



House of Commons

Committee of Public Accounts

HM Revenue and Customs' estate private finance deal eight years on

Thirty-second Report of Session
2009–10

*Report, together with formal minutes, oral and
written evidence*

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The Committee of Public Accounts

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Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

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The current staff of the Committee is Sian Woodward (Clerk), Lori Verwaerde (Senior Committee Assistant), Pam Morris and Jane Lauder (Committee Assistants) and Alex Paterson (Media Officer).

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Summary

In 2001 the Inland Revenue and HM Customs & Excise, now HM Revenue & Customs (the Department), signed a 20-year contract with Mapeley STEPS Contractor Limited, one of several companies in the Mapeley Group, transferring ownership and management of 60% of its estate. At contract signature the Department expected to pay £3.3 billion (2009 prices) over the 20 years of the contract. To date it has paid 20% (£312 million) more than expected, and now expects to pay £3.87 billion over the 20 years. Moreover, signing a contract which involved tax avoidance through an offshore company has been highly damaging to the Department's reputation.

The cost increase stems from changes in building specifications, increased provision of services and slower than expected use of allowances in the contract for vacating defined amounts of space each year. The Department has failed to achieve value for money so far, as it has not secured all the benefits available over the first eight years and had no plan for obtaining the savings available from the vacation allowances. If it had used all the allowances as soon as they became available each year, it could have saved £1.1 billion to £1.2 billion (2009 prices) over the life of the contract. Possible savings have now fallen by some 25% to around £900 million over the 20 years. The Department now has a major programme of office closures underway up until 2011 but it needs to develop a plan for the remainder of the contract, covering its estates strategy and use of the vacation allowances.

While the Department got a good price for the contract, it has not managed the contract well and we are concerned that it has not demonstrated adequate commercial skills or business acumen. In particular, it has failed to establish an effective partnership with Mapeley, even though the Committee highlighted the need for this in 2005. For example, the Department has not obtained key information on Mapeley's financial position and profitability, and has not monitored overall costs or Mapeley's viability, even though it could incur substantial costs in the event of contractor default.

There were good reasons why the Department needed to manage this contract much more proactively. Mapeley was a new company and had put in a low bid based on speculative returns from increases in property values, with minimal operating profits. The Department should have recognised the importance of tracking Mapeley's financial position as, early in the contract, Mapeley sought financial assistance from the Department to deal with serious cash flow problems. There is an ongoing and urgent need to establish a more effective partnership as the Department's office closure programme creates financial pressures for Mapeley, exacerbated by the economic downturn and falling property values.

The Department is seeking to obtain better value from the remainder of the contract and we welcome the constructive way in which the current senior management has responded, setting work in train to strengthen its estate management function, resolve outstanding

commercial issues and develop partnership working with Mapeley.

On the basis of a report by the Comptroller and Auditor General,¹ we examined the Department and Mapeley on: managing costs and benefits; managing the contract effectively; working in partnership; and contracting with an offshore company.

1 C&AG's Report, Session 2009–10, *HM Revenue & Customs' estate private finance deal eight years on*, HC 30

Conclusions and recommendations

- 1. The Department has failed to achieve value for money so far as it has not secured all of the benefits available and it had no plan for obtaining the savings available from allowances in the contract to vacate properties. It still has no plan beyond 2011.** The Department must now develop a plan up to 2021 that details how it will use the contract to deliver the objectives of its estates strategy, and how it will make use of allowances for vacating buildings.
- 2. During the first eight years of the contract, the Department did not monitor overall costs and value for money.** The Department's senior management is now taking a more positive and proactive approach to managing the contract, and as part of this, is committed to preparing an annual value for money assessment for its Board. It should develop cost and value for money targets for the remainder of the contract, measure its performance against these, and reflect the targets in its plan.
- 3. The Department lacks visibility of Mapeley's financial position and profitability, limiting its ability to manage risks, negotiate effectively and develop a functioning partnership.** Mapeley assured the Committee it will provide the Department with full access to its financial information in line with HM Treasury guidance on information rights in PFI contracts. The Department should understand and monitor such financial information, and use it to strengthen its management of the contract and negotiations.
- 4. The Department's vacation plans create financial pressures for Mapeley, exacerbated by the economic downturn and falling property values. Seven months into the contract, Mapeley approached the Department for help in dealing with serious cash flow problems.** Mapeley gave assurances that it could afford the contract and would not seek any additional financial assistance from the Department. In any case, the Department should not offer any concessions on the contract terms without obtaining commensurate benefits.
- 5. The Department has lacked the skills and business acumen to manage a contract of this size.** The Department should identify the commercial and legal skills it needs to achieve effective strategic and risk management, strong contract administration and good financial management. It should then appoint and deploy people with these skills over the remaining life of the contract.
- 6. Lack of sound commercial skills is a common problem across government, reducing the value for money obtained from large private finance deals such as this and other commercial projects.** The Treasury should undertake an annual assessment of commercial skills across government. It should use these assessments to identify skills shortfalls and establish centres of expertise that departments could tap into.

7. **The Department did not undertake robust monitoring of Mapeley's viability and did not understand its own risks and liabilities in the case of Mapeley default.** The Department should understand and keep abreast of changes in Mapeley's financial position and the Department's potential liabilities in the event of Mapeley default. It should maintain an up-to-date business continuity plan.
8. **Even though the Committee highlighted in 2005 the need to establish an effective partnership, the Department and Mapeley have not achieved this.** The Department must establish an effective partnership with Mapeley, including:
 - using joint Board meetings for early and regular dialogue on strategy;
 - sharing strategic aims, and
 - establishing a shared property database.
9. **Signing a contract involving tax avoidance through an offshore company has been highly damaging to the Department's reputation. It is also unlikely that the arrangement delivers any overall benefit to the Exchequer, as any reduction in contract price is accompanied by lower tax revenue.** Sensitivities over offshore ownership have led to delays in including additional buildings in the contract. As a result the Department has incurred additional estate management costs and continues to lose out on additional vacation allowances it could otherwise claim on these properties. As a matter of principle and good value for money, public sector organisations should not use tax avoidance schemes. The Department should take whatever action it can to persuade Mapeley to bring the properties onshore. It should also reach agreement on including additional buildings in the contract.
10. **It remains uncertain what tax savings Mapeley will obtain over the course of the contract from being offshore, and therefore whether these are passed on in full to the Department.** There have also been delays in Mapeley providing the information needed by the National Audit Office to complete the analysis we requested. The Department should track the savings Mapeley actually obtains and Mapeley should provide full and timely information to enable the Department to do this. The Department should seek to recoup any additional benefits Mapeley obtains.

1 Managing costs and benefits

1. In 2001 the Inland Revenue and HM Customs & Excise (merged in 2005 to form HM Revenue & Customs (the Department)) signed a 20-year contract with Mapeley STEPS Contractor Limited, one of several companies in the Mapeley Group. Under the contract the Department transferred ownership and management of 60% of its estate to Mapeley.²

2. The Department sold 132 freehold properties to Mapeley and now leases them back. Mapeley now manages these and 459 buildings the Department leases from other landlords, and provides facilities management and maintenance services to the Department in exchange for a fixed monthly payment (**Figure 1**).³

Figure 1: Main features of the contract⁴

AT CONTRACT START	The Department sold freehold buildings and assigned responsibility for managing leased buildings to Mapeley for a £220 million up-front payment and a further £150 million through reduced charges over the contract. 591 properties, mainly office accommodation, were transferred.
DURING THE CONTRACT	The Department makes monthly payments to Mapeley to cover rent, facilities management, maintenance and debt costs. Mapeley provides fully-serviced accommodation and bears the associated risks.
INTENDED BENEFITS FOR THE DEPARTMENT	The contract was intended to enable the Department to: exit up to 60% of the estate and manage its accommodation according to business needs rather than fixed lease terms; transfer day-to-day management of services; transfer financial risks such as increased rents, and share in windfall gains.

Source: National Audit Office

3. At contract signature the estimated cost of the contract to the Department over its 20 years was £3.3 billion (2009 prices). By the end of 2008–09 the Department had paid 20% (£312 million) more than expected, and it now expects to pay £3.87 billion (2009 prices) over the 20 years. The increase related to changes in building specifications, increased provision of services and slower than expected use of the vacation allowances. While the Department had calculated expected annual costs and checks monthly invoices, it had not had strong processes for monitoring costs against initial models. It assured the Committee it would prepare an annual value for money assessment on the contract, including updates of costs against forecasts, potential liabilities and risks and available benefits.⁵

4. The Department had not achieved value for money on the contract so far, as it had not obtained all the benefits available to date, and had no long term strategy for using the property vacation provisions in the contract. The Department can make savings by vacating properties using allowances in the contract which let it vacate defined amounts of

2 C&AG's Report, paras 1 and 2.7

3 C&AG's Report, para 2

4 C&AG's Report, Figures 1 and 2

5 Qq 31, 42, 84 and 87; C&AG Report, paras 1.3, 1.4 and 1.7, Figure 4

space each year. These allowances enable it to exit buildings at a time of its choice rather than having to wait for lease breaks. Under the contract it can vacate 60% of the estate, 42% at no additional cost and 18% attracting compensation. The NAO estimated that if it had used all the allowances as soon as they became available under the contract, the Department could have saved £1.1 billion to £1.2 billion (2009 prices) over the life of the contract. Possible savings have now fallen by 25% to around £900 million (2009 prices) available over the 20 years.⁶

5. The Department did not have a strategic approach to obtaining value from the contract and had no plan in place from 2001. After the creation of HM Revenue & Customs in 2005, it developed in 2007 plans for its estate to March 2012. It carried out extensive consultation (including with staff, unions, local Members of Parliament and Mapeley) on whether to close 258 buildings and published the results in December 2008. In January 2010 it confirmed the 130 buildings it planned to close in 2010–11. It has no plans for closures beyond 2010–11, although more space would continue to become available for vacation under the terms of the contract. To make the most of remaining benefits available in the contract, the Department now needed to identify buildings for vacation in 2012 and beyond.⁷

6. The recently announced closures affected some 3,150 staff. The Department has already agreed that 1,450 staff will transfer to other locations, and it has been discussing a range of severance options with the other staff. The Department incurs its own costs in closing offices, including accommodating staff elsewhere, and redundancy costs. It may also have to pay Mapeley compensation as set out in the contract, for some closures.⁸ The Department has committed to keeping enquiry centres open in their current locations or nearby, which could involve partially vacating buildings and incurring costs to move the enquiry centres.⁹

6 Qq 3, 40 and 88; C&AG's Report, paras 2.5–2.6 and 2.21

7 Qq 2–4, 54 and 94; C&AG's Report, paras 2.9 and 2.22

8 Qq 69, 70–72, 76, 77 and 94

9 Qq 78–80

2 Managing the contract effectively

7. The Department got a good price for the contract but has not managed it well. It has generally reacted to risks and issues as they arose, and was currently negotiating with Mapeley to resolve a number of commercial issues that dated back as far as the start of the contract.¹⁰ The Department did not have a good understanding of the profitability of the deal or the benefits realised by Mapeley. Lack of information on Mapeley's financial position also weakened the Department's ability to negotiate and form an effective partnership.¹¹

