# The Tax Avoidance Industry

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## Introduction

Tax revenues are the vital life-blood of all democracies. Without these no state can alleviate poverty or provide social infrastructure, healthcare, education, security, transport, pensions and public goods that are necessary for all civilised societies. In his 2012 budget speech, UK Chancellor George Osborne described "tax evasion and aggressive tax avoidance as morally repugnant[1]". Yet tax avoidance flourishes. All over the world tax revenues are under relentless attack from a highly organised tax avoidance industry, consisting of well-paid accountants, lawyers and finance experts operating from gleaming city centre offices. The erosion of tax revenues is also a major cause of the deepening economic crisis and has constrained government ability to intervene in the economy and formed the basis of austerity programmes which are inflicting misery on millions of people.

This paper sheds some light on the tax avoidance industry and its practices. The main focus is on major accountancy firms who employ thousands of university graduates and dominate the global tax avoidance industry. This paper is organised into four further sections. The first section provides a brief overview of the debate about the meaning of tax avoidance, tax evasion and tax planning. The second section provides some estimates of the tax gap (covering tax avoidance, tax evasion and delayed payments). It also shows that major accountancy firms are key players in the tax avoidance industry. The third section provides a brief glimpse of some of the tax avoidance strategies developed by major accountancy firms. The fourth section concludes the paper with a brief summary and suggestions for reform.

## Tax Avoidance, Tax Evasion and Tax Planning

There are perennial debates about the difference between tax avoidance and tax evasion. So what exactly is tax avoidance and how is it distinguished from tax evasion? Dennis Healey, a former UK Chancellor of the Exchequer is credited with saying that "The

1 The Guardian, Budget 2012: let's see George Osborne's tax return, 23 March 2012 (www.guardian.co.uk/commentisfree/2012/mar/23/budget-2012-george-osborne-tax-return; accessed 20 May 2012).

difference between tax avoidance and tax evasion is the thickness of a prison wall" (cited in Murphy, 2008). This quote highlights the constitutive role of the law in separating tax avoidance from evasion. Tax evasion is an illegal activity, intentionally designed to reduce a taxpayer's tax liability. It is considered to be a crime and carries severe punishment. There are a range of fines for non-compliance or negligent compliance.

Taking advantage of allowances and reliefs permitted by law does not constitute avoidance and is part of wise tax planning. Individuals and corporations are expected to take advantage of tax free personal allowances, tax exemptions for interest earned on Individual Savings Accounts (ISAs), capital allowances on qualifying assets, relief for interest paid on qualifying borrowing, etc., and much more in computing their tax liability. The difficulties arise with practices which cannot easily be classified as tax planning and tax evasion, or are often beyond the terms envisaged by the sponsors of the legislation[2]. The role of law is important, but in common with many other social practices the issues cannot easily be resolved, especially as there is considerable difference between 'law on the books' (formal law) and 'law in action' (Weber, 1977). The latter is influenced by antagonisms, practices and unintended consequences and may differ from the formal law. Over a period many concepts and practices evolve and become significant adjudicators of tax liabilities. For instance, the concepts of taxable income, economic transaction and residence[3] are vital to adjudication of tax liabilities, but their interpretation is shaped by practices rather than just the strict letter of the law. Contemporary developments also pose challenges. For example, with increased cross-border trade and easy travel the conventional approaches to establishing 'residence' for tax purposes have been under strain and practitioners and judges have been obliged to develop working rules.

The difference between the legal form and economic substance of transactions is a recurring feature of the tax avoidance debate. The tax avoidance industry frequently invokes the judge's remarks in the case of *IRC v Duke of Westminster [1936] 19 TC 490)* to justify its trade. In this case, the Duke paid employees, including gardeners and an architect, whose services ranged form four years to forty years, through a deed of covenant. Under this arrangement, the employees continued to receive an agreed weekly sum for a period of seven years.

