

TAX AND WELFARE: Destructive Role of Financial Experts

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- **“Taxes are the price we pay for civilization”** (US Supreme Court Justice *Oliver Wendell Holmes Jr.* in *Compañia de Tabacos v. Collector* in 1904)
- **“Taxation is the price which we pay for civilization, for our social, civil and political institutions, for the security of life and property, and without which, we must resort to the law of force”** (1852 committee appointed by the Governor of Vermont)

- Tax Gap – based on estimates and assumptions
- EU: Tax evasion/avoidance - around €1 trillion?
- UK losing £35bn - £150bn revenues each year?
- USA losing \$345bn - \$500bn?
- Developing countries \$500bn each year?
- Variety of techniques: Offshore tax havens, transfer pricing, complex corporate structures, charitable foundations, trusts, tax holidays, novel interpretation of tax laws
- Big corporations and wealthy elites opting out of taxation.

- **New Masters of the Universe**
- Talk Ethics – Practice Unethical
- Talks social responsibility – Practice irresponsibility
- Talk public interest – Practice public exploitation
- Expert knowledge used to undermine democratic choices
- Boosting corporate earnings and executive pay and key drivers of tax avoidance

- “Stresses the crucial role of large accounting firms, including the “Big Four”, in the design and marketing of rulings and tax avoidance schemes that exploit mismatches between national legislations; stresses that those firms, which seem to derive a considerable amount of their revenue from tax services, to dominate most Member States” auditing markets and to prevail in global tax advising services, constitute a narrow oligopoly; considers that such a situation cannot continue” **(para 33, EU TAXE COMMITTEE on tax rulings and other measures similar in nature or effect (2015/2066(INI))**

- Accountancy firms have “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 ...”
- US Senate Permanent Subcommittee on Investigations (2005), **The Role of Professional Firms in the US Tax Shelter Industry,** Washington DC: USGPO

- “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. ... 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 (**Hansard, UK House of Lords Debates, 17 March 2011, col. 375**).

ACCOUNTANCY FIRM INCOME AND SIZE 2014/2015*

■ Firm	<u>Global Fees</u>	<u>OPERATIONS</u>		
	<u>US\$bn</u>	<u>Employees</u>	<u>Countries</u>	<u>Offices</u>
■ PwC	35.4	208,100	157	776
■ D & T	35.2	225,400	150	670
■ E&Y	28.7	212,000	150	700
■ KPMG	24.4	162,000	150	717

*Information as per annual reviews and firm websites.

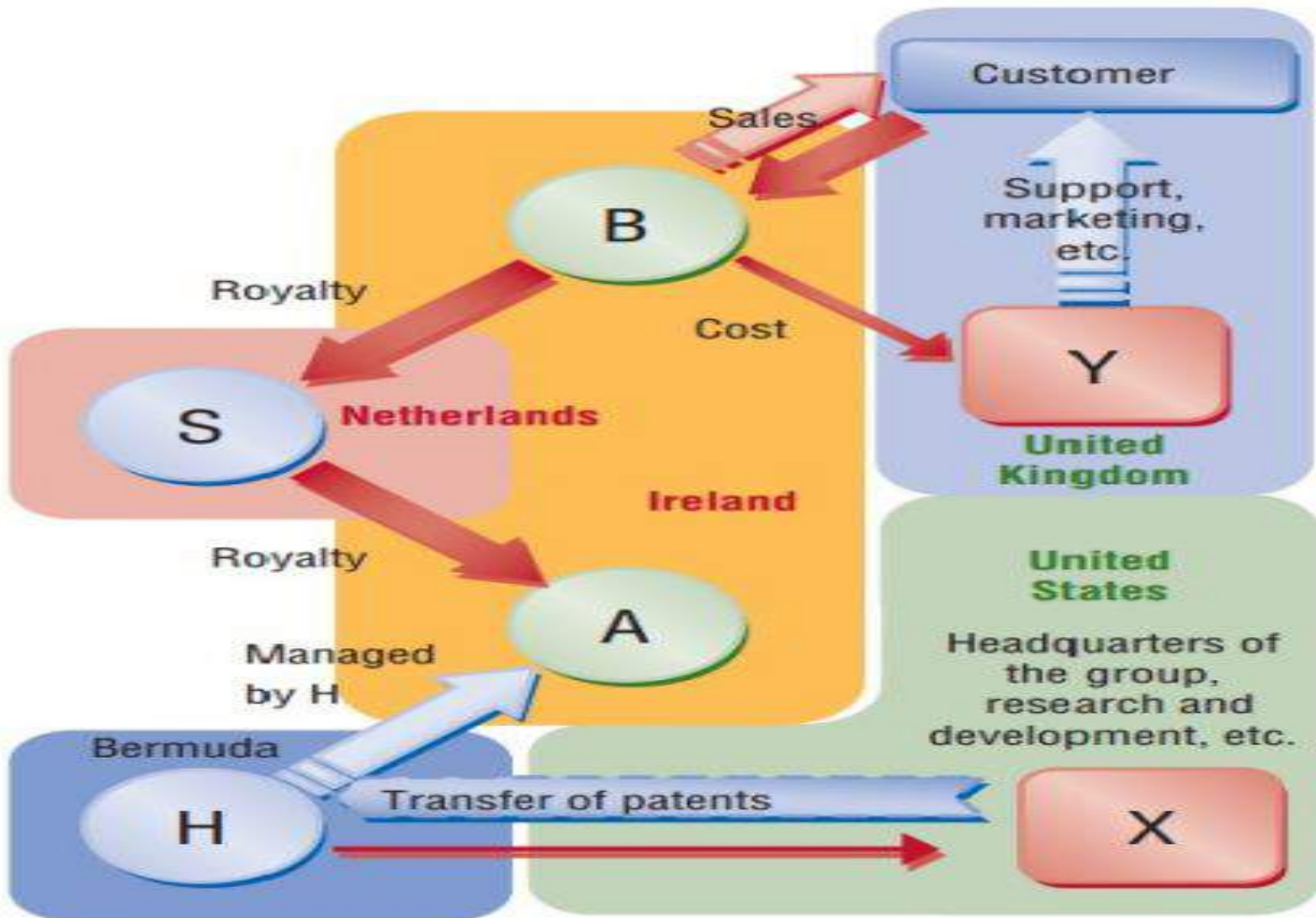
- Big Four firm revenues are around \$124bn; making them the world's 58th largest economy
- Vast amounts to pursue economic and political interests

