Citizens turn on avoidance

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Campaigners from ten countries met in Paris last month to discuss global taxation issues and found themselves surrounded by Russian TV cameras.

The Global Tax Justice Network invited a key witness for Russian prosecutors in the case against Yukos director Mikhail Khodorkovsky to address a press conference.

The next day, US journalist Lucy Komisar told an audience of 200 people, some of the 50,000 attending the European Social Forum, how the large accounting firms 'help people around the world cheat on their taxes'.

Beyond the rather narrow debate about tax avoidance in the UK there is growing concern about the erosion of the tax base of democratic countries around the world.

Khodorkovsky, former head of the Russian oil group Yukos whose merger with Sibneft now appears to be on hold, was arrested at gunpoint in October on charges including fraud and tax evasion.

The merged group YukosSibneft would face an uncertain future, said the Moscow Times, partly because the Russian Finance Minister brought forward a resolution to revoke regional 'tax breaks' said to be widely used by both Yukos and Sibneft. The OECD has warned that the 'Yukos affair' will slow investment growth in Russia in 2004.

The Audit Chamber, the Russian parliament's accounting watchdog, was reported to have passed to the Tax Ministry evidence of 'wrongdoings' in the tax affairs of Sibneft, formerly controlled by Chelsea football club owner Roman Abramovich. The company was reported to have denied any wrongdoing and later reports said the auditors had 'backtracked'.

But the Moscow Times said Sibneft had been 'making maximum use of legal loopholes that allow companies to be freed from the regional portion of their tax payments by transferring sales through trading companies registered in so-called internal offshore zones such as Kalmykia and Chukotka'. It suggested that the company had managed to halve its effective corporation tax rate.

The witness in the Khodorkovsky case was Yelena Collongues-Popova, 49, a French national born in Russia but now living under police protection in Paris. She claimed that when she worked for finance director Alexei Golubovich she collected evidence about transfer pricing activities, alleged tax evasion and insider trading.

Collongues-Popova told us how, while working for Golubovich, she set up 30 shell companies in offshore jurisdictions on his instructions. She became aware that some of those companies were used for ‘transfer pricing’ resulting in ‘profits remaining in the offshore company in order to avoid tax in Russia’.

Without her knowledge, she alleged, she was listed as the beneficial owner of hundreds of millions of shares ‘so that they could not be subject to capital gains tax in Russia’ and a large number of transactions were made from Moscow that she did not know about, a rubber stamp being used to forge her signature.

The Russian Interior Ministry, reported to be investigating Golubovich’s brokerage, provided Collongues-Popova with papers reportedly showing that her identity and signature were indeed used without her knowledge.

We have to presume that all parties are innocent of any charges until the contrary is proved, of course. Post-Communist Russia may not be typical, but note the alleged use of ‘onshore offshore’, hardly confined to Russia.

Bank analysts estimated that YukosSibneft would pay an additional $620 million in income taxes in 2004 because of the proposed ‘elimination of the tax havens’, according to the Washington Post .

The distinction between evasion and ‘aggressive avoidance’ is of little interest to governments who see both as a threat to democracy, and there are signs that civil society is beginning to demand reform.

This is not entirely unexpected. Jeffrey Owens, Head of the OECD Centre for Tax Policy and Administration, wrote:

> ‘Perhaps, as we move into the new millennium, governments will need to reach out and develop a social compact with citizens. They would undertake to provide the service requested by citizens in an efficient and cost-effective manner and to minimise the complexity and compliance costs of tax systems. In turn, citizens would seek to meet their tax obligations. Civil society would put peer pressure on those who wish to avoid their obligations. Illegal tax behaviour would be seen for the crime that it is. Aggressive tax planning by tax advisers would be considered sociably unacceptable. This would help governments to break out of the vicious circle of each new tax loophole, leading to more complex tax legislation that in turn generates further loopholes.’
> [OECD Observer, March 2002]

The Global Tax Justice Network (TJN) campaigns for fairer taxation in the face of ‘harmful trends’ that ‘threaten the ability of states to tax the wealthy beneficiaries of globalisation’.

Its prime target is the use and abuse of tax havens. John Christensen, co-ordinator of the TJN, says this creates an unlevel playing field and distorts the economy.

> ‘It favours the large business over the small one, the international business over the national one, and the long-established business over the start-up. In combination this runs totally counter to the dynamics of an efficient free market.’

Responsible taxes

Managing ‘effective tax rates’ is a key feature of international tax planning. Prem Sikka, Professor of Accounting at Essex University, told The Guardian that a random sample of 16 out of nearly 2,200 companies listed on the London Stock Exchange revealed a shortfall of £5 billion between the corporation tax that the companies might be expected to pay on the basis of corporation tax rates and the amounts actually paid over four years.