2 The 1993 House of Lords judgement in Pepper (Inspector of Taxes) v Hart [1992] UKHL 3 (26 November 1992) established that under certain circumstances the courts may may refer to statements made by sponsors of the legislation in the UK parliament (Commons and Lords) to interpret the meaning of the legislation.

3 The statutory rules are to be found in Section 829 et seq of the UK Income Tax Act 2007. They do not cover all circumstances and more importantly do not specify the tests for determining whether an individual is resident in the UK.

The Duke claimed that under the extant law the amounts under the deed of covenant were a deductible expense thus reduced his liability to surtax, a higher marginal rate of income tax levied on wealthy individuals. This would not have been possible if the sums were merely deemed to be payment of wages. One of the arguments was that, in substance, the annuities paid under the deed were wages and should thus be subjected to the extant law on taxes. However, the House of Lords refused to disregard the legal character (form) of the deeds of covenant merely because the same result (substance) could be brought about in another manner. The Law Lords said that "Here the substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles" and that "Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax". This has become the mantra of the tax avoidance industry.

By the 1970s with the intensification of globalisation, emergence of tax havens and an organised tax avoidance industry, many commercially artificial schemes began to appear and threatened tax revenues. Unlike the Duke of Westminster case the new schemes involved multiple parties and multiple transactions and the courts began to develop rules to deal with the problems. One of these resulted in the development of what became known as the Ramsay principle[4]. In this case the taxpayer had two loans. The plan was to make a tax free gain on one loan and an allowable tax loss on the other. To achieve the tax objectives, money was sent around in a series of transactions which started and ended with the promoter of the scheme. One of the Law Lords said that "In each case two assets appear, like "particles" in a gas chamber with opposite charges, one of which is used to create the loss, the other of which gives rise to an equivalent gain which prevents the taxpayer from supporting any real loss, and which gain is intended not to be taxable. Like the particles, these assets have a very short life. Having served their purpose they cancel each other out and disappear. At the end of the series of operations, the taxpayer's financial position is precisely as it was at the beginning, except that he has paid a fee, and certain expenses, to the promoter of the scheme". By paying attention to the economic substance of the transaction the Law Lords decided the taxpayer did not make any real loss and therefore was not entitled to have tax relief for that loss. This judgement marked a significant departure from the Duke of Westminster case and

4 W. T. Ramsay Ltd. v. Inland Revenue Commissioners, Eilbeck (Inspector of Taxes) v. Rawling, [1982] A.C. 300.

suggested that commercial substance could be the guiding principle rather than the legal form. Many cases subsequent[5] to the Ramsay principle have muddied the waters further, but the commercial substance v legal form remains central to contemporary debates about tax avoidance. In essence, critics argue that many of the present day schemes have little/no economic substance and are primarily designed to avoid taxes (Sikka and Willmott, 2010).

## Tax Gap and the Tax Avoidance Industry

In response to claims that higher corporate and personal tax rates discourage investment and enterprise and also fuel tax avoidance, successive UK governments have cut the rates of corporation and income taxes. The corporation tax rate has declined from 52% of taxable profits in 1982 and will reach an unprecedented low of 22% in April 2014. The top marginal rate of income tax has declined from 83%, plus a surcharge of 15% on investment income, in 1978-79, to 45% in 2012. Successive governments have shifted taxes to labour, consumption and savings through higher national insurance contributions, higher VAT and the failure of tax-free personal allowances and income tax bands to keep pace with inflation. As a result, in 2011-12 alone some 750,000 additional middle-earners became subject to 40% tax rate and their number will swell by another 850,000 in 2014[6]. At the other end of the scale, households in the bottom 20% of income bracket pay 35.5% of their gross income in direct and indirect taxes, compared to 33.7% for the top 20% of households (UK Office for National Statistics, 2011). These changes are masked by the overall tax revenues raised the government. Overall, the UK state's share of national income, in the form of tax and national insurance contributions has declined from 38.2% in 1982-83 to 34% in 2009-10[7]. The shifting of the tax burdens and the decline in the tax revenues has constrained the government's and the ordinary person's ability to stimulate the economy.