- Internal HMRC Study (UK): Big Four accounting firms behind “almost half of all known avoidance schemes” .
- 2012 NAO Report: HMRC investigating about 41,000 tax avoidance schemes – How many relate to the Big Four? – Vast Public Expense
- 2015 - About 30,000 tax related UK court cases awaited.
- 30-40% of the UK Finance Bill plugs loopholes.

- **Addicted to Tax Avoidance:**
- UK House of Commons Public Accounts Committee Report (April 2013): PwC “will approve a tax product if there is a 25% chance—a one-in-four chance—of it being upheld. That means that 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”.
- Other Big firms claimed that their firm’s threshold was 50%.
- What if producers of food, medicine and other essentials did the same?

- Accountancy firms have close relationship with corporations and tax havens
- Deloitte – advise companies to how to invest in Africa via tax havens and avoid taxes (Action-Aid Report)
- PwC advising Jamaica on how to become a tax haven
- PwC and Ernst & Young wrote the Jersey LLP law – used to leverage liability concessions from the UK.
- PricewaterhouseCoopers- close relationship with Ireland tax regime.
- The case of the Double Irish Dutch Sandwich – used by Apple, Google, Amazon, Adobe, Microsoft, etc.

Figure 5.1. Tricks of the Trade



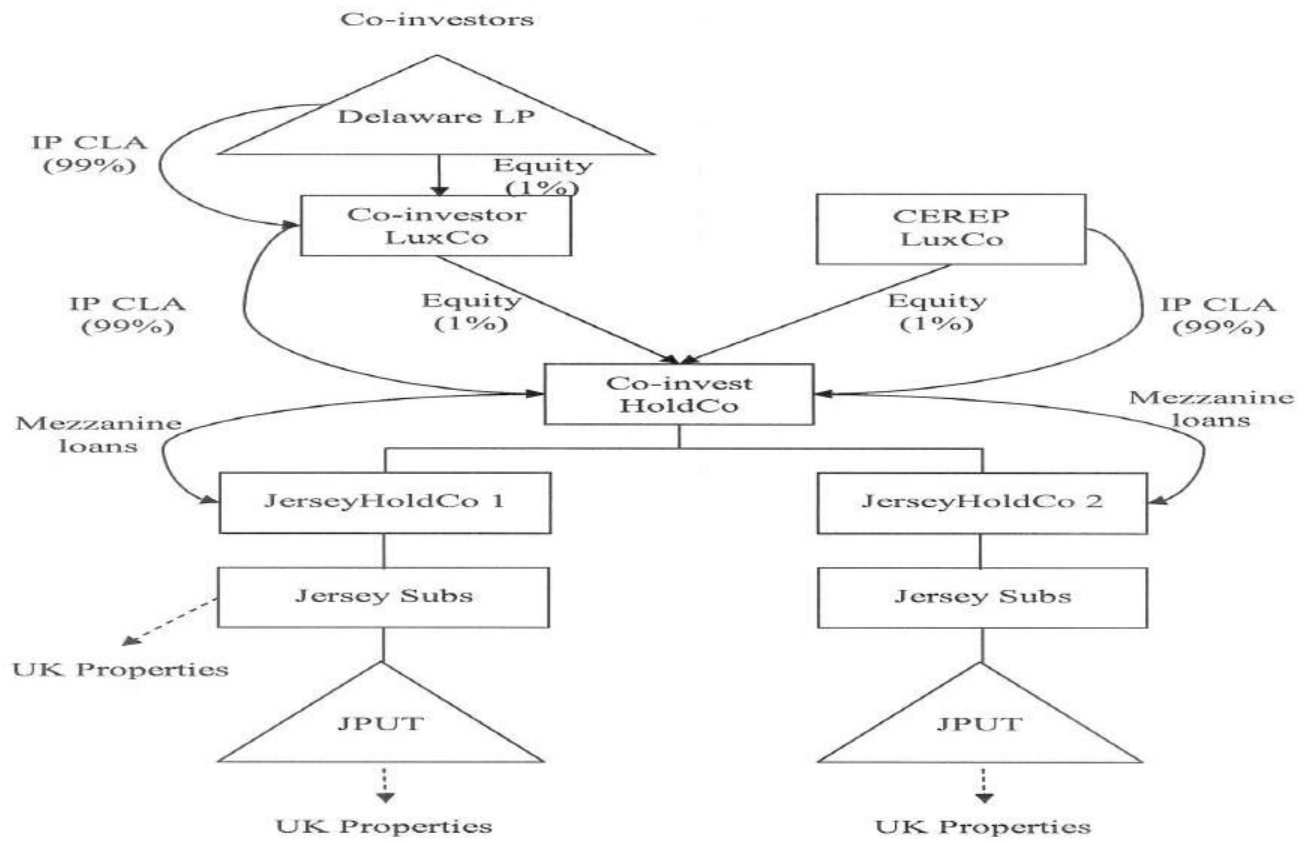
- Firm X in the US wants to **make profits in the UK but does not want to pay tax.**
- So it sells directly from Ireland through B, with firm Y providing customer services in the UK. Firm Y is reimbursed on a cost basis. Little tax paid in the UK.
- **How to get profits out of Ireland?**
- Transfer intellectual property (patents) to company H in Bermuda (no corporate taxes) at low value (e.g. early stage of development). So little/no capital gains tax in the US.
- But US may reject Bermuda structures – sham and apply its anti-avoidance rules (CFC rules)
