*TAX AVOIDANCE: The Role of the Accountancy Firms

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The key message of my talk is that no country will be able to effectively combat tax avoidance without shackling the tax avoidance industry and the Big Four accountancy firms in particular.

In recent days tax avoidance attributed to Apple, Google, Microsoft, Amazon, eBay, Starbucks, Facebook, Panama Papers, Luxembourg Leaks (LuxLeaks), Swiss Leaks (HSBC Leaks) and Offshore tax avoidance/evasion has dominated the media headlines. However, little attention is paid to the tax avoidance industry which designs, markets and implements tax avoidance/evasion schemes at an industrial scale.

The tools of this industry are complex corporate structures, arbitraging tax treaties and international tax systems, shifting profits through transfer pricing, fictitious intragroup loans, royalties and management fees. It uses dubious charitable foundations, trusts and novel interpretations of tax laws to ensure that its clients dodge taxes.

Accountancy firms, particularly the Big Four firms (Deloitte and Touche, PricewaterhouseCoopers (PwC), KPMG and Ernst & Young) are key players in the global tax avoidance industry. Their international networks and combined global revenue of about $130bn provides plenty of financial and political resources for designing and marketing tax avoidance schemes. The firms sell avoidance schemes to their audit clients and then pretend to audit the outcomes. Unsurprisingly, company accounts provide little meaningful information about tax avoidance or even about the taxes that companies pay in each country of their trade.

The European Commission is too close to big accountancy firms and has done little to shackle the tax avoidance industry even though the alarm bells have been ringing for some time. For example, the US Senate Permanent Subcommittee on Investigations concluded that

> “The sale of potentially abusive and illegal tax shelters is a lucrative business … accounting firms ... have been major participants in the development, mass marketing, and implementation of generic tax products sold to multiple clients. … tax shelter industry was no longer focused primarily on providing individualized tax advice to persons who initiate contact with a tax advisor. Instead, the industry focus has expanded to developing a steady supply of generic “tax products” that can be aggressively marketed to multiple clients. In short, the tax shelter industry had moved from providing one-on-one tax advice in response to tax inquiries to also initiating, designing, and mass marketing tax shelter products ... dubious tax shelter sales were no longer the province of shady, fly-by-night companies with limited resources. They had

> become big business, assigned to talented professionals at the top of their fields and able to draw upon the vast resources and reputations of the country's largest accounting firms ...[1]"

A former Commissioner of the US Internal Revenue Service (IRS) noted that

> "the low point came when we discovered that a senior tax partner at KPMG (one of the Big Four, which by virtue of their prominence set standards for the others) had advocated — in writing — to leaders of the company's tax practice that KPMG make a "business/strategic decision" to ignore a particular set of I.R.S. disclosure rules. The reasoning was that the I.R.S. was unlikely to discover the underlying transactions and that even if we did, any penalties assessed could be absorbed as a cost of doing business[2]".

A UK legislator added that

> "There are armies of bankers, lawyers and accountants who ensure that even though the letter of the law is respected, increasingly immoral ways are found of perverting the spirit of the law to ensure that tax is avoided. …To hide its true purpose, the tax avoidance industry adopts the language of real business, so technical innovation and reinventing your business model do not mean finding new products, services and markets, and new ways of supplying them. No, they mean registering your business in a tax haven and becoming a non dom to avoid tax while still enjoying the, admittedly decreasing, benefits and services which make this country the civilised place that it is[3]".

Big Four firms employ and train thousands of graduates into the dark arts of financial engineering and tax avoidance. They advise government departments and enjoy taxpayer funded contracts. Tax avoidance is very profitable and is a key part of their business model. Tax departments and individuals working within them are assigned revenue and profit generating targets. Those meeting them are promoted and rewarded. The firms operate with impunity and show a cavalier disregard for decency, business ethics and rule of law.

In 2013, the Big Four firms became the subject of a hearing into their tax avoidance practices by the UK House of Commons Committee of Public Accounts. Just before the hearing the Committee received evidence from a former senior PwC employee stating that the firm's policy was that it would sell a tax avoidance scheme which had only a 25% chance of withstanding a legal challenge, or as the Committee chairperson put it

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[1] US Senate Permanent Subcommittee on Investigations (2005), The Role of Professional Firms in the US Tax Shelter Industry, Washington DC: USGPO,

[2] Everson, M.W. (2011). Lawyers and Accountants Once Put Integrity First, New York Times, 18 June 2011 (http://www.nytimes.com/2011/06/19/opinion/19everson.html).

[3] Hansard, UK House of Lords Debates, 17 March 2011, col. 375.

> “you are offering schemes to your clients—knowingly marketing these schemes—where you have judged there is a 75% risk of it then being deemed unlawful[4]”.

