

Treasury Committee

Oral evidence: HM Revenue and Customs Annual Report and Accounts, HC 315

Wednesday 21 November 2018

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Members present: Nicky Morgan (Chair); Rushanara Ali; Colin Clark; Mr Simon Clarke; Charlie Elphicke; Catherine McKinnell; John Mann; Wes Streeting.

Questions 148 - 263

Witnesses

I: Jon Thompson, First Permanent Secretary and Chief Executive, HM Revenue and Customs, Jim Harra, Tax Assurance Commissioner and Deputy Chief Executive and Second Permanent Secretary, HM Revenue and Customs, and Justin Holliday, Chief Finance Officer, HM Revenue and Customs

Examination of witnesses

Jon Thompson, Jim Harra and Justin Holliday

Q149 **Chair:** Good afternoon. Apologies for starting slightly late. We were discussing something that is going to come up in this afternoon's evidence session. Perhaps, just for the tape and those watching, introduce yourselves and then we will get straight into it. Mr Thompson.

Jon Thompson: I am Jon Thompson. I am the Chief Executive Officer and Permanent Secretary of Her Majesty's Revenue and Customs.

Justin Holliday: I am Justin Holliday, Chief Finance Officer.

Jim Harra: I am Jim Harra, Deputy Chief Executive of HMRC.

Chair: Lovely. Thank you very much. It will not surprise you to know we are going to talk about Brexit quite a bit this afternoon, but we thought we would start with something more constructive and so Catherine is going to start with Child Benefit.

Q150 **Catherine McKinnell:** Yes. As much as I would like to launch straight in with Brexit, we would like some clarity on Child Benefit: the publicity that there has been about the link between Child Benefit and National Insurance credits, and the concerns that people do risk losing out on some of their State Pension entitlement. Since this has been highlighted, both by DWP and by this Committee, has HMRC seen any change in the way that people are applying or the way they may be changing the recipient of the Child Benefit or the transfer of National Insurance entitlements?

Jon Thompson: I could not say that we have seen any change. To be clear, even if you are subject to the higher income charge for Child Benefit, it is definitely worth still registering for Child Benefit. You have two choices. One is that you can register your eligibility for Child Benefit and not receive the payment, which does then create the National Insurance record or, alternatively, you can pay the tax. One way or the other you can still create a National Insurance record. Plenty of people do do that. We continue to try to publish, as transparently as possible, that those are the routes forward for customers.

We have also undertaken some research, which we are looking to publish, on whether customers have changed their behaviours. At the minute, I could not tell you what the outcome of that research is but it should be published fairly shortly.

Q151 **Catherine McKinnell:** Is that the research that you refer to in your letter of 29 August to the Chair of this Committee?

Jon Thompson: Yes.

Q152 **Catherine McKinnell:** That was expected in October, so I am assuming you must have been busy with some other things perhaps.



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Jon Thompson: Yes, we have been busy with a few things. Just to be clear, we have a commitment through Ministers that all research that is undertaken by HMRC—either itself or through other parties—that we publish that transparently, so you will be able to see it.

Q153 **Catherine McKinnell:** When will that be published?

Jon Thompson: I have not been told when it is going to be published but, again, we are committed to doing so.

Q154 **Catherine McKinnell:** Will that include the impact of the high income Child Benefit charge on claimants? Will that be included within that research?

Jon Thompson: I have not seen the scope of the research but I will happily give you a further letter to clarify what is in the scope, if that would assist.

Q155 **Catherine McKinnell:** Yes, that would be helpful. Also, an indication of when it will be published will be helpful because, obviously, the longer this goes on the more people are impacted by it and the more we perhaps delay putting in whatever is required to make sure that this is not an issue.

Jon Thompson: They could be impacted.

Q156 **Catherine McKinnell:** Yes, could be impacted, exactly. I have been contacted by one constituent—a number of constituents, one in particular—on the high income Child Benefit charge. They were a family on an income that was just over the threshold. They had no idea that they were subject to this charge. They have been notified by HMRC that they have been overpaid, from 2012 to 2017, and they have been given a bill of £1,700 and very little time to pay it. They have to pay the full amount by 10 November, which is obviously quite distressing. I want to ask whether you think that is an acceptable way to deal with this issue but, also, what record you have of the number of families that are affected in this way and may have been receiving letters of this sort.

Jon Thompson: To be clear, I will happily look at your constituent's case if you would like me to.

In relation to debts owing, the best thing to do is to give us a ring. We are happy to discuss flexible payment arrangements. We often strike time-to-pay agreements. With 96% of those people who cannot pay initially, we do strike a time-to-pay arrangement where they can spread the payments over up to three years so I would encourage your constituent to do that if that helps.

Q157 **Catherine McKinnell:** Would you accept that this has complicated what was a very straightforward entitlement that people had?

Jon Thompson: Yes I would, because it mingles together individual tax liabilities with a family situation. The tax system is not around families or



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family units. It is around individuals and, therefore, you do have cases, which have been reported back to us, of two people who both earn £40,000 and do not have to pay it, versus one who has £55,000 and someone who does not earn anything. That is the construct of this policy and, you are right, it has made it more complicated.

Q158 **Catherine McKinnell:** Yes. It has made it more complicated for individuals affected by it but also for HMRC to deal with it.

Jon Thompson: Agreed.

Q159 **Catherine McKinnell:** The National Insurance credits and the State Pension are obviously DWP responsibilities, but HMRC are responsible for the customer interface in relation to these matters. You are the people interfacing with the customers, so do you feel you are being listened to, in any concerns being fed back to DWP in relation to the policy, or is some of this falling between the cracks?

Jon Thompson: We are in a constructive conversation with the DWP about what other policy options are available to the Government to try to address the issue that you are putting to us. We have made some good headway with that. The recent change of Secretary of State means that that might get slightly delayed. The latest information that we had last week—Jim and I—was, though we had made good joint steps forward on that, policy developments would be put to Ministers and then I would expect Ministers to consider the changes that might be possible.

Q160 **Catherine McKinnell:** That is in relation to making sure that people get their National Insurance contributions correctly and, also, are not falling foul of the Child Benefit requirements, which means that people then have to pay it back?

Jim Harra: Yes. To be clear, HMRC maintains the National Insurance record for everyone. It is our job to record the NI credit. We do do that, but it is important that the right person in the household claims the Child Benefit, the person who would benefit from the NI credit. In a household where there is high income and Child Benefit, as Jon says, it is important that, nevertheless, that person claims for the benefit, even if they do not take payment, because it secures their credit. But it is our Department that manages the record.

Jon Thompson: Can I go slightly further? It is also very easy now to access your National Insurance record. You can access it through your personal tax account. We have had a number of questions about gaps in people's history. It is now transparently available to everyone who has a National Insurance number.

Catherine McKinnell: Thank you.

Q161 **Chair:** We are going to embark now on the thorny issue of Brexit. I want to start with the Withdrawal Agreement and the political declaration. Presumably, it is important for HMRC that the Withdrawal Agreement is



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approved, in order to secure the transition agreement, so that things remain as they are until December 2020.

Jon Thompson: Yes.

Q162 **Chair:** In terms of the political declaration, perhaps you could help. One of the commentaries out there has been that the political declaration states, "Zero tariffs, no fees, charges or quantitative restrictions across all goods sectors, with ambitious customs arrangements that build on the single customs territory". How is that different from being in a customs union, in your professional opinion?

Jon Thompson: It looks close to that but it is not. The Government published something in the White Paper called the Facilitated Customs Arrangement. I think we have discussed that before.

Q163 **Chair:** Yes, I am sure we have.

Jon Thompson: Forgive me, after 13 Select Committees on Brexit, I cannot quite remember who I have talked to about what. But it certainly does do that. It establishes if you are a member of a free trade area with deep regulatory and customs co-operation too. That is also in the political declaration. Of course, what it does not say is how you operationalise that.

If you have further questions about: what does that mean about IT systems or data access, or what is it going to cost and all of that, it is quite difficult to answer those at the minute. It does establish an independent customs territory for the whole of the United Kingdom, which the Government believe, therefore, establishes the right to independent trade deals and so on, establishing different tariffs. There is also the zero tariff free trade area, as you quoted, in the political agreement.

Q164 **Chair:** There is obviously lots of controversy and discussion about the backstop. I think it is fair to say the Government hope that is not needed, because a new arrangement is put in place because of the political declaration so the backstop is not required. Let's say that the backstop is invoked. One journalist described the backstop as only frictionless, "in so far as you believe there are no frictions in product checks, customs declarations for VAT, visits to customs offices of exports, and checks to ensure you're not smuggling fish". How would you respond to that?

Jon Thompson: To be clear, what the Technical Explanatory Note for Northern Ireland does—which is in two pages if you have read that—is it establishes a series of agreed principles in paragraph 4. I will not read out what those agreed principles are, but there are six. A reasonable extrapolation of those principles would be: if you are in Northern Ireland and trading with the European Union there is no change for your business. In relation to GB to Northern Ireland trade, it would be an appropriate declaration for regulatory purposes but not for customs purposes because you are then in a no tariff, no quotas and no checks on



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rules of origin situation. Nevertheless, a regulatory process would be required.

Therefore, one has to assume that that means some sort of paperwork. It would be in electronic form but now you can extrapolate that from: what does that mean about friction? But it would be an appropriate declaration, yes, from GB to Northern Ireland and also from GB to the EU.

Q165 Chair: Okay. I started off talking about the transition and things staying as they are, because I assume that that obviously helps with preparation. Although we hope the backstop may not be needed, it might be. If the agreement is to be approved in the course of the next few weeks, for example, is there enough time for the backstop arrangements to be put in place by December 2020?

Jon Thompson: It is really difficult to answer that question for three reasons. First, because we need further clarity on how you would operationalise—you asked me about backstop—the backstop. In the Technical Explanatory Note on Northern Ireland, it sets out the fact that it would “clearly require further work and discussion between the EU and the UK” and, “There are potential different approaches that could be adopted to give effect to these Articles”. That is paragraphs 4 and 5 of the Technical Explanatory Note. We would require some further clarity on what exactly is required in order for us to be able to work out what IT systems we would need to build.

Secondly, as has been pointed out already, part of that would be what IT systems would we have access to in the EU. We require clarity on both of those points: what needs to be operationalised and what IT systems do we have access to? Once we have that, then we are in a position to be able to specify what operations we require and what IT systems we would require. We then have to build those or amend them, as appropriate, from where we currently are. Then we would need businesses that are transacting towards Northern Ireland to adapt or amend their own systems. In broad terms, if we were to make a number of assumptions, we think it could be up to 30 months to do that work.