Despite the massive tax concessions to corporations and the wealthy elites, organised tax avoidance has continued. The amount of tax avoided and evaded is difficult to measure as the estimates depend on economic models, which in turn depend on data and various

5 For example see IRC v Burmah Shell (1982) STC 30 and Furniss v. Dawson, (1984) AC 474.

6 The Daily Telegraph, 1.6m to pay higher rate of tax for first time, 31 January 2011 (www.telegraph.co.uk/finance/personalfinance/consumertips/tax/8292286/IFS-1.6m-to-pay-higher-rate-of-tax-for-first-time.html; accessed 14 May 2012).

7 As per the Bluebook, Table C1 published by HM Treasury (www.hm-treasury.gov.uk/d/public_finances_databank.xls#'C1'!A1)

assumptions. The knowledge of illegal or underground economy is inevitably very sketchy. Various models try to measure tax gap (the difference between tax which ought to be collected and actually collected; and may relate to tax avoidance, tax evasion and late payments). The UK Treasury estimates that each year £40 billion of tax revenues may not be collected (HMRC, 2010), but leaked government papers[8] suggest that the amounts may be between £97 billion and £150 billion. Some economic models suggest that around £100 billion (Lyssiotou, Pashardes and Stengos, 2004), and possibly £120 billion (Murphy, 2010) of tax revenues are lost each year, large enough to cover the annual cost of running the National Health Service. A UK government report (National Audit Office, 2007) showed that for the year 2005-2006, 220 of the 700 biggest companies paid no corporation tax; a further 210 companies paid less than £10 million each; 12 of the largest companies extinguished all liabilities in 2005-2006 and scores more claimed tax losses. Some UK companies have caught public attention. For example, in 2009 Barclays Bank declared global profits of £4.6 billion, but paid only £113 million in UK corporation tax, an effective rate of 2.4%[9]. In February 2012, the UK government introduced retrospective legislation to halt two tax schemes that would have enabled Barclays to avoid around £500 million in corporate taxes. The Treasury referred to the schemes as “highly abusive … designed to work around legislation that has been introduced in the past to block similar attempts at tax avoidance. … The first scheme seeks to ensure that the commercial profit arising to the bank from a buyback of its own debt is not subject to corporation tax. … The second scheme … aims to convert non-taxable income into an amount carrying a repayable tax credit in an attempt to secure ‘repayment’ from the Exchequer of tax that has not been paid[10]”. Vodafone has also come under scrutiny. In 2012, it reported global pre-tax profits of £9.549 billion, including £1.3 billion in UK. However, the company did not pay any corporate taxes in the UK. In 2011, its UK operations generated pre-tax profits of £1.2 billion, but Vodafone only paid £140 million in corporate taxes[11].

Opaque corporate structures, complex transactions, secrecy and offshore jurisdictions have become a hallmark of tax avoidance schemes (US Senate Permanent Subcommittee on Investigations,

8 Sunday Times, Brown targets celebrities’ tax perk, 4 June 2006.

9 BBC News, Barclays UK corporation tax bill for 2009 was £113m, 18 February 2011 (www.bbc.co.uk/news/business-12511912; accessed on 8 May 2012).

10 HM Treasury press release, Government action halts banking tax avoidance schemes, 27 February 2012 (www.hm-treasury.gov.uk/press_15_02.htm).

11 The Daily Telegraph, Vodafone paid zero UK corporation tax last year, 10 June 2012 (www.telegraph.co.uk/finance/newsbysector/epic/vod/9322368/Vodafone-paid-zero-UK-corporation-tax-last-year.html; accessed 10 June 2012).