- So another company A is incorporated in Ireland, managed by H

- The US will treat A&B as single Ireland entities. CFC rules are lenient for Ireland. BUT Ireland treats A as a company resident in Bermuda.
- So how to get the money from B to H? Need to avoid withholding taxes
- Now form company S in the Netherlands. Various royalty payments suck out profits and channelled to Bermuda (no corporate taxes). B to S and S to A. No withholding tax between EU based companies.
- No withholding tax on transfer from A to H because of Dutch domestic laws.
- If dividends eventually paid by H to X then US taxes may be levied.



Appendix 1

Simplified structure chart



- **US Senate Permanent Subcommittee on Investigations**
- Ernst & Young sold generic tax products to multiple clients despite evidence that some ... were potentially abusive or illegal tax shelters
- PricewaterhouseCoopers sold generic tax products to multiple clients, despite evidence that some ... were potentially abusive or illegal tax shelters
- KPMG devoted substantial resources and maintained an extensive infrastructure to produce ... at times, illegal or potentially abusive tax shelters

The Pinstripe Mafia : KPMG

- **KPMG** –organisational culture exposed by US Senate hearings.
- Inventory of 500 tax avoidance schemes
- Staff trained to sell tax avoidance schemes and meet profit targets; cold-calling; secrecy
- Firm knowingly violated laws because profits were greater than the costs/fines.
- 2005 - Firm admitted “criminal wrongdoing”
 - Fined US\$456 million and put of probation
 - some partners and employees sent to prison.
- KPMG still heavily into tax avoidance

- **KPMG AND ITS WORLD OF TAX AVOIDANCE:**
- Auditor silence on tax avoidance schemes operated by auditees (General Electric, Citigroup, others)
- WorldCom and “Management Foresight”
 - Companies pays royalties to itself
 - Royalties parked in low tax jurisdiction
 - US\$20bn income escaped taxes.

