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A Code of Conduct for Taxation

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The need for a Code of Conduct for Taxation

Tax is an emotive subject. This is evident from the definition that many dictionaries offer for it, of which the following is typical[1]:

1. *A sum of money demanded by a government for its support or for specific facilities or services, levied upon incomes, property, sales, etc.*

2. *A burdensome charge, obligation, duty, or demand.*

The conflict inherent in taxation is clear from this definition. Most would agree that conflict is best avoided, wherever possible, especially on matters relating to something as vital to social well-being as tax. The services supplied by the state and paid for out of taxation revenues are in many cases regarded as basic human rights that should be available to all, free at the point of delivery. The collection of tax, however, requires the state to challenge the property rights of its citizens, and to request personal information. However, the right to hold property and to respect for privacy are also basic human rights. It is unsurprising that emotions run high as a result and that this has led to dispute, both between taxpayers and their own states, but also between taxpayers and other states and between states themselves. Indeed, the use and abuse of tax prerogatives has been the cause of many wars within and between states.

It is precisely because the risk of conflict is inherent in all tax systems that an international Code of Conduct is needed to regulate its administration. In a world where people and capital can move freely, that Code has to be capable of application and enforcement both internationally and locally. It needs also to apply to all parties likely to be affected by taxation disputes, whether they be taxpayers, their agents (typically lawyers or accountants) and governments. And since taxpayers include not just citizens but the whole myriad of legal entities now capable of being created under statute through which people may organise and administer their affairs, including companies (with and without limited liability), partnerships (with and without limited liability), trusts, charities and other more esoteric structures, any Code has to consider the consequences of these structures as well as those arising for natural persons.

It is therefore important to note what a Code of Conduct can achieve that other mechanisms cannot, especially since a Code is not law and consequently involves voluntary adoption by those who abide by it. The benefits of a Code are:

1. It is not law. This means it can be promulgated and used when there is no agency that could promote the same purpose on a statutory basis. There is at present no agency that can promote a worldwide basis for taxation law;

[1] tax. (n.d.). Dictionary.com Unabridged (v 1.0.1). Retrieved 4 December 4 2006, from Dictionary.com website: http://dictionary.reference.com/browse/tax

2. A Code is a statement of principles, which makes it more flexible than a legal statement because there can be no doubt that it is the principles, and not its detailed wording, which should guide those involved in interpreting the Code.

3. A Code is flexible. Whilst specifying matters of principle, issues of detail, which evolve rapidly and can lose relevance almost as fast, can be handled without requiring changes to the structure of the Code itself. This ensures durability;

4. A Code can concentrate on the rights of participants rather than the minutiae of individual issues, which is essential if the Code is be applicable to a wide variety of circumstances.

These merits can also create problems. Many voluntary codes have lacked teeth. If, however, governments have committed to them, as has for example been the case with much of the work of the United Nations or the EU Code of Conduct for Business Taxation[2] then codes can be made to work.

The Code of Conduct for Taxation proposed in this report seeks to address high level conceptual issues in a more comprehensive way than has previously been attempted. The Code's sponsors are conscious that they are breaking new ground, but their motive for doing so is:

1. To encourage debate on the role of a Code of Conduct for Taxation;

2. To promote a methodology it might embrace;

3. To suggest issues it should address.

The last of these is addressed within the text of the Code and the attached commentary, which form the bulk of this report. The first two need to be addressed at this stage.

There are numerous reasons why an embracive, high level global Code of Conduct for Taxation is relevant:

1. Companies continue to adopt transnational structures but the structures of the state, regulation, and taxation have not developed to suit the demands and pressures that the new market structures have created. A Code of Conduct on Taxation should address some of the resulting issues;

2. Codes of Conduct have been used to tackle some international taxation issues, the EU Code of Conduct on Business Taxation being one such example. A precedent has been created for their use, but there is a need to be more ambitious in terms of the issues addressed;

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[2] http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm accessed 15-5-07

3. There is significant anecdotal evidence that disputes between taxpayers and the state are a matter of significance, and one on which tax agents, as major opinion formers in this arena, frequently comment[3]. Codes of Conduct have been referred to as a means of resolving such issues.

