HMP0005

Written evidence submitted by TaxWatch

Summary and introduction

On 15 September it was revealed in the trade press that HMRC had reached a settlement with General Electric over a long running tax dispute. The settlement resulted in a tax liability of just 10% of the potential liability GE had previously disclosed to shareholders ($112m out of a potential $1.1bn). If HMRC had applied interest and penalties, the potential impact could have been much larger.

During court proceedings HMRC had alleged that the disputed tax benefits obtained by GE had been obtained fraudulently, however, the final settlement included a statement exonerating GE of any wrongdoing before those allegations could be put before a court.

Coming 10 years after the Public Accounts Committee found “systemic” failures in the way that HMRC reached settlements with large corporations, the agreement with GE raises questions as to whether HMRC’s approach to settling tax disputes has improved.

Settlements with large business customers represent a substantial tax risk to the public purse and so represent an important area for the Department. HMRC have not published the total tax under consideration in their latest annual report, as they have done in previous annual reports. As of March 2020, HMRC had £35bn in total tax under consideration in dispute with large tax payers.

About TaxWatch and this evidence

TaxWatch is a UK charity dedicated to compliance and sound administration of the law in the field of taxation.

We conduct forensic research and analysis on tax avoidance, tax policy, and tax law, publishing our research to improve public understanding of tax issues.

Through our work we seek to encourage high standards of tax conduct and civic responsibility.

In August 2020 we published a report into the dispute between HMRC and GE which brought the issue to wider public attention. The report can be found here:
https://www.taxwatchuk.org/ge_hmrc_tax_fraud_allegations/

The evidence presented here derives in large part from an analysis of documents put before the High Court in the case of IGE USA Investments Limited (a subsidiary of GE in the UK) vs HMRC, which TaxWatch obtained from the court.

In August 2021 TaxWatch applied to the Supreme Court for permission to intervene in this case and make the submissions in the public interest.

HMRC's dispute with General Electric

The dispute between GE and HMRC involved a complex hybrid arbitrage tax avoidance scheme implemented by GE. This involved a series of multi-billion dollar transactions routed though the United States, Luxembourg, the UK and Australia that allowed GE to claim the deductions against tax in three different jurisdictions, including the UK and Australia, on the same item of expense – a so called "triple dip" scheme.

The UK has long had rules in place to prevent these kinds of schemes from having any effect. The 1996 Finance Act introduced the Loan Relationships for Unallowable Purpose rule which allowed HMRC to disregard interest deductions where the loan relationship had no commercial purpose and was designed to obtain a tax advantage.

In 2005, HMRC introduced new rules in the Finance (No.2) Act 2005 which specifically targetted hybrid arbitrage schemes of the kind implemented by GE. Again, this denied the tax benefit of a scheme where the main purpose was to obtain a UK tax benefit. The 2005 rules allowed companies to seek advanced clearance with HMRC for transactions to ensure that they did not fall foul of the rules.

GE entered into discussions with HMRC in relation to 107 cross border loans amounting to £21.2bn in April 2005. One of the arrangements under consideration involved the refinancing of an Australian subsidiary via a UK company.

The arrangement involved GE borrowing AUS $5bn from a bank in the US, and then routing that money via Luxembourg, the UK, and then Australia, before returning it to the US and repaying the bank just 4 days later. One of the entities involved was an Australian partnership with two UK companies as partners.

Under UK law the UK partners were responsible for the tax liabilities of the partnership. Under Australian law the partnership itself was responsible for tax in Australia. The interest payments that were created by the circular flow of funds resulted in losses for the partnership, which GE could use to write off their tax liabilities in both the UK and Australia. In effect GE were claiming the two deductions in two different jurisdictions on just one payment, something which should not be permitted under long established principles of international taxation.

According to HMRC, they were not aware of the full details of the flow of funds and the details of the scheme when they were negotiating with GE over giving clearance to the transactions.

Despite initial scepticism from HMRC case officers working on the case, HMRC reached a partial settlement and clearance agreement with GE over the transactions in December 2005.

HMRC would later claim that they were unaware of the full structure of the scheme when the clearance agreement was negotiated. The negotiation proceeded on the basis that the transactions were of a commercial nature and HMRC claim they received assurances from GE that the structure was not designed to avoid UK taxation. If the hybrid structure was not in place, the tax deduction would arise in the UK and so the purpose of the structure was to gain a tax advantage in Australia.

However, in 2011, HMRC began exchanging tax information with the Australian Tax Office which revealed that the nature of the transactions was different from what had been understood. This information included a series of documents which set out the full details of the scheme that had not been disclosed previously to HMRC.

In particular, HMRC were able to obtain the full minutes of a board meeting setting out key information about the flow of funds. Previously, HMRC had only been provided a partial minute of that meeting with key passages having been deleted by representatives of GE.

Legal proceedings

On October 16, 2018 HMRC wrote to GE to state that they would be rescinding the agreements reached in 2005, and seek a repayment of tax. GE disclosed in their accounts that the potential impact of this would be $1.1bn, before taking into account any interest or penalties, which could be substantial.

