. It gives some guidance of those sorts of cases. I have also heard the Minister responsible for tax, the Exchequer Secretary, discuss exactly these principles. I participated in a thing on "Newsnight" with him where he set out what the approach of the law was to some situations. That does not get away from the point that Mr Murphy talked about that there may be some factual circumstances in the case of a particular company or group which do not fit in those general rules, where they have not done what it was perhaps hoped they were going to do. Obviously, it is right that the tax authorities and ultimately the courts should look at that. If they reach a finding that this company does not meet those rules, fair enough.

Q33 Baroness Wheatcroft: I would just like to pursue this issue of the international corporations. You, Mr Dodwell, said that on the whole in a global world they would structure in the most efficient way possible. But then what are we to make of one of these global companies having paid no tax in this country then, when the media starts getting enthused about the issue, deciding to make an ex gratia payment of £20 million? Does that not imply that something was wrong somewhere?

Bill Dodwell: I think that that is a particularly complex case that you refer to. The analysis that was initially reported by *Reuters* was, I thought, misleading. There is a much better analysis of the company and its affairs in the *FT*'s "Alphaville" column, written by a journalist called Lisa Pollack. You may find that interesting and useful. Essentially, the *FT*'s conclusion is that the company, for whatever good or bad reason, made losses in the UK before making any payments overseas. That was its conclusion having reviewed the accounts and that sort of thing.

Baroness Wheatcroft: So why did it pay HMRC £20 million?

Bill Dodwell: I think it was probably affected because it is a very consumer-facing business. It is out on the high street. We walked past one on the way here. It was perhaps concerned that its customers felt that it should have made a profit. Even though the company knew that it had not, its customers thought that it should have done. Particularly what looks like a very important, apparently very successful company ought to be making a profit and therefore paying tax on it.

Baroness Wheatcroft: We heard in evidence at our last session that the United States was much more effective in extracting tax from its multinationals than other countries are. Would you take that to be the case? If so, is there anything you think that we ought to be able to do to enhance our tax take from these businesses?

Bill Dodwell: I think the UK Revenue and Customs has stepped up its game enormously over the last five years or so. The formation of the large business service, which is the section that deals with the largest companies, both UK and inbound multinationals, is an extremely effective service, in our view. It also, interestingly, does very well in the reports from companies, who like dealing with it. But it has raised billions and billions of additional tax through a more focused approach to taxation.

At the same time, HMRC's transfer pricing team is a central team but also then has arms in the large business service and elsewhere. It has adopted a much more focused approach to transfer pricing. It has tried to focus on the big cases of risk and not the trivial cases where, frankly, plus or minus thre'pence makes no difference but there is still a lot of paperwork. It has ditched a lot of those trivial inquiries and is focusing there. It is probably true to say that it could go further in that strategic approach and address in more detail some of those bigger cases.

Richard Murphy: I would like to comment on that question. I should declare an interest: I worked on the Starbucks stories with *Reuters* and Tom Bergin. I do not agree with the

analysis that Starbucks was not a profitable company, first of all. If a company says its UK operation is profitable and does so consistently for many years, I think we have reasonable grounds for believing that it has a profitable operation. Starbucks simply did that so I do not believe the alternative narrative that it was not. I also do not believe it was massively profitable. I think it was a gesture in the face of losing up to 25% of its revenue, which it did following publication of the story. However, the importance of that is way beyond the fact that it is going to pay £20 million in tax. It shows that companies have a choice about how they structure their affairs with a consequence on the amount of tax they pay where. The point is that Starbucks recognised that it made deliberate choices and structured its pre-tax profits in a way that ensured that they arose in countries other than the UK but where the cashflow originated within the UK. That is at the core of the discussion there. That is why I think it is making this gesture. I also suspect that it will hope that in two years people will have quietly forgotten and then it will go back and reclaim the losses and everything else, which will have let it not pay tax again for time to come, which I am sure it could—to be candid and slightly cynical.

Q34 Lord Tugendhat: My question to Mr Dodwell follows that intervention quite well. I would just like to clarify your thinking. You said when you were talking about how companies structure their affairs that in deciding where to locate, as it were, the bulk of their taxpaying, they were not engaged in tax avoidance. I think it would be fair to say—I do not know if you agree with me—that what the company is trying to do is minimise its tax liability. It is looking at the countries within which it operates and it takes a view on how it can structure its taxes in such a way as to minimise the total take, if I can put it that way. That is perfectly legal. But it then is up to individual governments to ensure that companies pay tax commensurate with their activities in that government's jurisdiction. That comes back to the point that Mr Murphy made. This is a matter of judgment for governments.

Some governments will take a more severe view and some a more lax view. In a sense there is a read-across, which I noticed in the last session we had, between this issue and regulation. At some periods, governments feel that it is in their interests to have light-touch regulation. The British Government felt that for a long time in financial services and boasted about it. We now take a different view, and similarly in the case of tax. If we run into a situation, as the Government have now, where they are short of money and the burden of taxation is bearing heavily on the people, then it is open to that Government and a perfectly reasonable action for them to stiffen up the way in which they deal with companies in trying to ensure that they pay a greater proportion of their total tax in this country rather than another.

