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U.K. Tax Shelter Is Considered As an Effort to Avoid the VAT

By Mary Jacoby and Diya Gullapalli
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A TAX SHELTER designed by the British affiliate of KPMG International for a U.K. slot-machine operator is an improper attempt to avoid Europe's Value Added Tax, an advisory opinion released by the European Court of Justice concluded.

The case highlights that aggressive tax advice, for which KPMG LLP is under criminal investigation in the U.S., hasn't been limited to U.S. companies, and that penalties could be expected for the shelters in Europe, as well.

The opinion by one of the court's advocates general, Poiares Maduro of Portugal, isn't binding. But the court usually follows the advice of its advocates general, whose role is to examine issues and propose solutions for the European Court of Justice. The court rules on the ultimate legality of European Union laws and treaties.

According to British court documents, the way the shelter worked is as follows: Using the advice of the KPMG affiliate, RAL Holdings Ltd. registered a company in the British Channel Islands tax haven of Jersey and licensed the British slot machines to that entity. RAL then claimed to British tax authorities that it was due VAT refunds of more than GBP 6 million, or about 8.5 million euros, because the islands are outside the EU and the U.K., and thus exempt from the VAT.

The shelter was called "KPMG's VAT Mitigation Proposals for Gaming and Amusement Machines," according to British court documents, and was marketed under strict confidentiality to RAL in 2000 for initial payments of GBP 75,000.

Loughlin Hickey, the head of tax for KPMG's U.K. affiliate, said his firm's advice in the RAL case was based on an earlier European Court of Justice precedent that applied narrowly to gambling companies. Unless the court enunciates some broader principle in the RAL case, "I don't think you'll see wholesale change" in how companies handle the VAT, said Mr. Hickey.

KPMG LLP's sales of allegedly abusive tax shelters in the U.S. remain the focus of a criminal investigation by a federal grand jury in New York. In the past, the U.S. firm has said that it no longer markets aggressive tax shelters and that it is cooperating with the U.S. Internal Revenue Service and federal prosecutors.

KPMG's tax-shelter wrangling hasn't gone unnoticed. At the World Economic Forum in Davos, Switzerland, this week, KPMG International was singled out by a coalition of public-interest groups for "encouraging clients to engage in aggressive tax avoidance."

"We are not seeing the same degree of scrutiny of tax shelters here in Europe" as in the U.S., said Richard Murphy, an accountant in Cambridge, England, who works with the Tax Justice Network, a watchdog group. "The fact they are actually making a finding like this would be unusual and welcome."