8. Under the contract, the Department does not have full visibility of Mapeley's financial information. It signed the contract in 2001 in line with guidance on information rights in place at that time. In 2007 HM Treasury issued updated guidance, suggesting departments negotiate greater information rights, including full access to financial information. The Department was working with Mapeley to obtain information rights in line with the updated guidance, including appropriate safeguards relating to freedom of information and data protection. Mapeley assured the Committee it would provide full information.¹²

9. Mapeley approached the Department seven months into the contract with a series of financial claims and requested more money to deal with a serious cash flow problem. Mapeley was a new company entering the market and had put in a low bid based on speculative returns from increases in property values to establish itself. It expected minimal operating profits. The Department and Mapeley finally resolved these claims in December 2005. The Department agreed to make additional payments to Mapeley in respect of specification errors in the information the Department provided about the size of its estate and changes to service requirements.¹³

10. The Department's plans to vacate properties created financial pressures for Mapeley exacerbated by the economic downturn and falling property values. Mapeley approached the Department in January 2009 with concerns about the financial pressures from these plans. It said that it had been seeking to get as much clarity as possible on the buildings and timings involved, and to resolve some outstanding commercial issues. It confirmed that it could afford the contract, and it was not seeking any relaxation or additional financial assistance from the Department beyond what it was entitled to under the contract. It would manage the vacation programme by selling vacated freehold buildings, and re-letting vacated leasehold buildings. The Department stated that it would not bow to pressure to provide assistance.¹⁴

11. The Department has no rights to voluntarily terminate the contract, but a Mapeley default would end it. The Department drew up a business continuity plan to manage the risk of Mapeley default in 2003, but did not keep this up to date. In 2008 it stepped up its

10 Qq 4, 24–31 and 42; C&AG's Report, paras 4 and 9

11 Qq 5, 40, 86 and 89; C&AG's Report, paras 9, and 3.10, Recommendation a

12 Qq 5, 6 and, 54; C&AG's Report, para 3.10

13 Qq 39, 57 and 113; Committee of Public Accounts, Twentieth Report of Session 2004–05, *PFI: the STEPS deal*, HC 553, para 8; C&AG's Report, para 4, Figure 4, Appendix 2

14 Qq 11, 13, 67–69, 107 and 110–112; C&AG's Report, paras 8 and 2.19

monitoring of Mapeley's viability, and in 2009 it set up a Commercial Stability Analysis Function to monitor the viability of its estates contractors, and updated its business continuity plan. The Department also assessed its liabilities in the event of Mapeley default. It estimated that it could incur one-off costs of £40 million–£110 million, because in the event of default, various liabilities of Mapeley would revert to the Department.¹⁵

12. The Department has lacked the appropriate commercial and legal skills to manage a contract of this size and significance. It considered that when it let the contract in 2001 the public sector tended to believe that contractors would deliver everything in accordance with the contract and so scaled down its capabilities, including strategic management. It was now planning to improve its estates function, and had strengthened its commercial and legal resources.¹⁶

13. HM Treasury recognised that a lack of commercial skills was a problem across government, and it was working with the Office of Government Commerce to tighten the criteria for recruiting expertise in delivering complex projects.¹⁷

15 Qq 34–37, 39 and 90; C&AG's Report, paras, 3.5, 3.9 and 3.11

16 Qq 4, 14, 30, 42 and 59; HC (2004-05) 553, para 18; C&AG's Report, para 9, Recommendation b

17 Qq 15 and 16

3 Working in partnership

14. To achieve best value on these types of deals takes partnership and a real understanding of each other's business. The Committee concluded in 2005 that, although there had been moves on both sides to work in partnership, it had not yet been fully achieved. In the first years of the contract, the offshore ownership put a strain on the relationship.¹⁸

15. Since then the Department and Mapeley had been improving the relationship but they had still not formed a fully effective partnership. The Department recognised that a true partnership involved sharing information about business strategy, transparency and engagement at Board level. The Department and Mapeley were working together to achieve greater transparency, and had recently set up a new Board consisting of members from both organisations, which will meet twice a year.¹⁹

16. The Department's vacation plans had offered an opportunity for greater dialogue, and the Department included Mapeley in its consultation for building closures, but only provided fuller details towards the end of 2008. In approaching the Department in January 2009, Mapeley wanted to obtain as much clarity as it could on the Department's plans, in terms of the buildings and timings involved.²⁰

17. The two organisations did not share key information in a consistent manner, such as having a shared database of property information, a joint understanding of vacation allowances use, or a shared risk register. The Department and Mapeley were currently negotiating settlement of a £12 million claim Mapeley lodged in 2009 for services that date back to 2002. The reason for the delay in invoicing was that the Department and Mapeley did not have an agreed methodology for pricing the services. They were now working to resolve the matter as part of wider negotiations on a range of issues. The Department was also improving its processes to obtain better visibility on issues such as these.²¹

18 Qq 17 and 60; HC (2004-05) 553, para 17; C&AG's Report, para 3.13

19 Qq 4, 54 and 55; C&AG's Report, para 3.12

20 Qq 11 and 54; C&AG's Report, para 2.19

21 Qq 25-27 and 30; C&AG's Report, paras 1.5 and 3.14

4 Contracting with an offshore company

18. Eighty per cent of the shares in Mapeley were owned by funds managed by the Fortress Investment Group, with 20% owned by management, individuals and professional investors. In June 2005 Mapeley was floated on the London Stock Exchange, but de-listed in April 2009 as Fortress held more than 75% of the equity. Mapeley's investments were held offshore and its Board of Directors were resident in Bermuda, but operational decisions were taken in the UK.²²

19. The freehold and long-leasehold properties transferred under the deal were held by a subsidiary company based offshore (Mapeley STEPS Limited). As a result, gains from selling the properties would not be subject to UK tax. Furthermore, as Mapeley's shareholders were also based offshore, they would not be liable to UK tax if they sold their shareholdings. Mapeley estimated that if it had been required to hold the properties onshore, the contract price would have increased by £55 million (in present value terms) to cover extra UK tax that may have been due. Mapeley told the Committee that it had passed on to the Department the tax advantages in a lower priced bid and agreed to demonstrate this by providing the National Audit Office with access to relevant financial information.²³

20. As recognised in current HM Treasury guidance (see paragraph 24) there is unlikely to be any overall benefit to the Exchequer from the offshore arrangements as reductions in price paid by the Department would be accompanied by reduced tax revenues. It remains uncertain whether Mapeley will obtain tax savings that are higher or lower than originally anticipated over the 20 years of the contract.²⁴

21. Offshore ownership was a widely used structure in the property industry. The Board of the Inland Revenue only discovered that Mapeley intended to hold the properties offshore four days before signing the contract, and the Board of HM Customs & Excise did not find out until after it signed the contract. At the time, the two Departments concluded that it would not have been lawful to exclude Mapeley from the procurement on the basis of its tax arrangements.²⁵

22. If Mapeley were to transfer ownership of the properties back into the UK, this would negate the tax advantage, and although Mapeley would consider bringing ownership onshore if asked, it would require compensation from the Department. The Department had not asked Mapeley to transfer ownership onshore.²⁶

23. The issue of offshore ownership has not only damaged the Department's reputation, it has also affected management of the contract. Concerns about offshore ownership have led to delays in including in the contract additional buildings that the Department has used since 2003. The delay on the first group of properties has meant:

22 Qq 45–46, 47, 50–51, 116–117 and 119

23 Qq 96–102 and 137; HC (2004-05) 553, paras 1 and 5; C&AG's Report, paras 1.14 and 2.13–2.14

24 Ev 16

25 Qq 18, 97, 122–123, 125 and 131–132; C&AG's Report, para 2.13

26 Qq 20, 105 and 106

- it did not get additional vacation allowances for these properties. The immediate impact has been that it will have to pay compensation under the contract for some of its planned vacations;
- it has had to continue to carry out estate management functions itself, and
- it had not begun negotiations to bring in other additional properties.²⁷

24. HM Treasury guidance now required that public sector organisations should avoid using tax advisers or tax avoidance schemes, as any apparent savings could only be made at the expense of other taxpayers or other parts of the public sector. Treasury approval would therefore normally be required because such transactions were likely to be novel or contentious. The Treasury now required central government bodies to:

- base procurement decisions independent of any tax advantages that may arise from a particular bid;
- restrict contractors' use of offshore jurisdictions, consistent with EU and other international obligations and the government's stated objectives on tax transparency and openness, to avoid harmful tax competition, and
- employ internal management processes to ensure that transactions that give rise to questions of propriety of tax arrangements are brought to the Accounting Officer's or, if necessary, Ministers' attention.

25. Public procurement projects involving the transfer of real estate or assets that were likely to appreciate in value could often give rise to specific tax issues. HM Treasury guidance advised organisations to consult the Treasury at an early stage to identify the likely tax implications and assess the proposal for propriety generally.²⁸

27 Q 21; C&AG's Report, paras 2.12, and 2.16–2.17

28 HM Treasury, *Managing Public Money*, October 2007, paras 4.2 and 4.27, Annex 4.4; C&AG's Report, para 2.13

Formal Minutes

Wednesday 24 March 2010

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Angela Browning
Mr Paul Burstow
Keith Hill

Mr Austin Mitchell
Dr John Pugh
Rt Hon Don Touhig

Draft Report (*HM Revenue and Customs' estate private finance deal eight years on*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 25 read and agreed to.

Conclusions and recommendations 1 to 10 read and agreed to.

Resolved, That the Report be the Thirty-second Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[The Committee adjourned.]

Witnesses

Wednesday 20 January 2010

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Lesley Strathie, Chief Executive and Permanent Secretary, **Mr Dave Hartnett**, Permanent Secretary for Tax and **Mr Simon Bowles**, Chief Finance Officer, HM Revenue and Customs, **Mr Nick Friedlos**, Chief Executive, Mapeley Estates Limited

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Oral evidence

Taken before the Committee of Public Accounts on Wednesday 20 January 2010

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Angela Browning
Mr Ian Davidson

Dr John Pugh
Geraldine Smith

Mr Amyas Morse, Comptroller and Auditor General, **Mr Rob Prideaux**, Director, Parliamentary Relations and **Ms Jane Wheeler**, Director, National Audit Office, gave evidence.

Mr Marius Gallaher, Alternate Treasury Officer of Accounts, HM Treasury, gave evidence.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HM REVENUE AND CUSTOMS' ESTATE PRIVATE FINANCE DEAL EIGHT YEARS ON (HC 30)

Witnesses: **Ms Lesley Strathie**, Chief Executive and Permanent Secretary, **Mr Dave Hartnett**, Permanent Secretary for Tax, **Mr Simon Bowles**, Chief Finance Officer, HM Revenue and Customs and **Mr Nick Friedlos**, Chief Executive, Mapeley Estates Limited, gave evidence.

Q1 Chairman: Good afternoon, welcome to the Committee of Public Accounts where today we are considering the Comptroller and Auditor General's Report on *HM Revenue & Customs' estate private finance deal eight years on*. We welcome Lesley Strathie, Chief Executive of HM Revenue and Customs and Nick Friedlos, the Chief Executive of Mapeley. Ms Strathie, would you like to introduce your colleagues please?