Chair: Thirty?

Jon Thompson: Yes.

Q166 Chair: That is a bit longer than between now and December 2020.

Jon Thompson: We have to make a series of extrapolations and assumptions about what we know, versus what needs to actually be discussed and agreed before I can be definitive about that, so that is why I am saying “up to 30 months”.

Q167 Chair: You mention about the access to the IT systems. Within the Withdrawal Agreement, I think there are 12 pages of customs excise and VAT systems and networks that the UK is losing access to. What are the



consequences of that?

Jon Thompson: The Withdrawal Agreement starts from the position that we lose access. Of course the political agreement then puts those back on the table, because the extent of UK commitments on customs and regulatory co-operation and so on is to be taken into account. The political agreement also says there will be reciprocal arrangements for the exchange of data, and that there will be further arrangements for data exchange and law enforcement authorities, all of which we would be looking for further access to existing databases.

To try to help, if we did not have access to those databases we are in a situation where we might have to build them ourselves, or we have to work around operationally what the impact is of the loss of those databases. At this point I am assuming that the Withdrawal Agreement would give us access back to where we are, but I cannot be definitive about that.

Q168 **Chair:** You mean the future relationship would do that?

Jon Thompson: The future relationship, yes. The political declaration on the future relationship would take us back to where we are now, but I cannot actually say that because I have seven pages to fill.

Q169 **Chair:** Yes. If that could not be negotiated or, if in the course of negotiation of the future relationship, access to all those databases could not be regained—if I could put it like that—that would be a further huge strand of work, depending on the database, for HMRC to embark upon to build its own?

Jon Thompson: Yes, and/or it is possible that we could decide that we are not going to try to replace that and we would have to work out the pros and the cons of what is it that we now do not have access to. Yes, you could build something that would be an alternative or you might say, “Looking at what we are getting access to, we will take a risk judgment on whether we want to build it or not”, but until we are clearer about, “You can have access to these lists and these databases and not those” it is difficult to give you an answer.

Q170 **Chair:** One of the things that the Withdrawal Agreement also states is that, by the end of 2020, the UK and the EU would lose access to each other’s turnover information on transactions currently available to the VAT Information Exchange System. What impact would that have on the risks or the likelihood, perhaps, of increased VAT fraud?

Jon Thompson: The VIES would be top of our list of things to continue to have access to, I believe.

Jim Harra: Yes. The Withdrawal Agreement provides that we will still have access to VIES, to the extent that that is required to run the backstop provisions in relation to Northern Ireland, but that does not then suppose that we would have any access to it in relation to Great



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Britain. It is obviously a source of information about cross-border transactions, which is relevant to VAT compliance and enables us to operate cross-border VAT without the need for customs declarations, for example. It replaces the data that you would otherwise get in those declarations, so there is a useful range of simplifying the VAT arrangements.

Q171 **Chair:** Just before we move on from that, one further question on your point, going back to this issue about needing longer than perhaps is provided for the backstop. If the backstop were to come into operation in January 2021, because political agreement has not been reached, what would that mean in terms of practical operations? For example, would HMRC have to adopt a light touch, the choice that we have discussed before between security, collecting revenue and the ability to get people through borders or goods across borders fairly speedily?

Jon Thompson: Yes, I think we discussed that. Those are the Government's strategic objectives for the border: the free flow of trade, the raising of revenue and security of the United Kingdom. You may have to make some trade between those strategic objectives. There is an alternative way through that, which is what we have begun to term a sort of managed transition, which is: if you are not able to get there exactly by various deadlines, what practical arrangements can you make for a period of weeks and months until you get back to an optimal situation?

We have begun to flesh out what exactly that might mean in practice. If somebody turns up at our border without the relevant pieces of paper, what exactly would we ask people to do or not do? It would then go to the heart of the three strategic objectives.

Q172 **Chair:** That is work that is ongoing?

Jon Thompson: That is work that is ongoing, yes, because we need to be able to give Ministers some advice about whichever route they are taking. We are clear about where the Government are striving to get to, which is to implement their political declaration on the future relationship. Nevertheless, we need to be able to set out for Ministers what all of the implications are.

Chair: I want to move on now. Obviously, we have heard a lot about business preparation for Brexit, and we know where the larger business sits, but we are also hearing that some smaller businesses are grappling with this. John, did you have a—

Q173 **John Mann:** Yes. Multinationals have had a lot to say and, by definition, they are able to consider issues multi-nationally. Let's take a small business, like the one I set up in this country, contracting people in wherever it worked, including, say, French, German, moving people across borders, bought all of the equipment from the Netherlands, got it serviced in the Netherlands, including all spare parts and any other servicing, sending equipment back, and took equipment regularly, weekly, by lorry into the European Union, sometimes beyond the



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European Union through the European Union. If there is no deal what does that mean in terms of the changes for a small business like that that, in essence, is buying capital equipment in from the EU and is selling a service physically by crossing into the EU?

Jon Thompson: Under no deal?

John Mann: No deal.

Jon Thompson: I think we discussed this before: what would happen in the event of no deal? Then you have to assume that the full rules of being a third country would apply to the United Kingdom. For your movement of equipment, there would be a customs declaration and one on the export side—and I think you said in the Netherlands—and then an import declaration in the United Kingdom, so that would apply.

I cannot speak to the movement of people question because that is clearly a Home Office issue and, in terms of selling, you mean selling from the United Kingdom into the EU?

Q174 **John Mann:** Selling a service, yes.

Jon Thompson: Selling a service or a good?

John Mann: Selling the service but taking the goods over, so physically going and working there.

Jon Thompson: For selling goods tariffs would apply.

Jim Harra: In the circumstances you describe, obviously there is a one-off import of a piece of equipment into the UK. At the moment there is no customs control on that at all. In the future, in the event of no deal, there would be an import declaration and potentially a tariff, depending on the UK's tariff policy. Thereafter, temporary movements of machinery to go and do a job and bring it back into the UK, or to send it overseas to have it repaired and brought back to the UK. At the moment you can do all of that quite freely.

In the future, you would have to use a customs simplification that allows for those temporary movements without you having to pay any additional import duties, but there would obviously be some bureaucracy to go through to qualify for those. For example, there is a relief called Inward Processing Relief, which says that if a good is moved to be repaired and then sent back, re-exported again, there is no customs duty payable on that movement but you have to comply with the terms of that relief in order to qualify, so there would be an additional admin burden to make sure that you did not have a financial liability compared with today.

Q175 **John Mann:** If I was doing that tomorrow with this business in that scenario, I would need to maximise all the equipment going out and make a customs declaration?

Jim Harra: Yes. You would have to register as an international trader for customs purposes. Then you would have to comply with the rules of the



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relevant reliefs to enable you to temporarily move your goods across a border and back again without incurring any duties, either in the UK or in the Netherlands in the case of goods being moved in there to be repaired before they are sent back.

In those circumstances, generally speaking, there is no question of you having to pay multiple import duty but there is a need to go through some bureaucracy in order to qualify for that.

Q176 John Mann: The bureaucracy: will there be any extra carry costs?

Jim Harra: The only tariff costs in the example you have given would be in the initial importation of the machinery from the Netherlands. If there were UK tariffs applying to the EU then that would be payable. Thereafter, there would almost certainly be reliefs that would apply for the temporary movement of those goods, provided that they are brought back to their original point of departure.

Q177 John Mann: The suggestion would appear to be WTO rules. I am just trying to clarify because the picture of small businesses, small businesses are reading this—well, some are I guess but the vast majority aren't in my area and I suspect in the country. I am trying to get a clear feel for: if there is no deal, are there any problems there or benefits that you can see for a business that is trying to buy and sell into the European Union?

Jon Thompson: We are being very clear, as we have in the past, that there are two costs. There is an administrative cost for the fact that, under no deal, you are almost certainly going to have to do customs declarations and other paperwork. We had an exchange in May about how much that might cost, and then there is the question about what might be the tariffs that you might also have to pay. There are clearly two costs in that.

Q178 John Mann: When I previously personally drove lorries beyond the EU, I always had a 24-hour delay at borders getting through. Is there any likelihood of any border delays?

Jon Thompson: It is plausible that there would be delays at the border, yes. It is very difficult to answer your question because we have a known/unknown. To bring this to life, if you are going to go from Dover to Calais, we do not know exactly how the French authorities would react when your lorry arrives there and whether or not there would be a queue. I have set out in public a number of times that it is highly likely there would be a queue in France and, because there is a closed loop system between Dover and Calais or across the Eurotunnel, you would end up with a queue in Kent. That is highly plausible in the event of no deal.

Q179 John Mann: It is the no deal scenario I am just trying to—

Jon Thompson: Yes. I am being as transparent as I can be.

Q180 John Mann: Small businesses want to have a clear picture. Are you prepared for that? If I am happy driving my lorries across, backwards and



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forwards, working for two or three days, coming back, sending bits of equipment backwards and forwards. Obviously we will need to get this expensive equipment fixed very quickly, so sometimes driving that to make sure it is immediately repaired. Are there any risks that ought to be built in for businesses now, thinking through the no deal scenario come 30 March?

Jon Thompson: I told the Public Accounts Committee last Monday that the date for putting in an optimal customs system for the United Kingdom, in the event of no deal, was passed months ago. You definitely have the issue that you are raising about the readiness of traders for those situations. You have the: how will 27 countries of the EU react to us being a third country trading under WTO rules? You have the readiness of ports and other exit and entry areas in and out of the United Kingdom. Those are the three significant risks.

The readiness of HMRC is essentially whether we can gear up to handling the dramatic rise in the number of customs declarations. That goes from our estimate of 55 million a year to 250 million a year, which then extrapolates out into the costs that we had an exchange about in spring.

Q181 **John Mann:** A final question in terms of criticality of risk. I can only ever recall being able to go through either Calais or the Hook of Holland when I was taking a large vehicle through, so the criticality of risk in terms of those two. There are no other options are there, really?

Jon Thompson: The Office of National Statistics on movements in 2016 bring it to life perhaps, which is that there were 2.6 million movements in and out of the Port of Dover; 1.6 million movements through Eurotunnel. After that is Holyhead at 500,000. The next biggest port in the United Kingdom is Portsmouth at 165,000.

Clearly, there are two dominant ports there, Eurotunnel and the Port of Dover, which is why we have established working groups with both of those to talk about the operational impact. I am conscious we have the Member for Dover on the Committee, but we have concentrated very closely on that and we have concentrated on Holyhead, obviously, because of the link to the Republic of Ireland.

