HIDDEN CACHE

AS MPs PLAN TO INVESTIGATE THE CORPORATE TAX AVOIDANCE ISSUE, SANTHIE GOUNDAR ASKS WHY TAX PLANNING AND MAXIMISING PROFIT ARE SUDDENLY AGAINST THE LAW

With the rise of protest groups like UK Uncut, images of shop fronts of 'tax-avoiding' businesses being smashed, public anger at reports on the disparity between large corporations' profits and actual tax paid, and recent discoveries revealing Google avoided paying around £3.2bn in taxes in Britain and other countries over the past five years, it's fair to say tax avoidance has hit headlines all through 2011.

Additionally, HM Revenue & Customs and the Treasury suddenly appear to be in crackdown mode on avoidance, in itself legal, and what it calls 'aggressive tax planning'. David Gauke MP, secretary to the Treasury, said the government was taking tax avoidance seriously. 'We must take every possible step to minimise tax avoidance. We cannot afford to let it undermine our efforts to reduce the deficit, and it is not fair that by deliberately creating schemes that avoid tax, some people pay less while the vast majority of the hard-working public pay their fair share,' says Gauke.

'Action against tax avoidance will be a priority, alongside improving the tax law-making process, introducing robust legislation and targeting HMRC counteraction and investigation,' he adds.

Many large companies and advisers are concerned about what they say is 'increased aggression' from the tax authorities – tax evasion, they point out, is illegal, but tax avoidance isn't; and many worry that, in HMRC's eyes, the lines are blurring.

The announcement by the Treasury Select Committee of its intention to investigate corporate tax avoidance by large multinationals has placed the issue firmly in the spotlight for the foreseeable future. It's a heated debate: tax-avoiding companies and their advisers insist they are working within the law and doing nothing wrong, while others – for example Dave Hartnett, permanent secretary of tax at HMRC – say avoidance goes against the spirit of the law and is an issue of morality.

SHAREHOLDER PRESSURE

Despite advertising revenue income of £2bn in 2009, tax experts claim Google paid only £3m in UK corporation tax rather than the expected £190m. Overseas profits have been legally moved between Google subsidiaries in at least five different jurisdictions, including Ireland and the Netherlands, eventually ending up in Bermuda, which has a 0% corporation tax rate. According to investigators such as Richard Murphy, a tax accountant and director of Tax Research UK , Google has not just avoided tax in the UK – it has also been avoiding significant amounts of tax in Ireland, which has a corporation tax main rate of 12.5% – less than half that of the UK.

A spokesman for Google says: 'We have an obligation to our shareholders to set up a tax-efficient structure, and our present structure is compliant with the tax rules in all the countries where we operate,' but Murphy says that Google was guilty of 'systemic tax avoidance'.

Google isn't the only multinational feeling the heat of protest. Last year, UK Uncut alleged that Vodafone had been 'let off' a £6bn tax bill by HMRC, although HMRC dismissed this as 'an urban myth'. And activists targeted Barclays earlier this year after it ran up profits of £11.6bn in 2009 – but paid just under 1% of said profits (ie, £113m) in corporation tax.