Ms Strathie: On my left I have Dave Hartnett, Permanent Secretary for Tax and Simon Bowles, Chief Finance Officer to Revenue and Customs.

Q2 Chairman: Perhaps we could start by looking at the recommendations from the Comptroller and Auditor General. You will see that he says you have not achieved value for money so far because you have not obtained all the benefits of the deal and you do not have a strategy for using the property vacation provisions. Why do you disagree with the Comptroller and Auditor General in his conclusions?

Ms Strathie: First, I do not disagree with the fact that maximum value from this contract has not been taken and that the Department could have been more strategic in its approach. The part where we disagree is what I perceive as the NAO's narrow definition of value for money when I actually think this contract has enabled much broader value for money for HMRC. It enabled savings to be taken, it enabled vacations which have not been taken but within the totality of the change which the Department has absorbed and what it has done, that is where we disagree. We can agree on that.

Q3 Chairman: We can agree on this: you did not obtain all the benefits; you did not have a firmed up plan for property vacation. We can agree on that. Do you want to comment on that Comptroller and Auditor General?

Mr Morse: Ms Strathie and I are in broad agreement as to the fact that the benefits were not obtained and there was not a firmed up plan. I am quite content if we want to disagree on precisely how we are defining value for money.

Q4 Chairman: We can move on. We have cleared that disagreement up, or at least found out the nature of it. Can you look now at paragraph 2.21? We read there that the total savings now available have reduced from £1.1–£1.2 billion to about £900 million. Obviously you have got considerably less out of this, one third of a billion less than you wanted to out of this deal. How are you going to maximise savings over the next 12 years? What is your strategy now?

Ms Strathie: May I ask Mr Bowles, who has taken the lead on this contract, to answer that question?

Mr Bowles: I would like to look to your question on how we will maximise value from this contract over the remaining period, particularly having joined the Department last March. While I cannot change the past, I can certainly focus on the future. There are three strands here. The first one is around strengthening and improving the processes within the estates function in HMRC because that is a key element of getting value out of this contract and that includes the links to the business change. This contract has an important role in enabling the business to shape itself, to deploy people as efficiently as possible and that gives us options which we would want to optimise. The first piece is around the improvement of the ESS, the estates function. The second piece is around a number of commercial areas which we are working on in collaboration with Mapeley. Some of them are day-to-day issues which have arisen over the last four or five years, where we will be clarifying savings available under the contract and taking advantage of them. That needs

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to develop into the third strand which is developing a partnership. I absolutely accept the recommendations and points made by the National Audit Office that we can improve the elements of partnership between Mapeley and ourselves. That will require work not only on our side but also on Mapeley's.

Q5 Chairman: Let us look at how we can improve this partnership, in particular paragraph 3.10. You do not know what profits Mapeley have made. If you do not know what profits they are making, how can you know whether they are charging you a fair margin or not?

Ms Strathie: If we just step back and accept the time this contract was negotiated and signed and the terms that were signed and from 2001 fast forward to 2007, we are working with Mapeley to try to agree transparency, open book and best practice as defined in 2007. That is probably a question for Mapeley as to where we are on that particular journey. We now have greater sight and we have proposals from Mapeley on greater insight into that but it is beyond what we are required to do in the contract. If we are to work in the spirit of alliance and partnership going forward, I believe that is what we need.

Q6 Chairman: Let us now turn to Mapeley. Mr Friedlos can you assure this Committee that you are going to share with the Revenue this information that they need, that you are going to give them full information on what profits you are making so that we know, on behalf of the taxpayer, whether we are getting a fair margin or not? Can you assure the Committee that you can give them that information and that you will cooperate fully with them?

Mr Friedlos: I can assure the Committee of that. We have asked the Government to consider one or two safeguards around freedom of information and protecting the data.

Q7 Chairman: That is in recommendation "a". If you are going to do that in the future, why have you not done it in the past?

Mr Friedlos: We have always responded to requests that we have received.

Q8 Chairman: That is now a given. Are you happy with that Ms Strathie?

Ms Strathie: Very happy.

Q9 Chairman: We are here to help you.

Ms Strathie: Thank you.

Q10 Chairman: Mr Friedlos, paragraph 2.19. You raised concerns with HMRC in January 2009 about financial pressures arising from the vacations programme. Obviously the Revenue want to vacate properties from time to time. You said this was putting great pressures on you. Were you not just looking for concessions?

Mr Friedlos: We were not looking for concessions.

Q11 Chairman: If you were not looking for concessions, what were you looking for?

Mr Friedlos: What was important to us at that time, when we gained visibility of the scale of their plans over the next few years, was really rapidly to get as much clarity as we could around exactly what those plans were in terms of timings and building and so on and also to get resolution of one or two outstanding commercial items between us.

Q12 Chairman: What would happen if HMRC vacated every building? Would you survive?

Mr Friedlos: It cannot vacate every building at once. What we are looking at is a plan over the next two to three years where it largely catches up on the vacations it has not used to date and we do survive.

Q13 Chairman: The truth is Mr Friedlos that you underbid for this contract, did you not? Your bid was way below other people and now you cannot afford the contract. Now that the Revenue are putting pressure on you, you are screaming foul, are you not?

Mr Friedlos: We are not screaming foul. We can afford the contract. We bid the contract at a keen margin which we knew at the time and was commented on at the last NAO Report. We can afford the contract.

Q14 Chairman: Ms Strathie, paragraph 10. I know that you personally were not involved but unfortunately you have to take the rap for this. Do you accept that your Department did not have the right commercial skills at the time when you were making this contract?

Ms Strathie: If I look back on my own experience of that time in another government department and I look at the prime contract the DWP have and their experience and I look back on HMRC's experience, I think that is fair criticism of the Department.

Q15 Chairman: What do the Treasury say to this? Do you think you can now ensure that departments have the right commercial skills for this type of contract in the future? Have you learned from this?

Mr Gallaher: Yes, we have and we have learned from other National Audit Office Reports which came in front of this Committee in recent months. We will be working with the Office of Government Commerce to tighten up the criteria for recruitment of expertise in delivering complex projects and, if I may, I will drop you a note on this.¹

Q16 Chairman: We have had other instances; Metronet for instance and highways maintenance.

Mr Gallaher: Yes.

Q17 Chairman: This was a massive own-goal, was it not? You did a deal with an offshore company. Here you are. You are supposed to be raising taxes on behalf of us. Why has this happened? How could you have got yourself in this mess that way down the negotiations you found that you were dealing with an offshore company? Is this how the Revenue should conduct themselves, you of all people?

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Ms Strathie: Certainly for the first two or three years of the contract that was the focus and much handling of the media and that is a very difficult time in the early days of a contract like this. I know much has been made of it.

Q18 Chairman: Do you agree that it is quite right that much should be made? It was a disgraceful situation that you got locked into a contract and you did not have the right commercial skills. When it was too late you found you were in bed with an offshore company, you of all people.

Ms Strathie: I do not know how disgraceful it was in 2001. What I do know today is that 82% of companies in this business hold leases offshore. I do know that you then have to question what that means and you have to balance overall. At the end of the day I am responsible for collecting the revenues and I am also responsible for an admin budget and you need to look at the trade-off of what it would cost if those leases were onshore, what that would mean for my partner's competitiveness.

Q19 Chairman: Mr Friedlos, will you now give an assurance to this Committee that you will bring ownership of these properties onshore?

Mr Friedlos: That is not an assurance I can give today.

Q20 Chairman: So you will not give that assurance.

Mr Friedlos: We have not been asked to do that. It is certainly something we will consider, if asked.

Q21 Chairman: This whole issue has delayed including additional properties in the contract, has it not? This is causing a difficulty with the HMRC, is it not?

Mr Friedlos: It would appear that the delay in bringing one group of 11 properties into the contract is because of an "offshoring" issue.

Q22 Chairman: It is not just a political, with a small "p", own-goal it is actually impacting on the contract, is it not? You should never have done a deal like this with an offshore company because you are now filled with embarrassment as you are trying to manage this contract. That is the truth is it not? It is better just to admit it now. You were not responsible at the time. We do not hold you personally responsible, but we just want you to tell the truth.

Ms Strathie: I am not embarrassed.

Q23 Chairman: You have a very high embarrassment threshold.

Ms Strathie: You have to have in my job. I do feel that much is made of this, what the tax implications would be at the end of this contract and would be today, with issues which I am sure Dave Hartnett is much better equipped to talk on. The issue of bringing other properties in is one that we need to take a strategic view on based on the offices that we are serving vacation notices on, those that we have announced will happen over the next two to three years and what that means then for the proportion

of buildings which are in this contract and the proportion of buildings which are outside it and what I believe is the best thing for HMRC and the UK taxpayer going forward.

*The Committee suspended from
3.45pm to 3.49pm for a division in the House.*

Q24 Angela Browning: Can you tell me why your company invoices HMRC for accounts dating back to 2001? Why were you unable to invoice in a timely manner?

Mr Friedlos: We do invoice the bulk of our charges on a very timely basis. We invoice around about £206 million a year on a monthly basis. There are occasionally items which arise outside the normal course of the contract where some specific agreement or discussion is appropriate before we bill. Those are the items which sometimes accumulate unbilled for a period of time.

Q25 Angela Browning: The period of time amounting to nine years according to this Report: £12 million dating back to 2001.

Mr Friedlos: Yes; that relates to additional services which we were asked to provide. At the time we were asked to do so, the methodology for pricing those services was not clearly agreed between the Department and ourselves. Once that agreement was reached, we then began a process of catching up on the invoicing for those amounts.

Q26 Angela Browning: I appreciate that if there is a dispute there will be some period of time for negotiations, but this does seem to be somewhat excessive. How timely were these invoices relating to this £12 million?

Mr Friedlos: The invoices relating to the £12 million were in relation to a number of individual items which accumulated over a period of years. The Department were aware that these were accumulating and once the methodology was agreed and we had done the work to substantiate and demonstrate to the Department the validity of those charges they were duly invoiced.

Q27 Angela Browning: Why is it then, if these disputed amounts were accumulating and the Department were aware of it, that it has taken so long to come to some agreement to get them paid?

Mr Bowles: I mentioned earlier that we had a number of areas where we needed to resolve long-standing commercial negotiations and I was very keen that as part of this partnership development with Mapeley we did not deal with things piecemeal. We are currently engaged with Mapeley in going through all of these to get the best result for the taxpayer. I am confident that we will get resolution relatively soon.

Q28 Angela Browning: Does part of this contract involve any element of surcharges or interest being accrued on late payment?

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Mr Bowles: Not to my knowledge.

Q29 Angela Browning: So we have not paid in addition to the disputes.

Mr Bowles: No.

Q30 Angela Browning: Are you content that you have now communicated sufficiently for these not to happen again?

Mr Bowles: The answer lies in improving our processes both within the Department and with our supplier to make sure we have early visibility to these and that is what I referred to earlier in terms of overall improving the processes and capability.

Q31 Angela Browning: Thank you. Ms Strathie, may I bring you back to something which was mentioned right at the beginning? If you look at page 8 and the summary, under “e” the heading is “Understanding value for money”. I was a little bit disconcerted at your comment about the interpretation of the NAO Report in terms of what value for money really means. Just to set my mind at rest let us look at that “The Department does not monitor the overall cost of the contract against initial models to understand whether it is achieving value for money”. Is your understanding of value for money that that is something you should be doing?