Bill Dodwell: I think you have covered a great deal of ground in that complex question. First, I would suggest that when a group of companies is choosing where to centralise an operation that is better centralised because it is cheaper, they will look at a range of different things. They will look at the availability of employees and people, the cost of employing them in that country and all the things that go with that as well as—I agree—the tax. But I do not agree that it is solely driven by the corporate tax bill that might be levied on those activities.

Lord Tugendhat: I agree. I would not want to overstate that.

Bill Dodwell: I have talked recently over the last few months to companies that have been looking at this. The question for them was whether they should move an activity into the United Kingdom that might have been carried on elsewhere. The focus of the coalition Government in reducing the corporate tax rate is encouraging some multinationals to make those choices here. Albeit that our rate of prospective 21% in 2014 is materially above the Irish rate, we in the UK are fortunate that we have lots of other advantages. I think it is a package choice in that sort of approach.

Q35 Lord Hollick: It seems to me that one consequence of this is that international companies have a significant competitive advantage over domestic companies. So for instance, if you are a UK-resident provider of coffee you have to pay your taxes here. Similarly, if you wanted to set up in competition with Amazon, you would not be able to avail yourself of the tax loopholes or planning—all of which, let us say, are completely legitimate. That puts the UK-resident corporate base at a significant disadvantage.

Bill Dodwell: I think that that is a really difficult question from which to reach that conclusion.

Lord Hollick: First, do you agree that there is some truth in that?

Bill Dodwell: I agree that there is a difference fundamentally in the economy of scale that a multinational can achieve that a local corner shop on its own cannot—absolutely. What the corner shop offers is a different individual experience, all those sorts of things. But I do not think that tax is the biggest issue there. Amazon in its evidence to the Public Accounts Committee suggested that the total profit as I understood it derived from selling to customers in the UK would, if it had been earned and taxed here, have given rise to about an extra £20 million. When you apply that to its total profits, that would have added 0.4%—virtually nothing, just £20 million—to its costs. It could easily have passed that on to the likes of you and me buying goods via it. There is one of the challenges: companies do not pay tax. Ultimately they pass on that tax bill to a combination of consumers, employees and shareholders. I know that Mr Murphy will debate about who ultimately picks that up. I think he thinks it is all rich shareholders; I think it is a range of people. But it is clear that it does not stick at the company level. Obviously on the day it is levied it does, but ultimately it feeds through into those activities. There is a range of economic research around the world that discusses that question.

Q36 The Chairman: My Murphy, I wonder if you could just explain to us the main differences between the GAAR proposed by the draft Bill and what is in the Meacher Bill, and how the second—the Private Member's Bill—would address the type of cases we have been talking about.

Richard Murphy: The fundamental logics of the two Bills are in a sense very different. We have as the test of what is an abusive arrangement in the general anti-abuse rule the double-reasonableness test, which I have some significant difficulties with because I think it is an inappropriate and biased system. What I would want is there to be an economic substance test. That, by the way, is entirely consistent with the Revenue's view of what tax avoidance is: whether the economic substance of the transaction is consistent with the way in which it is reported and within the intention of the legislation, and if there is mismatch between that economic substance.

For example, we have a company in the UK with 15,000 staff operating a major operation through many warehouses, but apparently tax resident with a couple of hundred staff servicing 27 countries in Luxembourg. There appears to some economic inconsistency. One might then turn round and say that these do not appear to somehow match together. That is the flag that brings the whole operation into play. So the fundamental one is that difference. I did summarise these in the evidence I gave to you. The second one is that I think HMRC should be allowed to take action in response to a general anti-avoidance principle on its own initiative. I do not think it is right that HMRC has to go out to a body that is made up from people entirely outside HMRC to ask permission to enforce UK taxation law. I think HMRC is accountable, ultimately through Ministers, to Parliament. I do not think there should be an advisory panel who can say yes or not to whether HMRC is allowed to do that, before it even gets to the point of making the inquiry as such. I think that is quite wrong. At the moment, the burden of proof is placed upon HMRC in the general

anti-abuse rule to prove that the taxpayer was not reasonable in thinking that this was reasonable—which is a completely absurd double-negative. I think the burden of proof should be, as is the case with almost all taxation matters, on the taxpayer to show that they were right to believe that this was a correct submission. After all, when you sign a tax return you say that it is complete and correct. I think therefore that it is completely wrong that the Revenue is going the other way round and having to prove otherwise. There should be penalties in the system. It is absurd that we are to have a general anti-abuse rule that has no penalty for getting it wrong. Where is the sting in the tail in this general anti-abuse rule if there is no penalty for being found to have got it wrong? That is not going to deter anyone. I am afraid to say that what we actually need is some pretty strong penalties attached to this. Suppose the penalty was up to 100% of the tax one tried to avoid. That would put an awful lot of people off, and it is perfectly allowed under current arrangements to charge 100% of the tax that one has tried to get round. But at the moment, that is very difficult. If we had an anti-avoidance principle that had a penalty regime then we will get that. Of course, I propose clearances and this does not.