In addition, it is clear that some of the basic human rights that services funded by taxation revenues are meant to address are not being met. The Millennium Development Goals[4], for example, identify deficiencies in this area. The problems addressed are:

Goal 1: Eradicate extreme poverty and hunger

Goal 2: Achieve universal primary education

Goal 3: Promote gender equality and empower women

Goal 4: Reduce child mortality

Goal 5: Improve maternal health

Goal 6: Combat HIV/AIDS, malaria and other diseases

Goal 7: Ensure environmental sustainability

Goal 8: Develop a Global Partnership for Development

These problems are substantial in scale; the estimated cost of addressing them amounts to between US$40 – US$60 billion a year[5]. Additional revenues will clearly need to be raised if these goals are to be fulfilled.

The issue of rights also underpins the methodology used for the Code of Conduct proposed in this report. This is because the issues that need resolution in taxation relate to rights, and to the resolution of conflicting claims that such rights create. It is for this reason that the proposed Code of Conduct has been developed after careful consideration of the United Nation's Universal Declaration of Human Rights[6], itself a Code of Conduct which requires subscribing nations to adhere to its inherent principles. The Declaration of Human Rights therefore provides a useful reference point for assessing abusive behaviour and dealing with its consequences.

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[3] See for example 'From debate to action – drawing the lines and finding the balance – legislation, principles and codes'. KPMG, London, 2006 available for download at http://www.kpmg.co.uk/pubs/beforepdf.cfm?pubid=1744&m1=1 accessed 5 December 2006

[4] The UN's Millennium Development Goals may be read at http://www.un.org/millenniumgoals/goals.html accessed 5 December 2006.

[5] The Costs of Attaining the Millennium Development Goals, The World Bank, 2004 http://topics.developmentgateway.org/aideffectiveness/rc/ItemDetail.do~402274?itemId=402274&itemId=402274 accessed 5 December 2006

[6] The United Nations, 1948 – 1998, http://www.un.org/Overview/rights.html, accessed 4 December 2006

Of the 30 clauses in the UN's Universal Declaration of Human Rights, the following are most relevant to a Code of Conduct on Taxation:

- All human beings are born free and equal in dignity and rights. (Article 1);
- Everyone is entitled to all the rights and freedoms set forth in this Declaration, without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status. Furthermore, no distinction shall be made on the basis of the political, jurisdictional or international status of the country or territory to which a person belongs, whether it be independent, trust, non-self-governing or under any other limitation of sovereignty. (Article 2);
- Everyone has the right to life, liberty and security of person. (Article 3);
- All are equal before the law and are entitled without any discrimination to equal protection of the law. (Article 7);
- Everyone has the right to an effective remedy by the competent national tribunals for acts violating the fundamental rights granted him by the constitution or by law. (Article 8);
- Everyone has the right to an effective remedy by the competent national tribunals for acts violating the fundamental rights granted him by the constitution or by law. (Article 10);
- No one shall be subjected to arbitrary interference with his privacy, family, home or correspondence, nor to attacks upon his honour and reputation. Everyone has the right to the protection of the law against such interference or attacks. (Article 12);
- Everyone has the right to freedom of movement and residence within the borders of each state. (Article 13);
- Everyone has the right to own property alone as well as in association with others. No one shall be arbitrarily deprived of his property. (Article 17);
- Everyone has the right of equal access to public service in his country. (Article 21, part);
- The will of the people shall be the basis of the authority of government; this will shall be expressed in periodic and genuine elections which shall be by universal and equal suffrage and shall be held by secret vote or by equivalent free voting procedures. (Article 21, part);
- Everyone, as a member of society, has the right to social security and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each State, of the economic, social and cultural

rights indispensable for his dignity and the free development of his personality. (Article 22);

- Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment. (Article 23, part);

- Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control. (Article 25, part);

- Everyone has the right to education. Education shall be free, at least in the elementary and fundamental stages. Higher education shall be equally accessible to all on the basis of merit. (Article 26, part);

- Everyone has the right freely to participate in the cultural life of the community, to enjoy the arts and to share in scientific advancement and its benefits. (Article 27, part);

- Everyone is entitled to a social and international order in which the rights and freedoms set forth in this Declaration can be fully realized. (Article 28);

- Everyone has duties to the community in which alone the free and full development of his personality is possible. In the exercise of his rights and freedoms, everyone shall be subject only to such limitations as are determined by law solely for the purpose of securing due recognition and respect for the rights and freedoms of others and of meeting the just requirements of morality, public order and the general welfare in a democratic society. (Article 29, part).