Ms Strathie: Yes; absolutely. I separate the two issues of what the contract was that was put in place and enabled versus the things that the Department has seen through since that time. It is absolutely the job for the strategic partners in managing this to look at the value from the contract as business strategy changes and ensuring our estate strategy follows it and that we get full value.

Q32 Angela Browning: It goes on to say the Department “has not undertaken analysis on the potential savings available”. Is that something which has now been put in place?

Ms Strathie: Yes, but, bearing in mind that we are talking about what happened from 2001 to 2009 and how we want to proceed from now on, we have a contract which enables us to move out of properties under different terms, depending whether they are core or otherwise. Rather than just take what the contract offers us at the moment, given how fast the world is changing, it is really important for us to look at this across both our businesses and ask how the taxpayer could get better value in the future.

Q33 Angela Browning: That would bring in the next bit which says “analysis on the potential savings available” and then, going on, it says “Until recently it had a limited understanding of its liabilities in the event of contractor default”. I assume you have addressed that now.

Ms Strathie: Yes.

Q34 Angela Browning: How have you addressed that?

Ms Strathie: We have a really extensive business continuity plan. We do have an understanding of our liabilities but I would say—

Q35 Angela Browning: Sorry; not your liabilities the liability of the contractor.

Ms Strathie: It would default to us.

Q36 Angela Browning: Yes, but there is an underlying issue here, is there not, in that you are obviously very aware of your own liability? However, what this is identifying is an understanding of the liability in the event of a contractor defaulting. In other words what their position was.

Ms Strathie: That falls on us.

Q37 Angela Browning: Yes; of course.

Ms Strathie: Primarily, if a company becomes insolvent, if any of my suppliers becomes insolvent, I have to have a plan for carrying up the risks associated with that. Clearly we have no preferred creditor status in any of this but we have done extensive work to understand what that would mean for HMRC were that to happen. Of course, not only would we lose the flexibility we have in this contract around reshaping the business, we could potentially have outstanding bills, depending what state the company was in at the point it became insolvent.

Q38 Angela Browning: In terms of a large long-term contract like this, what interim steps do you take from the time you sign a contract to ensure the viability of the contractor? Presumably when you first sign a contract you do the usual checks and so on in terms of their viability.

Ms Strathie: Yes.

Q39 Angela Browning: What interim steps do you take? It seems to indicate here that it was only recently that the Department had an understanding of the liabilities, of what might happen if the contractor defaulted. What interim measures do you take to make sure that all is as it was originally said in the contract?

Ms Strathie: I would not like to give the impression that it is only now that that work is going on because my own piecing together of what has happened over the time suggests otherwise, that it is an ongoing part of the Department’s business to assess that.

Mr Hartnett: The right thing to say is that we started to look at the viability of Mapeley very early because it was some nine months after the contract was signed that Mapeley raised with us the issue of financial difficulties. We brought in bankers and accountants at the time to have a very good look at their viability and over a period of about two years then put in place checks both through conversations with Mapeley and through looking at the markets through professionals. It is fair to say that the intensity of the work then did not continue. We thought we had reached a position which was reasonable and then it started again in the last couple of years when there have been market difficulties and the like. So there have been two periods of really intense work.

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Q40 Angela Browning: May I take from that that your understanding of value for money, from the replies you have just given, are actually no different from that of the Comptroller and Auditor General?

Ms Strathie: The point made in the Report was that the contract was set up to enable an amount of money. The Department did not appear to have had a strategic approach as to how it was going to extract maximum value throughout it. I can only say “appear” because I was not there. My issue was that the Department has achieved significant savings and significant value for money in the way it has shaped its business and this contract has enabled us to do that as the Department has modernised. That is the only difference.

Mr Morse: I do not think anything you say is wildly apart. Just to be clear about the test we apply, it is not a counsel of perfection; it would be unreasonable to expect that everything which could conceivably be achieved must be achieved. That is not the position the NAO take. What we do say is that what, by normal diligent effort, could and should have been achieved, if that has not been achieved, then I am not prepared to say that something is value for money. If you should have sold something for £3 and you sold it for £2, just because £2 is more than it cost you does not make it value for money unfortunately. There is an expectation of due care and attention and effort to preserve public value and if you are not at that point, I do not think we can testify that it is value for money. It is our view that if you had had those plans in place and you had been more engaged and more constantly concerned about viability and so forth than you actually were, we would not have been criticising on value for money. It is not a question of saying you should have achieved every pound but we feel the diligence, the effort and the competence applied to it was not really enough for us to come to a positive opinion about what could reasonably have been expected in the circumstances.

Q41 Chairman: I am afraid we cannot accept in this Committee, just because a department makes some money, that it has achieved value for money. We have to look at objective criteria. It seems to me that what the Comptroller and Auditor General is talking about makes sense.

Ms Strathie: I do not disagree with anything that Mr Morse has said.

Q42 Angela Browning: At the bottom of “e” there is a specific recommendation from the National Audit Office and I think I would be happy if you could just confirm that you accept that and that is what will happen in the future, where it begins “The Department should prepare” et cetera.

Ms Strathie: I can absolutely confirm that is what will happen in the future. I can confirm that all of our strategic arrangements and contract management from board level downwards are in place including the strength in both our commercial and our legal resources in this area. Absolutely.

Q43 Mr Bacon: Could you tell us what would embarrass you?

Ms Strathie: Not very much.

Q44 Mr Bacon: Not very much; my point being that if being the boss of one of the world’s leading tax authorities and entering into a property deal with an offshore tax avoider for your own property does not embarrass you, then what would?

Ms Strathie: I said I was not personally embarrassed and I tried to set out why. I would be embarrassed if I felt I were not doing the job I am paid to do. I accept all of the success that HMRC have had and all of the areas for improvement when I take the job. The only thing I can do is change the future, so I am not embarrassed about what I have done in this contract since I took the job.

Q45 Mr Bacon: That is a great line for a 1960s folk song: the only thing I can do is change the future. Mr Friedlos, who owns Mapeley?

Mr Friedlos: About 80% of the shares in Mapeley are owned by funds which are managed by Fortress Investment Group, a US fund management company.

Q46 Mr Bacon: Right. And the other 20%?

Mr Friedlos: The other 20% are owned by management, individuals and some other professional investors.

Q47 Mr Bacon: It says in the Report that when the deal was struck Fortress Registered Investment Trust and Soros and Delancey Estates owned the business. There is a piece in the *Sun* newspaper, which as we all know is a paper of record, which said on 17 June 2005 that Mapeley had made a dashing stock market debut yesterday. Was there then a flotation followed by a private buy-back, a private equity deal of some kind, where it was taken off the stock market again? Is that what happened?

Mr Friedlos: No, there was a flotation in June 2005. We were a public company for just over three years. The company de-listed, came off the stock market in April 2009 because Fortress, or the funds managed by Fortress held more than 75% of the equity and we were required at that level to de-list.

Q48 Mr Bacon: It says in your CV that you are responsible for all areas of day-to-day business of the company, including day-to-day operations.

Mr Friedlos: Yes.

Q49 Mr Bacon: Do you live in Bermuda?

Mr Friedlos: No, I do not live in Bermuda.

Q50 Mr Bacon: I do not understand. The company is based in Bermuda and, if you are responsible for the day-to-day operations, how do you run it?

Mr Friedlos: The company’s investments are based in Bermuda and the Bermudan company is run by a board of directors.

Q51 Mr Bacon: So there are people over in Bermuda running it.

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Mr Friedlos: There is a board of directors in Bermuda who take decisions around the property investments. Those are generally not day-to-day decisions. The day-to-day decisions around the contract and how we operate it are taken in the UK.

Q52 Mr Bacon: And you live in the UK.

Mr Friedlos: I live in the UK.

Q53 Mr Bacon: Are you domiciled in the UK for tax purposes?

Mr Friedlos: I am.

Q54 Mr Bacon: Excellent; good to hear it. On this Committee we all like people who pay tax in this country. I should like to ask about the old NAO Report which I was looking at and which was published back in May 2004. It said “The Departments” two at the time “and Mapeley STEPS needed to develop a single business focus that will involve the Departments developing an understanding of how their own decisions impact on the contractor” perhaps slightly worrying that the departments did not have that anyway “and the latter” that is Mapeley “continuing to provide access to its income and forecasts”. Yet we find in the present Report which has just been published, in paragraph 3.14 on page 26 that there still is no shared database of information. It says in paragraph 3.14 “The two organisations do not share key information in a consistent manner, such as having a shared database . . . and a joint understanding of the vacation allowances used” in other words, a joint understanding of the way in which the contract that enables you to vacate properties is working. It also says “. . . the organisations do not have a good understanding of each other’s objectives and strategies. There is also no shared risk register” either. This is despite the fact that these things were identified and pointed out five years ago and the need for the company, Mapeley, to provide access to its income and forecasts and the need for you and your predecessor departments to have a clear understanding of how your decisions impacted on the contractor. Why has so little happened in the last five years that the NAO is still making this criticism? It is five and a half years.

Ms Strathie: The first thing I would say is that it is degrees. Mapeley do have a shared view of our business plans. As you probably know, because I wrote to you, we have firmed up our vacations. We had a very extensive consultation exercise which finished and the results were announced in December 2008. We have now firmed up our intention of where we planned to cease business activities during the financial year 2010–11. All of that Mapeley has had sight of. The issue comes back to the original question which Mr Friedlos already answered in terms of shared financial information. I would hate the Committee to go away with any notion that there was nothing in that period. My view is that from 2007 Treasury guidelines and best practice suggest a different type of relationship. This contract was not negotiated in 2007 but in 2001. My

expectation is, if we are in true partnership with Mapeley, that they will live up to that best practice from 2007.

Q55 Mr Bacon: That is your expectation but what are the actual barriers to having an effective partnership? Are you saying it is whether Mapeley cooperates or not?

Ms Strathie: Yes, but we have to take some responsibility in HMRC. A true partnership is an alliance where there is win-win, there is absolutely shared information about a business strategy going forward, shared thinking of the shape of the business, so a lot of transparency and strategic sharing needs to happen at board level. That is something we put in place with both the Chief Finance Officer in the lead and Dave Hartnett on that board and myself and Nick on a biannual basis. I accept that the Department could have perhaps been more strategic.

Q56 Mr Bacon: The Report actually says that the Department have not assessed the benefits realised by Mapeley in the STEPS deal nor the profitability of the Mapeley group. This is something I struggle with because you did say earlier in answer to the Chairman that you disagreed with the National Audit Office in terms of their narrow definition of value for money but if you have not done that basic assessment—I think Angela Browning asked this question and I am not really content that I understood your answer—of Mapeley’s profitability and the benefits which have accrued to Mapeley, how can you possibly undertake a thoroughgoing assessment of value for money? How are you in a position sensibly to disagree with the National Audit Office?

Ms Strathie: I think we are mixing currencies and we have already had this conversation twice. One issue here is managing the contract and managing the value of the contract. There is another issue about Mapeley’s robustness and resilience and its viability.