Q37 Baroness Kramer: I was interested to know how Mr Dodwell and Mr Stevens might respond to the restructured form of GAAR that Mr Murphy suggested. I think it is fair to say that at a time of austerity the public mood has changed. There is an expectation that people will pay their fair share, whether they be an individual or a large company. Therefore, the political environment in which the GAAR was originally drafted has fundamentally changed. I wondered about your comments on the GAAR. Mr Murphy, I am trying to understand how much the line moves if we follow the principles you just denoted. It sounds as if the GAAR at the moment will capture a fairly narrow group of people who are behaving in a very overtly ridiculous way. You move the line but it did not sound as though it moved

awfully far. I am just trying to understand how much movement there was there. Perhaps I could ask Mr Dodwell and Mr Stevens to just comment on your proposal.

Patrick Stevens: I think, as we were saying earlier, that the proposed GAAR deals with a relatively small group of people doing ridiculous things—that is not quite the appropriate term. But generally the running of the tax system as it is currently carried on and is understood by HMRC, taxpayers and people who represent them should remain roughly as it is now. It is not intended to change the broad flow of transactions and the tax arising from it. That is not to say that everything else is fine and should be left as it is, but it is not intended that it should be turned upside-down. We have got a system that is running well, albeit not quite correctly in places. The idea is, "Let us change it bit by bit to try and get at things that are perceived to be wrong", rather than, "Let us have a revolution, turn upside-down the system we currently have and start from scratch".

I must admit I have not previously looked in detail at Mr Murphy's proposal. It has not been something—

Richard Murphy: Here.

Patrick Stevens: Thank you kindly. But from the sound of it, it certainly gives hugely more discretionary power to HMRC. I am not saying that is good or bad, but that by itself takes away from, I suppose, the power of Parliament to lay down detailed rules of the way that the system should work. It is more of a revolution.

Bill Dodwell: I am happy to say it is fundamentally bad to hand a wide discretionary power to HMRC to work out what the individual assessing officer thinks should be the tax in a case. That is the job of Parliament, quite clearly.

Patrick Stevens: Yes.

Q38 Baroness Kramer: Can I ask you about that? We all know that the minute there is a rule it is immediately arbitraged. When I was in banking we saw it all the time. The first

thing to do is find out how to get around it and twist its purpose to probably produce the opposite effect that was intended.

Bill Dodwell: I do not think that is true. I think if you—

Baroness Kramer: I think you are pressing credibility.

Bill Dodwell: May I pick up some recent examples of where the law has been set in particular cases? There are transactions called disguised interest: essentially, what looked to you and me, looking at the economic substance, like a lending of money at interest but you managed to transform it to look like something different. A rule was introduced I think two years ago. That was done in a principles-based fashion. It essentially said that if you do this, in broad terms, we will tax you as if you had directly received interest. Since that rule came in, I am not aware that any schemes have been notified to HM Revenue and Customs under the tax disclosure rules that Lord Hollick referred to and I am not aware that HMRC considers that there is any form of widespread abuse in that sort of area. So I think that if you get the form and substance of the legislation right in particular cases you simply shut something down. It is the same with film schemes that were massively abused. There were some ridiculous arrangements out there. Once the Government of the time—the previous Government—finally realised that dishing out reliefs to rich people to invest in schemes was potentially costing the taxpayer far more than ever went into film, although most schemes failed before the courts, they transformed it into a grant from the Exchequer to the film companies directly. Suddenly, all that tax arbitrage vanished. We also saw another structural change in something called sideways loss relief. What that means is a very tight restriction on the use of investment-style losses—film scheme type losses and others—against people's regular income. Those sorts of structural changes have really changed the nature of some of that activity out there.

Q39 Baroness Kramer: Are you underestimating the deterrent effect of a well-written GAAR that would allow greater scope and discretion? You are saying: abuse happens, it is chased; abuse happens, it is chased; abuse happens, it is chased. The whole point of the GAAR, is it not, is to switch that around so that the threat of action is so imminent and clear that the abuse does not happen in the first place. I am just interested as to why you are choosing such a narrow area for that to apply, even though I think we have all discussed the fact that there is a general sense that there are very broad tax patterns with which the public will no longer live.

Bill Dodwell: My suggestion is that in relation to some of those broad patterns, should you be able to sell over the internet from Ireland, Luxemburg or wherever, those questions need to be dealt with in an international manner. Probably the OECD or perhaps the G8 is the right forum to take those complex allocation-between-country questions forward, rather than trying to go it alone. Going it alone could simply result in potential double taxation. We have to remember that the rules we have in this area—I agree that in some parts they need some updating—are designed to avoid economic double taxation because that was unhelpful for global economic growth. By all means take them forward and negotiate them again, but we should do that on this multilateral basis.