The Universal Declaration of Human Rights provides a generally accepted statement of principle on the rights and duties of individuals, the obligations of government, and the responsibility one state has to another. It provides a valid basis from which to derive statements of principle on which it is possible to base a Code of Conduct on Taxation.

Such principles should explicitly address the tensions inherent within the Universal Declaration of Human Rights and provide a framework for consideration of practical issues relating to taxation, many of which are transient.

In undertaking this task any resulting principles should explicitly seek to replace the outmoded maxims with regard to the management of taxation promulgated by Adam Smith in 1776 in The Wealth of Nations[7]. These are (each extract being from the original text, but shortened to contain only its key elements):

[7] Smith, A, The Wealth of Nations, 1776, Book V, Chapter II, Part II. Extract downloaded from http://www.bibliomania.com/2/1/65/112/frameset.html 4 December 2006

1. *The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.*

2. *The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.*

3. *Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.*

4. *Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.*

These have been summarised using the following four words:

1. Equity

2. Certainty

3. Convenience, and

4. Efficiency.

These maxims (as Smith called them) are inappropriate to modern circumstances. They assume a role for government that is now unacceptable. They fail to recognise the obligation of the State to the citizen with regard to the provision of public goods, and relate primarily to the practice of taxation rather than the principles that underpin it.

Unfortunately the Universal Declaration of Human Rights makes no reference to taxation, though Article 29 implies that there is a universal duty of the citizen to the community of which they are a part, which could be interpreted to include an obligation to pay democratically agreed taxes levied upon them. However, the following principles on taxation can be derived from the relevant articles (shown in brackets) of the Universal Declaration of Human Rights:

1. A State has a duty to protect its citizens; (3)

2. A State has a duty to provide public goods for its citizens; (22, 23, 25, 26, 27)

3. A State may not discriminate in the provision of protection or provision for its citizens; (1, 2, 3, 7, 8, 10, 21)

4. The extent of the provision to be supplied by a State shall (subject to achievement of those rights inherent in the Universal Declaration) be determined by democratically elected governments; (21)

5. The right of a State to determine its will shall not be constrained by the actions of another State; (28, 29)

6. A State has the right to levy taxation; (implicit in the obligations imposed in Articles 3, 22, 23, 25, 26, 27 and 28 which could not be achieved if this were not true)

7. Any charge to tax must respect the right to hold private property; (17)

8. The charge to tax must not be arbitrary; (17)

9. Taxation must be imposed by law; (12)

10. All citizens of a State shall be subject to the same taxation laws; (1, 2, 7)

11. Each citizen has the duty to pay the tax due by them; (the corollary of 21 and implicit in 29)

12. The citizen shall have the right to appeal against any charge to tax; (8, 10)

13. The State may only oblige a citizen to disclose that data required by law when requesting information for the purposes of assessing their liability to tax; (12)

14. A citizen shall have the right to leave the State and its protection and shall as such deny themselves the right to its provision but be relieved of the obligation to contribute to its upkeep. (13, 28, 29).

This framework of principles is longer than that set out by Adam Smith, but reflects the reality of a society that is radically different from that in which Smith lived.

These principles provide the basis for the following Code of Conduct. In suggesting them it is however explicitly accepted that some have potentially conflicting interpretations inherent within them.

Relevant jurisprudence

Having determined these principles there is a further vital issue to resolve, relating to how the law of taxation should be interpreted. There are two options. Interpretation can based upon the principles inherent in legislation or the strict construction of legislation.

The legal systems of the world vary considerably, as do the jurisprudential systems that they use. These two possibilities do, however, accord with the broad categorisation of determining obligations in accordance with the principles of either equity or law. For these purposes "equity" is the name given to the set of legal principles which supplement strict rules of law where their application would operate harshly. The intention is to achieve "natural justice." In contrast the "law" refers to laws enacted by Parliament or established by "common law", the latter being based on precedents set by judges when they decide cases.