On 23 October 2018 HMRC issued proceedings in the High Court seeking a declaration from the court that the settlement had been validly rescinded. At the time, HMRC stated that the amount they were seeking to recover was £650m.

In the claim before the High Court HMRC alleged that the agreements were entered into on the basis of material misrepresentations and non-disclosures by GE, but made no allegations as to how those misrepresentations and non-disclosures arose. HMRC's claim was that they were entitled to rescind the settlement in common law.

However, in October 2019, HMRC applied to the court to amend their particulars of claim to state that GE made the misrepresentations and non-disclosures fraudulently and to introduce a further allegation of fraudulent misrepresentation on the part of GE. The proposed amendment introduced a new claim that HMRC are entitled to rescind the settlement in equity in addition to their right to rescind the settlement in common law. In relation to the claim in equity, the High Court granted HMRC permission to amend their claim in July 2020, which GE appealed to the Court of Appeal.

In April 2021 the Court of Appeal found in favour of GE, stating that HMRC were prevented from introducing the claim in equity based on an allegation of fraud by the Limitation Act 1980, which places a 6 year time limit on claims based on fraudulent misrepresentation.

HMRC applied to the Supreme Court for permission to appeal, and TaxWatch made submissions in support of HMRC's case. TaxWatch's arguments, which were different from those made by HMRC, was that the Limitation Act 1980 contains an exemption for any proceedings by the Crown for the recovery of any tax.

Both the arguments put forward by HMRC, which focused on contract law, and TaxWatch, were of general public importance. HMRC's submissions stated that the outcome of their case would apply to "any victim of fraud who is thereby induced to enter a transaction".

With regard to TaxWatch's submissions, HMRC conclude a large number of settlements with taxpayers of all kinds every year. The decision of the Court of Appeal severely limits the agency's ability to pursue claims against taxpayers where there is an allegation of fraudulent conduct on the part of the taxpayer.

In July, the Supreme Court granted HMRC permission to appeal, and HMRC resisted TaxWatch's application to intervene in support of their case.

Before the case could reach the Supreme Court, HMRC reached a settlement with GE, ending the dispute in September 2021.

Terms of the agreement between HMRC and GE and its impact

According to a statement issued by GE, the settlement resulted in $944m in interest payments being disallowed, but that GE could offset that against other tax assets it had to result in a $112m (£82m) deferred tax charge (meaning no cash payment), just 10% of the potential impact the company had previously disclosed in their filings. Furthermore, the settlement attributed no fault to either party.

As stated above, HMRC's original claim sought the recovery of £650m in tax. Where tax losses arise from deliberate behaviour on the part of the taxpayer, HMRC can change penalties of up to 100% of the tax due, taking the potential liability to £1.3bn. The settlement for no additional cash and an amendment to the company's deferred tax position of less than 10% of the potential liability represents very favourable terms for GE.

Relevance of the agreement to the work of the Public Accounts Committee

Given the amount of tax under consideration, the settlement with GE potentially represents a substantial loss to the public purse, and it is therefore appropriate for the Committee to scrutinise the agreement.

Although in previous years the Committee has had difficulty in obtaining information on specific agreements reached by HMRC, in this case, there can be no argument that HMRC are prevented from discussing the details of the scheme by a legal duty of confidentiality. Details of HMRC's claim and the evidence supporting it have already been put before an open court and as such the details are in the public domain. Under the Revenue and Customs Act officers of HMRC are not prevented from disclosing material that "had already and lawfully been made available to the public."

The nature of the settlement raises questions about how the settlement was reached. The abandonment of the proceedings before the Supreme Court resulted in an important point of law being left unresolved and the prevailing law being prejudicial to the public revenue. This appears to be contrary to HMRC's settlement and litigation strategy.

The behaviour alleged by HMRC clearly constituted a criminal offence, in addition to providing grounds for their civil claim. However, the agreement that GE were at "no fault", means that HMRC will not pursue criminal proceedings against GE or their representatives, despite the fact that a substantial adjustment to the amount of interest that the Department could deduct was in the end disallowed. The Committee should question whether this decision was in line with HMRC's criminal investigations policy.

Finally, the Court of Appeal did not allow HMRC to allege fraud in their additional claim in equity given the time that had passed between HMRC receiving the evidence they used to make their claim, and the allegation being made. Why did it take HMRC take more than 6 years to introduce allegations of fraud? Did this delay damage HMRC's case and the potential to make recoveries?

In 2011 the Public Accounts Committee published a highly critical report on HMRC's settlements with large taxpayers, stating that the "systemic issues" found must be "addressed with the utmost urgency". The current case provides an opportunity for the Committee to revisit the issue and to probe whether the improvements necessary have been made.

The settlement of tax claims with large businesses is an important issue and presents a substantial risk for the public purse. In their latest set of accounts HMRC have not published their total tax under consideration in disputes with large taxpayers. However, as of March 2020, the total amount of tax under consideration of HMRC's large business unit was £35bn, with £9.9bn coming from companies headquartered overseas.

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