Q182 **John Mann:** Would any of you three invest currently in a business like that? I might have to reinvest. There might be a snap general election. We have to think these things through. You are the real experts in this in what the problems might be. I can assure you it is a good sector to be in, profitable if you can get across.

Jon Thompson: I am not a spokesman for the Dover Harbour Board but, if you look at the growth of the Dover Harbour Board over the last few years, it is a deeply impressive organisation. I have visited it three times, walked it. It is working incredibly efficiently, almost at the absolute limit of what it can be but it is a deeply impressive operation.



Jim Harra: It might help if I can describe the steps we have taken to help small businesses, like the one that you mention. We have identified about 145,000 small businesses that currently move goods between the UK and the EU only and, therefore, probably have never had to engage with customs before. We estimate there is about a further 100,000 small businesses that we cannot identify that we also need to reach.

The ones that we can identify we did write to in September. We pointed out to them that they are affected if there is no deal. We drew their attention to the technical notices that had been published, explaining what the impact would be, and encouraged them to familiarise themselves with what might be relevant to them.

We have a communication plan, which we will continue to implement between now and March if we go into no deal, to convert that call to awareness into a call to action and encourage them to take the steps they need to take so that, if they do move equipment between the UK and the EU, for example, they know what simplifications they need to apply for and how to make sure that they don't fall foul of either our rules or the EU's rules.

Q183 **Chair:** Thank you. I am going to go to Charlie in one minute but, just following on from that, of course, there are a number of businesses that operate across the EU27 that are not in goods but are in services, particularly, obviously, financial services. It will not surprise you to know we have had quite a lot of representations from financial services firms. Their response to Brexit is to reorganise and obviously to perhaps restructure their operations, dispose of part of their businesses or set up operations in the EU27.

How are HMRC handling requests from businesses like that, who are worried, potentially? They are saying, "We are being compelled to do this in order to continue in business but, of course, that might end up leading to a tax bill". How does HMRC respond to advice on that sort of issue?

Jim Harra: Restructuring of a business, which involves moving an asset from the UK into another country, which might be goodwill if they are moving part of a business or customer data or some other intangible asset, can give rise to an exit charge or a tax liability in the UK, in the same way as any other cross-border transaction.

We have been talking to businesses to make sure that we understand what they need and that we give them the service that they require. Every case is different. Although we do have general guidance published—and most businesses that are restructuring will be aware of that—each business needs to have its own particular circumstances looked at and we would aim to make sure that they can get rulings from us, so that they have clarity before they undertake any such transactions, about what the tax consequences would be, if there is any uncertainty about those.



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If they are a large business, they can contact their customer compliance manager and they have an existing relationship with them. If they are a mid-sized business or a smaller business, and they don't have an ongoing relationship with us, we do have a service whereby, if a business is going through a business life cycle event that means they need some intensive support from us, we can appoint someone that they can contact to make sure they get the service they need.

It is the case that it is quite difficult to give any more general guidance than we have already published. Case by case, they will need to go through their own arrangements.

Q184 **Chair:** What is the name of that service that you just referred to about the business life cycle?

Jim Harra: Anyone who is in our mid-sized business service, for example, while they might not have a regular customer compliance manager, if they contact us and explain the circumstances we will appoint someone who they can deal with.

Q185 **Chair:** Are you seeing a spike in those sorts of requests?

Jim Harra: Yes, we have several working groups going with industry bodies to work through some of these restructuring issues because, obviously, while every case is different—because their assets and their structuring is different—there are common sectors affected. We have several working groups working with them to make sure that we understand what their service needs are and we have a good awareness of what they need, and we will try to meet that. Obviously, the tax rules will apply and there could well be a tax charge.

Q186 **Chair:** Finally, are Ministers asking you or are you passing on to Ministers overall impressions, I suppose, of the work that has been generated? For example, numbers of companies who are asking for restructuring advice, the 145,000 who are coming to you asking for help with customs in the way they probably have not done before, are you passing the overall picture back to Ministers?

Jim Harra: Yes, we keep Ministers advised of what we are doing and what we are finding in our dealings with customers. In particular, in relation to the working groups on the company restructuring there are Treasury officials on those groups, so if any policy issues are identified in the course of those negotiations or discussions, as opposed to operational issues that we can deal with, they would be fed in as necessary.

Chair: That is very helpful.

Q187 **Charlie Elphicke:** Being the Member of Parliament for Dover, I have followed this, as you will know, with some degree of interest. I was interested in what you were saying that, if there are queues at Calais, they stop and cause queues; it is a closed loop system and it will drag it all to a halt. Why do you think they would do that when they sell us twice



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as much as we sell them through the Dover Strait?

Jon Thompson: Why do I think the French might do that?

Charlie Elphicke: Yes.

Jon Thompson: What I said was I don't know. I know it is a known unknown. That is what I said. We do not know how they are going to behave. They could be anywhere between perfectly reasonable and completely legalistic. If they are legalistic about it, and they decide to check more than they currently do, it will slow the traffic.

Q188 **Charlie Elphicke:** Because of risk we say, "We are doomed. We have to remain in the customs union. We have to fold up and pay up and agree to all their demands"?

Jon Thompson: I did not use any of that language and neither did I evaluate it. You used that language, not me. I did not use any emotive language about that at all.

Q189 **Charlie Elphicke:** Looking at the systems, can a max fac or backstop system be ready by 2021? Will customs systems be ready and in place by the end of the transition period, by the end of December 2020?

Jon Thompson: In the event that there is a deal?

Charlie Elphicke: Yes.

Jon Thompson: Under the Facilitated Customs Arrangement—let's assume that that continues to be what we are asked to do—we are required to do two things. One is to implement a dual tariff, one for us and one for the European Union. That then applies to goods coming into the United Kingdom. Our estimate is that that takes 24 months from certainty.

Throughout all the previous Select Committee hearings that Jim and I have done on this, we have not said when something can be ready. We have said how long it will take from the moment of certainty. Therefore, it is 24 months from when you tell me what exactly you want me to go and do.

Charlie Elphicke: It will take two years.

Q190 **Chair:** When you say "moving to certainty"—I am sorry to interrupt—is that if the political declaration were to be turned into something, was very clear, it is at that moment, when it is clear, what the future relationship is going to be 24 months from that moment?

Jim Harra: If we stick with a Facilitated Customs Arrangement, we can make some assumptions about what will be agreed and, indeed, in January we intend to move into the next phase of building that, based on certain assumptions. I will be pleasantly surprised if the political declaration, when it is completed, gives us that level of certainty. In a Facilitated Customs Arrangement there is quite a lot to be agreed with



the EU, which I would expect us to have to do in the next phase of the negotiation. While we have to proceed at some risk, there is a chance that we will make the wrong assumptions and, therefore, we will have to redo some work.

I think we have two timeframes. Operating the dual tariff and then making sure that businesses know which tariff is right for them and are able to apply the right tariff at the outset, and we think we will probably need two years. There will be other businesses that will not know which is the right tariff for them. They will have to pay the higher one and then later someone will reclaim the difference on a repayment mechanism. That does not exist anywhere else in the world so we cannot buy that off the shelf, so we think that will take some time longer to implement, which would definitely bring you beyond December 2020 before a fully operational arrangement was in place.

Q191 Charlie Elphicke: There are two years from the moment of certainty. When are you expecting the moment of certainty?

Jon Thompson: I do not know when the moment of certainty is. We have a seven-page political declaration. We have to assume that will continue to be negotiated, enhanced, fleshed out and so on, and then there will be a point—it may not necessarily be a public point but let's hope it is some point in 2019—when we have enough certainty to say, "Right, we know exactly what we need to go and do. Now we can operationalise". Then we can say how long it will take from that point to the end.

Q192 Charlie Elphicke: Let's say the moment of certainty—because it will take some time to discuss the political declaration, flesh it out, negotiate it—comes in August 2019, when are the systems going to be ready?

Jon Thompson: Twenty-four months after that.

Q193 Charlie Elphicke: That would be in August 2021, but it is meant to all be ready by January 2021, isn't it, so what happens?

Jon Thompson: I am answering your questions clearly about how long it takes to build something. My understanding is the Government have various options that they could deploy. My understanding is that, by 1 July 2020, the Government have to make a choice about whether they wish to extend the implementation for a short period of time—I think the Prime Minister has set that out—or whether they wish to move into the backstop.

Q194 Charlie Elphicke: Therefore, it might extend the transition beyond the end of December 2020?

Jon Thompson: I think the Prime Minister has made that clear.

Q195 Charlie Elphicke: That could be for an indefinite period?

Jon Thompson: The Prime Minister said it would be for a short period.



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Q196 **Charlie Elphicke:** Right. Do you have a sense of how long a short period is? You are the person in charge of implementing systems to make it happen.

Jon Thompson: If you can tell me when you want me to start and what you want me to do, I can tell you when it is going to be ready. We can go round this infinite loop if you want but—

Q197 **Chair:** To summarise, I think what you are saying is you are very clear about a period of time, 24 months, which runs from a moment of certainty. That moment of course is unknown, because you do not know when the certainty on the future relationship is going to be achieved. It could be August 2019. It could, of course, be December 2020.

Jon Thompson: It could be a private moment in the spring when Ministers say to us, "We are prepared to take the risk. Go and build what you know now". In fact, we had this conversation at some length with the Chancellor of the Exchequer yesterday, so that he was clear about what the underpinning assumptions are and what the elapsed time is.

Jim Harra: To be clear, we believe that in 24 months we can stand up an operational version of the Facilitated Customs Arrangement but it would not extend to everyone who wished to use it because, for that small minority of businesses that needed to access a repayment mechanism, we think it would take longer than 24 months for that.

Q198 **Charlie Elphicke:** Just looking at a no deal, you said, "We have passed the deadline months ago to be ready with the systems". Can you tell us a bit more about that?

Jon Thompson: Yes. Clearly, Ministers were trying to wrestle with the delicate balance between negotiating the Withdrawal Agreement and the political statement on the future relationship, versus signalling that businesses should implement no deal, therefore, no deal was not implemented. We are in a phase of implementing it now but, in parallel with your comment about the maximum facilitation, to get to an optimal new customs system you require broadly 24 months to do whatever is necessary to change systems.

To be clear, it is not largely about the Civil Service or HMRC. Even if we say we are clear about what needs to be operationalised, this is a highly automated system in which a whole range of other people then need to change their own systems. That is one of the factors about: why does it take so long to get to an optimal system now to a new optimal system in the future? Because it is traders, haulage companies, ports, airports and so on that need to adapt their own systems to what it is that we are saying they need to do.

Q199 **Charlie Elphicke:** If we had said immediately after the referendum, "Right, we are going to build a standalone system. It would take two years to get ready", you could have delivered that?