It has been commonplace for tax to be charged in accordance with "law". For example, it was decided in a legal opinion given in the House of Lords in the United Kingdom in 1869[8] that:

> *If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute.*

This principle remains enshrined in most British tax law (in particular) and appears to heavily influence taxation thinking in general. This decision has implicit within it the following assumptions:

1. That the right to hold property is sacrosanct and that taxation violates that property right. As such tax may only be charged when specifically sanctioned irrespective of the equity of the resulting payment, or absence of payment of taxation;

2. The letter of the law can be determined without reference to the intent of those who created it or the context which gave rise to it, even if the circumstance in which it is used was not envisioned by those who created it;

3. That it is equitable as a result that some will, or will not, fall out of the charge to tax on the basis of the strict interpretation of the meaning of words which could not have been envisaged by those who passed them into law and whether or not (as is explicitly noted in the legal opinion, above) the resulting charge to tax is equitable or just.

The alternative approach to legal interpretation with regard to taxation is purposive. It may be summarised by an Australian law of 1901[9] on legal interpretation which said:

> *In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.*

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[8] *Partington v. Attorney-General* (1869), L.R. 4 E. & I. App. 100, *per* Lord Cairns at p. 122.

[9] Section 15 AA of the Acts Interpretation Act, 1901 downloaded 4 December 2006 from http://www.austlii.edu.au/au/legis/cth/consol_act/aia1901230/s15aa.html

In this context interpretation 'looks though' the strict structure of the words in the law to determine their just and equitable meaning, and uses that meaning in deciding upon the application of the law.

The United Nations Universal Declaration of Human Rights is based upon principles. It is concerned with justice and the equitable treatment of all people. In that context a purposive or equitable approach to the interpretation of law is essential if miscarriages of justice contrary to the spirit of equity, noted to be possible in the UK legal decision of 1869, are to be avoided.

Equitable construction of the law is therefore considered an essential element of any set of principles for taxation that recognise the rights of the citizen and the mutuality of obligation inherent in the relationship between the citizen and State, and between states.

The consequences of an equitable approach to taxation law for a Code of Conduct

Much of the debate on taxation focuses on three issues:

1. How to reduce tax evasion;

2. To what extent, if any, tax avoidance may be considered legitimate;

3. What behaviour on the part of a taxpayer is considered compliant, and therefore acceptable.

This is unfortunate, because the words evasion, avoidance and compliant are being used as nouns. This requires them to be precisely defined to be of use, especially if a strict legal usage of the word is to be used for interpretation. Such a definition is not, however possible because of the complexities inherent in all language and because any definition may not stand the test of time.

For example, to evade tax means that a person has acted illegally to secure a tax advantage in the form of a reduced liability to pay tax. However, what is and is not illegal in tax law varies over time. For example, an action which may be quite acceptable in one country is quite commonly not in another, or may be acceptable in a country at one time, and because of a change in the law may not be at a later stage. In practice this means that whilst the principle of evasion can be described, it is difficult to define what is meant by the term unless the context and time of the evasion is known. Even then the ambiguities of language always make the transition from the state of tax evasion to tax avoidance porous, in contrast to the pragmatic description of the difference offered by a Chancellor of the Exchequer of the United Kingdom who famously said that it was 'the thickness of a prison wall'[10].

[10] Dennis Healey is reputed to have said this, and claims to have done so but no date on which he is supposed to have done so is known. See http://en.wikipedia.org/wiki/Tax_evasion accessed 8 December 2006

Overcoming this limitation in language is essential if any Code of Conduct for Taxation is to have practical application. This is easier if the terms evasion, avoidance and compliance are considered to be verbs. This is possible if the terms describe approaches to the management of taxation, and not the specific transactions that result from that activity. In other words, the test of acceptability of a transaction is primarily an *ex ante* rather than an *ex post* test, albeit the possibility that error in execution of the transaction resulting in an unacceptable legal outcome occurring even when the motivation is sound cannot be excluded (but should not be subject to significant penalty, if any at all). This contrasts with almost universal current legal practice where investigation is *ex post* i.e. outcomes are all that matter.

