



POWER WITHOUT RESPONSIBILITY: TAX AVOIDANCE AND CORPORATE INTEGRITY

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In a world of globalised business the integrity of national tax regimes has come under increasing pressure from businesses and wealthy people who are able to avoid taxes and use their political power to secure favourable tax treatment. In the vanguard of this process, but generally operating behind the scenes, are accountancy firms which through their intimate knowledge of the international financial system encourage clients to engage in aggressive tax avoidance schemes that, intentionally or otherwise, undermine democratic governments and harm global economic growth and the welfare state.

As the global economy shifts towards fewer and larger corporations, a small number of accounting firms have also emerged as transnational corporations, typically headquartered in offshore tax havens. The commercial interests of these accounting mega-firms have become increasingly aligned with those of their clients, particularly since a large part of their fee income is derived from sell consulting services and tax advice. Accountancy firms have taken a lead role in promoting the 'race to the bottom' in regulation and tax.

The economic strength of globalised businesses has shifted the balance of political power in their favour, allowing them to secure the upper hand in

negotiations with governments around the world. They have used this political power, enhanced by considerable political patronage, to advance their own interests, to oppose change, and to ensure that they are not held to account for their actions.

Nowhere is the lack of corporate accountability more apparent than in the related areas of tax avoidance, tax competition and illicit capital flight. Whilst the glossy corporate social responsibility statements of major corporations proclaim their attachment to high ethical standards and to generating welfare for their wider stakeholder communities, nothing or almost nothing is said about their tax policies in the countries in which they operate. In practice many corporations use their political power to lobby for tax breaks and subsidies; exploit legal loopholes to avoid taxes; and use aggressive tax avoidance techniques, typically involving tax havens and so-called special purpose vehicles, to reduce tax payments wherever they operate.

Since paying taxes is generally regarded as a prime role of the corporate citizen, this disconnect between the glossy corporate statements and the reality of widespread aggressive tax avoidance suggests major flaws in the ethical values of many corporations. It is also clear that the integrity of accounting professionals and tax advisers has been compromised by their involvement in schemes that are frequently elaborated with the intention of subverting the integrity of tax regimes. What should we make, for example, of the following comment by a senior tax practitioner at a major accounting firm?

"No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken."

What is notable about this quote is the fact that this person felt sufficiently confident about the political power of his industry that he could voice this view with impunity in a national newspaper.

The globalised accounting firm KPMG has played a significant role in devising aggressive tax avoidance strategies. KPMG employs over 100,000 professionals worldwide, including 6,500 partners in 148 countries. In 2003/4 its global fee income amounted to US\$12.2 billion. What KPMG does not promote in public, however, is that it also operates through a network of offices based in at least 18 tax havens across the world, including Belize, from where it provides advice on such things as how to obtain 'economic citizenship' in order to avoid capital gains tax and death duties. That same office is also happy to act as a client's agent in setting up tax exempt international business companies which are not required to provide audited accounts or file annual returns.

Tax havens such as Belize and international business companies are used for aggressive tax avoidance techniques such as transfer mis-pricing, re-invoicing, the hiding of assets and liabilities in offshore trusts and special purpose vehicles, and the operation of complex lease-back deals. Some might argue that these techniques are legal, but few would challenge our view that tax avoidance is ethically unacceptable and that the prime attraction of tax havens lies with the secrecy space they offer, which makes them perfect locations to place capital in flight from either tax, politics or the law.

A US Senate Committee enquiry has made public how KPMG has derived considerable fee income from marketing aggressive tax avoidance schemes involving tax shelters and offshore tax havens. In an email obtained by the Senate Committee, a senior KPMG tax adviser told his colleagues that even if regulators took action against their sales strategies for a tax shelter known as OPIS the potential profits from these deals would still greatly exceed the possible court penalties: *"our average deal"* he noted *"would result in KPMG fees of US\$360,000 with a maximum penalty exposure of only US\$31,000."* In other words, encouraging clients to engage with a scheme that might be outside the law would be profitable.

During its enquiries the US Senate Committee discovered that KPMG had devised over 500 'active tax products', some of which may have been illegal. Just four of those 500 products cost the US Treasury US\$85 billion annually in lost tax revenues, whilst KPMG booked US\$180 million in fees. Committee member Senator Carl Levin said that:

"our investigations revealed a culture of deception inside KPMG's tax practice."

KPMG's role in promoting aggressive tax avoidance schemes is at best unethical and anti-social, and can also be harmful to corporate governance and shareholder interests. For example, KPMG was explicitly cited in the final report on the collapse of giant multinational WorldCom for "*malpractice and negligence*" in their advice on tax strategies used to avoid state taxes in the United States.

Since the publication of the Senate Committee report KPMG has claimed to be a reformed company which no longer sells the tax products that were highlighted by the Senate report cited above, but in August 2004 the *New York Times* reported that the KPMG's tax avoidance advisers are still busy designing newer versions of what are to all intents and purposes the same abusive tax shelters.

Most business and economic commentators would agree that part of the business of business is to pay appropriate taxes. However, aggressive tax avoidance is not just ethically unacceptable. It is also socially and economically harmful because it distorts global markets to the disadvantage of small and local firms and reduces the efficiency of competitive markets.

KPMG promotes itself to its clients as an adviser on corporate responsibility. According to a public statement by a KPMG chief executive officer "*There is a strong business and overwhelming moral case for CSR.*" If KPMG genuinely believes this to be the case it should adopt corporate responsibility standards in relation to its policies on tax. These standards should include requirements to publish

all necessary accounting information on actual tax payments and to refrain from the use of profits-laundering vehicles created without substantial economic purpose. It should advise its clients to list in their accounts and CR statements all the countries in which they trade, how much profit is derived from genuine economic activity in each of these countries, and where these profits are booked for tax purposes, indicating any special purpose vehicles and trusts that are used and the extent of tax avoidance arising from the use of tax minimization strategies.

And in the spirit of practicing what it preaches, KPMG should also apply these standards to its own trading operations. Only by doing this can KPMG demonstrate in a convincing manner a commitment to good corporate citizenship in a globalised economy.

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