Jon Thompson: Yes.

Q200 **Charlie Elphicke:** That would be in our national interest because we would then have a different quality of negotiation possibly.

Jon Thompson: That is for you to judge as a politician.

Q201 **Charlie Elphicke:** Okay. With more money, more resources from the Treasury, would you be able to build something faster than two years?

Jon Thompson: We were asked this question yesterday and we don't believe that money would speed it up, particularly. It might shave a bit off it but, to be upfront about it, you are not suddenly going to find that if you gave me a £1 billion that it is going to turn out to be nine months, hypothetically speaking.

Q202 **Charlie Elphicke:** Also, the record of the Government and projects is they do not always get along too well, so is it possible that it might take more than 24 months? It could, say, take three years rather than two years?

Jon Thompson: Theoretically, yes. To reiterate the point I have made several times before, it is not just about us. Let's use the example that you are familiar with, as the Member for Dover. If the Government decide that they want to introduce an inventory linked system that requires ports and the ferry operators to introduce some new technology so that we know what lorries are crossing Dover Strait, so that when they enter the United Kingdom we can decide which ones to stop—that is a plausible scenario—that requires other people to build IT systems, to purchase IT systems or amend IT systems. That will take some time. It will not necessarily be about HMRC.

Q203 **Charlie Elphicke:** The Eurotunnel believes that the French have a treaty requirement to process lorries as fast as they come out of the tunnel. Are you aware of that?

Jon Thompson: I am aware of the position of Eurotunnel, yes.

Q204 **Charlie Elphicke:** What you could do then is: you could send the full lorries through the tunnel and the French would have to process them and send the empty lorries back through Dover if the French play games. That would be in our national interest to make sure we plan for that possibility, would it not?

Jon Thompson: I think that would be an interesting decision for the board members of Eurotunnel to make.

Q205 **Charlie Elphicke:** In terms of contingency planning, to keep trade going in the event that the French authorities decided to have a go slow or do any other measure that we are worrying about—that, by the way, they deny—that would be functional and effective as a strategy, would it not? What could be done to plan for that?

Jon Thompson: That would be risky, though, wouldn't it?



Q206 **Charlie Elphicke:** Has anything been done to plan for it in our national interest?

Jon Thompson: So I am clear about the question you are asking me, you are saying: should we just send lorries anyway, irrespective of whether we know they will get through or not? Is that the question you are asking?

Q207 **Charlie Elphicke:** No. The question I am asking is: for the operation of the tunnel concession, there is a treaty obligation on the French to process lorries as fast as they come out, to make sure there are no tail-ups and no queues. In that case, if you had a go slow in France or any kind of international games, shall we say—the politicians sometimes like to play on both sides of the Channel—in that case you could say, “Well, lorries that need to be processed can go through the tunnel. Lorries that do not need to be processed could go through Dover”, until everyone settles down and starts to behave sensibly. Is that part of the contingency planning for a no deal situation?

Jon Thompson: It is not one that I have been made aware of.

Jim Harra: First of all, we talk about people playing games but, to be fair to the French, they will have obligations to the European Union that they will have to comply with. If we are third country, and even if people are not trying to play games but are trying to do their best to keep trade moving, nevertheless, everyone is going to have to adapt to new processes in the event of a no deal.

We have in place plans that mean, in the event of us leaving on 29 March with no deal, we will be able to operate a functioning customs border with the EU. We hope that the French and the Belgians and everyone else will do the same but, as Jon says, that is not something that we can guarantee for anyone.

We talked about the length of time to get to a steady-state model. There is no end point in terms of improving things. What I think would happen, in the event of no deal, is we would start off with a functioning but, clearly, suboptimal customs border. There would likely be some fiscal risk attached to that, depending on what the tariff decisions are.

Over time, we would improve our systems. We would expect the ports and the ferry operators and the hauliers to improve their systems and their infrastructure, and we would move to a steady-state model. I suspect we would constantly iterate on that and improve it, but I think we are looking at a minimum of two years from the no deal to getting to a point where you could say, “We have a steady-state system, where we are comfortable that we can manage all the fiscal risks in the way we would like and trade in the way we would like”.

Q208 **Charlie Elphicke:** At the beginning of this session, the Chair effectively said the contemplated arrangements look awfully like the existing customs union, and you were sort of lukewarm on that. Can you give us



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an example as to how it would differ from the existing customs union?

Jim Harra: Are you talking about the arrangements identified in the political declaration?

Chair: Yes.

Jim Harra: The UK intends to be able to operate its own independent trade policy in the future, including making trade agreements with other countries and setting its own tariff. It has been clear from the outset that that was one of the Government's objectives. They will be going into negotiations for the future economic partnership to come out with a model that gives us as frictionless as possible trade between the UK and the EU, which enables the UK to do that. That is a clear difference between the current customs union, where the UK must apply the EU's tariff and cannot pursue its own trade policy.

Q209 **Charlie Elphicke:** On the backstop issue or Northern Ireland situation, looking at a no deal scenario and your guidance to businesses, it looks awfully like there is some kind of no deal backstop in the guidance. Mr Varadkar, the Taoiseach, seems to indicate such as well. Can you tell us what the understanding with Ireland is in the case of no deal in relation to the border?

Jon Thompson: Sorry, you are asking us about a no deal backstop? I am not clear what a no deal backstop is.

Q210 **Charlie Elphicke:** It says here, "The UK government is clear that in a 'no deal' scenario we must respect our unique relationship with Ireland, with whom we share a land border and are co-signatories of the Belfast Agreement. The UK government has consistently placed upholding the Agreement and its successors at the heart of our approach. It enshrines the consent principle on which Northern Ireland's constitutional status rests. We recognise the basis it has provided for the deep economic and social co-operation on the island of Ireland", and then it talks about how we will be working with Ireland to avoid any kind of border. Is there a wider understanding there?

Jim Harra: That is not in relation to the backstop agreement. That is in relation—

Q211 **Charlie Elphicke:** No, it is a no deal situation. Is there effectively a form of no deal understanding?

Jim Harra: HMRC does not have any agreement or understanding with Ireland in relation to how customs will work in the event of no deal. We have negotiated with the European Commission in relation to the future, but in a no deal there is no deal between the UK and the EU.

Q212 **Mr Simon Clarke:** Gentlemen, let's just set out, as a prerequisite to all your answers, that these are purely directed at you as customs experts rather than as politicians.

My first question is around the necessity of the backstop. Last week at



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the Northern Ireland Affairs Committee, Lars Karlsson, who was the former director of the World Customs Organisation, was asked: is it possible to have a technical solution that would remove the need for a backstop? He said, "Yes, it is possible". Then Mr Hans Maessen, who is the former Chairman of the Dutch Association of customs brokers, was asked the same question. He said, "To give a very clear answer, no. There is no need for a backstop. You can organise this system within the transition period, and it is all working fine. It is there. It is all in the Union Customs Code. There is no cherry picking. You do not need new systems or new laws—you do not need a backstop, because you can have this transparent border within two years". Do you agree with them and, if not, why do you not agree with them?

Jon Thompson: The Government set out what could be done in a paper on Northern Ireland in the summer of 2017, where we put forward that you could overcome the challenges of the Northern Ireland/Republic of Ireland border through purely administrative reasons, removing the question about whether you needed technology solutions or technical solutions. "Technical" can be used in this space too.

We set that out. We thought that those administrative arrangements were perfectly reasonable and a reasonable extrapolation of the Union Customs Code. At this point those have not been able to be negotiated.

Q213 **Mr Simon Clarke:** As a matter of principle, though, you believe that there is no reason why a backstop is required. Could that outcome be negotiated?

Jim Harra: It is certainly our aim during the transition period. While the Withdrawal Agreement provides for a backstop, it also provides that both the EU and the UK wish to avoid implementing that backstop and will seek to agree some alternative, in which case it would be superseded by that alternative and, certainly, we are very open to doing that.

In relation to our future economic partnership with the EU, the UK has set out a couple of proposals since the referendum that would avoid the need for a hard border in Ireland and, in one of those cases, still enable customs controls to operate. Where we are today, the Withdrawal Agreement has set the pace. This is the backstop that will apply if we cannot agree something better before the end of the transition period.

Jon Thompson: In the Technical Explanatory Note on Northern Ireland, paragraphs 4 and 5 open up that possibility because paragraph 5 specifically says, "There are different potential approaches that could be adopted to give effect to these Articles" and we would want to continue to advance alternative ways of doing that.

Q214 **Mr Simon Clarke:** Thank you. On that point, there has been talk this week that maximum facilitation is essentially back on the table and that this is something which the Government are considering as a means of removing the backstop. Has anyone from the Government spoken to you



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or your colleagues about this and, if so, what have they asked you to do?

Jon Thompson: We are being asked to have a look at what might be the technology or other technical solutions to the problem. Again, to reiterate, in my opinion, the Technical Explanatory Note on Northern Ireland keeps that option open.

Jim Harra: I envisage that, from this point forward, we will be doing two things. We will be scoping out how we can implement the backstop, if that is what came into force. We will be continuing to work on what would be the better alternatives to that, both working within the UK and seeking to engage with the EU.

Q215 **Mr Simon Clarke:** To be clear, that request has now come from Ministers to reopen that line of inquiry?

Jim Harra: I think Ministers have always been interested, as the Withdrawal Agreement makes clear. They have always been interested in having something better than what is in this Withdrawal Agreement and they will want us to keep working on that.

Q216 **Mr Simon Clarke:** When have you been asked to report by on that point? I am just trying to understand when we will know whether the maximum facilitation is going to—

Jim Harra: I do not have anything specific on that.

Q217 **Mr Simon Clarke:** In terms of Northern Ireland and the issue of the visible border, assuming a sufficient level of co-operation and trust between the UK and the European Union, can you tell me in any scenario, including no deal, what checks or activity would, as of necessity, need to be conducted at that border rather than, for example, online or away from the border?

Jim Harra: The UK has been clear that under no circumstances will we be putting in any infrastructure or any associated checks at the Irish border. Even if there is no deal, we do not envisage doing that and, certainly, the backstop would remove the need for it as with some of the other models that the UK Government have put forward since the referendum, but I cannot speak for the EU or the Irish.

Jon Thompson: In general, our approach would be threefold. First, in collecting customs declarations we use the IT system to risk those customs declarations. In the current model for the rest of the world that removes huge tracks of those declarations, more than 98%.