Using this understanding:

1. A person who evades tax seeks to limit a tax liability by means known to be criminal;

2. A person who avoids tax seeks to minimise a tax liability by any means believed possible, even if it is apparent that the law of one or more states may be abused in the process, but without criminal liability arising;

3. A person who is tax compliant seeks to settle a tax liability in the location where it can be best determined to be due, at the time when it is likely that a legislature wished it to be paid and only after claiming deductions and reliefs that were clearly intended to be provided given the economic substance of the transactions undertaken by the taxpayer.

This approach differs radically from conventional thinking. It presumes:

1. That the intention of the taxpayer is known to them;

2. Intention can be evidenced, e.g. through documented statements of intent prior to adopting a course of action, the validity of which is at least in part accepted on the basis of a relationship of trust which this Code would seek to encourage;

3. This evidence is reliable if:

    a. The evidence is systematic i.e. the procedures used to produce it are a part of the management process for taxation used by the taxpayer, or by the taxpayer in association with their agent;
    b. There is no evidence that outcomes persistently fail to match documented intent which would suggest the evidence was fabricated;

4. That only in the absence of documented intent, or in the presence of persistent failure of realisation of intent would an *ex post* test of culpability with regard to tax be the primary test of intent, and therefore culpability for error.

The result would be a transformation in the way in which taxation compliance is appraised. The emphasis would shift from attention to outcomes alone to an additional focus upon the management of taxation. Only those who could be sure that they could document compliance would enjoy an easy relationship with taxation authorities. Those whose behaviour indicated the intention to avoid, or evade, would be much more likely to be subject to scrutiny. This risk based approach would be dependent upon effective appraisal of management systems by both the taxpayer and tax authorities, and on a risk appraisal being an inherent feature of the tax return process. This would take the form of a self-scoring declaration submitted with any tax return and intended to assist identification of all compliant tax payers. Failure to correctly complete such a return would, of course, give rise to automatic penalties for the taxpayer. Incentives to comply would therefore be high.

The logical next step

The purposive approach inherent in the draft Code of Conduct suggests the final key component in any system promoting tax compliance should be a General Anti-Avoidance Principle as a central component part of taxation law. It is stressed that a principle and not a rule should be used: a rule pre-supposes a legal interpretation of statute; a principle an equitable construction. The idea behind a General Anti-Avoidance Principle is simple: if a step is added to a transaction with the sole or principal aim of securing a tax advantage (which is defined as a saving in tax) then that step in the transaction is ignored for tax purposes. In other words, it tackles pre-meditated attempts to subvert the intention of the tax system and is consistent with the management approach towards the regulation of taxation proposed here.

The existence of a General Anti-Avoidance Principle (now generally called a “Gantip”)[11] allows a government to pass purposive legislation. This is legislation that states the intention of the law that is being created and devolves responsibility for the detailed rules that actually make it work to the status of regulations. This offers a number of advantages:

1. Few politicians fully understand the details of the laws that they are asked to pass; it is much more likely that they will understand and be able to discuss purposive taxation law;
2. The purpose of law will be clearer: taxpayers will have greater chance of understanding and complying with the law;
3. The detail of regulation can be devolved to those with appropriate expertise;
4. Appeal arrangements are needed to ensure that those who claim that regulation does not accord with the purposive legislation can be heard, and can have the claimed conflict ruled upon. This is a necessary judicial over-ride for the administrative function of the State which is almost always responsible for the detail of tax legislation;
5. Where a government intends to use legislation or regulation in a way that was not anticipated it will be obvious, and appeals should succeed. There will, therefore be greater obligation on governments to disclosure their intent as to how they propose

[11] See Freedman, J 2004. “Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle” available in British Tax Review 332 http://denning.law.ox.ac.uk/tax/BTR_version_inaugural_lecture.pdf accessed 21.12.06

to use the legislation available to them and to not subsequently change it, which should increase certainty for taxpayers.