- **Spectrum Computer Supplies Ltd v Revenue and Customs Commissioners; Kirkstall Timber Ltd v Revenue and Customs Commissioners [2006] STC (SCD) 668**
- KPMG scheme: No prior relationship with co.
- Avoid UK NIC and income tax by paying their directors with the debts of the company instead of cash
- Scheme defeated: “the assignment of book debts constituted a payment, but that they did not constitute trading arrangements”.

- **Commissioners for Her Majesty's Revenue and Customs v Pendragon plc and others; [2015] UKSC 37**
- VAT avoidance scheme designed and marketed by KPMG relating to demonstrator cars used by retail distributors for test drives
- Purpose: to ensure that companies in the distributor's group were able to recover input tax paid on the price of new cars acquired as demonstrators from manufacturers, while avoiding the payment of output tax on the price at which the car was ultimately sold second-hand to a consumer.

- **Commissioners for Her Majesty's Revenue and Customs v Pendragon plc and others; [2015] UKSC 37**
- The KPMG scheme was designed to exploit three exceptions to the normal incidence of VAT.
- **Judge:** “In my opinion the KPMG scheme was an abuse of law”.

- **Jan 2014: SALEM FINANCIAL, INC v United States:** Tax avoidance scheme marketed by KPMG and Barclays Bank – sold to companies such as AIG, Microsoft, Intel, and Prudential
- Complex transactions known as STARS (“Structured Trust Advantaged Repackaged Securities”)
- Purpose: to generate large-scale foreign tax credits for a U.S. taxpayer, which could be used to enhance revenue and reduce taxes in the United States.
- Judge: “abusive tax avoidance scheme ... circular cash flows ... no economic activity ... The conduct of those persons ... who were involved in this and other transactions was nothing short of reprehensible”

- **Cont' d - “Structured Trust Advantaged Repackaged Securities”**
- Wells Fargo & Company v United States of America Case No. 09-CV-2764 (PJS/TNL)
- Judge: Wells Fargo's claim for a \$177 million tax refund is based on a sham deal with Barclays Bank to exploit loopholes in foreign tax credits.
- The transaction “lacked any economic substance whatsoever”

- **Commissioners for Her Majesty's Revenue and Customs and McLaren Racing Ltd [2014] UKUT 0269 (TCC)**
- With KPMG help McLaren sought tax relief on £32 million fine has been told a £32m fine imposed by the sport's governing body FIA for spying on Ferrari.
- Not Allowed: “the activities which gave rise to the penalty were not carried out in the course of McLaren's trade”.

- **ERNST & YOUNG AND ITS WORLD OF TAX AVOIDANCE**
- History of aggressive tax avoidance schemes
- Phones4U directors paid in gold bars, fine wine, and platinum sponge – avoid income tax and National Insurance Contributions.
- Pay directors through an offshore employee benefit trust and complex foreign currency loans - avoid income tax and National Insurance Contributions.

- **Iliffe News and Media Ltd & Ors v Revenue & Customs [2012] UKFTT 696**
- Ernst & Young client advised a media company, to treat its newspaper mastheads as a new asset
- The mastheads transferred to the parent company for a nominal sum - £1.
- Then leased back to the subsidiaries - £51.6m royalties to the parent company over 5 years.
- This transaction did not result in any transfer of cash to an external party
- Claimed tax relief on royalty expense.

- **"Project Pita"** or "Pain in The Arse" – sold to major UK retailers, including Tesco and Debenhams
- VAT avoidance by exploiting rules on taxability of financial services – 2.5% of all credit card billing to be exempt.
- Tax-Efficient Off-Market Swaps (or TOMS)
 - Sold to Prudential and 30 other companies
 - Complex hedging transactions developed to generate losses.

- Predatory culture exposed by US Senate Hearings
- A number of partners and employees sent to prison
- Paid US\$123 million fine in March 2013
- But no end of tax avoidance
- Crafted tax avoidance schemes for Wal-Mart
 - Real Estate Investment Trusts (REITs) to avoid corporate taxes
 - Company effectively paid rent to itself.

- **PRICewaterhouseCOOPERS AND ITS WORLD OF TAX AVOIDANCE**
- Organisational culture exposed by US Senate hearings.
- Patent donations as a tax avoidance strategy
- Canal Corporation and Subsidiaries - Complex corporate structures
- Complex schemes sold to Prudential
 - Details concealed by 'professional privilege'
- Westpac Banking Corporation - structured finance transactions

- **Vocalspruce Ltd v The Commissioners for HMRC [2014] EWCA Civ 1302 (30 October 2014))**
- PwC mass marketed a scheme which relied on complex financial transactions, but in essence assumed that due to deficiencies in legislation profits on loan notes would not be taxable.
- A series of legal battles.
- The scheme was rejected by the courts and declared to be a “fiction”.