If you do need to physically inspect something you do not necessarily need to do it at the actual physical border. You can take it inland. You can inspect it at somebody's premises if they are a trusted trader and so on, and we set all of that out too. Your absolute last resort would be to do it at the physical border and the Government have been clear that they would not do that in Northern Ireland, so you would want to maximise those first two rules.



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Q218 Mr Simon Clarke: Lars Karlsson said last week it is possible to have no checks at the border, no infrastructure, "no slowing down". The head of the Irish tax authorities, Niall Cody, said he was "practically 100% certain" that no new customs posts would be necessary. Last week Mr Hans Maessen called the problem with the Irish border, "fictitious", and now we have your testimony. Therefore, why do the Government persist in accepting the argument that the Irish border would need to be hard under any circumstance?

Jim Harra: What happens on cross-border movements at the moment is there are cross-border VAT rules and there are cross-border excise rules. We are able to administer those without any border posts or without any checks at the border, but we are able to do this in the context of having access to EU systems and EU databases. The customs union and the single market remove the need for any other controls or checks on cross-border movements.

When the UK leaves the European Union, we will lose access to those systems and databases and we will be leaving the single market and the customs union, so there are potentially additional controls and checks required for leaving those. In addition, excise and VAT administration becomes more difficult because you do not have access to those EU systems and databases so the challenge increases.

If you set the challenge of, "Well, we want to operate customs controls between the UK and Ireland and find a way of doing that that does not involve doing anything at the border", we would be committed to exploring how you do that. I am not aware of any customs border in the world today that has found the technology that operates completely in that way, so it is a very significant challenge despite the evidence that those witnesses gave.

If it was the case that within two years you could have this at a customs border, I would expect to see lots of countries around the world jumping to do it and no one that I am aware of has succeeded. No matter how much you reduce the friction there is some in every customs border, but the more co-operation we can have with the EU and access to systems and everything, the more we can make that a possibility and that is something, as I say, we would keep exploring alongside preparing for the backstop.

Q219 Mr Simon Clarke: A low friction border is achievable with goodwill would, in essence, be a fair summary of that?

Jim Harra: We have it now and it involves a lot of goodwill but, also, a lot of very deep co-operation, which, as part of implementing the referendum, the UK will be withdrawing from some of that.

Jon Thompson: To put some numbers on it, there is some shorthand here about customs declarations but the declaration can be used for a whole range of other things and not necessarily for us as tax



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administrators, so approximately 40% of the intervention that we ask the Border Force to do is not for tax reasons at all. It is for tariff-related quotas, it is for safety and security purposes and for regulatory checks and so on. I think we are trying to be clear with you, as tax administrators, that that is where we are. I cannot really speak for what the Home Office thinks about safety and security, for example.

Q220 Mr Simon Clarke: Indeed. On the point of what happens in the event of a so-called hard border being the outcome, has the Government instructed you on what customs arrangements to implement on the Irish border in the event of no deal?

Jon Thompson: Apart from the really clear statements made repeatedly by the Prime Minister that this will not be happening and there will not be a hard border?

Q221 Mr Simon Clarke: No specific instructions beyond that?

Jon Thompson: Then we would go into advising the Prime Minister on what does it actually mean, in that unlikely event.

Q222 Mr Simon Clarke: Given Leo Varadkar and Jean-Claude Juncker have stated explicitly that Ireland and the EU respectively will not, under any circumstances, introduce customs infrastructure at the Irish border, who do you think is going to put up customs infrastructure at the Irish border?

Jon Thompson: I think we are being extremely clear with you—as we have been with the Prime Minister and she has been in public—we would not be asking for any customs infrastructure at the border. To be really explicit as to what that means, it means no barriers, no people in a booth, no drones, and no cameras.

Mr Simon Clarke: No nothing basically.

Jon Thompson: No nothing. That is my understanding of what a hard border means.

Mr Simon Clarke: That sounds like a very soft border to me.

Jon Thompson: I think that is what it means.

Jim Harra: People, I suspect, think of it as a physical thing but also as a psychological thing. We have been clear we do not expect to have to put in any physical infrastructure at the border. However, you can see that potentially the procedures people have to comply with and the bureaucracy they would have to engage with could change. In my view, part of the definition of a “hard border” is psychological as well as physical. We currently operate cross-border VAT and excise rules in a way that the communities in Northern Ireland find acceptable and uncontroversial.

Q223 Mr Simon Clarke: A final question from me: you stated—I am sure it is correct and I think it speaks to the dreadful negligence, frankly, of the Government’s preparation for a no-deal scenario for which I think



culpability will be hard and fast in due course—the moment of optimal preparation for a no-deal scenario, a no-transition scenario, has long gone. What can you have ready, were such a scenario to become reality next month?

Jim Harra: We have no-deal plans in place. We will have a functioning customs border in the event of no deal on 30 March 2019. We know the priority is to keep trade flowing and that fiscal risks may have to increase over the short term to enable that. Therefore, the arrangements we will have in place will be suboptimal. They will not give us the level of assurance of taxes we would want to have and we would have to build on them over time. However, we recognise—because the priority is to keep trade flowing—that is what we will have to do.

To give you an example, at ro-ro ports there is not time to have in place by March the kind of systems that link customs declarations to consignments to the vehicle carrying them so we would have limited intelligence available to us to identify any consignments that we wanted to intercept. Also, there is not time to build additional infrastructure at ports or near ports, even if we did identify those consignments there is no infrastructure to take them to. Therefore you would expect we would carry additional fiscal risk initially. We have some plans in place to manage that. For example, we have procured inland sites to which we can take the consignments of high-risk traders. We will be relying on our intelligence to identify those traders we think are—

Q224 **Mr Simon Clarke:** Those sites have been secured?

Jon Thompson: They open on 1 December.

Jim Harra: Yes, we have two existing sites that are going to be closing and two new sites will be opening on 1 December. They are available for use both for containerised traffic—what they are used for now—and in the event of no deal we can use them for any high-risk traders using, for example, ro-ro. Over time we would expect those systems and that infrastructure to be put in place, and we would move to a steady-state model.

The other area is in terms of trader readiness. We know now that, although we are communicating with traders, there is a high likelihood many traders will not be ready to comply with their obligations. There is also a high likelihood the intermediaries market will not be able to support the demand at day 1 because they have not invested at risk for that eventuality. Our plan is to get a message to traders that says, “You must try to comply but we are here to support you. In the early days if you cannot comply our approach will be supportive rather than penal”. I would envisage that over a period of time, two years or more, we would move to what I would regard as a more steady-state model.

Q225 **Chair:** We are going to move on, thankfully, from Brexit in a moment. Jim, you were just saying the priority was to keep trade flowing with,



obviously, the fiscal risks that go with that decision. Where does safety and security at the border come in that?

Jim Harra: The Government have been clear. The Financial Secretary gave evidence to a House of Lords Committee, I believe, the Government will not compromise on safety and security. Obviously the EU border is already quite a secure border, but when we leave the EU we have talked about the access to systems and databases that we will lose. That is the highest priority in terms of not compromising, whereas we would compromise on the level of fiscal risk that potentially we would take for a short period of time.

Chair: That is very helpful.

Q226 **Wes Streeting:** I know we have all been really enjoying Brexit and you will be really disappointed to move onto a different topic. You might be a bit more disappointed when I tell you it is disguised remuneration on the loan charge and the more than 100 MPs who have signed the Early Day Motion, which I think you have written to everyone about.

It is worth saying, from the outset, that there are two principal concerns for me. One is that people should be paying their fair share of tax and you personally, Mr Thompson, and HMRC are regularly asked about what more is HMRC doing to make sure that is the case. We have to see this in that context. There are also—putting on my constituency MP hat—concerns people have, myself included, about how this then works in practice, what type of people are caught and whether HMRC's approach is, and has been, reasonable. Therefore let me put some questions to you about HMRC's role, particularly, in that context and very much in a fact-finding tone.

In the letter you sent to MPs, "DR schemes have always been an attempt to avoid tax and our view has always been that they do not work". Let me begin by asking: how were individuals involved in arrangements now targeted by the disguised remuneration loan charge allowed to go on for so long without HMRC letting them know their arrangements were regarded as unacceptable tax avoidance that could be challenged? What took you so long?

Jon Thompson: It is our view we told the organisers of the various schemes that we did not believe they were within the frame of the law. While people could register a scheme and could get a number, it does not necessarily mean, therefore, it is approved in some way. Lost in this is that if HMRC registered a scheme and gave it a number that somehow gave it credibility that it was okay, but it never was.

In the 2016 Budget, when the change was made, I think it was well publicised the Government's view was these were contrived. You can trace ministerial statements all the way back to 2004 where Ministers are making it clear these arrangements are contrived and therefore we believed people were avoiding tax. It is conceptually possible an



employer can loan an employee money but we believe in these cases the vast majority of them are contrived.

I could give you an anonymised real example to bring it to life. From what you said in your opening question it sounds like you have a constituent who might have shared a problem, but I am happy to spell it out.

Q227 Wes Streeting: As a Committee, in terms of people writing to us, I think we have a large number of examples.

Veering away slightly from what HMRC has been doing around this for a moment, there is an issue with tax advisers. I have a constituent who was given tax advice and managed his self-employment in a scheme that has been caught up under the description of disguised remuneration. He is now facing a whopping great bill for £100,000 that he cannot pay back, certainly could not pay back over a five-year period, is not someone I would describe as the super-rich tax avoiders we all get very angry about and is worried about bankruptcy. HMRC is going after him. What are you doing with regard to the people who gave him the tax advice in the first place?

Jon Thompson: Our view is that the vast majority of tax advisers do not get into this, for the ones who do we have a range of powers to pursue them and we actively pursue many of them. The other track for us is to go through the various regulators. We are not the regulator or any of these markets. For example, Jim and I regularly talk to the Institute of Chartered Accountants in England and Wales, or the Solicitors Regulation Authority, about some of the promoters of these schemes.

HMRC has been able to pursue—and I think prosecute—some of the promoters. There have been some extreme cases where there has been criminality by the promoters. We have had to take a position on what that means to the taxpayer where there has been some criminality against them. In those cases, one of which I have personally been involved in with a group of customers, we suspended all actions while the criminality is worked through the criminal justice system in order to then visit what we would do in those circumstances. It is theoretically possible that, if a crime is committed and you were not aware of that, ultimately you might not be liable. It depends whether you had the cash or not, if we are being completely crude about the situation.