2006). The UK's 100 largest companies listed on the London Stock Exchange have more than 34,000 subsidiaries and joint ventures. Around 8,000 of these are located in sparsely populated tax havens that offer low tax rates or require limited disclosure to other tax authorities. 98 of the FTSE 100 companies have a presence in tax havens. HSBC, Royal Bank of Scotland, Barclays and Lloyds have 1,649 offshore subsidiaries. These banks, all reliant on taxpayer loans and guarantees, have the largest number of entities registered in the Cayman Islands, with Barclays alone registering 174 subsidiaries and ventures there. HSBC has 156 subsidiaries in Delaware (a tax haven within the US, which has limited reporting requirements), compared to 97 in the rest of the USA. Lloyds Group has 97 companies in the Channel Islands (Action-Aid, 2011). Little is known about the commercial aspects of these offshore entities but they do enable organizations to engage in regulatory arbitrage[12].

The tax avoidance machine is operated by highly-paid professionals on a global scale. Experienced observers say that "Britain's corporation tax revenues are under relentless attack from several multinational companies and the global accountancy firms' mass production of tax avoidance[13]". A legislator told the UK House of Lords[14] 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".

Accountancy firms PricewaterhouseCoopers, KPMG, Deloitte & Touche and Ernst & Young, collectively known as the Big Four, are the driving force behind the creation of complex corporate structures, tax avoidance schemes and creative compliance. They operate from

12 This is a process by which firms circumvent regulation in one place by taking advantage of lax rules (secrecy, low public accountability, poor enforcement, low/no taxes) in another jurisdiction. Thus companies might develop ways of booking sales revenues in offshore subsidiaries even though they engage in little direct trading, with the aim of shifting taxable profits to those places and avoiding taxes in other jurisdictions (see Sikka and Willmott, 2010, for some illustrations).

13 Hansard, House of Commons Debates, 3 February 2005, col. 992.

14 Hansard, House of Lords Debates, 17 March 2011, col. 375.

hundreds of cities, including over 80 offices in offshore tax havens[15] which often do not levy income and corporate taxes, or require companies to file audited accounts.

**Accountancy Firm Income and Size – 2011**

| Firm | Global Fee US$bn | Employees | Countries | Offices |
|---|---|---|---|---|
| PricewaterhouseCoopers | 29.2 | 168,710 | 158 | 771 |
| Deloitte & Touche | 28.8 | 182,000 | 150 | 690 |
| Ernst & Young | 22.9 | 152,000 | 140 | 700 |
| KPMG | 22.7 | 138,000 | 150 | 717 |

**Source:** Annual reviews published by the firms

The Big Four accounting firms have gross global annual revenues of around US$104 billion (£68 billion) from audit, tax, consultancy and other services, making them the 54th largest economy in the world. Around £8 billion comes from the UK. The secretive firms do not reveal the fees earned from tax avoidance, but in 2005, an internal HMRC study[16] estimated that the UK offices of the Big Four accounting firms generate around £1 billion in fees each year from "commercial tax planning" and "artificial avoidance schemes".

An increasing number of cases are being referred to tax tribunals, and many relate to tax avoidance schemes. The outstanding number of tax disputes has reached 22,100[17] though the numbers relating to contrived tax avoidance are known. Each year, between 30%-40% of the UK Finance Bill strives to deal with abusive schemes. As part of its armoury, the UK Finance Act 2004 introduced the "Disclosure of Tax Avoidance Schemes" (DOTAS) rules and required promoters of avoidance schemes to disclose the main elements of the schemes to Her Majesty's Revenue and Customs (HRMC) within a specified time period. The UK disclosure requirements are modelled on the US Tax Disclosure Regulations. Here are some observations by a former US

15 Daily Mail, Big four auditors 'embedded in tax haven world', 29 January 2011, (www.thisismoney.co.uk/money/article-1351703/Big-auditors-embedded-tax-haven-world.html; accessed 17 May 2012).

16 The Guardian, Gilt-edged profits for profession's 'big four', 7 February 2009 (www.guardian.co.uk/business/2009/feb/07/tax-gap-avoidance-schemes; accessed 14 May 2012).

17 Financial Times, Tribunal faces rise in number of tax disputes, 5 June 2012 (www.ft.com/cms/s/0/74c00434-af1e-11e1-a8a7-00144feabdc0.html#axzz1x8DOKa1u; accessed 5 June 2012).