Richard Murphy: I would just like to challenge the last point that Mr Dodwell made. The OECD rules as they stand at present—this refers back to what Lord Hollick said—guarantee that a multinational company should never be taxed on its full profits. If you assume that a multinational company is made up of entirely independent entities, and each individual subsidiary is independent, and you adjust the tax affairs of each subsidiary until it is taxed at the rate that an individual company would have in that subsidiary if it was not part of a group, you inevitably do not tax the profits that arise from the synergy of having the group, because the OECD rules guarantee you cannot. Therefore, under the current OECD rules,

you always end up with untaxed profits. Therefore, to look to those current OECD rules to solve this will simply guarantee a perpetuation of the system where multinational will always have a competitive advantage over UK-based companies, which is deeply damaging to the UK economy. I think some UK companies have made the point very fairly that they feel as though are being harmed in that way. I would say that there is an absolutely clear economic rationality to what they have said so I disagree with Bill on that.

Where do I want to take the Bill? I could spend hours talking on that point but I will not. I will take a number of things. First, we obviously have the Duke of Westminster case of 1936. It really is time that the Duke of Westminster was put in his coffin and allowed to go gracefully—that particular one. It is no longer appropriate that we can allow a person to structure their affairs however they will so long as there is a loophole that they can exploit. It is absurd that it has taken this long to try and find a way to overturn the principle in the Duke of Westminster case that has underpinned all tax avoidance activity since then. I want to get rid of that idea that so long as you can find a way round the law then it is legal. That is not legal: it is simply not finding that there is nothing that says at present that it is not illegal. That is not the same as legal, in my opinion.

What else is this general anti-avoidance principle that I propose trying to do? Well, actually it is another case, really. We had the Ramsay principle, created in the House of Lords in a tax case in 1981. For 20 years, fundamentally, we thought we virtually had a general anti-avoidance principle that if you put an artificial step into a transaction to secure a tax advantage that would be ignored when it came to assessing that transaction for tax. Then we lost that because of a change of sentiment in the House of Lords. Fundamentally, I am trying to say let us have Ramsay on a statutory basis. Let us make no pretence about it: that does not give the Revenue the power to tax arbitrarily. Of course, there will be a right of appeal, a right to litigate and there will always be the right of a taxpayer to go forward and say, "We

think you have got it wrong". This is not some sort of diktat that overrules the will of Parliament or ignores the legislation. The Revenue will still be subject to all the rules of evidence that it is now. It is just saying that we are trying to find that economic substance should be the basis on which you are taxed but at the moment it is not, it is actually, "Can you find a way round the law?".

The Chairman: I think we will have to move on fairly quickly because we are going to run out of time otherwise. Would you like to move on to the next question?

Baroness Kramer: I followed up on mine. The next question was with Baroness Wheatcroft.

Q40 Baroness Wheatcroft: Judging by what you were just saying, Mr Murphy, you will be glad that at least the proposed legislation has gone wider than the first draft, so that it includes inheritance tax as mentioned. I wonder whether you also feel that HMRC has sufficient resource to cope with this wider draft that we now have.

Richard Murphy: Yes. If it has not, it can hire the people it needs. What is the problem with HMRC going out and hiring people? We have a difficulty at the moment that the Government seem to think that HMRC is a cost centre when actually it is a revenue centre: it makes money for the Government. Therefore, if you are actually trying to close the deficit and you are watching your tax revenues disappear, you obviously go out and hire more people to make sure you collect the tax that is earned. If it has not got the resource in its existing and significantly contracting staff then it should actually change its policy, ask for more money, be given it, go out there, raise the money and make the business case that I think is beyond any question: these people will pay for themselves and it should have the staff necessary to collect. Where are those people working now? Well, they are probably working for the big firms of accountants so they have to be offered a suitable salary. We have to accept that these people are going to be skilled. They are going to have salaries that

are higher than they might customarily have been paid through traditional routes in the Civil Service. But if we are serious about collecting money and we want to close our deficit, that is what we have to do.

Baroness Wheatcroft: It is exactly the same with the regulators of financial services.

Richard Murphy: Yes. Absolutely.

Patrick Stevens: I do not think that the Revenue will have a huge amount of difficulty in administering what we have here. I would echo almost everything that Mr Murphy has just said regarding ensuring that HMRC is fully and properly staffed. The economics are difficult—in government, out of government; let us not go there. But it needs to be tackled and it needs to be properly resourced.

Bill Dodwell: And the only follow-up on that is that, within HMRC's around 60,000 staff are 17,000 staff with tax expertise. That number is not changing. The numbers that are planned to be reduced are those in the clerical and administrative roles, and this is fundamentally a matter for HMRC to address to you rather than us. But HMRC at least makes the point that it thinks that there is a bit of a technology dividend as more stuff is automated. We all agree that we would like to see a properly resourced tax administration.

The Chairman: Let us move on.

Q41 Lord Hollick: The advisory panel to be set up does not follow the Aaronson recommendations because HMRC is not to be represented on it. The chartered institute has welcomed the advisory panel. Do you agree that it is appropriate that HMRC should not be on that advisory panel? Mr Murphy, I think you will be on the proposed advisory panel. Perhaps you can give us your view as well.