Jim Harra: If you take disguised remuneration schemes, the players in these schemes obviously are the contractors. Sometimes the engagers, who engage them, have been complicit in them, their advisers and the promoters who designed some of these schemes in the first place. If you look at our past counter-avoidance strategy, up until about five years ago, our focus really was on the employers and the users and we had limited powers to go after the promoters and the advisers who enabled them. Since 2014 we have had increasing legislative powers to pursue them as well. We have also worked with the professional bodies, for them



to strengthen their codes of conduct and the disciplinary action they can take against their members. We now really tackle the whole of the supply chain. That is clearly having an impact on the supply of avoidance schemes as well as the demand for them. For example, back in 2005-06 we had 600 schemes registered under our disclosure scheme, in 2017-18 that was down to 15 so we believe we are having an impact on the whole of the chain. However, it is fair to say that, until about five years ago, we did not really have the range of powers we needed to go after the promoters and enablers of these schemes that we now have.

The Promoters of Tax Avoidance Schemes, which was brought in, in the Finance Act 2014, gives us really quite penal powers to discourage promoters from this market. It is clear that some of the biggest and highest-profile promoters have given up the game, have stopped promoting schemes all together and in some cases have also stopped supporting their former clients in continuing to defend the schemes they have sold in the past.

Q228 Wes Streeting: You have addressed the issue of those cases that involve potential criminality and ongoing court cases. How might someone involved in such a scheme, on the basis of advice given by their tax adviser, reasonably or possibly have known that what they were doing was outside the rules?

Jon Thompson: I have to say I personally prefer the opinion piece in *The Sun* newspaper about this, if it is too good to be true it almost certainly is. I can give you a specific anonymised case. I went through a case recently in Leeds of an IT contractor who earns £100,000. The £100,000 gross is paid into a trust in the Caribbean. They pay him £12,000 a year so he has enough to create to a National Insurance record. They deduct a fee of £14,000 and then they lend him £74,000. Therefore he has received an income of £12,000 and a loan of £74,000; out of the £100,000 he has had £86,000. That is clearly contrived to avoid income tax. That was, one assumes, sold for a fee of £14,000. It just looks too good to be true, doesn't it?

To some degree you have to think there are very, very limited ways in which you can reduce your income tax bill, washing it through a Caribbean trust does look like it is going to be breaking the law to me. I appreciate some people may have recourse to their advisers. We have certainly seen some cases where people are in schemes who have tried to take recourse against their advisers. That is clearly a matter for them. The extreme version of that is the criminality version. It is common sense but there is obviously clearly a route for people to sue their advisers for this. We have seen some of those cases and been involved in them.

Jim Harra: I would add how we have strengthened the law in recent years. In 2009, we introduced a law that requires promoters of schemes to tell their client, when a scheme has been registered as a tax avoidance scheme with HMRC, that means they are entering into tax avoidance, HMRC will be informed and it is likely HMRC will investigate them for tax



avoidance. Those rules were strengthened in 2015, so as well as promoters and tax advisers having to give that advice if an employer or engager involves their workers in schemes they also have to give that advice. There is a defined form of words in an HRMC approved form that they are legally obliged to hand over, and there is a £5,000 fine for every instance where they do not do that.

Q229 Wes Streeting: Have you carried out any analysis of the earning levels of people targeted by the disguised remuneration loan charge?

Jon Thompson: We have, I think.

Wes Streeting: If you do not have the numbers to hand we would really appreciate if you could share those with the Committee. I do not want to dwell too long on the numbers per se.

Jon Thompson: We certainly did, because we made a decision as Commissioners, led by Jim, we would split the population between those who currently earn more than £50,000 and those who earn less than £50,000.

Jim Harra: We will give you evidence of the incomes of users of the schemes. We estimate about 50,000 people have used these schemes, about 10,000 of them self-employed and about 40,000 employed as contractors. On average their income was twice the average UK income.

I know we have recently given more information about this to a House of Lords Committee and I am quite happy to share that with you¹.

Q230 Wes Streeting: My concern here is they do not sound like very rich people. I am not excusing all of the schemes but I am thinking about the consequence of some very large bills landing at the door and people's ability to pay back significant sums. When Mr Thompson gives the example he gives, I have to say my sympathy vanishes instantly in a case like that. I am also thinking of the culpability of all of the people involved, some schemes do look too good to be true and you can smell a rat a mile off. I wonder how obviously bad these schemes are and how representative the case you gave is in terms of your caseload.

Jim Harra: My view is these are highly artificial and contrived arrangements. I do not think many people would reasonably expect to be remunerated for their work by non-recourse loans from an offshore trust. It is an extremely unusual way for anyone to be remunerated. More than half of the users of this have incomes well above the average². I would describe disguised remuneration schemes as marketed avoidance schemes for the middle class as opposed to very bespoke schemes that might have been constructed for extremely wealthy people.

Q231 Wes Streeting: Two final points before we have to move on, I am sure

¹ Refers to income levels at the time of the avoidance

² Refers to income levels at the time of the avoidance



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Parliament will come back to this issue again. How many people have taken up the contractor loan settlement opportunity? How many does that leave who might pay the loan charge? What estimate have you made of the number of people who will end up bankrupt?

Finally, one of the really strong feelings of resentment on the part of people who are caught up in all of this, and on behalf of parliamentarians—you will have seen the record of the Westminster Hall debate yesterday—is the sense this is retrospective and these charges and the collection is now being applied retrospectively.

The view of my constituent last Friday—whose case sounds quite different to the one you described, Mr Thompson, I have more sympathy for his case—is people are happy to abide by the rules but they feel they need to know the rules upfront and then be penalised if they are falling short. I think lots of people feel they have been inadvertently caught up in something, the rules are now being applied retrospectively and they are being asked to find a huge amount of money retrospectively. How would you answer that kind of criticism?

Jon Thompson: It is not retrospective because it is on the outstanding loan balance on 5 April 2019. It is not retrospective. It is on the loan balance you have. The reason for announcing it in 2016, and bringing it into force on balances on 5 April 2019, was that it gave people three years to resolve the situation. If there was a legitimate reason for having that loan from the Cayman Islands, say, then it gave you three years to unwind that before 5 April 2019 came into force. We do not believe that is retrospective.

Q232 Chair: The point made to us as a Committee is that it was not something that was necessarily cracked down on. The language of HMRC and Ministers became tougher and tougher over the years. However, that toughness was not apparent when people took the advice, in the way it has subsequently become very clear that Ministers and HMRC will not accept these types of schemes and will require disclosure of numbers and everything else. That is what they mean by “retrospective”.

Wes Streeting: We are finishing by going right back to my first question. Having read the letter you sent to us and listened to your evidence this afternoon I think HMRC is making a very reasonable case about the kinds of behaviours we want to clamp down on. However, unless you can persuade us otherwise, I think a very fair criticism of HMRC is that some of these cases go back well over a decade. Why have you not been clamping down on these kinds of schemes? What assurances can you give to the Committee that for other schemes, other elaborate tax arrangements and other types of models we are not going to be in the same position in five or 10 years down the line having this conversation again with your successor?

Jon Thompson: Let us deal with the last question first. If you now want to set up such a scheme you have to register with us. The number of



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schemes being registered with us has fallen from a high of over 400 several years back, I cannot remember the high year, to—

Jim Harra: There were 600 in 2005-06 and there were 15 last year.

Jon Thompson: The number has plummeted, because you now have to register that you are going to attempt something like this and we make it clear we highly doubt that a tax avoidance scheme is going to work.

In terms of some of your earlier questions, to give you the numbers, 24,000 people have come forward to settle. To reiterate our position, if you earn less than £50,000 you will automatically be given five years to pay. If even that is not long enough the best thing to do is to talk. If you earn more than £50,000 it is definitely in your own interests to come forward and talk. We will strive to avoid bankruptcy, as we do in pretty much all cases. I know we receive press for making some people bankrupt but it is very unusual. In the vast number of customers we have, 96% manage to strike a time-to-pay arrangement with us to pay their outstanding debts.

Q233 **Wes Streeting:** You still have not answered the very first question: why has it taken so long to clamp down on this?

Jim Harra: We feel we were active throughout. We brought, for example, the Rangers case. Where an employer should have been paying tax under pay-as-you-earn we go after the employer. We did send lots of signals, going back to 2009 and increasing in recent years, we did not believe these schemes worked. We did take up thousands of investigations. We did take cases to court. The fact is that in marketed avoidance generally you have very, very large numbers of cases of people who are very determined not to pay tax.

In recent years we have had increasing powers that enable us to crack through the casework, change the economics of avoidance and also reduce that demand. We can certainly give you assurance the landscape has completely changed today compared with the late 1990s, which was really the highpoint of disguised remuneration and tax avoidance.

Q234 **Wes Streeting:** I accept the point HMRC has been given new powers relatively recently and you are using those powers, which is good. However, your position and the Government's position is that these schemes have always been illegal, yet we have constituents who have been using them for well over a decade. I do not think, "We did not have the powers" or, "We have been clamping down recently" is very satisfactory in terms of explaining how HMRC has allowed some of these schemes to operate for so long.

I think my final point is an important practical one. Mr Thompson, you have given us the numbers of people who have already approached you and the numbers outstanding. Are you adequately resourced in this area in terms of the numbers of staff who will be processing and reviewing cases, dealing with people who will in many cases be quite distressed



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about their situation and trying to come to an appropriate arrangement? Do you have sufficient levels of resource in place at HMRC to deal with this on top of everything else you have to deal with?

Jon Thompson: We believe so. We are keeping it under constant review because, clearly, we are going through a large number of customers in a relatively short period of time, but we believe we do.

Wes Streeting: Thank you very much.

Q235 **Colin Clark:** I am going to come in at a slightly different angle. My constituency is very big with oil and gas and we have lots of contractors in the oil and gas industry. Someone wrote to me recently—I have a lot of this because you know an awful lot went on in the oil and gas industry—with regard to the famous case against the Rangers. He asked me the question, “The Supreme Court decided in the Rangers’ case that earnings which players got as loans should have been subject to PAYE and under current tax law the liability to pay this is that of the employer”.

The question I want to ask is: how liable are the employers or the companies, which in many cases industrialised this practice and encouraged particularly contractors, who were more interested in working offshore in a dangerous situation, to go into this? How liable are the employers, or are they not?

Jim Harra: It is certainly the case that the first port of call is employers. They are supposed to operate pay-as-you-earn on the earnings of their employees. We have always held a view that this remuneration—despite it going into trusts and back out in the form of loans—was remuneration on which they should have been operating pay-as-you-earn. Our first port of call is the employer if we reasonably can.

However, many of these individuals signed up to schemes that were designed to be opaque, including opaque to some of the employers it has to be said. There were many entities that were created as employers that were only put in place for the purposes of the avoidance scheme, they were either offshore themselves or they were created until the scheme ran its course and then they were closed down. Where we cannot reasonably go after the employer for this tax then we do have powers to go after the worker and we will do that in appropriate cases.