Q57 Mr Bacon: On that last point, may I stop you there? Mapeley came to you within seven months of the contract being signed in 2001 and started bleating that it was running into difficulties and it has done so recently because of pressures arising from the economic downturn. This has been a company with a history of coming to you saying it has financial problems right from the inception of the contract, has it not?

Ms Strathie: I cannot answer that. Can you?

Mr Hartnett: Certainly seven months into the contract.

Q58 Mr Bacon: Not very impressive and it was not a depression then or anything like it, was it, in 2001 and 2002? Most people thought it was a boom.

Mr Hartnett: I do not think it was in the context of Mapeley because property prices went on to rise and some of the reverse premia that Mapeley took later enabled them to come out of that particular financial difficulty. It was not quite a boom in the property that Mapeley held at that time.

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Q59 Mr Bacon: I should just like to go back to the first of your two points in your last answer Ms Strathie and that was about the management of the contract. You agreed that it was a fair criticism that not enough, in the words of the Report, appropriate legal and commercial skills were applied to it. I still do not understand why not. This was a £4 billion contract. Regardless of what particular Treasury guidance there was or was not at the time, surely if you are entering into a contract of this scale, common sense would suggest that you apply serious commercial and legal resources to it. Why was that not done?

Ms Strathie: It would be very easy for me to agree with you and simply say I do not know and my predecessor should have done better. All I can point to is the history of this type of outsourcing at that time. I know from different departments I worked in at that time—and I do think it is fair criticism—that there was a tendency to believe that the outsourcer was going to deliver everything as per the contract and that we scaled down the capabilities, what I would probably refer to as strategic management, strategic thinking, when we did outsourcing, which was something many parts of Whitehall had to learn from going forward. We accept that criticism. I do know from driving the structure we put in place and the relationship now how we can get better value from the contract and better sharing.

Q60 Chairman: I know there is a convention in this Committee that permanent secretaries have to take the rap for their predecessors and they cannot say they were not there, but we would be much happier if you could just give us your honest assessment of what happened then. If you think it was badly handled, say so. It is much better so we can learn lessons for the future. There is no point always just dropping a straight bat on something and not getting the truth.

Ms Strathie: I do not know the extent to which the Department managed the risk of Mapeley as a new player in the market coming in on the bid they did and what that meant the Department ought to have done to ensure that this was the right contract and ready to deliver. I do not know. I know they are some of the things I have learned. I also know on this side of the contract there is little point in anybody adopting a procurer/supplier/deliverer relationship. It does take a partnership and it does take real understanding of each other's businesses to get best value. I also know that if Mapeley can only help us get that value, if the Department has a clear understanding about its direction of travel over years to come and what that means and that that is shared, those for me are the things I have learned over the years.

Q61 Dr Pugh: The contract is extremely odd to my way of thinking about it because it seems to me that you are committed to a process of building rationalisation regardless of any other corporate needs you may have. Just to test my understanding of it, do I conclude correctly if I think that if you go too fast in shedding buildings, there will be penalties

attached, but if you go slowly, as you apparently have done according to the NAO, you will be castigated for making fewer savings?

Ms Strathie: I think I am well used to being in that “damned-if-you-do-and-damned-if-you-don’t” situation because it is difficult to please everybody all of the time. The contract enables us to take different actions in coming out of properties according to whether they are core or otherwise. First I would say that after this contract was signed in 2001, you then had an expansion of business in the shape of tax credits in 2003. Whilst you had enabled a contract here which allows you to vacate the estate, you had lots of other changes which have happened. I am not driving the rationalisation of our estate simply from getting value from this contract. I need to reshape the business to match the risks that we face in tax collection.

Q62 Dr Pugh: If you had a business requirement which involved fewer savings on this contract you would be comfortable with that.

Ms Strathie: If I had a business requirement—

Q63 Dr Pugh: You needed more accommodation than you thought.

Ms Strathie: It would not change my decisions or the consultation exercise and the result about vacating the premises and ceasing business.

Q64 Dr Pugh: If you vacate at too rapid a rate, presumably Mapeley then invokes some penalty clauses to some effect, do they not?

Mr Bowles: Yes, there are costs involved if we go faster in using the vacation allowances.

Q65 Dr Pugh: You cannot go too fast and you cannot go too slowly without getting the wrath of the NAO. Following through on that, the Chief Secretary to the Treasury wrote to lots of Members of the House of Commons last week saying that 130 tax offices were scheduled to be closed in the financial year 2010–11. That is correct, is it not?

Ms Strathie: Yes.

Q66 Dr Pugh: In terms of those parameters, too fast or too slow, which side are you on?

Ms Strathie: The first thing to say is that we are exercising the contract; we are not exceeding that. It is important here to say that what I have written and announced is that we will cease business and the first people we had to tell that to were the individuals who are located in those offices who are employed by HMRC. The vacation notice and actual vacation is quite separate from ceasing business to allow the next stage.

Q67 Dr Pugh: Of those 130 properties, how many are leasehold, how many are freehold? It would be helpful if you could send us a note.² Mr Friedlos, what is going to be the effect on Mapeley and their finances if 130 tax offices become surplus to requirements? You could propose in one case you get

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a huge penalty sum from HMRC. In the other case you might be landed with a lot of property you cannot sell. What has been the effect?

Mr Friedlos: The effect when a property becomes vacant is broadly that if it is a freehold property and it is vacant, we can sell it. If it is a leasehold property and it is vacant, our job is to re-let it.

Q68 Dr Pugh: Do you welcome the prospect of having a large *tranche* of freehold property, some of it quite unattractive, to have to sell in current market circumstances? Is it good for Mapeley?

Mr Friedlos: It is our business to deal with it; it is the contract we signed up to.

Q69 Dr Pugh: If 130 tax offices close on time will you receive any financial help from HMRC because of the contract?

Mr Friedlos: Those vacations will all be dealt with under the contract. We will not receive any money.

Q70 Dr Pugh: Will you get any money because of the 130 suddenly being put on the table that were not there before?

Mr Friedlos: It will be dealt with in accordance with the contract.

Q71 Dr Pugh: Will you get any money?

Mr Friedlos: Some of those vacations in the contract can happen without any additional payments to us and some of the vacations require some additional payments.

Q72 Dr Pugh: Can you tell us how much money you will get?

Mr Friedlos: I cannot tell you exactly how much money we will get; it will depend on the timing and the exact pattern of those vacations.

Q73 Dr Pugh: Let us assume the hypothesis is that they all go, as the Permanent Secretary has said, in 2010 and 2011. Could you send us a note saying how much payment you will get as a result of that?

Mr Friedlos: We will clarify that.

Q74 Dr Pugh: There are going to be additional costs in moving out of these 130 places and I would like to turn to Mr Hartnett. You presumably calculated the cost of accommodating those staff who will be moved out of them?

Mr Hartnett: That is really one for Mr Bowles.

Mr Bowles: That depends ultimately on how many of the staff affected leave the organisation and how many are redeployed.

Q75 Dr Pugh: You must know what your need of staff is and presumably you do not have the buildings for staff from 130 offices at the moment, do you?

Mr Bowles: No.

Q76 Dr Pugh: So are you going to have to purchase some more buildings?

Ms Strathie: No, we have 2,400³ people in those buildings; 1,900⁴ will transfer to other locations which have already been agreed. People there concerned had already volunteered for that and did. The remainder, 1,450⁵ have been given a range of options around severance; we are not going to acquire new buildings, they will move to one of the strategic locations.

Q77 Dr Pugh: I understand all that. What I am trying to get at is that you must be working with some working assumptions about what would be the cost of re-accommodating staff from 130 offices elsewhere and that has to be factored into the exercise; I assume it will.

Ms Strathie: Yes, that is the case.

Q78 Dr Pugh: If you can give us any information on that it would be very helpful.⁶ According to a letter I have received from Mr Hartnett, enquiry centres, in all these offices presumably, will be retained in their current locations or nearby. I assume not their current locations because that would make the property more difficult to sell. Do you have a figure in your budget which illustrates the amount you will need to keep all these enquiry offices open?

Ms Strathie: We always intended to retain face to face because that was part of the consultation.

Q79 Dr Pugh: Do you still intend?

Ms Strathie: We do still intend. As you will know from the letter I sent, on 59 of those we are open to consultation as to whether they are full time.

Q80 Dr Pugh: What I am getting at is that you are going to have to find new premises to keep these enquiry offices open in the place they are supposed to be open and Mr Hartnett said they will be open. That has a cost; that has a figure. I assume in your planning you know something and you can give us this.⁷

Ms Strathie: Let me start with service. Just to be clear, we are not closing any face-to-face locations we have; these are back office people. We are talking here about ceasing business where we had business because it has already moved some time ago and people have been involved in other work. In many cases this is a floor of a building, so if it came to it at the margins that the only way we could vacate was because there was a much better deal to put that small business face to face elsewhere, we would work with the partners to do that.

Q81 Dr Pugh: What I am trying to do is price the additional costs of this workforce renewal/change/rationalisation of accommodation. When I enquired about Duke's House, which is in my own constituency as to what would be the effect of closing down the office, I got from your office a statement which said that on current figures the payback,

³ *Note by witness:* This figure is revised to 3,150.

⁴ *Note by witness:* This figure is revised to 1,450.

⁵ *Note by witness:* This figure is revised to 1,700.

⁶ Ev 15

⁷ Ev 15

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accommodation versus other costs, accommodation rationalisation, would take approximately 19 years. Are you able, for all these 130 offices, to have some idea of what the payback would be for all of them? Can you send us a note?⁸

Mr Hartnett: We can do that but I have to say I have no recollection at all of saying that, so it would be very helpful if I could have a look.

Q82 Dr Pugh: It is a document from your implementation team and it is the business case for the rationalisation. It does suggest the rather high figure of 19 years before there is any saving out of this closure.

Mr Hartnett: Let me say how much that surprises me in this sense: I know the building well, I have been in it many times in my career but we have other very substantial buildings not very far away. To think that it might take 19 years to realise the savings surprises me. I put it no stronger and we will send you a note.⁹

Q83 Dr Pugh: My general concern is that it may look like you are making some sort of saving but if you do not have all these costs built into the equation, you may, in the short term at any rate, be tasking yourself—

Mr Hartnett: One thing, if I may, about the enquiry centres. In our calculation of savings we have not taken the saving in relation to enquiry centres because we know we have to keep enquiry centres. In some places there might be a marginal increase in the cost for the enquiry centre, but I do not think there are any substantial ones. We will check that.

Q84 Geraldine Smith: Just so I am clear, how much more has the contract cost than you originally estimated? Is it £507 million?

Mr Bowles: Yes. The NAO Report very helpfully actually puts a number of numbers together here. It is probably just worth mentioning the bid from Mapeley which came to £3.3 billion in 2009 currency and then a recent estimate of contract life of £3.87 billion. The difference between those is £570 million.

Q85 Geraldine Smith: The contract put forward by Mapeley was supposed to be £300 million cheaper than managing it within the public sector, basically you doing your own nationalisation of buildings. Rather than have this complicated contract with a private offshore company which is not even paying tax on the properties, would it not have been much more sensible just to manage it within the public sector yourselves?

Ms Strathie: Again we go back in time.

Q86 Geraldine Smith: Yes, or no. Would it have been cheaper? On the figures I am looking at it would have been.