His research was necessarily based on pre-tax profits in the published accounts, because tax computations are not published. Campaigners are calling for publication of companies’ transfer pricing policies, along with details of profits made and taxes paid in each country.

Vito Tanzi, former director of the IMF’s Fiscal Affairs Department, said in March 2001 that estimates of deposits in entities such as international business corporations and offshore trusts exceeded $5 trillion. Trade within multinational corporations was one of several ‘fiscal termites gnawing away at the foundations of tax systems’.

Sikka argues that evasion and avoidance by the very wealthy and the multinationals via tax havens discourages compliance among the wider UK population.

This is difficult to measure but there is evidence of a growing culture of ‘cheating the system’. Recent research by University of Keele scientists showed that 70% of people questioned in England and Wales felt they had been ‘ripped off’ or been made victims by businesses, banks or tradesmen.

More than 60% of people admitted that they had padded an insurance claim, paid cash to avoid tax or kept the money when they were given too much change. Professor Susanne Karstedt asked whether this was evidence of a predatory society emerging.

A survey of UK matrimonial lawyers by Grant Thornton's Forensic Practice found that it was 'not uncommon to discover hidden assets – almost always managed by men – in offshore bank accounts or trust arrangements'.

And the National Audit Office has qualified a section of its 2002-2003 report on the Inland Revenue's accounts of collection of tax and NICs because of a 'high level of overpayment of Working Families' and Disabled Person's tax credit'.

On the other hand there appears to be a widespread belief that UK taxpayers and advisers are somehow more scrupulous than most. This may be partly because of the attention given to recent scandals in the US.

A 'tawdry tale'

Tax shelters marketed by accountants, law firms, and others have been scrutinised by the Permanent Subcommittee on Investigations of the US Senate Committee on Governmental Affairs.

Senator Carl Levin complained that 'the engine driving the tax shelter industry today is the effort of a horde of tax advisers cooking up one complex scheme after another – so-called "tax products" that are unsolicited by any client – and then using elaborate marketing schemes to peddle these products across the country'.

The subcommittee focused on four products designed and sold by KPMG and known as BLIPS, FLIP, OPIS, and SC2. They revealed a 'tawdry tale', said Levin:

> '… a highly compromised internal review and approval process at KPMG, highly aggressive marketing efforts to sell tax schemes aimed at producing paper tax losses, and schemes which attempt to disguise tax reduction scams as business activity in the case of Bond Linked Issue Premium Structure or BLIPS, or a charitable donation in the case of SC2'.

KPMG in the US said that these strategies 'represent an earlier time at KPMG and a far different regulatory and marketplace environment' and that none of them, nor anything like them, was currently presented by KPMG. There was 'intensive and thorough review' at KPMG, a process resulting in vigorous, 'sometimes even heated' debate.

Significant changes had been made within KPMG and the firm was 'anxious to continue to demonstrate our commitment to improved clarity and fairness in the tax laws'.

Senator Levin was sceptical. 'I'm afraid we cannot trust this industry to police itself. We need to take strong and forceful action to stop the pilfering of our Treasury and the damage to the credibility of our tax system.' Calvin H Johnson, Professor of Law at the University of Texas, said:

> '… the tax shelter industry has succeeded in doing real damage to the national tax system … Every day well-trained, well-paid and highly motivated tax professionals have been launching vicious attacks on the tax base and they have had considerable success … Uncle Sam seems to be losing the war against tax shelters and tax shelter industry.'

A KPMG source indicated that the UK firm regarded this as a US issue.

The New Economics Foundation, in evidence to the Treasury Select Committee last year, attacked the large firms for aiding forms of aggressive tax minimisation 'that ultimately undermine democratic government and implicitly supporting dubious financial regimes and other forms of sleaze'.

One director of a 'big four' firm had told the NEF that where money laundering, bribery and other forms of dubious and illegal practice were concerned, the 'only question is whether it happens in 30-40 or 50 affiliated country offices around the world'.

Ethics

Some tax advisers are beginning to express their concern about the growth of 'offshore' and there is some debate on the matter of professional ethics in tax planning.

The American Institute of Certified Public Accountants says it 'has a clear position on abusive transactions – they should be eradicated. Tax shelters insult the large majority of honest taxpayers and their CPA advisors, who strive every day to obey the increasingly complex tax laws.'

Recent scandals such as Enron have illustrated the fine line between tax avoidance and evasion, and the new money-laundering regulations pose new dangers.

Advisers need to consider whether clients are engaged in legal avoidance or illegal evasion bearing in mind that, as the Chartered Institute of Taxation's guidance to advisers warned, 'uncommercial transactions … could be regarded as a fraud on the Inland Revenue'. Some may now have to be reported to NCIS.