Internal Revenue Service (IRS) Commissioner on the effectiveness of the US disclosure regulations: “Companies (and wealthy individuals) pay handsomely for tax professionals not just to find the lines, but to push them ever outward. During my tenure at the Internal Revenue Service, 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” (Everson, 2011).

## Accountancy Firms in Action

This section provides a brief glimpse of some tax avoidance strategies developed by major accountancy firms (for further details see Mitchell and Sikka, 2011). Despite claims of ethical conduct they are routinely involved in tax avoidance and evasion (Sikka, 2010).

KPMG received considerable exposure from the 2002 collapse of WorldCom, a giant US communications corporation. For a fee of US$9.2 million KPMG advised WorldCom to increase its profits by creating “management foresight”, a previously unknown intangible asset. Management foresight is little more than providing various bundles of services. The asset was registered to a subsidiary in a low-tax jurisdiction, which in turn licensed it to other companies in the WorldCom group for annual royalty payments. The royalty payments by subsidiaries qualified as a tax deductible expense whilst the income in the hands of the receiving company attracted tax at a low rate. In effect, no cash went outside the corporate group. The arrangement enabled WorldCom to avoid between US$100 million and US$350 million in taxes.

The ingenuity of KPMG is highlighted by the 2007 UK case of *John Astall and Graham Edwards v Her Majesty’s Revenue and Customs*[18]. The case involved attempts by two wealthy entrepreneurs to shield almost £5 million of income from UK income tax. Under the scheme cash was loaned to specially-created trusts, and the resultant IOUs then traded to banks at an apparent loss. The "loss" could then be offset against personal tax bills. KPMG stood to make a profit of £15 million from the scheme. The Special Commissioner quashed the claims for losses because they were not genuine economic losses. The

18 www.financeandtaxtribunals.gov.uk/judgmentfiles/j3422/SPC00628.doc

case went to Court of Appeal[19], but the original judgement was upheld. The case was important because a number of millionaires had purchased blueprints of the same scheme to shield some £156 million of income from the UK taxes[20], resulting in a loss of £50 million of tax revenues. Another mass marketed KPMG scheme enabled companies and their employees to avoid National Insurance Contributions (NIC) and income tax[21] by paying their directors with the debts of the company instead of cash[22]. The scheme was thrown out by Special Commissioners.

In 2003, KPMG became subject to a US Senate inquiry (US Senate Permanent Subcommittee on Investigations, 2003). The Senate Committee scrutinised just four of the firm's 500 "active tax products". Three schemes manufactured paper losses to enable clients to reduce their income tax. The fourth used a "charitable contribution strategy" to reduce the tax bills of companies. KPMG received around $124 million in fees. The Senate investigation found that KPMG had an extensive organisational structure for developing and marketing tax avoidance schemes. It had a "Tax Innovation Center" with income generating targets and its sole function was to generate new avoidance schemes. Presentations to potential clients were made on chalkboards and erasable whiteboards. Written materials were retrieved from clients before the salesman left meetings. Potential clients had to sign "non-disclosure" agreements. Staff were advised not to keep revealing documentation in their files and to clean out their files, to limit detection of the firm's activities. In order to orchestrate these transactions banks, including Deutsche Bank, HVB, UBS, and NatWest provided loans for millions of dollars. Sceptical clients were reassured through opinion letters by friendly lawyers. The firm made a deliberate decision to not comply with the US disclosure law, and internal documents showed that the firm did a cost-benefit analysis and concluded that profits from suspect schemes would exceed the costs, if caught. Eventually, the US Justice Department caught-up with the firm and KPMG admitted "criminal wrongdoing and agreed to

19 Astall v Revenue & Customs (2009) LTL 9/10/2009

20 The Guardian, Sheltering cash: the intricate schemes drawn up by KPMG, 7 February 2009 (www.guardian.co.uk/business/2009/feb/07/tax-gap-kpmg; accessed 15 May 2012).

21 Spectrum Computer Supplies Ltd v Revenue and Customs Commissioners; Kirkstall Timber Ltd v Revenue and Customs Commissioners [2006] STC (SCD) 668.