- **Nov 2014: Luxembourg Leaks (Luxleaks)**
- Some 28,000 pages of tax agreements, returns and other papers relating to over 1000 businesses.
- Tax avoidance schemes crafted by PwC 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.
- Avoidance schemes approved by the Luxembourg government
- 28,000 pages make no mention of ethics, morality, or the possible social impact of lost tax revenues

- UK House of Commons Committee of Public Accounts report (2015) “PwC did not convince us that its widespread promotion of schemes to numerous clients, based on artificially diverting profits to Luxembourg through intra-company loans, constituted anything other than the promotion of tax avoidance on an industrial scale”
- No UK investigation of PwC.

- **UK case of Schofield v HM Revenue and Customs [2012] EWCA Civ 927**
- Test case for a scheme sold to 200 entrepreneurs to avoid capital gains tax on £1bn of gains.
- Schofield made a gain of £10,726,438 on the sale of his business.
- PwC scheme generate £11 billion paper loss through complex transactions.
- The presiding judge said that “Under the scheme as a whole, the options were created merely to be destroyed. They were self cancelling. Thus, for capital gains purposes, there was no asset and no disposal. There was no real loss ...”.

- **DELOITTE & TOUCHE AND ITS WORLD OF TAX AVOIDANCE**
- Advised Enron on tax avoidance
 - Deloitte & Touche was a key adviser to Enron and was one of the promoters behind exotic schemes known as Condor, Valhalla and Tammy
 - US Senator Charles Grassley: Enron's tax avoidance schemes read "like a conspiracy novel, with some of the nation's finest banks, accounting firms and attorneys working together to prop up the biggest corporate farce of this century
- Royal Bank of Scotland and its tax avoidance

- Vodafone in India and the UK- Offshore entities, transfer pricing and debt structuring used to reduce taxes
- MG Rover - leasing, loans and offshore entities
- Glencore International – transfer pricing strategies to avoid taxes in Africa.
- WHA – VAT avoidance on motor breakdown Insurance by using offshore entities.
- VAT avoidance on holiday homes in Ireland

- **Deutsche Bank Group Services (UK) Ltd v Revenue & Customs [2011] UKFTT 66**
- Bankers paid through an Employee Benefit Trust (EBT) to avoid income tax
- More than 300 bankers participated in the scheme which operated through a Cayman Islands-registered investment vehicle called Dark Blue Investment (DBI), managed by Investec.
- The presiding judge said that “the Scheme as a whole, and each aspect of it, was created and coordinated purely for tax avoidance purposes”.

The Pinstripe Mafia

- These firms have developed tax avoidance for corporate and private clients
- Bending the rules' to make profits at almost any cost is considered to be a 'competitive necessity'
- Devising of tax avoidance schemes demonstrates how self-interest and shady practices have become normalized
- Employees are socialized into selling avoidance schemes – tax divisions are profit centres
- Governments shift taxes away from corporations and wealthy elites to labour, consumption and savings, depressing ordinary people's purchasing power and contributing to economic and social crises.

- **US** – fines for some firms; imprisonment for some partners and employees, but little respite from tax avoidance
- **UK** – No such action: Parliamentary Committees held hearings, but no government action
- Big Four firm partners advise UK Treasury – help to write tax laws e.g. Patent Box, Controlled Foreign Company (CFC) legislation
- (Former) Big Four firm partners sit on HMRC Board
- No accountancy firm ever investigated or prosecuted
- No firm ever disciplined for selling tax avoidance by professional bodies
- Auditors sell tax avoidance to audit clients

The Pinstripe Mafia

- **Prospects:** OECD:BEPS project –mainly relates to corporations
 - Deals with hybrid mismatches;
 - restrict tax relief on intragroup interest payments
 - Can't address the fault lines of transfer pricing
- EU TAXE COMMITTEE REPORT
- EU: The Common Consolidated Corporate Tax Base (CCCTB) project could check corporate profit shifting to tax havens and transfer pricing abuses
- Slow progress; Opposition (e.g. UK)

The Pinstripe Mafia

- **What Else?**
- Abolish tax relief on intragroup loans?
- Put tax returns of corporations and wealthy individuals on public record
- Publicly available CBCR
- No public contracts for tax avoiders
- Fine company directors for tax avoidance
- Fines for designers of avoidance schemes
- More test cases, prosecutions

THANK YOU

ANY QUESTIONS?

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