The CIOT is a registered charity with the classification ‘education and training’ and the listed beneficiaries include the elderly, other charities and voluntary bodies, the general public and mankind. Its officers and many members do a good deal of useful work, much of it unpaid, in consultations with the Revenue, training and examinations, and setting standards.

It is interesting to contrast the AICPA approach mentioned above with the CIOT’s journal Tax Adviser. Its September 2003 edition carried an article entitled ‘Tax-Free in New Zealand’, declaring that ‘the OECD and others are trying to reduce the number of tax havens; onshore-offshore locations have grown; New Zealand deserves attention as a location’.

It proclaimed that ‘more care now needs to be taken on the selection of jurisdictions and the design of structures to ensure the risk of scrutiny is minimised’.

I asked CIOT President Tim Ambrose whether he thought publication of the article was compatible with the CIOT’s charitable status. He said:

> ‘I do not see that there is any conflict … the CIOT is formed for the “advancement of public education in and the promotion of the study of the administration and practice of taxation ...” i.e. as an educational charity, and the article was informative and educational about certain aspects of taxation.’

‘Mankind’ may wonder how charitable it is to invite advisers to steer clients offshore to cut the tax bill in their home country. But the CIOT pointed out that the author’s views were not necessarily shared by the Institute.

Simon Sweetman, an independent tax consultant and vice-chair of the taxation committee of the Federation of Small Businesses, told me:

> ‘My view is that there is a moral imperative to paying your taxes where you reap the benefits of citizenship, and that indirectly applies to companies as well though companies are not moral actors as such’.

He does not see moral imperatives as absolute and accepts that ‘there will be times when there may be respectable reasons for mitigating the tax you have to pay where it seems oppressive – as for example where there is tax to pay but no money to pay it’.

Mainstream tax planning is not the issue here. A very large number of accountants and tax advisers never get involved in ‘offshore’. Sweetman added:

> ‘Systematic tax avoidance “just because you can” seems to me to be offensive in itself and also because it increases the tax burden on those who do not avoid. This leads to “if everyone is doing it I’d be a fool not to” and to the peddling to the less well off of what they think of as tax schemes which in fact break the law, like the offshore scams the Revenue hopefully is starting to look at. Also, of course, it leads to increasingly complex legislation which attempts to block all the loopholes in advance.’

International action

New compliance and enforcement measures were announced in the 2003 Budget with the aim of generating an additional £1.37 billion over three years. The National Audit Office says that with the help of outside legal and other expertise, a new Inland Revenue initiative will focus on a number of areas of significant risk including concealment of undeclared income or profits offshore and avoidance of corporation tax.

The NAO said that in one project the Special Compliance Office ‘discovered that 500 individuals committed an estimated £90 million in tax fraud by concealing their transfers of funds offshore’.

Meanwhile the UK Government continues to refuse to sponsor research into the size of the ‘tax gap’ – the difference between 100% tax compliance and actual compliance. Dawn Primarolo told the Commons recently that ‘it would be impractical to arrive at a precise and meaningful figure as to the scale of the problem without a considerable investment of time and resources’.

The National Audit Office said last February that it was ‘difficult to assess the effects of the Revenue’s efforts to tackle tax fraud in the absence of any overall estimate of the problem’. The impact of what the Revenue has called ‘aggressive tax avoidance at the boundary of tax evasion’ is anybody’s guess.

The UN has called for better co-ordination worldwide to counter tax evasion and avoidance. It warned that tax competition was leading to countries ‘neutralising each other’s incentives, and lowering each government’s tax take’.

> ‘The growth of business conducted over the Internet, of multinational corporations and of cross-border trade in services has had a host of ramifications regarding which national authorities should collect taxes on which activities. Tax policy and administration has improved in many developing countries, but governments need to co-operate better to combat international tax evasion and tax avoidance.’

Closing globalisation’s ‘loopholes’ would assist the fight against transnational crime and international terrorism, said the UN. Its General Assembly appears set to adopt the Secretary-General’s recommendation to grant intergovernmental body status to an ad hoc group of experts on international co-operation in tax matters.

I asked a sole practitioner chartered certified accountant recently about the effect of Enron and other scandals on the reputation of what I called the accountancy profession.

‘Accountancy is not a profession, Andrew. It ceased to be a profession long ago’, he said.

There is much to be done to salvage reputations. Growing use of tax havens is beginning to be regarded as anti-democratic and unethical by both governments and citizens around the world. Globalisation brings many benefits, but having democratic governments robbed of their capacity to raise fair taxes is not one of them. Perhaps if more professionals could acknowledge that, reputations may begin to be restored.