Q236 **Colin Clark:** Could or should they—if they can prove they were encouraged to do it or were deliberately led down that path—make that case?

Jim Harra: By all means. It is our practice to go after the employer first if we believe the employer should have operated pay-as-you-earn on the payments and we can still reasonably collect the tax from the employer.

Q237 **Colin Clark:** If the employer has better lawyers than the individual you would end up going after the individual? It may be cynical, but is that the case?



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Jim Harra: That is overly cynical, I am afraid.

Chair: Surely not from a Scot.

Jim Harra: Sorry. The Rangers' case shows we do go after employers. Under pay-as-you-earn it is our first port of call to go to the employer, "You should have deducted tax. You failed to do so, we want it." However, as I say, in some of these disguised remuneration schemes the employer was not a very substantial creature. They were often set up for the purposes of the avoidance scheme and they were either set up offshore or set up and then dissolved.

Q238 **Rushanara Ali:** Good afternoon. Most of my questions are about customs fraud disputes with the EU. Perhaps I can start with Mr Harra, the European Commission has made serious allegations that the UK failed to prevent the fraudulent undervaluation of Chinese textiles into the EU through UK ports. In September the Commission gave the UK two months to act. Is it the case the UK owes the EU around €2.7 billion? What actions are we taking and what are your thoughts on this?

Jon Thompson: We do have a reasoned opinion and we are carefully considering the reasoned opinion. To be absolutely clear and consistent, our position has been for some considerable time, first of all, we do not accept the liability at all in principle and, secondly, we do not accept the quantum estimate. It has been extremely difficult to get information about how they even calculated the number.

Q239 **Rushanara Ali:** We have done nothing wrong?

Jon Thompson: I said we do not accept the liability and we do not accept the quantum. The Government will therefore respond as appropriate, given where we are in the legal process.

Jim Harra: We consider that we have taken reasonable steps to collect customs duty. As Jon said, we are in a process with the EU. We have received their reasoned opinion, we have to respect that process and we will do so.

Q240 **Rushanara Ali:** There is obviously a difference in view. The Commission seems to believe customs evasion in the UK is growing. Do you accept that and, if so, what steps has HMRC taken to reduce the risk of customs fraud since 2014?

Jon Thompson: We do not accept it. To go back a bit, in 2014 we established the inland processing centres so we could, away from the physical border, open more containers to undertake various checks in accordance with our requirements. That has deterred a number of Chinese exporters from exporting to the United Kingdom. That was an addition to the long string of things we were doing before that, various different operations and so on. There are always things we could do. There are always things we could improve. However, we just do not



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accept either the liability or the quantum and the Government will defend itself in the process.

- Q241 **Rushanara Ali:** Thank you. I am going to move onto a couple of follow-up questions from the earlier discussion about returning to consider maximum facilitation as an alternative and so on. We are all familiar with the session where you gave an estimate—I know you got a lot of stick for it—of £17 billion to £20 billion per year to implement. Do you stand by that cost or is it higher or lower? You mentioned the timeframe as well, the 24-month period. Does that include stress testing and making sure all will be in order rather than just making sure the work is completed?

Jon Thompson: To be clear, which scenario are you asking me to put a price tag on? For almost all of them, from this point on, the answer is: I cannot tell you. It is very difficult to estimate now because those previous policy positions the Government had, where we had the infamous exchange, are all in the past.

We are now in a situation with a political declaration on a future relationship with zero tariffs, no fees, no charges, quantitative restrictions and so on and we need a bit more information about where might appropriate declarations be required. They would not be required for customs, which was an earlier conversation in the Committee.

In relation to the Northern Ireland backstop it is also quite difficult to estimate that because we need to understand how that might be operationalised, what level of declaration is required, what that might cost and what the volume is. Therefore at this point in time I am afraid I cannot give you an estimate of either of the ways forward, which I know might be a disappointment.

- Q242 **Rushanara Ali:** That is fine. At some point in the future—as you said earlier, at the point of certainty—you will be able to give us some further clarity about costs and so on?

Jon Thompson: Yes.

Rushanara Ali: That will be really helpful.

- Q243 **Chair:** Is that work you are doing anyway? I am just thinking pre-meaningful vote in this place in terms of costs to be incurred by businesses in different scenarios, is that advice you have been asked to provide to Ministers? Are you able to give that sort of information?

Jon Thompson: We have the earlier work, which can be used for no deal. We have the earlier work we did on the Facilitated Customs Arrangement where our estimate was £700 million per year, no deal is £13 billion for the administration. You then have CBI's estimate on the tariffs, which is between £4.5 billion to £6 billion. You are therefore looking at £17.5 billion to £19 billion for no deal on the customs front and around £700 million for a Facilitated Customs Arrangement.



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To be really clear, the FCA may not be the actual model that is negotiated. It is the best proxy at the minute but one would anticipate that will change. I do not think we are going to have enough time to be able to change that for the meaningful vote. Instead the Government are, I believe, going to give a broader economic analysis covering the, I think, 15 core assumptions that need to be made to differentiate between the options that will be before Parliament, set those assumptions out and then cost them up in terms of what it means for the economy overall. In that will be the cost or otherwise of moving to these arrangements.

Q244 **Rushanara Ali:** That is really helpful, thank you. I have one final question, which is more about how HMRC treats ordinary members of the public when they have not managed to pay their tax bills on time. Earlier you mentioned paying back within three years. Usually it tends to be applied with interest. I was very struck by a recent pilot that was done by, I think, The Behavioural Insights Team about what motivates good behaviour. The taxman is still perceived as being scary.

Jon Thompson: Surely not.

Rushanara Ali: If you get that notice, many of my constituents do come to see me in my surgery really freaking out, frankly.

Jon Thompson: We understand what happens if you receive a brown envelope through the post.

Rushanara Ali: Your brown envelope is still really scary. I wanted to know how many people—not people who are fiddling the system or whatever, the kind of example you gave earlier, but who are stuck in situations where those sorts of notices and that sort of punitive approach to tax collection create more problems in their lives—are ending up in the criminal justice system being penalised or facing bailiffs turning up? In the case of local authorities that happens.

I have a broader concern about how Government institutions can add further problems to ordinary people's lives. Is there a different approach to how we deal with them? What are the lessons that have been learnt from the sort of pilots you have been running about an entirely different approach to people who are in those sorts of circumstances? I am not saying you should not carry on being austere, or whatever, with those who deserve it but there are a lot of people who are in very difficult circumstances where they find themselves treated pretty harshly by state institutions. Do you have a view on it?

Jon Thompson: I do have a view on it. If one might recommend it, there is a superb "File on 4" documentary on the approach taken by local authorities in relation to council tax. There is the infamous case of the man who committed suicide.

We strive to avoid bankruptcy because if you go down that route you discover that what can be a relatively small debt of a few thousand can very quickly turn into a huge debt. The court will appoint an independent



person who goes through all their assets and they rack up significant fees, the fees will be more than the debt. We try to avoid that in all cases. We have a dedicated debt management service. We think the staff is well trained in terms of trying to understand why the debt is occurring, "Is it because there is something else in your life that is happening?" We have a dedicated needs enhanced service. If you are in a particularly vulnerable situation then we can arrange to visit you and do this face to face and/or with someone you appoint to deal with your case. That is a service that is highly rated by customers. The voluntary and charitable sector is also very supportive of that. We will go to the local town hall, a library, somewhere appropriately discreet where you can talk about it and we can work through the situation.

What we are striving to do, in as many cases as we humanly can, is to respect the situation you are in, respect the fact there is a debt, and strike with you a deal that gives you time to pay.

Q245 Rushanara Ali: Does it always include interest?

Jon Thompson: If one might be crude about it, there are some who do not pay their tax bill on the basis that we are the lowest form of credit. The Government cannot be a bank for people who prefer to pay other people.

Rushanara Ali: They are not the people I am talking about, you will understand.

Jon Thompson: No, I appreciate those are not the people you are talking about, but that is certainly the case in the corporate sector. We try to level the playing field in that regard.

The best thing to do is to talk and in 96% of cases, which seems to me to be a pretty remarkable statistic, we strive to reach agreement with you and do reach agreement.

Q246 Rushanara Ali: Do you think there are lessons that could be learnt by local authorities when they are organising bailiffs to turn up to people's homes, especially vulnerable people's homes, to collect debt or council tax? Particularly in the current climate of high levels of poverty, are there lessons Government institutions can learn from your institution? This is a much more wide-spread societal problem now.

Jon Thompson: It is. The lesson that really people need to learn is from the financial services sector because of the new legislation that was passed for financial institutions to be much savvier about vulnerable customers. Banks have gone through fairly radical changes in terms of how they chase debts. We have followed on from that. However, I do recognise—indeed, the "File on 4" documentary states this—there are still parts of the public sector that need to learn lessons from the best performing sector, which frankly in my opinion remain financial services.



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We struck some interesting partnerships with various different banks about how they operate on different fronts where they have similar operations to ours, debt management, customer services, and digital services and so on. We continue to learn from them. There is always more for us to learn. I think we are in a reasonable place at the minute. However, to reiterate, for customers the best thing to do is to talk and be transparent and then we will see what we can do.

Rushanara Ali: Thank you.

Q247 **Chair:** That is very interesting. You may know we are doing an inquiry into access by vulnerable customers to financial services. I think you are right. We will highlight some good practices and some not so good practices. If you do not mind, we might write to you about some things that get thrown up, only because you might have some examples. One of the areas we are talking about is things like powers of attorney, where you have to deal with third parties who are trying to deal with the affairs of somebody else.

Before I hand over to Colin finally, is it right that the interest rate for those who owe money is 3.25% but for those who are owed money the interest rate is 0.5%?

Jim Harra: I cannot, off the top of my head, confirm the numbers but it is the case the rate of interest we charge on debt is higher than the rate of interest we pay on repayments and that has long, long been the case.

Q248 **Chair:** Is that right?

Jim Harra: Yes.

Chair: Not right as in, "Is that correct?" I do not doubt you at all that you are correct.

Jon Thompson: It is correct.

Jim Harra: It is correct, yes.

Chair: Is that the right judgment to make, a different rate is charged for people who owe money as opposed to HMRC owing its customers money?

Jim Harra: I am not sure what the rationale for it is. It has been a long, long-standing thing. As Jon says, we charge a rate of interest. We are not trying to be punitive but we are also trying to say, "We are not here to offer unapproved overdrafts to people". However, I am afraid I have long lost track of the rationale for the difference.

Jon Thompson: We could go back and find it.