Ms Strathie: No, because even the NAO have concluded that this is a good contract.

Q87 Geraldine Smith: I am still not with you. It says in this Report that the contract you originally negotiated would have been £300 million cheaper than managing it within the public sector. However, it is now working out at £570 million more.

Mr Bowles: Many of the factors which affect that were changes in the specification of the building, details of the building, which would have affected the public sector equivalent against which it was compared.

Q88 Geraldine Smith: Do you not lose a lot of your flexibility when you are in this long-term contract, if you are managing it yourselves? You said before that there were tax credits, there were different policy changes which affected your buildings and affected where people are working. You do not have the flexibility because you are dealing with a private company.

Mr Bowles: If I may, I think it is actually the converse because the attraction of this contract was that it gave a great deal of flexibility as the Department has the right to vacate 60% of the STEPS estate, 42% of which is at no additional cost and 18% which attracted compensation.

Q89 Chairman: The Comptroller and Auditor General is nodding. He might be able to row in to your help.

Mr Morse: I was agreeing with the fact that those costs adding up to around £300 million are mostly ones which I am afraid we carried into the public sector comparator. That is undoubtedly the fact. Secondly, we do not regard the fundamentals of the contract, if it had been operated exactly as it should have been, unfavourable to HMRC. That is not what our Report says. Being able to place contracts at will when you wanted to move out should have been—should have been—pretty useful. Is it impossible to replicate that in the public sector? Well, I leave you to consider. I do not know but I think that having it there and being able to do it at relatively short notice without immediate penalty, assuming you wanted to rationalise the estate, appeared to be a useful contractual form. We are not fundamentally saying that is a bad contract. We are saying we are talking about the way the contract has been conducted not about the fundamentals of the contract itself.

Chairman: Thank you for that.

Q90 Geraldine Smith: You cannot voluntarily terminate a contract, can you?

Ms Strathie: We have a shared dependency here and there would be significant costs attached to termination of that contract, if that were something we assessed we wanted to do, particularly having assessed the costs anyway if Mapeley were to become insolvent.

Q91 Geraldine Smith: In hindsight, would you do that again?

Ms Strathie: Again I have to dwell more on my own experience here. This is not our core business and generally speaking you get better value, better

⁸ Ev 16

⁹ Ev 16

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flexibility, able to do things more quickly in doing it this way. I cannot judge, with all of the things the Department has been through since the contract, how much it could have done sooner, but I do know that it enabled the merger in the first instance, the creation of HMRC, and the pace at which that Department was created would have been much more difficult if we had not had this contract.

Q92 Geraldine Smith: So basically you feel the contract was a good thing but you did not have people with the legal skills and the commercial knowledge to negotiate a better contract.

Ms Strathie: Yes and I also think the contract was signed and I can only assume that it enabled the things that it enabled because we were all living in a time where we could see that lots of jobs were going to be replaced by technology and that is always a real challenge for any leader in the scale of change. You could have assumed that you were going to need far fewer buildings because of the merger dividend. Lots of assumptions were made but the reality is that a lot of other things have been asked of HMRC in the meantime.

Q93 Geraldine Smith: May I ask one question on page 14 where it mentions windfall gain? Mr Friedlos, apparently the Department has not received a certificate from Mapeley confirming that it was not eligible to share in windfall gains. Can you tell me a bit about that and why the Department has not received a certificate?

Mr Friedlos: The windfall gain was looked at at the time it was required to be in the contract and it was concluded and agreed with the Department that no gain was payable. At the same time as that was going on, there was also a refinancing of the bank arrangements around the STEPS contract which was taking place which actually relied on largely the same information and under which we did agree to make a payment to the Department. That was duly done and the matter was considered concluded in respect of both items. I understand the Department would now like the certificate which is effectively for a nil return, but they would like it. We are planning to provide that to them as soon as possible.

Q94 Geraldine Smith: Going back to the staffing, what is going to happen after 2012 with the buildings? What is the situation?

Ms Strathie: We have a total of 258 buildings which we consulted on and which have a future of different times and the 130 are the ones which we nailed down as ceasing business that year. We then have outline views of the next two years but they have to be taken in line with our workforce and my budget because obviously the cost of exiting people from the organisation is something we have to factor in. We are clear for this and we are clear for funding for those staff who cannot take advantage of any other vacancies and who take the exit terms, which are the most generous available under the civil service rules, before we can bring greater detail for the following years.

Q95 Geraldine Smith: Do you accept the recommendations of this Report? I think it is the future which is important and how you work within this contract.

Ms Strathie: Yes; absolutely.

Q96 Mr Davidson: Is there any advantage to HMRC of Mapeley being offshore?

Mr Hartnett: The only one I can think of is the one that was picked up in the last NAO Report in that the best estimate is that Mapeley were able to bid £55 million low because £55 million of capital gains tax would not be paid because they were offshore.

Q97 Mr Davidson: Apart from dodging the tax, is there any other gain in operational terms to HMRC of you being based in Bermuda?

Mr Friedlos: No, there is not; it is a very widely used structure in the industry.

Q98 Mr Davidson: So presumably the only gain in this whole thing to the British Government of you being offshore is that because you dodge tax you are able to quote a lower price.

Mr Friedlos: We passed the tax benefit back as a lower price in assembling our bid.

Q99 Mr Davidson: May I ask the NAO whether or not there is any evidence that the benefit of dodging the tax has been reflected in the lower price?

Ms Wheeler: The figure of £55 million which was quoted as an estimate had been reflected in the bid. Within our Report we did actually try to get an assessment about what the tax benefit had been so far and I believe the figure was £2 to £3 million. However, that is on the basis that much of the tax benefit would come towards the latter end of the contract on that £55 million.

Q100 Mr Davidson: Because I do not understand all of this, could we ask for a note from you about the extent to which firstly there was a benefit to the Government as a result of it being offshore and, secondly, whether or not the company have played fair in terms of giving the price back.

Mr Morse: May I define it like this and see whether this is helpful? If we have full access to Mapeley's costs and their financial details then we can work out what tax advantages they have obtained from being offshore. Only if we know that can we know whether it is being shared back with HMRC.

Q101 Mr Davidson: Is there any problem about giving the NAO access to that?

Mr Morse: I cannot see how I can do it otherwise.

Mr Friedlos: I have already given an assurance here that we are committed to providing more information.

Mr Morse: I am not denying that.

Q102 Mr Davidson: I am just trying to be clear. You mention you need access and I am just asking, in the limited time I have available to ask questions, whether or not that is a difficulty for you.

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Mr Friedlos: It is not a difficulty.

Q103 Mr Davidson: Fine. So we should in due course get something back clarifying all that for us.

Mr Morse: We will put something together in cooperation with HMRC.

Q104 Chairman: That must be done promptly before we publish our report.

Mr Friedlos: Yes; agreed.¹⁰

Q105 Mr Davidson: May I seek clarification? A question has also been asked about whether you had ever been asked about bringing the properties back to the UK and you said you had never been asked. Can you just clarify that for me? If the property ownership is brought back to the UK, does that then negate the tax advantage or is there a different way of doing it. I did not quite understand the significance of bringing the properties back to the UK. Can you clarify that for me?

Mr Friedlos: Yes. If the properties were brought back to the UK it would negate the £55 million tax advantage which we have just been discussing.

Q106 Mr Davidson: If you did that, you would seek to renegotiate the contract to bump the price up.

Mr Friedlos: We would need some compensation for that benefit being given up.

Q107 Mr Davidson: That is the same thing basically, is it not? That is helpful. To what extent is this company a bit like the Royal Bank of Scotland in that it is too big to fail? If you are negotiating with it and they come to you and say “Look, things are hard, you have to be a bit softer on us because otherwise we will be pushed into bankruptcy and then you will end up with all sorts of costs”, is that an accurate representation of the position or do they have a bottomless pit of money and you can just hold them to the terms of the contract?

Ms Strathie: I can only speak about my experience on the work I have done since I have been in HMRC. I am absolutely clear that HMRC is not a soft touch here. I am clear that what we are asking for is no more than the contract entitles us to ask for. Mapeley is accepting that and the challenge. I do know broadly the cost were this to revert to us but I actually believe that there is much value to be extracted and I would not accept under any circumstances Mapeley saying they had real financial difficulty and expecting the taxpayer to help out if I did not have full visibility over finances.

Q108 Mr Davidson: They have refinanced themselves a couple of times, have they not, in one way or another so presumably they could do a bit of moving things around which would put them in a position as some of the building societies and banks did that meant they had to be bailed out.

Ms Strathie: We have not had to cross that bridge, which is good. I think you know from the business payment support service that HMRC put in place at

the start of the recession that lots of companies have come to us for support in our time-to-pay arrangements. The law is pretty clear on all of this. We work with people to bring them into compliant regimes provided they are a viable business. We all know the history of the banks.

Q109 Mr Davidson: Yes, but there is a slight difference between bringing them into compliance in terms of being your customers, so to speak, as distinct from you being their customer.

Ms Strathie: Yes, but in the recession we recognised, particularly while we were dealing with the banks, that there are cash flow issues for business and we were doing our best to support. Mapeley is a business too. What I am saying is that I cannot see us being in a position where we would be looking for public money to bail Mapeley out. We would have to take on the costs and manage the risks according to the plans we have.

Q110 Mr Davidson: Mr Friedlos, what security can we feel that you will not come to HMRC in a little while and say that the market is tough and you cannot meet the terms of the contract? In terms of the way in which some of the deal was done at the beginning, we have heard suggestions that you were sharks which took advantage of the gullible to some extent. This was before Ms Strathie was there and no doubt you were dealing with other people from private schools and Oxbridge who were not aware of the ways of the world. How do we know that you are not going to be up to bad things later on?

Mr Friedlos: When we came to the departments at the outset of the contract, we settled some money in respect of errors in the data and additional services which we were being asked to provide and that was settled some years ago. We do not expect to come back to the Government asking for any more money outside what we are entitled to under the contract. We have looked at the Department’s vacation plans.

Q111 Mr Davidson: So no relaxation of the contract.

Mr Friedlos: We will not be asking for relaxation of the contract.

Q112 Mr Davidson: You have already done that once, have you not?

Mr Friedlos: No, we have not asked for a relaxation of the contract.

Q113 Mr Davidson: So what was it you asked for? Did you not come back and ask for something some time ago?

Mr Friedlos: We asked for some additional payments in respect of errors in the original bid data and where we were providing services in addition to those bid for.

Mr Hartnett: May I add a point which I think is really important here? Turning to the other side of HMRC’s work, monitoring companies and taxpayers and the like, one of the things we often see is that property companies do not have a lot of equity in the actual property. It is different here. Mr Friedlos knows a great deal more than I do about

¹⁰ Ev 16

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this but what is clear to HMRC from work we have done recently is that there is equity in the properties that Mapeley hold that we use. I just wanted to make the point that it is really important to bear this in mind.

Q114 Mr Davidson: Thank you. May I ask about the refinancing gain of 30% and that has been agreed going forward? May I ask the Treasury or NAO whether or not that is a reasonable figure or would you normally expect it to be more?