In combination a Gantip, purposive legislation, equitable interpretation of the law, and a clear framework of the responsibilities of all parties, provides the following benefits:

1. Clarity as to the purpose of the law;
2. The opportunity to adopt a management based approach to taxation, overcoming the almost insurmountable difficulties in determining the difference between tax evasion, avoidance and compliance;
3. An enhanced prospect of practical compliance with legislation designed to achieve that purpose;
4. A fairer method for appraising culpability when errors occur;
5. The chance for a taxpayer to object to inappropriate regulation through use of the Court system;
6. Greater certainty within any tax system.

It is these benefits that the proposed Code of Conduct is intended to promote.

A Code of Conduct for Taxation

Objective
This Code of Conduct relates to the payment of taxes due to a State or other appropriate authority designated by it.

Scope
This Code applies to:
1. Governments and their agencies in their role as tax legislators, assessors and collectors;
2. Taxpayers, whether individuals, corporate bodies or otherwise;
3. Tax agents, whether they are undertaking tax planning or assisting with tax compliance.

Application
It is intended that this Code be voluntarily adopted by States and should be used to guide the conduct of taxpayers and their agents who choose to comply with it whether or not they reside in a State which has adopted the Code.

The Code
The Code is divided under six sections, each of which includes three statements of principle.

1. Government
a. The intention of legislation is clear and a General Anti-Avoidance Principle ('Gantip') is in use;
b. No incentives are offered to encourage the artificial relocation of international or interstate transactions;
c. Full support is given to other countries and taxation authorities to assist the collection of tax due to them.

2. Accounting
a. Transparent recording of the structure of all taxable entities is available on public record;
b. The accounts of all material entities are available on public record;
c. Taxable transactions are recorded where their economic benefit can be best determined to arise.

3. Planning
a. Tax planning seeks to comply with the spirit as well as the letter of the law;
b. Tax planning seeks to reflect the economic substance of the transactions undertaken;

c. No steps are put into a transaction solely or mainly to secure a tax advantage.

4. Reporting

a. Tax planning will be consistently disclosed to all tax authorities affected by it;
b. Data on a transaction will be consistently reported to all tax authorities affected by it;
c. Taxation reporting will reflect the whole economic substance and not just the form of transactions.

5. Management

a. Taxpayers shall not suffer discrimination for reason of their race, ethnicity, nationality, national origin, gender, sexual orientation, disability, legal structure or taxation residence; and nor shall discrimination occur for reason of income, age, marital or family status unless social policy shall suggest it appropriate.
b. All parties shall act in good faith at all times with regard to the management of taxation liabilities;
c. Taxpayers will settle all obligations due by them at the time they are due for payment.

6. Accountability

a. Governments shall publish budgets setting out their expenditure plans in advance of them being incurred, and they shall require parliamentary approval;
b. Governments shall account on a regular and timely basis for the taxation revenues it has raised:
c. Governments shall account for the expenditure of funds under its command on a regular and timely basis.

Enforcement

States seeking to comply with the Code will voluntarily submit themselves to annual appraisal of their Conduct. These appraisals will in turn be reviewed by a committee of independent experts appointed by participating States. Differences of opinion will be resolved by binding arbitration.

Any taxpayer or agent wishing to comply with the Code may do so. A State should presume that a person professing compliance with the Code has done so when dealing with any tax return they submit. In consequence the administrative burdens imposed upon that person should be reduced. In the event of evidence of non-compliance being found any consequential penalty imposed should be doubled.

Explanatory Note: The Objectives of the Code of Conduct

The Code says that:

This Code of Conduct relates to the payment of taxes due to a State or other appropriate authority.

Government is not possible unless a State can command taxation income. The corollary is that the accountability of government for the resources entrusted to its care underpins the practice of good governance. It is this relationship between government, taxation and the taxpayer that is the subject of this Code of Conduct.

The ability of a State to collect the tax due to it is threatened by three things:

1. Its own inability to define the sum due or to collect it;
2. tax evasion, and
3. tax avoidance.

This Code of Conduct considers all three issues. In doing so it recognizes that there are three parties involved in this issue:

1. Governments and their agencies;
2. Taxpayers;
3. Taxpayer's agents, typically lawyers or accountants but also other financial intermediaries.

