Why combatting tax avoidance means curbing corporate power

Prem Sikka shows how a tax avoidance industry has facilitated the corporate capture of UK policymaking

With the intensification of economic globalisation, corporations have become adept at shifting profits and avoiding taxes through complex corporate structures and a variety of accounting techniques (Sikka and Willmott, 2010). Her Majesty's Revenue and Customs (HMRC), the UK's tax authority, is currently examining some 41,000 tax avoidance schemes (National Audit Office, 2012). Against a background of austerity programmes, public anger has been amplified by a series of inquiries into corporate tax avoidance by the UK House of Commons Public Accounts Committee (for example see UK House of Commons Public Accounts Committee, 2013a: 2013b). Those inquiries have shown that transnational corporations, such as Google, Microsoft, Amazon, eBay and Starbucks are able to avoid corporate taxes even though a large part of their economic activity takes place within the UK. Those companies are supported by a well organised tax avoidance industry dominated by lawyers, financial experts and major accountancy firms in the shape of KPMG, PricewaterhouseCoopers, Deloitte & Touche and Ernst & Young (Mitchell and Sikka, 2011). On occasions, tax tribunals and courts have declared some of those tax avoidance schemes to be unlawful. However, none of this has persuaded the UK Treasury to investigate or prosecute any of those companies or any accountancy firm. On the contrary, corporate interests enjoy an insider status, crafting UK tax laws. This is illustrated by the three episodes below.

The Patent Box

Under the weight of corporate lobbying, successive UK governments have reduced the headline corporate tax rate from 52 per cent in 1982 to 21 per cent in 2014. Still, further ways have been found to reduce effective tax rates for corporations. One example of this is the Patent Box.

The legislation relating to the Patent Box came into effect on 1 April 2013. The key idea is to tax corporate profits derived from patents and certain intellectual property at the rate of 10 per cent rather than the headline rate of 21 per cent. Companies don't have to legally own a patent and many are indeed now leasing them. The beneficial ownership of the patent can be held in a tax haven.

The legislation was drafted by a working party consisting entirely of representatives of large corporations. These included GlaxoSmithKline, Rolls-Royce and Shell, no strangers to tax avoidance controversies. There was no representation from trade unions, investigative journalists, tax justice campaigners or critics.

Controlled foreign companies legislation

The controlled foreign companies (CFC) rules represent another piece of legislation crafted by corporate interests. The legislation applies to companies controlled from the UK but resident in an overseas territory. The details are complex but in essence they mean that if, for example, a group treasury is located within the UK and receives income from overseas subsidiaries, it would be taxed at a rate of 5.25 per cent rather than the full corporation tax rate.

A number of working parties were created to craft various parts of the legislation. Their membership came from BHP Biliton, Diageo, Tesco, G4S, Rio Tinto, International Power, Vodafone, Shell, Kraft, GlaxoSmithKline, Reed Elsevier, Cable and Wireless, Cookson, Intercontinental Hotels, Prudential, Lloyds, Barclays, HSBC, Citigroup, Standard Chartered, Aviva, British American Tobacco and Xerox, just to mention a few. All have an economic interest in securing advantageous tax laws. No other civil society organisation, trade union or other critical voice had representation on those working groups.

The combined effect of the CFC and the Patent Box legislation could slash government tax revenues by about £5 billion a year, at a time when ordinary people are facing massive hardships.

The UK government was advised on those two schemes by KPMG, a firm behind many aggressive tax avoidance schemes. In 2005, it paid $456 million fine to the US authorities for facilitating tax evasion (Mitchell and Sikka, 2011). The UK House of Commons Public Accounts Committee noted that:

> *KPMG seconded staff to advise government on tax legislation, including the development of the 'Controlled Foreign Company' and 'Patent Box' rules. It then produced marketing brochures relating to both sets of rules highlighting the role its staff had in advising government. The brochure 'Patent Box: what's in it for you', suggests that the legislation is a business opportunity to reduce UK tax and that KPMG can help clients in the 'preparation of defendable expense allocation'. KPMG denied that it was advising its clients on how to use those laws in ways that Parliament did not intend, but we are not convinced by its*