Richard Murphy: I probably said something in advance of an announcement. I have had a letter from the Government suggesting that I serve on the interim advisory panel. I have concerns about the whole of this arrangement, but when Graham Aaronson first told me

about the advisory panel he was including in his proposal—we are talking about the summer of 2011—he and I had a long session on it. I was seeing him then as an adviser to the TUC, which I am on taxation matters. We had a long discussion about this advisory panels and I said that if there was to be such a panel I thought that of the three members, one should be somebody who had judicial status, which could of course be a commissioner for taxation but somebody who was bound by the rules, one should be from HMRC and one should have other tax expertise. In other words, we should have a balanced approach with a chair of the panel who had experience in adjudicating. Instead of that, we are going to have a panel that is made up of, basically, nobody from HMRC. I think that means that the double reasonableness test will inevitably be biased because the view of what is reasonable will reflect very largely the views of tax practitioners. I do not think that that is appropriate.

Patrick Stevens: Our view, and my view, is that you have the tax authority and the taxpayer, and every time something from here comes up they will be in conflict in some way—such as, does GAAR work or not? If you have three independent people on the panel, having one of the parties to a dispute on the body that is to decide something relating to that dispute seems not what such an independent body should be. It is not independent any more.

Bill Dodwell: I would only add that it is not a judicial body. It will not make binding decisions on anyone. It is asked for its opinion. The panel of three on a particular matter may deliver one, two or three separate opinions. HMRC can completely ignore them if it thinks they are wrong. The judicial authority is the tribunal and the court system.

Lord Hollick: So is there any point in setting it up in the first place?

Bill Dodwell: The idea is just to make HMRC think a little, I believe, before rushing straight into a rapid application of this, to possibly the detriment of certainty in that.

Lord Hollick: That seems to be a theme running through this: the GAAR might make people think a little bit and the advisory panel might make people think a little bit. It reminds me of those speed traps that you have in the road that apparently have no cameras in them. It might make people slow down, but if they realise there is no camera they just drive on.

Patrick Stevens: I think that the panel is well worth while, more so than my colleague here. It is bringing in knowledge of the way in which the system works. That is what the GAAR as drafted is intended to do. That is an element of whether it should be relevant to a case or not. The panel is important.

Bill Dodwell: Your words are probably better than mine. I support your formulation. I make the point that it is not judicial and not making a decision.

Q42 Lord Rowe-Beddoe: First, one quick follow-up on that, if I may? There was some dispute on Monday when we had our first session with regard to the guidance being part of the legislation or not. Do you have any comment on that?

Bill Dodwell: Well, Mr Aaronson obviously proposed that it should have been legislated because he wanted that guidance to have the same ranking as statute. I think that HM Revenue and Customs just thought—I agree—that that was completely impractical. That is why it proposed the route instead—a lesser route, one has to acknowledge—where the panel approves guidance having made modifications it wants to make. That at least must be considered by the tribunal, albeit it does not bind the tribunal.

Lord Rowe-Beddoe: Do you have anything you want to add?

Richard Murphy: I have to say that on this occasion I think Graham Aaronson's advice was better than the policy that is being put into place. What he was moving towards was a principled basis for interpretation and the reason for putting it there was to give it that authority to provide a principles basis for interpretation. I do not think we have got there as a result of the changes since then.

Q43 Lord Rowe-Beddoe: Thank you. Could we just move on to the double reasonableness test? In your written submission, at 6.4 you explain your view quite comprehensively. Given the technical matter that is involved here, what realistic alternatives are there to establishing what is and what is not reasonable for the purpose of GAAR?

Richard Murphy: My answer is the economic substance test that I have already referred to. I do not think that this is the right test. This is a highly subjective double reasonableness test, where it even says that a judge may think it is unreasonable but actually has to decide it is reasonable because other people think it might have been reasonable to have thought it was reasonable. How many nuances are we going to get into this before we actually get to the point where we get some action? I think it is ridiculous.

Patrick Stevens: Just to put that into context, when you go over into the concept of economic substance and so on, we are talking about a hugely wider area for the GAAR to affect. If that is where you want to go, then we can discuss whether that is so. I think most of us agree that, as currently written, it will deal with the specific targets that it is intended to. I have not actually heard that disputed. Therefore you are back to this great big principle of how far you want it to go.

Bill Dodwell: I am going to partly agree with Mr Murphy. I accept that this is subjective.

The Chairman: I am sorry: we are going to have to vote. We will be back as soon as we can.

Sitting suspended.

Q44 The Chairman: I think we can probably resume, even though we are not all here. We are going to have a time problem in that we are going to lose some Members soon, including myself, who have other commitments. With the agreement of Colleagues, we have done a great deal on the GAAR so could we move on to the annual residential property tax,

unless there is anything else you would wish to say on GAAR that you do not feel has been covered?