Ms Wheeler: That was broadly in line with guidance, albeit that there was no provision in the contract for this gain. Then new Treasury guidance came out and that was viewed as appropriate. It is reasonable.

Q115 Mr Davidson: So that is a reasonable figure.

Ms Strathie: It is very reasonable and something we are not entitled to under the contract so it should be seen in that light as a real positive.

Mr Davidson: So Mr Friedlos is not as bad as we thought possibly.

Q116 Chairman: Mr Friedlos may I just return to Mr Bacon's question about the nature of your company. I am curious. How many people do you employ in Bermuda?

Mr Friedlos: We do not employ any people in Bermuda. Our investments are owned in Bermuda and we have a board of directors in Bermuda who make decisions.

Q117 Chairman: You have a board of directors. Do these people live in Bermuda?

Mr Friedlos: Yes, they are resident in Bermuda.

Q118 Chairman: But you are resident here and you pay tax here.

Mr Friedlos: Yes, I am resident here and I pay tax.

Q119 Chairman: So all your staff are employed here.

Mr Friedlos: They are.

Q120 Chairman: I am not in this high finance world; it is not our sort of world. Is this not all a bit odd that this chap seems to be paying tax here, working here having all his people here but he is an offshore company. I am very naïve. Could you give me some help as a taxpayer?

Ms Strathie: The help I am going to give you is in the form of Mr Hartnett, the Permanent Secretary for Tax. It is something that I have had to get my head round along with all the rest of the learning about tax products.

Q121 Chairman: How can I become an offshore company then?

Mr Hartnett: Set one up.

Q122 Chairman: I am a bit fed up with paying taxes as well.

Mr Hartnett: Let me try to unpick it a little for you. Some of the Mapeley group of companies are actually onshore in the UK but the investment is offshore. Holding property in an offshore entity like

this has been a common feature of property ownership in the United Kingdom for many, many years. Personally the first time I saw this as a tax inspector was 25 years ago and I did just check this morning the figure that Ms Strathie came out with which is that 82% of commercial property—I think it was last year—in London was held in an offshore structure. Whilst I cannot, for reasons we are all aware of, say anything about our advice to ministers, successive governments have looked at this on a number of occasions. That is how property is held. If I may, as someone who was around when the contract was made, the thing I regret most is that those working on that contract took legal advice and were told that tax planning, tax avoidance of this sort, was not a reason not to go into the contract and it is a matter of history that the Board of Inland Revenue at the last minute and the Board of Customs afterwards learned that.

Q123 Chairman: That is one thing we find very difficult to understand. How could you just learn this at the last minute? You seem to be giving the impression that this is quite common.

Mr Hartnett: It is very common.

Ms Strathie: It is common.

Chairman: It is very common so you would have suspected, you as a serious department, full of very bright people, that this might have been the case, but it seems not.

Q124 Mr Davidson: I take it Mr Friedlos did not point this out to them during the negotiations.

Mr Friedlos: They were aware of it during the negotiations.

Mr Hartnett: Absolutely.

Q125 Mr Bacon: The Report says that the Revenue was but at the point of contract signature the Board of Customs and Excise was not.

Mr Hartnett: I think the record from previous hearings says that the Board of Customs and Excise did not know at the point of signature. The Board of Inland Revenue learned four days before signature and legal advice was obtained from senior counsel in those four days.

Q126 Mr Bacon: From whom did they learn this? Who told them? Was it you?

Mr Hartnett: It was.

Q127 Mr Bacon: What was their reaction?

Mr Hartnett: What happened—and this is going back in a history a little bit—is that the Chairman of the Board of Inland Revenue was not available to sign the contract.

Q128 Mr Bacon: Was this Mr Varney?

Mr Hartnett: No, Sir Nicholas Montagu.

Q129 Chairman: Sir Nicholas Montagu was not available.

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Mr Hartnett: Not available because the contract signing was delayed. I as a commissioner was asked to sign in his place and I asked what structure we were selling into. That is when the Board of Inland Revenue learnt.

Q130 Mr Bacon: It rather reminds me of a story told by a parliamentary colleague of mine who signed the Maastricht Treaty because Norman Lamont was very conveniently not around on the day. I have one question about this 82% figure. You are saying that 82% of commercial property in the United Kingdom is owned through the structure.

Ms Strathie: In London.

Mr Hartnett: In London.

Q131 Mr Bacon: If I am on the continent and I fly in over London and see all of London laid out before me as you do on a sunny day, roughly 820 out of every 1,000 office buildings are owned in this type of way.

Mr Hartnett: Transactions in one year. I referred to the year before last but it has been prevalent—

Q132 Mr Bacon: But if it has been like that for 25 years then typically—you only have to go round the City of London to see how often holes are being dug and offices are being rebuilt—it would be fair to say that the vast majority of buildings you fly over and look at which are commercial property buildings in London are owned in this type of way; that is what you are saying.

Mr Hartnett: Yes.

Q133 Mr Davidson: So if I flew into Hamilton in Bermuda I would be able to look out of the window and say “I can see the nameplates of 82% of the property in London down there”.

Ms Strathie: They are not necessarily all in Bermuda.

Q134 Mr Bacon: If that is the case that 820 out of every 1,000 commercial buildings are owned in this type of structure, I would not wish to incite you into suggesting what advice you might give to ministers as you just mentioned but has it occurred to anyone that the reason for this might be that the environment here from a tax point of view for commercial property is so unattractive that it causes this to be the case and that a slightly different environment might encourage them all to come back onshore?

Mr Hartnett: I do not know the answer to that question. There has been a lot of analysis by various policy teams over the years on this tax issue but it is as it still is.

Q135 Mr Bacon: What proportion of public sector buildings are owned in this way?

Mr Hartnett: I do not know the answer to that question.

Q136 Mr Bacon: Can you find out and let us know?

Mr Hartnett: I am not sure we can but we will try.¹¹

Q137 Chairman: As a result of using an offshore company how much tax have you lost?

Mr Hartnett: We think at the moment—and it is a best estimate—that so far £2.5 to £3.5 million of capital gains tax that might have been paid in different circumstances has not been paid.

Q138 Mr Davidson: But the estimate is still that it would be £55 million over the period of the contract.

Mr Hartnett: If I may, it is worth going back to the last NAO Report and just one line “The location of Mapeley STEPS Limited in Bermuda has no material effect on the overall value for money of this deal to the UK taxpayer”. That was the NAO conclusion then.

Mr Morse: Just to make sure I have understood this, you think the tax liability that might have arisen would have been on the HMRC estate, the amount you mentioned, the £200 million.

Mr Hartnett: No, £2.5 to £3.5 million.

Mr Morse: Just out of curiosity and I am not entitled to ask questions but if I might be indulged in this one thing, Chairman, looking at all of that estate how much tax are we losing to the UK Exchequer by not having it onshore?

Mr Hartnett: Capital gains tax or corporation tax will not be paid by an offshore company when it disposes of the property. The property market has been pretty volatile during the life of this contract and it would be interesting, when we get to look at all the details, to see losses and gains but our best estimate if £2.5 to £3.5 million has been lost, if that is the right word, so far.

Q139 Chairman: Mr Hartnett, Ms Strathie, Mr Friedlos that concludes our hearing which has been very interesting. Whatever tax has been lost clearly the reputational damage to your Department has been great and lessons will have to be learned for the future. It is not just the reputational damage which has been caused, in our Report we will express concern about the fact that you have no detailed plan for vacating properties and we will obviously want to return to this question of value for money, we will want to stress the fact that you paid £300 million more than you planned and the overspend is expected to rise to £570 million by the end of the contract. I am afraid that this will not be one of your finest calls. Do you want one last comment?

Ms Strathie: We welcome the NAO Report and thank you for the hearing.

Chairman: Thank you very much; that concludes our hearing.

¹¹ Ev 16

Memorandum from Public and Commercial Services Union (PCS)

The Public and Commercial Services union (PCS) represent over 80,000 members working in HMRC. We have serious concerns about the STEPS contract and would be grateful if these could be considered at the committee's meeting on 20 January.

By transferring ownership or leases of around 60% of its estate (591 properties) to a private contractor, Mapeley, in 2001, the Inland Revenue and HM Customs & Excise planned to reduce their running costs and had the opportunity to save up to £1.2 billion by reducing the size of the estate. PCS are concerned that the contract does not contain an "escape clause"—an interim period during the life of the contract at which point HMRC could renegotiate or cancel it. It is concerning that, in this instance, it runs for a full 20 years.

When the contract was negotiated, the financial climate was very different to what it is now. We are concerned that no consideration had been given to the possibility of such a significant economic downturn.

The previous financial returns experienced as a result of huge leaps in property values is not now being enjoyed. The returns that were available no longer exist in the same way and consequently will impact on Mapeley's financial stability and possibly their ability to deliver the contract as set out within the terms of the contract.

HMRC are pressing ahead with their Workforce Change programme and on 13 January announced the closure of 130 offices, affecting 3,150 staff. These closures will be costly and will increase the financial and resourcing pressure on the department which is particularly concerning at a time when vast amounts of taxes remain outstanding and the tax gap is estimated to be £100 billion.

The office closures will also have a financial impact on Mapeley. Given that they received financial assistance from the public purse during the first year of the contract and have only recently gained financial stability, the timing of the announcements to close these offices and the impact on Mapeley needs to be seriously considered by HMRC.

QUESTIONS FOR CONSIDERATION BY THE PAC

- HMRC has just announced it is spending tens of millions of pounds to close 130 offices.
- How much money has been set aside or is available to pay for the early releases and redundancies required to deal with the 3,150 affected staff? What will be the estates, IT and extra travel costs of moving staff to other offices?
- How much money does HMRC expect to save by closing these 130 offices? If the Department expects to save hundreds of thousands or even millions of pounds by closing these 130 offices—what strategy does Mapeley have to cope without that income?
- Has Mapeley been consulted on the closures and given sufficient time to implement plans to tenant the empty buildings and retain an income from the estate?
- It is noted that the Department needed to bail out Mapeley within a year of the contract being signed. If Mapeley's financial position were to struggle, what would the Department's response be? If HMRC were able to assist Mapeley financially, how would this be funded?
- If the company was to fail what effect would this have on the HMRC estate?
- The National Audit Office¹ report highlights the STEPS contract being comparably lower than other Departments due to the number of regional offices within the Estate. With the Workforce Change office closure programme likely to reduce this number, is it the case that HMRC still getting value for money?
- HMRC is criticised for not considering Mapeley's profits during the Workforce Change programme. What are the impacts of Workforce Change on Mapeley's profits?
- Why has HMRC not committed sufficient resources, commercial and legal, to managing the contract? What effect will job losses have on this area of work?
- Given that value for money is not going to be realised for the lifetime of the 20 year contract, why was an "escape" clause not negotiated at the time?
- Are HMRC aware of Mapeley's banking and tax payment arrangements? Mapeley bank off-shore, thus depriving the Exchequer of income. Can HMRC provide assurance that monies paid by them under the STEPS Contract which attract tax, are banked in the UK?

19 January 2010

¹ National Audit Office report—HM Revenue & Customs' estate private finance deal eight years on—10 December 2009.

