



House of Commons
Treasury Committee

**Government Response to
the Committee's Fourth
Report on The Handling of
the Joint Inland
Revenue/Customs and
Excise STEPS PFI Project,
HC 184, Session 2002–03**

Fifth Special Report of Session 2002-03

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The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the HM Treasury and its associated public bodies.

Current membership

Mr John McFall MP (*Labour, Dumbarton*) (Chairman)
Mr Nigel Beard MP (*Labour, Bexleyheath and Crayford*)
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Mr Andrew Tyrie MP (*Conservative, Chichester*)

The following Members were members of the Committee during the inquiry:

Mr David Laws MP (*Liberal Democrat, Yeovil*)
Kali Mountford (*Labour, Colne Valley*)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in the House of Commons Standing Orders, principally in SO No. 152. These are available on the Internet via www.parliament.uk The Committee has power to appoint a Sub-Committee, which has similar powers to the main Committee, except that it reports to the main Committee, which then reports to the House. All members of the Committee are members of the Sub-Committee, and its Chairman is Mr Michael Fallon.

Publications

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) from Session 1997-98 onwards are available on the Internet at: www.parliament.uk/parliamentary_committees/treasury_committee/treasury_committee_reports.cfm. A list of Reports of the Committee published in the present parliament is at the back of this volume.

Committee staff

The current staff of the Committee is Crispin Poyser (Clerk), Alex Kidner (Second Clerk), Lis Partridge (Committee Assistant), Amanda Waller (Secretary), Mike Cruickshank (Senior Office Clerk), Dominic Lindley (Committee Specialist) and George Hodgson (Committee Specialist).

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Fifth Special Report

1. On 12 February 2003, the Treasury Committee published its Fourth Report, *The Handling of the Joint Inland Revenue/Customs and Excise STEPS PFI Projects*, as House of Commons Paper No. 184. We have now received a response from the Government (dated 2 May 2003) which is appended below.

APPENDIX: MEMORANDUM FROM HM TREASURY

(a) **In this short inquiry we have examined the way the STEPS project was handled administratively by the Departments. We have not sought to examine the STEPS contract in detail and we have not come to any conclusions as to its merits for the Departments. The National Audit Office has indicated in its forward programme document that it proposes to examine the STEPS PFI project and we look to its report to determine whether value for money was obtained for the taxpayer (paragraph 6).**

The Government welcomes and supports the NAO's proposed work programme.

(b) **We note the Inland Revenue's view that it is not correct to describe the offshore structure adopted by Mapeley for the contract as tax avoidance. But on the basis of Mapeley's own evidence to the Committee it had "structured its tax affairs to minimise exposure to Capital Gains Tax ..." Tax avoidance was clearly one of Mapeley's objectives in the way the deal was structured (paragraph 15).**

The Government notes the Committee's conclusion.

(c) **We accept both that Mapeley was entitled to minimise its tax liabilities and the evidence that the avoidance of tax in this case was legal. However, we consider that the Inland Revenue, responsible for implementing the Government's policy of reducing tax avoidance, should of all departments have been alert to the difficulties of being party to a deal that transferred ownership of its properties to an offshore company. We are concerned that these difficulties were not recognised at the time. We regard the fact that the project team did not explore with Mapeley the possibility of an alternative structure to the deal that might have avoided them as a failure in the way the project was handled (paragraph 16).**

The Departments agree that mistakes were made. Exploring options for an alternative structure would have been legally possible, but the Departments judge that to have done so at a late stage in the process would have raised serious complications.

(d) We were told that even if the properties had been transferred to a UK based company, nothing in the contract could have prevented a subsequent restructuring of the consortium to transfer them to an offshore company. While this may be the case, this argument ignores the tax liabilities that could arise for a company resident in the UK transferring assets offshore (paragraph 17).

The Government notes the Committee's conclusion.

(e) The Departments maintain that procurement law prevented them excluding bidders from using an offshore tax structure and that this was confirmed recently by advice from leading Counsel. We recommend that procurement guidance be reviewed to ensure that it contains comprehensive advice on this matter (paragraph 18).