22 Accountancy Age, KPMG scheme advised paying directors with debt, 21 September 2006 (www.accountancyage.com/aa/news/1785797/kpmg-scheme-advised-paying-directors-debt; accessed 15 May 2012).

pay $456 million in fines[23]". A number of its former partners and employees have received prison sentences (Mitchell and Sikka, 2011).

Ernst & Young has a history of crafting ingenious tax avoidance schemes. One enabled directors of Phones 4U (part of the Dextra Group of Companies) to pay themselves in gold bars, fine wine, and platinum sponge[24] and avoid National Insurance Contributions (NIC). No sooner had legislation killed off that scheme, than Ernst & Young devised another. This enabled higher paid employees and directors of Phones 4U (and other companies) to avoid NIC and income taxes by securing payments through an offshore employee benefit trust[25] (EBT) in Jersey. The gist of these schemes was that as long as the transaction looked like a loan, for example by carrying interest, tax is avoided by the company and the employee. The House of Lords held[26] that the contributions by the companies to the EBT were, however, potential emoluments and hence liable to income tax and NIC.

The Ernst & Young factory manufactured another novel avoidance scheme codenamed "Project Pita" or "Pain in The Arse" designed to enable Debenhams and 90 major high street retailers to avoid VAT and increase their profits. The outward sign of the scheme was a statement printed on the customers' credit card receipt. It read "I agree that 2.5% of the above value is payable to DCHS (Debenhams Card Handling Services Ltd, a wholly owned subsidiary of Debenhams Retail) for card handling services. The total amount I pay remains the same." Of course, the price paid by the credit card customer was the same as for a cash sale. As financial services were exempt from VAT Debenhams claimed that 2.5% of the proceeds were not subject to VAT and therefore the output tax payable to the Treasury would be less. Ernst & Young correspondence seen by the court referred to the £4 million VAT saving for Debenhams as "a very lucrative tax planning opportunity ... an ongoing opportunity unless legislated against ... counteracting measures would take a number of years to enact. ...". Ernst & Young informed Debenhams of a strong "counsel's opinion that Customs would need a legislative change to stop this[27]". A tax tribunal rejected the scheme and concluded that it was "carried out solely for the purpose of avoiding tax. Other than tax avoidance there were no commercial or economic reasons ..." Subsequently, the Court

23 US Justice Department press release, 29 August 2005 (www.justice.gov/opa/pr/2005/August/05_ag_433.html; accessed 23 April 2012).

24 Mail on Sunday, £6m tax threat to Phones4U founder, 15 February 2004.

25 For details, see www.taxbar.com/documents/dextra_sp.pdf.

26 MacDonald v. Dextra Accessories Ltd & Others [2005] STC 1111

27 See Debenhams Retail PLC v Customs and Excise [2003] UKVAT V18169 (03 June 2003); available at www.bailii.org/uk/cases/UKVAT/2003/V18169.html

of Appeal[28] killed off the scheme. Through this avoidance scheme the participating retailers hoped to increase their profits by some £300 million to £500 million a year. A relieved Treasury spokesperson said, "This was one of the most blatantly abusive avoidance scams of recent years, and the court's decision to quash it is very welcome[29]."

The UK authorities have failed to mount any investigation of the tax avoidance industry, but Ernst & Young has been the subject of a US Senate inquiry (US Senate Permanent Subcommittee on Investigations, 2005). The Committee concluded that Ernst & Young sold "abusive or illegal tax shelters ... marketed a number of questionable tax products to multiple clients" (p. 6 and 82). A number of its former employees and partners have received prison sentences too (Mitchell and Sikka, 2011).