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> *insistence that all the advice it offers to clients seeks to fulfil the purpose of the legislation*.
> (UK House of Commons Public Accounts Committee, 2013b)

General Anti-Abuse Rule

A new law known as the *General Anti-Abuse Rule* (GAAR) came into operation on 1 July 2013. The principle behind GAAR should be to discourage organised tax avoidance by focusing on the economic substance rather than just the legal form of a transaction. This way, it can be argued that many of the corporate transactions are a sham, because they have no economic substance and are merely internal book-keeping entries designed to avoid taxes and should thus be ignored. However, the UK legislation is not like that. Lord MacGregor, Chairman of the UK House of Lords Economic Affairs Sub-Committee on the Finance Bill said that:

> *There is a misconception that GAAR will mean the likes of Starbucks and Amazon will be slapped with massive tax bills. This is wrong and the Government need to explain that to the public. GAAR is narrowly defined and will only impact on the most abusive of tax avoidance.*

Moreover, the legislation puts major hurdles in the way of a clampdown on tax avoidance. It contains a 'double reasonableness' test which HMRC use to show that the tax avoidance schemes – the Treasury prefers to call them tax arrangements – under scrutiny 'cannot reasonably be regarded as a reasonable course of action'. An avoidance scheme will be treated as abusive only if it would not be reasonable to hold such a view. Under the UK law, whether something is abusive is not necessarily a matter of economic fact, or connected with erosion of tax base, or that fact that some portion of someone's income and profits has escaped tax. The test is whether what has happened is reasonable. If some dubious practice is widespread – or is something that is established practice in a particular industry or type of financial practice – then it may well be considered to be reasonable.

HMRC can't easily go to the courts to enforce GAAR. To do so it will need permission from a panel of experts who will give their opinion as to whether the arrangements in question constitute a reasonable course of action. The panel is chaired by Patrick Mears, senior tax partner at law firm Allen and Overy. Other members are Michael Hardwick (a consultant at law firm Linklaters), David Heaton (a partner in accountancy firm Baker Tilly and chairman of the Tax Faculty of the Institute of Chartered Accountants in England Wales), Brian Jackson (vice-president for group tax at Burberry Group plc, previously tax partner at KPMG), Sue Laing (a partner at law firm Boodle Hatfield), Gary Shiels (business consultant) and Bob Wheatcroft (a partner in accountancy firm Armstrong Watson). The panel members are unpaid and this inevitably favours businesses who can bear the cost of seconding staff.

If matters reach a court, then judges need to take into account the opinion of the GAAR Advisory Panel given to the HMRC. No doubt, to secure legitimacy some initial cases may be undertaken, but the long-term prospects for GAAR's effectiveness are bleak because any benchmarks established will apply to businesses represented on the GAAR panel too.

Embedded interests

The brief examples cited in this article show that business interests are deeply embedded within the state policymaking apparatus. There is little effective action against companies engaged in organised tax avoidance.

A popular view associates corruption with violation of laws to gain undue private advantage. Such a view is limited as it takes no account of how private interests are embedded within the system at the expense of wider social interests. As the brief discussion of the three episodes in British government policy making illustrated here, policy *fora* often function as a market where those with the financial and political resources are able to access the policymaking apparatus to influence public choices. Under the guise of technical expertise, corporations are able to second staff to important policymaking committees to shape laws that prioritise their interests. By bearing the cost of secondments to legislative committees, corporations are effectively renting access to public policymaking arenas (Johnston, 2005).

Corporate interests are given special privileges to write laws and shackle the law enforcement powers of HMRC. This market for influence increaces corporate profits, but leaves ordinary citizens with the possibility of either paying higher taxes to support a crumbling social infrastructure, or foregoing hard won social rights such as education, healthcare and pensions. Thus the state could enhance its social legitimacy by exposing corporate wrongdoings, but evidently there is little political will to scrutinise corporate capture of public policymaking and prioritise citizens' concerns. ■

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