To prevent confusion it is important that the currently understood difference between tax avoidance and tax evasion, referred to in the opening chapter of this report be understood. Failure to collect tax undermines the capacity of a government by reducing the resources at its command. If it is allowed to prevail, this failure is likely to undermine respect for the rule of law and harm the relationship of trust that exists between the state and the majority of taxpayers who willingly and voluntarily comply with the requirement to pay tax imposed on them by law[12].

This Code explicitly assumes that:

[12] Dave Hartnett, Director General of HM Revenue & Customs, suggested in June 2006 that research undertaken in Canada showed that 50% of taxpayers would be compliant irrespective of the circumstances, and 10% would be non-compliant. The remaining 40% were capable of being influenced into compliance. http://www.kpmg.co.uk/pubs/beforepdf.cfm?PubID=1744 accessed 20.4.07

1. The services provided by government enhance the well being of the majority of the people who are governed or that government will fail in democratic elections;

2. A government that is accountable for the income that it commands is more likely to govern well;

3. The rule of law passed by democratic process in accordance with international conventions is a precondition of a successful society, and payment of tax due on a timely basis is a clear indication that this rule of law prevails in a state;

4. It is unacceptable for one state to either subvert taxation revenues reasonably due to another state or to provide the means by which others might do so because:

    a. This always be harmful to internal relations, and
    b. This will be detrimental to the rule of law in both states.

5. A significant majority of all taxpayers share these opinions.

This Code also implicitly assumes that it is in the best interests of each taxpayer that they and their fellow taxpayers pay the obligations requested of them by their government since to do so:

1. Broadens the tax base to the greatest possible degree and thereby reduces to a minimum the tax rate that is required to raise a particular sum in taxation revenue;

2. Reduces the cost of enforcing taxation legislation and so reduces the burden of taxation;

3. Increases the pressure on their government to be accountable for the revenue they have received.

Explanatory Note: The Scope of the Code of Conduct

An effective Code of Conduct must be accepted as reasonable by those who subscribe to it. It should therefore cover the activities of all who are involved in the activity it seeks to regulate.

In the case of taxation taxpayers can already be said to be regulated by law. Many tax advisers are regulated by or are subject to the ethical codes of their professional bodies. They also have contractual obligations to their clients. Taxation authorities are accountable to governments which in most cases are accountable to an elected parliament. Governments are generally not, however, accountable to each other with regard to taxation[13].

Each of these parties is subject to a degree of regulation and control, and with varying degrees of commitment being required. What is missing is any significant mutuality of obligation either within the state or between states[14]. This explains why the proposed Code of Conduct says that it should apply to:

1. *Governments and their agencies in their role as tax legislators, assessors and collectors;*

2. *Taxpayers, whether individuals, corporate bodies or otherwise;*

3. *Tax agents, whether they are undertaking tax planning or assisting with tax compliance.*

If all parties to taxation are subject to the Code then it has the capacity to be fair. This is vital to its acceptance[15].

[13] The system of taxation treaties between governments do, however, have a role to play in this area, and federal and other inter-governmental structures are important in the regulation of tax. The interaction of federal and state taxes in the USA and the operation of VAT on a European-wide basis by EU member states are clear evidence of this. It would be possible to make this Code of Conduct a part of such tax treaties, increasing the chance of international enforcement as a result.

[14] The 'Taxpayer's Charter' introduced by the UK government in the early 1990s was a curious example of an attempt to create such mutuality of obligation. It did not, however, extend to tax agents and failed to address issues of aggressive tax planning. In addition it had no international dimension. It appears to have never been formally abandoned, but fell into quiet disuse with the arrival of the New Labour government in the UK in 1997. It was little mourned. A new version with obligation imposed solely on HM Revenue & Customs is now under discussion. See http://www.hmrc.gov.uk/about/17_oct_05_minutes.htm. Charters do exist elsewhere. See, for example, the Australian Code at http://www.ato.gov.au/corporate/content.asp?doc=/content/charter.htm, the preamble to which says 'The taxpayers' charter (the charter) outlines taxpayers' rights and obligations under the law, as well as the service and other standards they can expect from us.' And which does therefore begin to address this mutuality of obligation.