The other three firms admitted to “selling schemes that they consider only to have a 50% chance of being upheld in court[5]”. Just imagine what the social consequences would be if manufacturers of food, drinks, medicine, cars, trains and aeroplanes adopted the same unethical and cavalier strategies.

PwC is credited with developing Ireland[6] as a tax haven and particularly with refining a scheme which subsequently became known as the Double Irish Dutch Sandwich. The scheme uses complex corporate structures to exploit tax treaties and tax rate differentials and arbitrage global tax systems. The essence of the technique is to shift profits to low/no tax jurisdictions through royalty payments for the use of intellectual property, transfer pricing techniques, intragroup loans and other internal transactions. Variants of the Double Irish have enabled companies such as Apple, Facebook, Google, Intel, LinkedIn, and Microsoft to avoid taxes in many countries. PwC is keen to develop new tax havens. The firm is helping Jamaica to become a tax haven[7].

And who can forget the role of PwC in the Luxembourg Leaks (or Luxleaks) which was highlighted by a whistleblower. Since November 2014, some 28,000 pages of tax agreements, returns and other papers relating to over 1,000 businesses have been available on the website of the International Consortium of Investigative Journalists (http://www.icij.org/project/luxembourg-leaks). The papers provide details of tax avoidance schemes crafted by PwC with the full co-operation of the government of Luxembourg, and relate to giant corporations, such as Accenture, Amazon, Deutsche Bank, Disney, Dyson, FedEx, Heinz, IKEA, JP Morgan, Pepsi, Procter & Gamble, Shire, and many more. The 28,000 pages do not contain even one instance where PwC make any mention of ethics, morality, or the possible social impact of lost tax revenues. There have been no EU sanctions against Luxembourg or PwC.

PwC mass marketed a scheme which relied on complex paper financial transactions. Amongst others, it was sold to Vocalspruce Limited, at that time a subsidiary of FTSE-listed group Brixton plc. The matter eventually went to the UK Court of Appeal and the judges in the case of *Vocalspruce Ltd v The Commissioners for HMRC [2014] EWCA Civ 1302 (30 October 2014)* described the scheme as “fiction” and rejected the scheme.

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[4] UK House of Commons Committee of Public Accounts, (2013). Tax avoidance: the role of large accountancy firms, London: The Stationery Office.
[5] UK House of Commons Committee of Public Accounts, (2013). Tax avoidance: the role of large accountancy firms, London: The Stationery Office.
[6] Bloomberg, Man Making Ireland Tax Avoidance Hub Proves Local Hero, 28 October 2013; http://www.bloomberg.com/news/2013-10-28/man-making-ireland-tax-avoidance-hub-globally-proves-local-hero.html
[7] Jamaica Gleanor, Offshore centre won’t cave to market turmoil, 3 October 2008; http://jamaica-gleaner.com/gleaner/20081003/business/business3.html.

PwC is not alone. On numerous occasions, avoidance schemes peddled by the Big Four firms have been declared to be unlawful[8].

Here are some further examples of the outcome of court cases which show that the firms are continue to engage in unlawful practices. The UK Supreme Court heard the case of Commissioners for *Her Majesty's Revenue and Customs v Pendragon plc and others; [2015] UKSC 37*. It related to a VAT avoidance scheme designed and marketed by KPMG. The scheme would have enabled car retailing companies to recover VAT input tax paid while avoiding the payment of output tax. The court declared the scheme to be unlawful and the judge said that **"**In my opinion the KPMG scheme was an abuse of law".

The US case of Salem *Financial Inc. v United States, No. 10-192T (Ct. Fed. Cl. Sept. 20, 2013)* shows how the Big Four firms market avoidance schemes at a global scale, playing one country's tax system against another's. In this example, KPMG collaborated with Barclays PLC to mass market a tax avoidance scheme to several global corporations, including AIG, Microsoft, Prudential, Wachovia, Wells Fargo, Bank of New York Mellon, and Branch Banking & Trust (BB&T). The purpose of the scheme was to generate hundreds of millions of dollars of foreign tax credits through paper transactions and thus reduce the US tax liabilities of the clients. The scheme was declared to be unlawful and the judge said that the scheme was "driven solely by the sham circular cash flows of the Trust". He described the scheme as "an economically meaningless tax shelter" and said that the conduct of those persons from BB&T, Barclays, KPMG ... who were involved in this and other transactions was nothing short of reprehensible"

The case of *Iliffe News and Media Ltd & Ors v Revenue & Customs [2012] UKFTT 696 (TC) (01 November 2012)* reported that Ernst & Young devised a tax avoidance scheme for its audit client, a highly profitable media company. The company owned a number of newspaper titles and was advised to treat its mastheads as a new asset. These were all transferred to the parent company for a nominal sum, and then immediately leased back to the subsidiaries for annual royalties. Over a five year period, the subsidiaries paid royalties of £51.6 million. This intragroup transaction did not result in any transfer of cash to an external party, but the subsidiaries claimed tax relief on the royalty payments. The company's board minutes, as reproduced in the court papers, noted that "[Ernst & Young] had confirmed that if the newspaper titles and/or mastheads were registered as trade marks in the ownership of [INML], it was possible for the latter [i.e. INML] to charge the newspaper companies a fee for the use of the former in a tax efficient manner that would significantly lessen the transparency of reported results. It was agreed to progress this matter in consultation with [E&Y]". The tax avoidance scheme was declared to be unlawful.