The Government agrees with this conclusion. The Treasury will issue further guidance to Departmental Accounting Officers. This new guidance will cover matters that go beyond the specific issues raised in the Committee's report, and will be incorporated within the next issue of Government Accounting. The revised guidance will ensure that departments have the discretion to consider restrictions to procurement processes to reflect the Government's stated objectives for tax transparency and openness, where they can be justified in terms of the objectives of the project and are consistent with international obligations. Because of the particular responsibility falling on the Treasury and Revenue Departments in this respect, Treasury ministers will implement this guidance for those departments by restricting successful bidders from taking advantage of offshore tax havens.

(f) We also recommend that further advice is sought and published so as to clarify whether it is possible to exclude bidders using an offshore tax haven in similar circumstances, and to restrict final beneficial ownership to companies registered in countries that have signed the agreement on Government Procurement. In particular, advice should be sought as to whether specifying this exclusion in the tender advertisement makes it lawful. We further recommend that the Treasury explores whether adjustments should be made to contract bids to reflect loss of tax revenue as we believe is the practice in the United States (paragraph 19).

A note by the Office of Government Commerce, providing further information on the relevant legal provisions, is attached as an Annex.

(g) The Board of the Inland Revenue was not informed by the project team that, under the contract, the Revenue's properties would be transferred to a company

registered in Bermuda. The Board appears to have discovered this fact a few days before the contract was due to be signed only because one of its members, knowing that arrangements of this sort were common, asked what the structure of the Mapeley companies was. The Customs and Excise Management Committee and the relevant Minister, the Paymaster General, were not told of the offshore structure of the contract before it was signed. We reject the proposition put forward by the Chairman of the Inland Revenue that at worst the charge against the project team is one of naivety, a view we believe is complacent. We view with great concern the fact that such failures in briefing senior management and the Minister have occurred. We expect the Departments to have identified exactly where and how things went so seriously wrong and to have taken the necessary steps to prevent a recurrence (paragraph 25).

The Government agrees that there are lessons to be learned. The two Departments have been requested to put forward proposals to improve the management of procurement processes, such that the structure of the bid is understood at an early stage. These changes, in conjunction with the new guidance to be issued by the Treasury, will strengthen project management for the future.

(h) A joint Inland Revenue and Customs and Excise press release in March 2001 announcing the signing of the contract, and the Revenue's Annual Report, wrongly refer to the transfer of the estate to a UK incorporated company rather than one registered in Bermuda. These errors were not corrected until September 2002, some 18 months after the initial mistake. Customs and Excise's Annual Report refers to the wrong company as the STEPS contractor. Parliament and the public rightly expect information provided by Government departments to be accurate. In this case errors have been made in describing the contract on several occasions. While we acknowledge that the Departments have corrected their previous statements, this standard of performance is not acceptable (paragraph 26).

Experience with the Mapeley project has clearly illustrated failings in the Departments' internal procedures, which the Departments regret and are working to resolve for the future. As the Chairmen made clear in their evidence, the Departments regret that incorrect details were shown in the original press release, accounts and report.

(i) It is clearly a matter of concern that only seven months after the twenty year contract was signed the Departments had been asked to provide a substantial cash settlement to alleviate Mapeley's cash flow problems. This must cast doubts on the robustness of Mapeley's bid and the standard of due diligence work undertaken by the Departments and their advisers before the contracts were signed. We are also concerned that the Departments' negotiating position with Mapeley appears to have been weakened by the concern that there would be serious operational difficulties and very substantial additional costs for the Departments if Mapeley failed

financially. We consider this to be a matter that should have been addressed and resolved before the contract was signed. We look to the National Audit Office to examine these aspects of the project as part of its value for money study (paragraph 35).

The Government will await the outcome of the NAO study before commenting further.

(j) We note the Departments' view that most of the financial pressures arose from areas where risks had been transferred to Mapeley. But the Departments' evidence was also that changes in their requirements and the bedding down of the contractual arrangements had affected Mapeley's cash flow. We are concerned that this state of affairs indicates weaknesses in the original contract which will have to be addressed in the ongoing negotiations with Mapeley. The fact that these may result in a more satisfactory settlement for the Departments than at first seemed possible appears to have been the result of fortuitous movements in the stock and property markets. We look forward to learning the outcome of these negotiations which we will report to the House (paragraph 36).

The Government notes the conclusion, and encourages the NAO to consider all aspects of the project.

(k) We are concerned that the financial crisis faced by Mapeley so soon after entering the contract, and the potential consequences of the company going bust, undermines one of the key stated objectives of this deal—to transfer risk to the private sector (paragraph 37).

The Departments recognise the importance of maintaining the transfer of risk to Mapeley when considering the options for concluding the negotiations.