PricewaterhouseCoopers (PwC) has also been on the US Senate Committee's radar. It concluded that the firm "sold general tax products to multiple clients, despite evidence that some ... were abusive or potentially illegal tax shelters" (US Senate Permanent Subcommittee on Investigations, 2005, p. 93). The firm continues to sell tax avoidance schemes (Mitchell and Sikka, 2011) and has now developed a new line in creative statistics to defend its clients and trade. A 2010 report by Action-Aid alleged that brewing giant SABMiller may be avoiding around £20 million in taxes each year in India and Africa through complex financial transactions (Action-Aid, (2010). With advice from PwC, SABMiller claimed (see Mitchell and Sikka, 2011) that for the year to 31 March 2010 the group reported US$2,929 million in pre-tax profits and remitted US$7,000 million to governments in corporate tax, excise tax, VAT and employee taxes. The cynical creativity of the above figures is noteworthy. These "blatantly misleading[30]" figures are manufactured by PwC, whose statistics attribute taxes to corporations, including those not directly borne by the company at all. For example, employees pay income tax and National Insurance Contributions (NIC). These are deducted at source by companies and then remitted to the tax authorities. Similarly consumers pay VAT and fuel duty on purchases. This is collected by companies and then at set intervals, after deduction of VAT on their purchases, is paid over to tax authorities. PwC's 'total tax contribution'

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28 Debenhams Retail Plc [2005] EWCA Civ 892 (18 July 2005); available at www.bailii.org/ew/cases/EWCA/Civ/2005/892.html

29 The Daily Telegraph, Debenhams lose VAT case, 19 July 2005 (www.telegraph.co.uk/finance/2919204/Debenhams-loses-VAT-case.html; accessed 14 May 2012).

30 New York Times, A misleading view of corporate taxes, 14 April 2011 (http://economix.blogs.nytimes.com/2011/04/14/a-misleading-view-on-corporate-taxes/; accessed 15 May 2012).

lumps corporate taxes, if any, paid by the company together with income tax, VAT, NIC and excise duties. In the UK, government reports show that major companies are avoiding taxes (National Audit Office, 2007). Other studies show that in 2009 only 33.6% of UK companies actually paid corporate tax (Murphy, 2011). In contrast, a PwC report claimed that in 2010 the UK's largest 100 companies made a total tax contribution of £56.8bn, which is 11.9% of government receipts from all taxes. This PwC spin includes £39.2 billion which is not borne by companies. In fact, as income tax, VAT, NIC and fuel duty is remitted in arrears to the government, companies are getting a huge interest-free loan from the taxpayer, even though they pass on the cost of acting as tax collectors to the consumer through prices.

Deloitte & Touche was a key player in enabling Enron, the collapsed US energy company, to avoid taxes. In late 2001 Enron collapsed and a US Senate report (US Senate Joint Committee on Taxation, 2003) noted that the company used complex transactions, opaque structures and offshore entities to avoid taxes. Enron's profits of US$1.785 billion for the years 1996 to 2000 attracted no taxes. Deloitte & Touche was one of the promoters behind exotic schemes codenamed Condor, Valhalla and Tammy. US Senator Charles Grassley said that 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[31]." The US Senate reports providing an introduction to Enron's tax avoidance schemes run to some 2,300 pages.

In the UK Deloitte & Touche is under the spotlight for its links with the Royal Bank of Scotland (RBS). RBS, bailed out by the UK taxpayer, is accused of avoiding £500 million of taxes through complex avoidance schemes[32]. The schemes were designed during the time of its chairman Sir Fred Goodwin and involved the movement of large amounts of cash, often through offshore places like the Cayman Islands. In another scheme, in 2004, Deloitte designed a scheme for the London office of Deutsche Bank (DB) to enable it 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 called Dark Blue Investment (DBI), managed by Investec[33]. A Tax

31 The Guardian, Scandal of crashed company's tax evasion, 14 February 2003 (www.guardian.co.uk/business/2003/feb/14/corporatefraud.enron1; accessed 12 May 2012).

32 The Guardian, RBS avoided £500m of tax in global deals, 13 March 2009 (www.guardian.co.uk/business/2009/mar/13/rbs-tax-avoidance; accessed 10 May 2012).