Another Ernst & Young scheme for an audit client was declared to be unlawful. The scheme involved loans between companies in the same group and its ultimate aim was to enable the company making the interest payment to claim tax relief on this

[8] For further examples see Mitchell, A. and Sikka, P. The Pin-Stripe Mafia: How Accountancy Firms Destroy Societies, Basildon: Association for Accountancy & Business Affairs, 2011 (http://visar.csustan.edu/aaba/PINSTRIPEMAFIA.pdf).

expense, whilst enabling the company receiving the interest to avoid tax. This scheme was sold to Greene King, a leading pub retailer and brewer. The company is audited by Ernst & Young. The firm was to receive a percentage of tax saved by the client company. The scheme was declared to be unlawful by the court judgment in *Greene King Plc & Anor v Revenue and Customs [2016] EWCA Civ 782*.

Deloitte designed a scheme to enable the London-based staff of Deutsche Bank to avoid income tax and National Insurance Contributions (NIC) on bonuses adding up to £92 million. More than 300 bankers participated in the scheme which operated through a Cayman Islands registered investment vehicle. The scheme was declared to be unlawful by the courts. The judge in the case of *Deutsche Bank Group Services (UK) Ltd v Revenue & Customs [2011] UKFTT 66 (TC))* said that "the Scheme as a whole, and each aspect of it, was created and coordinated purely for tax avoidance purposes".

Deloitte enrolled clients[9] to launch a mass class action and demand VAT refunds of £400 million from the UK government, dating back to the 1970s. It claimed that the motor industry has been overcharged VAT by possibly as much as £2 billion. Deloitte brought a case against the UK government on behalf of Warranty Holdings Limited (trading as WHA Limited). The case related to an insurance company which entered into a series of complex transactions with Gibraltar-based companies to enable it to reclaim VAT on motor breakdown insurance sold to UK motorists. Gibraltar is part of the EU for trade purposes, but for VAT purposes it is treated as a non-EU jurisdiction. As the services were supplied in Gibraltar, the company argued that the VAT on its supplies is exempt from VAT. The case eventually went to the European Court of Justice and then the Supreme Court (*WHA v HM Revenue & Customs [2013] UKSC 24*) which said that the scheme was unlawful

WHAT TO DO

The Big Four accountancy firms produce tax avoidance schemes at an industrial scale. This does not add anything to the gross domestic product (GDP), wealth and prosperity of any country. The firms are addicted to tax avoidance and 'bending the rules' to make profits without any concern for society has become a key feature of their business practices. The courts continue to say that the Big Four firms are engaged in unlawful practices, but neither the EU nor the government of any member state has investigated the Big four firms, prosecuted them or fined them. Despite the courts declaring many schemes to be unlawful, no EU professional accountancy body has ever disciplined any firm or its partners. Unsurprisingly, the firms continue to abuse laws and deprive the public purse of much needed revenues, which are so essential for any government to function, make investment in social infrastructure, alleviate poverty and protect and advance human rights.

There is an urgent need to shackle the Big Four firms and a good start can be made by implementing the following reforms.

9 The Daily Telegraph, Deloitte threatens £400m excess VAT suit, 8 July 2007.

When a firm's avoidance scheme is found to be unlawful, it should face a fine of ten times the tax which would have been avoided. The partners responsible for promoting the illegal schemes should be personally liable to pay at least 50% of the fine. Persistent offenders should be shut-down. As a matter of principle, no one involved in deliberate tax avoidance should receive any public contracts and this means that the Big Four firms should be denied any publicly funded contracts. Tax returns of large companies and related matters (e.g. advice given by accountancy firms) should be publicly available. The availability of such information would generate public pressure on firms to curb their anti-social practices. Accountancy firms should be required to publish fee from their tax avoidance trade and explain whether they have agreements with companies for sharing a proportion of the taxes avoided. There should be a complete ban on accounting firms selling tax avoidance scheme to their audit clients.

The above are not some panacea for ending the addiction of accounting firms tax avoidance schemes, but they will make mark the beginning of reforms to ensure that the firms face the consequences of their practices. Without pressure from the EU parliament and press the EU Commission is unlikely to move and I very much hope that the delegates present at this conference will urge their governments to act.