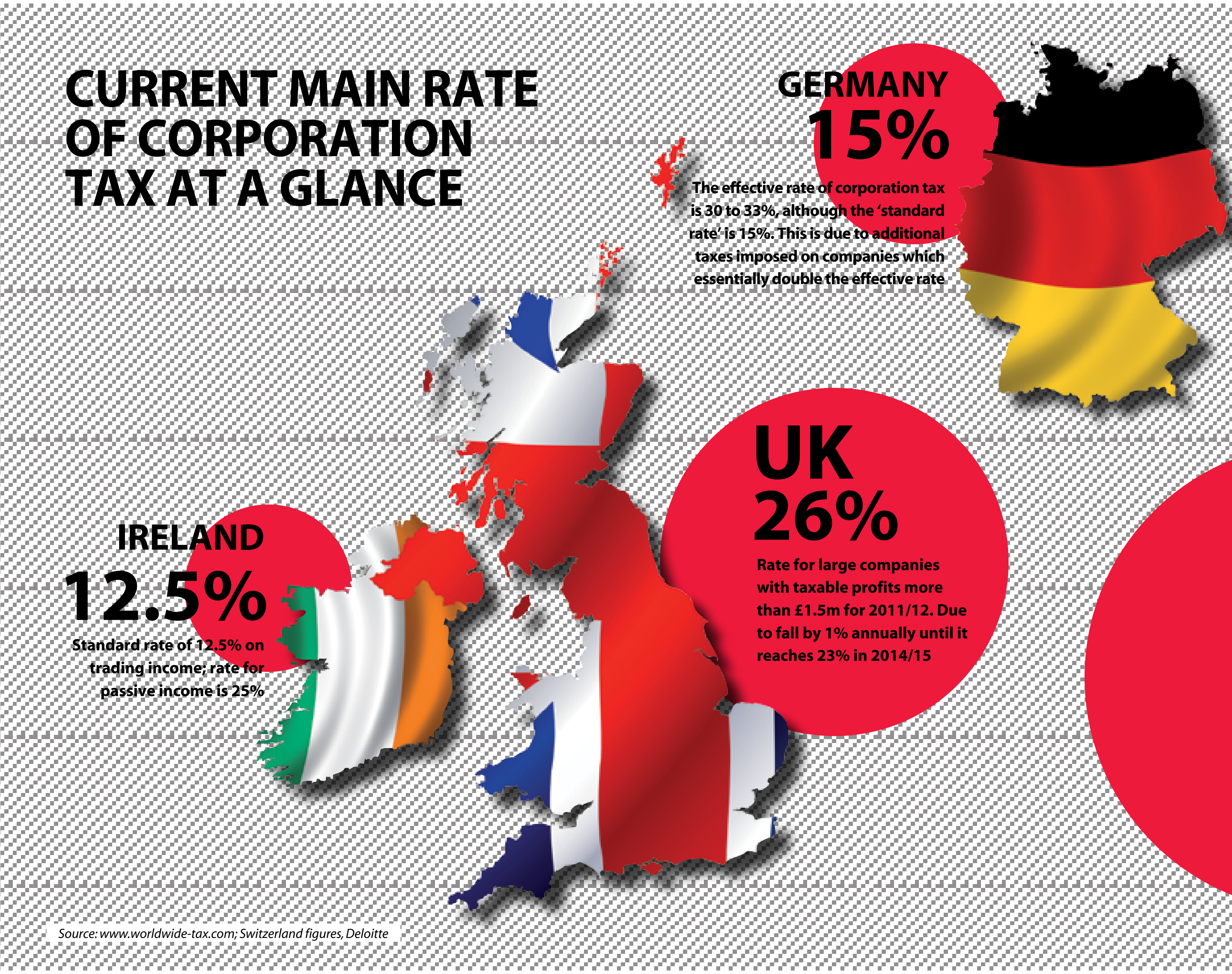
Murphy says the public reaction to such reports, combined with pressure to raise revenues to fill the fiscal deficit, is why HMRC is clamping down on tax avoidance and the reason some companies practise such avoidance in the first place often comes down to greed.

'Using the tax ignorance of many analysts, if companies avoid tax it often pushes up the share prices – and executive share options would be triggered, so directors can exercise these and become wealthy,' he says.

But Robert Field, head of tax at law firm Farrer & Co, disagrees. 'Companies have a responsibility to their shareholders [to maximise returns],' he says. 'At the moment, much tax avoidance is to do with the disparity between the current corporation tax rate of 26% and the top rate of income tax of 50%. Companies are reorganising their affairs to avoid paying this 50%, so to that extent tax has completely driven behaviour.

'The introduction of the 50% rate was driven by politics, rather than because it raises a significant amount for the Treasury. It has been shown that if you reduce tax rates, tax revenues rise. If rates are unfairly high, people will try to avoid paying and a whole industry often springs up around finding ways to legally minimise the tax bill.'

However, says Field, reducing corporation tax to 23%, as is planned by 2015, will not completely stop avoidance. Murphy is even more direct. 'Reducing the



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corporation tax rate will not stop tax avoidance,' he says. 'There will always be avoidance unless the rate is zero.'