Lord Tugendhat: The first question is that CIOT's evidence suggests that enveloping, which is the avowed target of the ARPT, is not as widespread an approach to SDLT avoidance as the Government think. The question is, do you think the Government are behind the game in this respect? Would you set out some of the SDLT avoidance schemes that your members come across? How would you propose that they should be countered?

Patrick Stevens: To the best of our knowledge, and you can only do it by trying to work it out, enveloping as a means of avoiding SDLT was relatively little used. The amount of SDLT avoidance before last year's Budget was enormous on expensive houses. It was just generally well known that it was so. Most of it, my understanding is, was various arrangements around sub-sale relief, which is just a technical provision in the legislation and different people came up with different ideas of how you got around it. Therefore it seems to me, on the assumption that we want to stop that and it was getting to a level that appeared absurd, it is all around trying to restrict sub-sale relief, which is being worked on but I don't think they are finding it as easy as they might do. A number of the cases are being challenged through the courts and they are having mixed success in doing so. Some they are winning, others have only got to a given level but they have lost at the Upper-tier Tribunal. I am sure that they will continue but it seems to me that hitting that area of legislation is far more important if you are looking at the big scale of that sort of avoidance.

Richard Murphy: I have never claimed to be a stamp duty expert—I always thought it was a lawyers' tax—but I have some comments on that. I think you are right to some degree: if we had had my sort of general anti tax-avoidance principle we would not have had those problems with those cases because they would all have been knocked out a long time ago and the legislation to stop them would have existed. It is a simple, straightforward statement

of fact that they would not have been there. The evidence is that we are talking about tens of thousands of cases, probably, with regard to enveloping—not many hundreds of thousands of cases. But they are expensive properties that are involved. It is an issue. When I heard that they were going to tackle this, I thought, "Brilliant, we are actually going to have a serious attack on the use of offshore companies owning property in the UK", and so on. I am afraid to say that the legislation is so weak that I do not think it will work in the slightest. As I wrote, I can walk round this in about 15 minutes and I am sure people will. It is just very weak legislation.

Bill Dodwell: Although it is worth pointing out that this legislation will be subject to the general anti-abuse rule we are having, so there is some counter to that particular proposal. The other point I would add, and we have talked about it before in relation to HMRC, is that the problem of stamp duty land tax started with pretty poor enforcement and compliance activities from HMRC. It has massively stepped up its endeavours now to establish the issue. It sort of became the norm that you could go and buy a house of £1 million or more—or even half a million—and you would be offered a scheme. That is not a clever way for the tax system; it got out of control. Fortunately, HMRC is now on the case but it happened badly in the past.

Patrick Stevens: I can remember speaking to relevant high officials in HMRC long before the crackdown in last year's Budget. It goes back to my basic point that anything that is going to undermine our tax system and is perceived by the public generally as making a mockery of it is bad for all of us. It just takes away from the whole system and you cannot do that. They did spend an awful long time before they started hitting it.

Richard Murphy: But this new arrangement is predicated, absolutely fundamentally, on the fact that they can identify who the beneficial owners of these properties are that the rule will attack. Well, I am not quite sure who wrote that, but if they know anything about offshore,

finding out who the beneficial owner of an offshore company is when it is owned through an offshore company owned by a trust that has absolutely no identified set law and no beneficiaries in a jurisdiction that is not going to be information-exchanging with the UK voluntarily, it is a little bit of a joke. This just is not going to happen. So the logic behind the legislation is built on an assumption that is simply not available in reality.

Q45 The Chairman: I must say that this is an area that I am not familiar with, but as I understand the draft HMRC guidance suggests that the GAAR will apply to sub-sale schemes. Would that not cover the sort of SDLT avoidance schemes you have in mind?

Bill Dodwell: It will from the future.

Richard Murphy: It will cover schemes. My problem with this particular piece of legislation is that it assumes that information will be available. The most fundamental point about taxing anything is actually identifying your tax base. I do not think that this legislation is built upon the premise of an identifiable tax base at the moment. If you are going to charge companies that own properties in the UK tax, you have to require those companies, for example, to be deemed to be UK resident and therefore put their accounts on UK public record. You have to require them to disclose somewhere the nature of the beneficial ownership, which would be consistent with the approach by anti money-laundering legislation. If you open a bank account, you have to prove your identity. We have got to have that sort of availability to HMRC with regard to these companies at some point. That is not there at the moment; there is no mechanism for that. So when it says that somebody is going to be submitting a tax return and supplying a valuation, who is that somebody? We are not going to be able to find them. As I say, there is a false premise in here that will mean in practice the legislation will just be walked round. This will be a voluntary box taxation.

Patrick Stevens: It does have to said that, even more, some people are making the argument that the sweep of legislation that there is surrounding this is actually encouraging

people to leave companies which are in offshore companies in there. Previously, if you had such a set-up and you wanted to sell the house to somebody else, and they said, "I wouldn't want to buy your company, I know nothing about it" and for the amount of SDLT saving you are talking about it is just not doing due diligence on the company to see what sort of things there are in there, the more that you put up the level of stamp duty and the capital gains tax charge of getting it out again, the more you are making it worthwhile to leave it in there. That is not to say that more properties will go into offshore companies but if they are in there it is beginning to look as though they are a bit stuck in there.