**Supplementary memorandum from HM Revenue and Customs, HM Treasury and
Office of Government Commerce**

Question 15 (Chairman): *What do the treasury say to this? Do you think you can now ensure that departments have the right commercial skills for this type of contract in the future? Have you learned from this?*

RESPONSE FROM HMT AND OGC

OGC agrees that complex public sector projects can only be delivered on time and to budget if the best calibre of expertise is recruited, maintained and continuously developed. As a result, OGC regularly modifies its guidance to help departments meet this aim.

OGC has three main initiatives in place, or under development, to improve the commercial skills within departments:

- Improving recruitment, retention and development of commercial expertise across departments through implementation of the Building Procurement Profession in Government Strategy, published by OGC in June 2009, and raising the status of the procurement profession.²
- Assessing departmental capabilities via the Procurement Capability Review Programme. The results of the first round of reviews showed that departments are improving their procurement capability in the areas of resourcing and skills, contract and supplier management, and influencing major projects. Departments have since built on these improvements against a structured improvement plan supported by OGC.
- Project assurance via the Gateway Review process³ has been strengthened so that it pays greater attention to procurement capability and confidence of delivery. OGC has also launched a programme and project management competency framework that sets out the key skills needed to successfully deliver complex projects.

Question 67 (Dr Pugh): *of those 130 properties, how many are leasehold, how many freehold?*

Of the 130 properties announced for closure on 13 January, only 102 properties are held by Mapeley under the STEPS contract. Of these 56 are leaseholds and 46 are freeholds that were transferred to Mapeley in 2001 as part of the STEPS deal.

Questions 77–78 (Dr Pugh): *What I am trying to get at is that you must be working with some working assumptions about what would be the cost of re-accommodating staff from 130 offices elsewhere and that has to be factored into the exercise; I assume it will. . . . If you can give us any information on that it would be very helpful. . . . Do you have a figure in your budget which illustrates the amount you will need to keep all these enquiry offices open?*

At this stage HMRC cannot be precise about the costs of re-accommodating staff from those offices as it will depend on a range of factors. These include the amount of Daily Travel Allowance (DTA) paid to staff that relocate, provision of IT kit, and other associated accommodation/optimisation costs at the new location. These costs will be met by the various business units involved, and they will be including estimates in their financial bids for next year and following years, as necessary. HMRC accepts that there will be short-term costs associated with closing an office and the resulting relocation of work and staff but these will be outweighed in the long-term by the overall efficiency savings realised by the restructuring programme as a whole.

Question 80 (Dr Pugh): *What I am getting at is that you are going to have to find new premises to keep these enquiry offices open in the place they are supposed to be open and Mr Hartnett said they will be open. That has a cost; that has a figure. I assume in your planning you know something and you can give us this.*

HMRC has made a number of public commitments to retain access to its face-to-face advice for customers who need it. The commitment is to retain access to that advice at or near the present Enquiry Centre (EC) location. The terms of the commitment do not constrain us in terms of specific building/location, service delivery patterns or operating model which will evolve in response to internal business drivers such as estates consolidation, and/or external factors such as co-location with other government departments, or changing patterns of customer demand. Our current plans to move to alternative service delivery patterns in response to falling customer demand are fully in line with the commitments made. The final cost of providing face to face advice in the locations affected by office closures will depend on how that service is provided in each location.

On average, it costs HMRC around £48,400 per annum to retain EC. When closing an office except for its EC, HMRC also incurs a one off cost of between £20,000 and £90,000, depending on the property to allow its estate supplier (such as Mapeley) to sub-let the space vacated. For the recently-announced closures of 130 offices, there are 12 locations where the ECs are in self-contained parts of the building which reduces these costs significantly.

² http://www.ogc.gov.uk/building_the_procurement_profession_in_government.asp

³ Gateway Reviews examine programmes and projects at key decision points in their lifecycle.

However, in line with the move towards shorter hours and part-week opening for the ECs, HMRC is actively pursuing, low-cost flexible accommodation solutions such as sharing with Local Authorities, County Councils, and Post Offices, or with other government departments like DWP. This solution has already been achieved in several locations with average costs of around £12,000 per annum along with one-off set up costs of around £25,000. This represents a significant cost saving over retaining a standalone EC presence in all 130 offices or the acquisition of new full-time premises to provide this service. The accommodation sharing option is being actively explored for the bulk of ECs in the offices announced for closure.

Question 81 (Dr Pugh): *What I am trying to do is price the additional costs of this workforce renewal/change/rationalisation of accommodation. When I enquired about Duke's House, which is my own constituency as to what would be the effect of closing down the office, I got from your office a statement which said that on current figures the payback, accommodation versus other costs, accommodation rationalisation, would take approximately 19 years. Are you able, for all these 130 offices, to have some idea of what the payback would be for all of them and*

Question 82 (Dr Pugh): *It is a document from your implementation team and it is the business case for the rationalisation. It does suggest the rather high figure of 19 years before there is any savings out of this closure*

HMRC cannot confirm which specific statement/document Dr Pugh is referring to, but hopes the following information will clarify the position.

In a letter dated 9 June 2009 requesting an internal review of a Freedom of Information Act 2000 request he made in May 2009, Dr Pugh refers to documents allegedly leaked from HMRC and passed on by the PCS Union to a local newspaper, the Southport Visiter, showing that savings from the closure of Southport tax office would not be generated before a period of at least 20 years.

In reply, HMRC referred to a document that was released to Dr Pugh under his FOI request, which set out some initial and incomplete analysis that was carried out for Duke's House. It did not represent a true business case. However, the document did specify that even without taking account of accommodation savings, the payback period, if salary savings were offset against possible redundancy costs, would be less than two and a half years.

Similar results might be expected if the same analysis was carried out for other offices, but it was not. HMRC is restructuring its office network to bring it in line with plans to modernise the Department and improve service to customers while delivering efficiencies for the Exchequer. The Department's transformation is expected to have long-term benefits in terms of efficiency savings, tax yield and service delivery.

Question 135 (Mr Bacon): *What proportion of public sector buildings are owned in this way?*

RESPONSE FROM OGC

The government's central E-Pims database captures the information that the government believes is important to monitoring, reporting and improving the efficiency and the sustainability of the civil estate. Information is not systematically captured on this database about the location of the government's landlords. The database captures the body to whom rent is paid, whether managing agent or landlord, but not necessarily the location of the landlord.

Note by the Comptroller and Auditor General on the tax implications of Mapeley being an offshore company

1. At the Committee of Public Accounts' hearing on 20 January 2010 (Qq100–104), Mr Davidson asked the C&AG to provide a note to the Committee on:

- “the extent to which there was a benefit to the Government as a result of it (Mapeley) being offshore; and
- whether or not the company have played fair in terms of giving the price back.”

Mapeley committed to providing the information necessary for the National Audit Office to complete this review.

2. We have assessed, with HM Revenue and Customs, how the tax savings arising from the offshore status of various Mapeley companies were reflected in Mapeley's financial model that underpins the contract and the prices paid by the Department. We also considered the likely tax savings obtained to 2009. In doing so we have examined accounts for the various companies involved and records provided by Mapeley. While Mapeley provided some information in February, most of the information was provided in mid-March. We are unable to be precise about the tax advantages obtained because of the complexity of the tax computations (which include the treatment of expenses, and offsetting losses in different periods, between trading income and capital gains, and between companies within the group). Nevertheless we have been able to reach broad conclusions on the two questions posed in paragraph 1 above.

BENEFIT TO THE GOVERNMENT

3. As recognised in current Treasury guidance there is unlikely to be any overall benefit to the Exchequer from public sector contracts using tax avoidance schemes since any apparent savings for a Department or agency in the form of lower contract prices can only be made at the expense of other parts of the public sector, in this case reduced tax revenues to the Exchequer.

TREATMENT OF TAX IN MAPELEY'S FINANCIAL MODEL

4. The main areas where advantages could arise in this contract relate to tax on capital gains in relation to disposals of property, rental income, and, to a lesser extent, profits retained offshore and deals with landlords to extend leases in exchange for up-front payments.

5. Mapeley estimated in 2004 that if it had been required to bring the STEPS properties onshore it would have had to increase the contract price by £55 million (in 2001 net present value terms), to cover the extra UK tax that might have been due. It estimated this by adjusting the tax assumptions in the financial model that underpinned the contract to produce an "onshore" model. This adjustment reduced the return on equity. To achieve the original planned return on equity it assessed it would have needed to increase the contract price from £1,579 million to £1,634 million in present value terms, an increase of 3.5% (£55 million).

6. We examined whether Mapeley had taken account of all possible tax benefits in its models. Mapeley's price reflects that benefits result from offshore ownership, but there is some uncertainty over the accuracy of its price increase estimate of £55 million. This is because the models did not take account of the Non-Resident Landlord scheme, which allows Mapeley to pay a lower rate of tax on rental income than if it were onshore. We estimate that this provides the potential for maximum additional tax savings of £1 million (in 2001 net present value). There is also uncertainty about the reflection of the purchase price for the properties, split between an upfront payment of £220 million and £150 million in reduced payments over the contract, in the models.

7. The estimated tax savings were not a deciding factor in the selection of Mapeley. The £55 million price increase was not material compared to the difference between the Mapeley bid and the public sector comparator (£300 million higher) and the nearest other bid (£500 million higher), and the uncertainties referred to in paragraph 6 are unlikely to materially increase the £55 million price increase. While comparisons with other bids are not straightforward, the rate of equity return sought by Mapeley was lower than the rate sought by other bidders.

TAX ADVANTAGES OBTAINED IN PRACTICE

8. We found that to date Mapeley has paid no tax in relation to rental income on offshore properties, as it has been able to use losses to offset any chargeable income. This is in line with its offshore model. It is difficult to compare what tax would be due were Mapeley onshore, as it is likely that it would have increased its price, thereby changing the profile of rental income and associated tax due. Mapeley's onshore model predicts that in an onshore scenario with HMRC paying a higher price, it would have paid around £13 million in tax by March 2009.

9. Mapeley expected that the majority of the tax advantages would arise at the end of the contract. The estimated tax payable over the 20 years of the contract if Mapeley was onshore was £184 million in cash terms, compared with £14 million in the financial model with Mapeley offshore. This gives Mapeley savings of £170 million in cash terms, £106 million of which arise in the final year of the contract on expected gains from the sale of properties. Whether Mapeley ultimately obtains higher or lower tax savings than anticipated remains uncertain. It will depend on various factors including the timing, scale and gains on disposals of property, operating profits and losses, and tax rates in force.

CONCLUSION

10. Tax advantages arising from the offshore status of companies in the Mapeley group were reflected in Mapeley's financial model and therefore the price that HMRC is paying for this contract, although there are some uncertainties about the accuracy of the £55 million estimate of the increase in contract price that would be needed to cover the extra UK tax if the arrangements were onshore. A fully developed onshore model would be needed to achieve certainty in the comparisons of tax savings achieved to date and what would be payable under an onshore scenario. As most of the anticipated tax savings were expected to arise at the end of the contract, it remains uncertain whether Mapeley will obtain higher or lower tax savings than anticipated over the 20 years of the contract.

11. As recognised in current Treasury guidance, there is unlikely to be any overall benefit to the Exchequer from such arrangements as any apparent savings for the Department are accompanied by reduced tax revenues.

22 March 2010