MIND THE GAP

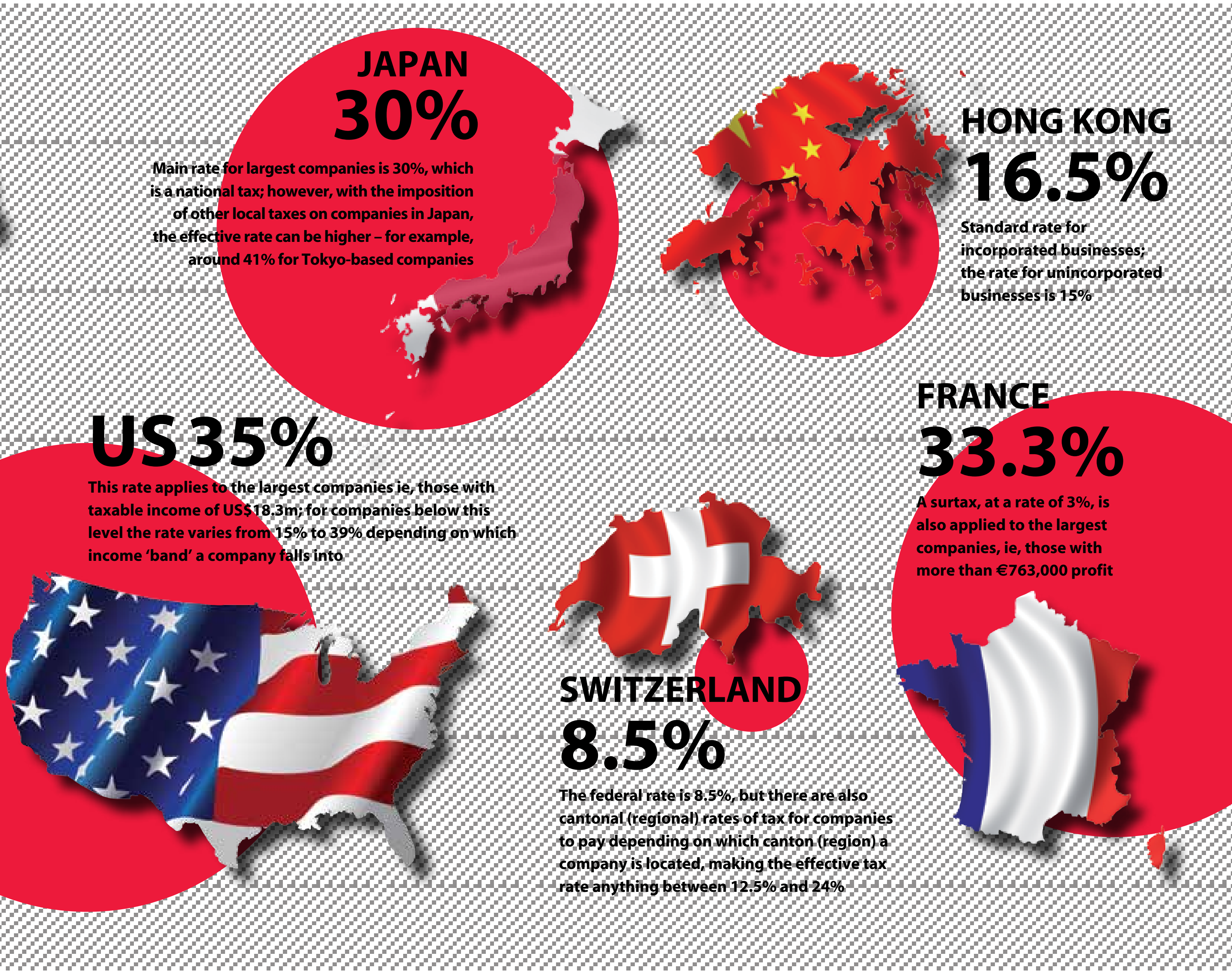
The tax gap – the difference between taxes owed to the Treasury and the tax actually paid – is around £40bn, according to HMRC figures. Gauke says that 'more than a sixth is due to tax evasion, that is illegally understating tax liabilities. But a further sixth is estimated to be due to tax avoidance, that is reducing tax liabilities by using the tax law to get a tax advantage that parliament never intended. And the problem is a persistent one.'

Murphy says he believes the tax gap is actually closer to £120bn, and that HMRC estimates did not consider all the facts. 'Errors and mistakes do not seem to have been included as part of the tax gap; and the government seem to have only considered an area as tax avoidance if they think they can tackle it.

'For example, I included figures for IR35 avoidance, even though the government say it's no longer on its agenda so it seems to have taken out figures relating to it,' he adds.

But Gauke refutes this, saying 'even a brief analysis reveals that it is deeply and systemically flawed,' adding that 'an element of double-counting [has been] involved. It is simply nonsense to categorise as tax avoidance the use of legal structures and allowances for purposes intended by parliament.'

So what's the solution? Murphy suggests country-by-country reporting, where a multinational has to report for every single country it operates in 'so if all the costs were in Germany, all the sales were in the UK, but all the profits were shifted to the Cayman Islands, we'd see it,' he says. 'It will shame them into compliance.'



Field, however, says the answer to tax avoidance is much more complicated. 'The argument UK Uncut put forward is too simplistic,' he says. 'For example, if you have a corporate group headquartered in the UK with a US subsidiary carrying on the same business, if the UK company makes losses it won't pay tax, but if the US company is profitable and these profits are dividended back to the UK, it will have already paid US tax on it, and this would be credited against the UK company's tax bill. So it's not as simple as saying that the company is avoiding UK tax.'

Where there is agreement is on the best approach moving forward. There is consensus that a principles-based approach is critical. 'Tax law needs to be drafted clearly,' says Field. 'The question is about whether or not you should enable legal avoidance. Lawyers and accountants can currently take what's in the law and use it against itself. Adopting a principles-based approach when drafting legislation would clearly show who is taxable, who is exempt, and help judges in cases.'

MPs SIGNAL INVESTIGATION

In March 2011, the Treasury Select Committee announced it would investigate corporate tax avoidance later this year, focusing on the ways that corporations minimise their tax bills. Members of the committee have been privately calling for an inquiry for some time and it is likely to involve evidence from the heads of large multinationals. The committee has not confirmed a specific timeframe as yet.

Some work on avoidance is already underway: details of the Tackling Tax Avoidance programme, which will run for the next few years, was released at the same time as the March 2011 Budget, and starts with consultations on income tax losses and unauthorised unit trusts. Meanwhile, the Aaronson study on a General Anti-Avoidance Rule (GAAR) will be completed by 31 October 2011.