Q46 Baroness Kramer: Do we have a completely distorted Land Registry? Because there have been chains of sales at the company level, the values of properties on the Land Registry at the upper end are fictitious to a very large extend now.

Richard Murphy: The same as we have a distorted companies registry because nobody knows who owns companies in the UK, we have a Land Registry that does not record the true the true ownership or value of land—yes. I am afraid that regulation in this country of such issues is dire.

Baroness Kramer: That has really serious consequences for all kinds of taxations issues, including council tax.

Richard Murphy: Yes.

Bill Dodwell: Only to a small extent. The vast bulk of houses are nowhere near any of this. You are not talking about a million houses or anything like that.

Richard Murphy: In some areas, it is significant.

Baroness Kramer: In London, it would be quite significant. In my area, around Richmond and Barnes, you are probably talking about a third of properties over the £1 million mark.

Bill Dodwell: But I doubt that you would find that a third of properties were in offshore companies or anything like this.

Baroness Kramer: You would find that a very significant number are.

Patrick Stevens: We did not believe that there were a remarkable number of properties in offshore companies. It was not the main area of the SDLT thing that we are talking about.

Richard Murphy: The last estimate that I saw was 90,000 properties.

Bill Dodwell: Nineteen?

Richard Murphy: Ninety. Nine zero thousand.

Q47 Lord Hollick: Sorry, can I ask on this? You are all pointing to some potentially serious flaw in this rather long piece of legislation. This must have been brought to the attention of the Government and HMRC. Has there been any response to the coach and horses that you have been describing?

Bill Dodwell: It is probably fair to say that, for this piece of legislation, the Government's *Tax Policy Making* approach was suspended. It launched on an unsuspecting world in a not terribly focused manner. I do think that HMRC has worked to try to improve it. Whether it has actually got to the best answer is questionable.

Lord Wakeham: Is there a more efficient way of achieving what they want to achieve?

Bill Dodwell: I would have thought that you have to start putting a reporting obligation on estate agents and conveyancers involved in transactions. That will not absolutely pick up everybody but it will pick up the vast bulk, because reporting obligations, as Mr Murphy said, are really important. It is why we ask banks to report details of bank interest and that sort of thing. They are a key part of our tax system.

Patrick Stevens: And you probably need to have a joint effect of putting up the amount of the annual charge—because, if you look at the economics of it, it is not huge at the moment—but giving a window for people to take property out of companies. The difficulty of taking it out, as I mentioned earlier, is substantial and would tend to encourage people to

leave it there. You have to let an escape clause happen to get it back on to norm, and then it can go forward.

Baroness Kramer: A sort of amnesty.

Patrick Stevens: Just allow—

Richard Murphy: A transitional relief.

Patrick Stevens: —a transitional relief, or a year before it comes in or something of that sort. I do not want to try and invent something on the hoof.

Richard Murphy: I do invent things on the hoof, but then I have put them in paragraphs 9.3 and 9.4 of my evidence, so I do not think it is worth repeating them here.

The Chairman: I think we can obviously pursue this with others, including HMRC, so let us have just one or two more small points on it. Lord Bilimoria?

Q48 Lord Bilimoria: I just build on what we have just been discussing. Accepting the Government's target, the amount of legislation for this seems huge. We are talking about 90,000 properties. The estimated yield is relatively modest. In fact, the figures are £16 million down to £13 million, and it affects very few taxpayers. So could this have been done more efficiently and more effectively, apart from what you have just said?

Richard Murphy: "Yes" is my answer to that. I think if they had gone through a better consultation process, we would have ended up with better legislation in this case. This is a case where they have clearly started on the wrong foot and have ended up on the wrong foot.

The Chairman: For the sake of the transcript, Mr Stevens, you nodded at that?

Patrick Stevens: Yes. I am terribly sorry. I agree. The whole package that we are talking about here for enveloping—because I just want to make sure that we are distinguishing that—is something that we are all looking at and saying, "This won't work", but nevertheless just seeing what we can do in practice to try and help people who are in this situation.

Q49 The Chairman: Okay. Thank you. Let us move on now to the cap on income tax reliefs, our last topic, and we will do that, if we may, very briefly. The evidence from both of you is very critical of this proposal as currently conceived. Accepting the Government's aim of restricting the use of certain tax reliefs in a period of austerity, how might a more effective measure of this kind have been designed?

Patrick Stevens: By homing in on the situation that gave rise to the loss or expense that the Government wishes to stop being allowed. If there is a valid loss in a trade, for example, I think most people would agree that it is reasonable to allow that to be set off against other profits, if it is a genuine trade and a genuine loss. Similarly with interests—there is a genuine interest in respect of investing in a genuine business. It has been so for years; nobody has suggested otherwise. If there are abuses of those, and I am not suggesting that there are not, then attack the abuses. Stop there being any relief in respect of abusive things, rather than chickening out and saying, "We can't stop the abuses. We'll just sweep everything up and only allow a proportion of everything".