(l) Despite the Minister's "strong reservations about paying increased amounts to Mapeley" the Departments sent two letters to Mapeley to reassure Mapeley's auditors, bankers and shareholders about the state of negotiations regarding a financial settlement. These appear, from the financial statements of Mapeley STEPS Contractor Limited, to have been fundamental to the company being viewed as a "going concern" despite net liabilities of over £23 million at 31 December 2001. We are surprised that the officials who saw a draft of the relevant "going concern" note in advance of these financial statements being published did not appreciate its significance. This was a serious failure (paragraph 45).

Experience with the Mapeley project has clearly illustrated failings in the Departments' internal procedures, which the Departments regret and are working to resolve for the future.

(m) Government Accounting requires departments to approach any request for a letter of comfort with a strong predisposition to reject it. Following the Treasury Officer of Accounts advice, it appears that the Departments have issued two letters of comfort to Mapeley without realising it. We note the Departments' view that their letters have not created any contingent liabilities for the Government, but we are concerned, as Government Accounting itself points out, that the letters may have led to a moral obligation and could lead to threats of legal action (paragraph 46).

While the Departments do not consider that the letters lead to a credible threat of legal action, they agree there are lessons to be learned, and have committed themselves to take appropriate action to improve procedures, in line with Government Accounting.

(n) The letters of comfort were not brought to the attention of either the Board of the Inland Revenue or the Customs and Excise Management Committee before they were sent and the requirements of Government Accounting were also overlooked. Again the Minister responsible was not informed. We are astonished, and extremely concerned, that such failures can have occurred. We consider these to be serious lapses in the standards required from officials and we expect the Departments to have identified exactly where and how things went so seriously wrong. We expect them also to have taken all necessary steps to prevent a recurrence (paragraph 47).

Experience with the Mapeley project has clearly illustrated failings in the Departments' internal procedures, which the Departments regret and are working to resolve for the future. The Departments will improve procedures to ensure ministers are kept in touch with significant developments in procurement projects, in line with the arrangements set out in Government Accounting.

(o) We are concerned at the evidence from this project of officials repeatedly failing to inform or seek Board level approval at appropriate times. Similarly, the responsible Minister was not informed of key events before they took place and she has, in our view, the right to be deeply disappointed by the service she received. This is not the first time that we have encountered such problems in the course of our work and we recommend that a review be undertaken of the relationship between Treasury Ministers and the bodies for which they are accountable to ensure appropriate standards of governance and accountability are met (paragraph 48).

On the issues covered by the Committee in this report, relating to the management of the STEPS PFI project, the Chairmen of the Inland Revenue and HM Customs and Excise are clearly accountable for the management of the project, and for the steps required by the Departments to improve procedures for the future.

On the more general point raised by the Committee, the Chancellor of the Exchequer has asked the Permanent Secretary to the Treasury, in consultation with other Heads of Departments, to advise him on any clarification and improvements that may be required. The Chairman of the Inland Revenue has also undertaken to conduct a Landscape Review by September 2003, as part of the Cabinet Secretary's wider programme, covering among other elements how well governance and accountability arrangements are managed in the Department.

Annex

Legal Provisions relevant to the Treasury Committee Report The Handling of the Joint Inland Revenue/Customs and Excise STEPS PFI Project

This note sets out the general legal framework applying to Government procurement decisions and discusses the extent to which these can be directed by wider tax policy goals.

The legal framework for Government procurement decisions

2. The general legal framework applying to Government procurement decisions comprises:
 - the provisions of the EC Treaty on non-discrimination on nationality grounds, free movement of goods and services and the right of establishment and the operation of the single market¹;
 - the public procurement Directives made under the single market provisions of the Treaty and the Regulations implementing those Directives in the UK²;
 - general legal principles of equal treatment, transparency and proportionality derived from the EC Treaty;
 - the WTO Agreement on Government Procurement ("the GPA") of 1994 to which the EU and its Member States and certain other States are parties and which is given effect in the EU via the relevant Directives; and

¹ Articles 12, 28, 43, 49 and 94.

² The main Directives are the Supplies Directive (93/36/EEC), the Works Directive (93/37/EEC) and the Services Directive (92/50/EEC); the main Regulations are the Public Works Contracts Regulations 1991 (S.I. 1991/2680), the Public Service Contracts Regulations 1993 (S.I. 1993/3228) and the Public Supply Contracts Regulations 1995 (S.I. 1995/201).