Chair: That might be interesting, yes.

Rushanara Ali: In the spirit of HMRC's image among ordinary taxpayers it might be a good thing. If these numbers are the right ones, some people can overpay tax by thousands of pounds in a year and if you are not paying even the current interest rate then that cannot be right or fair.



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Jon Thompson: As we are being open, we will have a look at it.

Chair: Thank you very much.

Jim Harra: I would say most institutions pay a lower rate of interest on their deposits than they charge on their loans.

Chair: Do not worry, we have asked the same question of the banks as well, whether interest rates are being passed on or not.

Q249 **Colin Clark:** To carry on the same theme from the loan charge and to bring us onto IR35. The Budget announced there is going to be an expansion of the IR35 measures from the public sector to the private sector. Again, being slightly cynical, is the Government outsourcing the responsibility for making sure that contractors who are not complying with IR35 rules pay the right tax?

Jon Thompson: At the minute these arrangements are all entirely between two private sector entities. I think the Government have been relatively transparent about what they are doing here, changing who is deciding from the supplier—let's use that word—to the engager. Where those are currently two private sector entities then it is shifting to the employer, yes.

Q250 **Colin Clark:** That comes back to the point I was making earlier about employers taking responsibility.

Jon Thompson: Yes. To be completely transparent with you as tax administrators, the more intermediation there is in a market the higher the standards of tax administration.

Q251 **Colin Clark:** Considering how painful the loan charges have obviously been for people, to be positive about it the IR35 rules are trying to correct this. How will the legislation give contractors a clear route of appeal if they disagree with a decision about their employment status? How big a risk is that?

Jon Thompson: They would presumably talk to their employer.

Q252 **Colin Clark:** Is it a material risk that their employer could decide for other purposes and they are disadvantaged?

Justin Holliday: To do?

Colin Clark: They are disadvantaged. The point is that given concerns that businesses engaging contractors will err on the side of caution and treat contractors within IR35 rules when they should not be. How could that arise?

Jim Harra: The way it will work—and the way it currently works in the public sector—is that the private sector engager will have to make a decision about whether the nature of the relationship is an employment one, in which case they will operate pay-as-you-earn, or self-



employment, in which case they will pay gross and they will leave it to the contractor or the personal service company to pay their tax.

Anyone who feels that the wrong decision has been taken and that they are being taxed under the wrong route—they are not in employment but are in self-employment—obviously has the ability through self-assessment and corporation tax self-assessment to challenge that and to seek for it to be changed. Our aim is obviously that most of these decisions are straightforward. We want to see the very high level of non-compliance that we have experienced with the old IR35 rules transformed into a very high level of compliance. We believe a lot of the decisions that are currently being taken are the wrong ones and we will see more correct decisions in future.

- Q253 **Colin Clark:** To follow on from that, the Budget states that IR35 rules are intended to ensure that individuals who work through a company, who would be regarded as employees if directly engaged, pay broadly the same employment tax as if they were employed. I suppose that comes back to the whole point of the loan charge, if you were sitting next to someone and you are paying significantly different tax you think you might ask the question of how could that arise.

Jim Harra: Correct.

Colin Clark: Is not the whole problem because the self-employed and employees are all taxed differently when, to all intents and purposes, they are all doing the same job?

Jim Harra: First of all obviously the IR35 rules do not apply to people who are genuinely self-employed. They apply to people the nature of whose relationship is one of employment. You are right that the tax system contains lower tax for self-employed people compared to employed people.

Colin Clark: That is the comparison, is that fair?

Jim Harra: Lower tax again for corporates compared with self-employed and employees. That clearly creates incentives for people to try to shift themselves into one of those lower tax groups, which is what we see. You can understand policy reasons for why you might have those differences but there is no doubt they then create incentives for behaviours that we have to shore up with things like the IR35 rules to prevent them from having the effect that—

- Q254 **Colin Clark:** I suppose, as you said, it is policy. It is a deliberate way to encourage entrepreneurs and people to be self-employed.

Jim Harra: Yes, and in the case of corporates obviously the UK has a low corporate tax rate, which is part of what makes the UK a competitive place to do business. Anyone can then incorporate and try to take advantage of that. We have rules, like IR35, which are designed to prevent that from happening.



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Q255 Colin Clark: We have spoken earlier about the historic difficulties in taxing contractors. It shows that the rules regarding employment status need to be made clearer and more straightforward for tax purposes as well as employment law. Is IR35 part of a much wider reform that is required?

Jim Harra: We believe that in the vast majority of cases it is quite a straightforward decision to make. However, there is the Taylor report that was given to Government last year that recognises there is complexity and that, in particular, as the economy transforms there are more and more people for whom that complexity applies. Therefore the Government more generally is looking at the case for reforming employment status.

In the meantime, taking the existing definition, we believe for the vast majority of people it is a straightforward decision. We have provided a tool that engagers can use, which gives them an answer in about 85% of the cases when they use it. From our perspective, provided you use that tool in accordance with our guidance, we will always treat ourselves as bound by its outcomes. We try to give people as much certainty as we possibly can.

Q256 Colin Clark: Is that to check employment status for tax?

Jim Harra: Correct, yes.

Q257 Colin Clark: There has been a lot of criticism of it, has that been fair or reasonable?

Jim Harra: Obviously there is quite a lot of resistance from people who would prefer not to be caught by IR35. Our view is some of that criticism stems from that reluctance to pay employment taxes. We have had the CEST evaluated, including bringing in external experts. We are satisfied that it provides a good service and gives a robust and correct answer in about 85% of cases. No one is bound by its decisions other than us. If someone uses the tool and it either does not give them an answer or they believe it gives them the wrong answer they are not bound by it. It is there to help.

Q258 Colin Clark: Is it still in its trial phase?

Jim Harra: No, it is in live operation. We are constantly iterating it and trying to improve it. Of course, if there are any new decisions that create precedent, we would want to reform the tool to take account of those. We are trying all the time to improve it but it is operational. In the public sector it has been used to very good effect since 2017.

Jon Thompson: To be transparent, it is currently under further review because we believe there might be some further enhancements you could make to that tool for introduction in April 2020.

Q259 Colin Clark: To come back to the Taylor review for a minute, when will that consultation be reported on, didn't it finish on 1 June 2018?



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Jim Harra: I cannot say. It is not an HMRC-led consultation. Obviously we have an interest in it but I think it is BEIS.

Jon Thompson: It is being led by the Department for Business, Energy & Industrial Strategy.

Q260 **Colin Clark:** One of the issues that have come up with the Low Incomes Tax Reform Group is people could be pressurised into umbrella companies. What consideration has HMRC given to these concerns? Is it a risk that people who are low paid could be forced into umbrella organisations?

Jim Harra: There is a risk. Obviously there are two parties that can save tax if they can get themselves out of IR35, one is the worker themselves but the engager can potentially save the employer's National Insurance contribution. Therefore, there can be incentives for engagers to get their workers into arrangements that save the engager employer NICs. I think workers sometimes do need to be protected. They are not necessarily the people who are taking steps to try to avoid tax themselves.

The rules we have put in place for the public sector, which will apply from 2020 in the private sector, do help to address that because it is ultimately the engager—the organisation for which they are truly working—who will have to make the decisions about whether it is employment.

Q261 **Colin Clark:** Will employers be likely to change their working practices? HMRC lost a Tax Tribunal case when a contractor that HMRC was using was incorrectly deemed to be an employee. How did that happen?

Jim Harra: Justin can probably give you more information.

Justin Holliday: The particular case I think you are referring to was settled rather than lost. It was on the application of the Agency Worker Regulations. It was part of those regulations that require agency workers, after they have worked in an organisation for more than 12 weeks, to be offered roughly the same terms and conditions as permanent staff. It caused us to make sure that for our various agency workers they were getting the same holiday pay and the same access to employment benefits as our permanent staff. It was not actually an employment status thing; it was application of the Agency Worker Regulations.

Q262 **Colin Clark:** In summary, the IR35 is to try to avoid what we were speaking about earlier in terms of the loan charge, to put more responsibility on the companies and employers.

Jim Harra: To clarify, they are two different things. What IR35 does is try to combat people who disguise an employment relationship through creating a corporate in between the worker and the engager. Disguised remuneration schemes try to disguise the remuneration as a loan. Obviously they are both intended to mitigate tax but they do it in different ways.



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IR35 has been in place for 18 years now. It looks through the corporate and says, "If the direct nature of the relationship is like an employment then that is the way you will be taxed, despite the fact you have a corporate personal service company in between". We are not changing those rules. What we are doing is saying since 2008 there has been a very high level of non-compliance at the level at which we put the obligation so we are moving the obligation to the engager. It is quite different from disguised remuneration.

Colin Clark: Thank you.

Q263 **Chair:** Thank you. I am very pleased, Mr Holliday, we have had an opportunity to bring you in. I am sorry there have not been more opportunities this afternoon, although you might be very grateful.

I have one final question about the Budget where HMRC was made a preferential creditor. Obviously that has happened in the past and the rules have been changed. Could you fill us in on why that decision was taken, was there a particular reason why you had requested that this is a change the Treasury make?

Jon Thompson: We were made a preferential creditor in respect of taxes collected by the entity, not all taxes. It split the taxes. You are trading and have employees, and you are deducting income tax from those employees. It made us a preferential creditor for those sorts of taxes, as well as VAT, National Insurance and so on. It did not make us a preferential creditor for corporation tax. You, the entity, are collecting taxes on the Government's behalf. It made us a preferential creditor for those taxes but not the taxes due on the value created from the organisation. It split it.

Q264 **Chair:** Was there a particular reason? Had you seen a spike or change in corporate insolvencies and what was happening in terms of payment of taxes or something that drove that change?

Jim Harra: I do not believe there was any particular spike that generated this. I feel it is a principled decision, where there is a difference between money that is being collected from your employees, which you are supposed to be paying over, and money that you owe yourself from your own profits, where we stand alongside other unsecured creditors.

It will enable us to recover more taxes than we would otherwise have done. At the moment in insolvencies we collect, on average, about 4% of the taxes at stake. We now expect to collect about 14% of tax that is at stake. It does obviously help with recovering tax debts but it is also a principle change, which is intended to reflect the fact that this body has held this money on trust for the Government as opposed to just something it owes in the course of its business.

Chair: That is helpful. I thank you all very much for being here this afternoon and for your evidence. I strongly suspect you will be back



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before us. We have lots of things we could talk to you about. Maybe one day we will have a session that is not completely dominated by Brexit but I am sure you will be back before us for some questions on that in due course. Thank you very much for your time this afternoon.