Bill Dodwell: I think the other thing to add is that we are not picking up everything. I completely agree with Mr Murphy's submission and with Mr Patrick Stevens on business reliefs. The business that the person is engaged in—that should be unrestricted, because that is a fundamental part of what he or she does. Investment-style reliefs should all have been picked up in one go, and all subject to a cap. The CIOT said that clearly in the representations that we made on that. We see no reason to leave out enterprise investment schemes. They are no more meritorious than some of the other things that have gone into the cap. If the Government legitimately says, "There is a limit to how much there is on these reliefs, which we have provided for in statute and therefore think are good things"—if they want a limit—apply it to the whole lot.

Richard Murphy: Yep. We agree.

Patrick Stevens: Next! Sorry.

Richard Murphy: I suspect some will say this is a political point, but I am afraid to say that the objective could have been much better achieved by keeping a 50% tax rate. You would have raised a lot more money much more simply, because, if this is trying to avoid people at higher rates getting round their tax liability, that would not raise the money.

Q50 Baroness Wheatcroft: But there is a political point here, is there not? May I speak briefly, Lord Chairman? If the Government believes that some reliefs are worth having because they presumably are beneficial, putting a cap on at all is somewhat contrary, is it not?

Bill Dodwell: I think it is simply saying that, in a time of austerity, you the taxpayer can choose from which of these government-favoured incentives you want, but we are just going to limit how much you can do that. I can see the economic logic behind that.

Baroness Kramer: Could I challenge that, though? For example, we have a gap, if you like, in the market to provide seed capital. Other countries enjoy a whole variety of institutions and investors that provide that seed capital, and you have got to build that up.

Giving extra favours to that area by excluding them from the cap has a logic to it, in economic terms. You are weighing the tax take that you want against building a future business and industrial base which you think you must have, so that changes the balance in a reasonable way.

Richard Murphy: But it would have been so much more effective to have put the money into a national investment bank and actually looked at investing directly rather than going through a venture capital trust arrangement or whatever else. I have had in my career an entrepreneurial part and have tried to raise money from a venture capital trust in my time. I found it mighty frustrating—an incredibly difficult process—partly because of the restrictions that tax relief requires, because it is so constrained. So I do not think these are particularly

useful schemes to most smaller businesses anyway, as somebody who has tried to use them and failed and has gone to other routes to try to raise the money. It would be much better to actually implement an industrial policy—to have direct investment rather than doing this rather odd roundabout mechanism for doing it. It is almost, as you were saying, about film relief—give the grant directly rather than doing it through some weird tax arrangement and you will end up with a better result.

There are so many. The idea of completing tax returns in the circumstances where some people will be at these limits and having to test all the possibilities of what is and is not going to end up as being a restriction where somebody is paying, or whatever, is going to be a nightmare. A lot of people are going to find, inadvertently, for example, that they have made a donation to charity and now cannot get relief, or something. Then what does that mean? All sorts of stuff is going to be coming up as a difficulty.

Lord Hollick: Charity is excluded.

Bill Dodwell: It is.

Richard Murphy: Yes, okay, because of the changes that we have had, but that was again a mistaken attempt—

Patrick Stevens: I—

Richard Murphy: Sorry.

Patrick Stevens: I was only going to say the question of whether you go through one route or another to get money into the sort of enterprise that you are talking about is probably outside our scope. Therefore I am not going there. I would just say that I believe that another part of the reason for us going there is because it was perceived that some of the losses and interest relief were as a result of abusive arrangements. I just go back to my point about preferring to strike down the abusive arrangements rather than doing an overall catch-all here. There are different parts to this question.

Richard Murphy: Yes. I would agree with that. For example, I know which charitable trust gave rise to the concern about removing charitable tax relief. I am quite sure I know which organisation that was now. Why was not that particular arrangement challenged rather than introducing something—again, now reversed, but causing major problems at that point on a particular issue—when in fact there was a particular way of solving it?

Q51 The Chairman: We are nearly at an end. We must end soon. Lord Hollick?

Lord Hollick: Mr Dodwell, you made a comment a couple of times that HMRC has upped its game over the past few years in relation to a number of things.

Bill Dodwell: Yes.

Lord Hollick: Do you believe that it is capable of monitoring the GAAR? Do you believe that it has the resources, the skills and the right attitude to monitor?

Bill Dodwell: Yes, I do, particularly the general anti-abuse rule. It is dealt with in the anti-avoidance group, who are a highly skilled collection of people, and I think they will be able to manage that.

Lord Hollick: And do you believe that if they were to go down the route of clearance, they would have the resources to do that so long as it was paid under some fair system?

Bill Dodwell: No, I do not. The issue is not the money; the issue is that they do not have lots of extra, highly experienced inspectors available.

The Chairman: On that note, we will have to conclude. Thank you very much indeed. We will be pursuing a number of these issues with other witnesses. We are most grateful to you for being here this afternoon.