- various agreements, known as the Europe Agreements, between the EU and individual European countries extending the relevant EC provisions on public procurement to them.

3. The relevant provisions affecting how far procurement decisions can be determined by wider tax policy considerations are contained in the public procurement Directives and UK implementing Regulations and in the GPA.

4. These concern the qualification and selection of bidders and the criteria for the award of contracts. They limit the factors which can be taken into account in the selection and award process with a view to countering restrictions on competitive purchasing or practices favouring national contractors. Under the relevant UK Regulations, a contract must be awarded on the basis of the lowest price or to the tender which is the most economically advantageous to the contracting authority³. Tax policy considerations unrelated to the procurement in question are not acceptable as selection or award criteria. It would not therefore be legally feasible to introduce guidelines to make the value of UK tax receipts a contract award criterion in evaluating bids. This would be potentially discriminatory against bidders not based in the UK and would be inconsistent with evaluation to identify the most economically advantageous tender, as provided for in the Directives.

The application of the legal provisions

5. The provisions in the public procurement Directives and relevant Regulations apply to contracting authorities. They are defined in the UK Regulations so as to include all Government Departments and their agencies and non-Departmental public bodies, local authorities, NHS authorities and trusts and certain education bodies⁴. The provisions in the Directives and the relevant Regulations apply for the benefit of contractors from EU Member States, GPA countries and countries party to the Europe Agreements.

6. The GPA countries are the EU Member States and Aruba, Canada, Hong Kong Special Administrative Region, Iceland, Israel, Japan, Republic of Korea, Liechtenstein, Norway, Singapore, Switzerland and the USA.

Excluding bidders using offshore jurisdictions from the possibility of bidding

7. Under the Directives and relevant Regulations, companies using or incorporated in tax havens may only be excluded from bidding if they fall within one of the limited permissible grounds for exclusion. The potentially relevant grounds are conviction of a criminal offence related to the conduct of a business or profession, having committed an act of grave professional misconduct in the course of a business or profession or failure

3 See for example regulation 21 of the Public Services Contracts Regulations.

4 See for example regulation 3 of the Public Services Contracts Regulations as substituted by regulation 4(2) of the Public Contracts (Works, Services and Supply) (Amendment) Regulations 2000.

to meet obligations to pay tax under UK law⁵. Arbitrary exclusions which could be a pretext for discrimination against bidders from other EC Member States or other relevant states⁶ or unequal treatment more generally are not permitted.

8. In the context of the Directives and Regulations, contracting authorities are precluded from direct or indirect discrimination. Direct discrimination would involve a failure to treat UK and non-UK bidders from other EU Member States or other relevant states alike. Indirect discrimination would involve imposition of a requirement which does not overtly discriminate against non-UK bidders but which is such that the proportion of UK bidders who could be expected to be able to comply with it is higher than the proportion of relevant non-UK bidders.

9. Excluding companies using or incorporated in tax havens from the possibility of bidding would fall outside the limited permissible grounds referred to under (7) above to the extent that companies from EC Member States or other relevant states were affected, regardless of whether discrimination between UK and non-UK bidders could be established on the facts.

Allowable restrictions

10. The award of contracts could in principle be restricted to companies incorporated in GPA countries (and countries parties to the various Europe Agreements) or otherwise classifiable as nationals of such countries. Alternatively a list of restricted countries could legally be specified in the tender document, provided those countries were not GPA member states, or party to the various Europe Agreements. It would also be possible for departments to make it a contract condition (notified in advance) that the successful bidder will be prohibited from using particular tax arrangements, including offshore tax havens provided such a restriction would not in fact be directly or indirectly discriminatory between EC/GPA bidders. Under this arrangement, bidders would not be excluded at the outset but would be able to bid on the understanding that they would have to re-structure their tax affairs to succeed in the competition. In considering a restriction along these lines, departments would, of course, need to be clear that it was consistent with the obligation, as set out in Chapter 22 of Government Accounting, to obtain value for money in all procurement, taking account of propriety and regularity. Value for money is defined as “the optimum combination of whole life cost and quality to meet the user’s requirement”.

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May 2003

5 See for example regulation 14(1)(d), (e) and (f) of the Public Services Contracts Regulations.

6 Other relevant States means other countries party to the GPA Agreement or to one of the Europe Agreements.

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