33 Deutsche Bank Group Services (UK) Ltd v Revenue & Customs [2011] UKFTT 66 (TC) (19 January 2011)

Tribunal rejected the scheme and the judge said that "…the Scheme as a whole, and each aspect of it, was created and coordinated purely for tax avoidance purposes".

Deloitte was tax adviser to MG Rover Group, a UK car manufacturer which collapsed in April 2005 with debts of £1,289 million and the loss of 6,500 jobs. A government inquiry (Department of Business Innovation and Skills, 2009) drew attention to large scale tax avoidance, using leasing, loans and offshore entities in Guernsey. The report noted that for 2000-2005 Deloitte received £30.7 million in fees from the MG Rover Group. £28.8 million of this was for "other services", including advice on taxes.

## Summary and Discussion

This paper has sought to draw attention to the prevalence of tax avoidance. Behind the headline figures are issues about quality of life, social justice and survival of the state and democracy. The avoidance of taxes by wealthy elites and corporations creates dilemmas for ordinary citizens and small businesses. They either need to pay higher taxes, or accept inferior quality public goods. The avoidance of taxes results in transfers of wealth and those able to avoid democratically agreed taxes are able to have a free ride. Arguably, tax avoidance has ushered in a crisis of democracy. We can all be persuaded to vote for a political party that presents a very rational and feasible plan to make greater investment in education, healthcare, transport, pensions and security, but its electoral mandate is easily undermined by the tax avoidance industry whose operations ensure that the government cannot have sufficient revenues to deliver its electoral mandate. Thus there is a fundamental clash between the forces of democracy and the tax avoidance industry whose sole aim is to enrich its clients.

Major accountancy firms are central to the global tax avoidance industry. Under pressure from economic elites, successive governments have reduced the rates of corporate taxes and higher rates of income tax, but this has not curbed tax avoidance. The Big Four accountancy firms have repeatedly shown willingness to make private profits at almost any cost and have knowingly marketed aggressive tax avoidance schemes, many of which have turned out to be schemes for tax evasion. Some of their partners have been sent to prison and the firms have been fined, but this has neither sharpened their sense of social responsibility nor dulled their pursuit of private profits.

The UK tax laws have been unable to combat twenty-first century tax avoidance with outdated practices. Clearly, a new social settlement is needed. Sunlight is usually seen as an effective antidote for abusive practices and should be used in this arena. The tax returns of all corporations and individuals earning above the median income should be made publicly available. The fear of public exposure may deter some from engaging in abusing schemes. Economic transactions should be taxed at the place they take place. Thus companies should not be able to generate transactions in the UK, but book revenues in offshore tax havens. Despite its diminishing role in the economy, the state is still the biggest spender. It should not award public contracts to any organisation that has avoided UK taxes in the preceding five years. The international financial scene is blighted by secrecy and tax avoidance facilitated by UK Crown Dependencies[34] (e.g. Jersey, Guernsey, Alderney, Sark, the Isle of Man) and British Overseas Territories[35] (these include Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar and Turks and Caicos Islands). The UK government advances the interests of these places in intentional arenas (e.g. United Nations, European Union) and has legal and moral responsibility for their good governance. Therefore, the government should end the corrosive secrecy provided by UK sponsored tax havens and subject them to the same regulatory requirements that apply to mainland UK. The firms engaged in persistent tax evasion should be closed down. The government spends a vast amount of public money to challenge tax avoidance schemes in the courts. However, after winning it rarely seeks to recover costs. This should be changed. Penalties for tax evasion and avoidance should be increased and be levied not only on companies, but also on their advisers. The above reforms do not represent some silver bullet for combating the tax avoidance industry, as the industry is innovative and entrepreneurial. Rather they equip societies for checking the worst excesses of the tax avoidance industry.

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34 They are not part of the UK but are self-governing dependencies of the Crown. They have their own directly elected legislative assemblies, administrative, fiscal and legal systems and their own courts of law (for some further details see Foot, 2009)

35 They are not part of the UK and are generally remnants of the British Empire. Compared to crown Dependencies have a different constitutional relationship with the UK (for some further details see Foot, 2009).

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