[15] This contrasts with KPMG's proposal, reported to have been made in May 2006, that any Code of Conduct for Taxation be nationally based and extend only to relationships between HM Revenue & Customs and the Big 4 firms of accountants (of whom they are one). http://www.kpmg.co.uk/pubs/beforepdf.cfm?PubID=1744 p40.

Explanatory Note: The Application of the Code of Conduct

The Code of Conduct applies to:

1. Governments;
2. Taxpayers;
3. Tax advisers and agents.

It will have greatest benefit when widely adopted by all three groups, but this is not an impediment to partial adoption.

The implications of adoption are different in each case.

Government

A government is, for these purposes, a body recognised as having the mandate to levy taxation on people, corporations and other entities and which has the responsibility for expending the resulting resources made available to it to supply services for the benefit of the population of a defined geographic area.

A government can, therefore, be any one of the following:

1. A federal authority e.g. the federal government of Germany;
2. A national government e.g. the government of Ireland;
3. A sub-national state government e.g. an Indian state government;
4. A regional authority e.g. a French Prefecture;
5. A city, town or village authority.

It is expected that this Code of Conduct will be of most relevance to those authorities with the greatest power to raise taxation. In that case it will normally apply to federal or national governments, but this Code of Conduct also has relevance where sub-national states within a federal system of government, or where regional and city authorities also have the power to raise taxation.

Any government may adopt this Code of Conduct independently of other governments. If this were to happen its international impact may be limited but it is important to note that most taxpayers do not have an international dimension to their taxation affairs and this Code applies just as much to them as it does to those who transact across international and taxation boundaries.

Governments operate in a number of different capacities with regard to taxation:

1. In their legislative capacity they create taxation systems and sets taxation rates;

2. In their assessment capacity they determine the tax due by individuals, corporations and others;

3. In their collection capacity they seek to recover the tax due by those who have been assessed to tax;

4. In their judicial capacity they establish procedures for the settlement of disputes with regard to taxation.

Until recently it was commonplace for these capacities to be separated. There is a growing trend for assessment and collection activities to be combined and for at least part of the assessment process to be administered by the taxpayer themselves[16].

Each of the first three functions might be separately registered for the purposes of the Code. It would be inappropriate for the judicial capacity of any government to be bound by it since that could create conflicting duties incompatible with judicial independence. Some provisions of the Code of Conduct may require registration by other government agencies as well. For example, if registers of companies, charities, trusts and other entities are not maintained by a state's tax authorities then the cooperation of the responsible departments will be required for compliance with sections 2(a) and 2(b) of the Code to be assured.

Government's adopting this Code are most likely to do so by enacting a General Anti-Avoidance Principle and legislation requiring an equitable interpretation of taxation law by their courts.

It is recognised that for some governments this Code will represent a radical departure from their existing practices. It does, for example, require the publication of information that is commonly withheld in many territories.

It would be unhelpful to require full adoption of the Code before any of its benefits were to be secured. As such partial adoption will be allowed so long as it is clear from which sections exclusion has been sought. A commitment to at least 13 of the 18 sections within the Code would be required for adoption to be recognised.

Taxpayers

Any taxpayer might adopt the parts of the Code of Conduct that apply to them. They cannot adopt Sections 1 and 6 since those solely relate to states.

[16] For example since 1997 the UK has had a system of self assessment whilst for the former, quite distinct, assessment and collection divisions are now both part of a combined authority called HM Revenue & Customs.

It may be that a taxpayer will be impeded in practice from fulfilling some of the commitments included in the Code. For example, in many countries there is no public register for the accounts of smaller companies, charities and trusts. However, companies, charities and trusts may place their accounts on a website instead. In addition, full accounts can be published even if less disclosure is required by law. In addition, the ownership structure of a group of companies and its associates may be voluntarily disclosed in its accounts or on a website even if such information is not required by law. As a result it is likely that voluntary compliance with sections 2 to 5 of the Code will be possible by a taxpayer even when governments have not provided the means to do so.

For the purposes of the Code a corporate taxpayer includes all members of the group of companies of which it is a member if the Code is to be complied with. An individual seeking to comply with the Code must apply it to all companies, trusts, charities and other entities that they control or over which they have significant influence. Partial or selective adoption by related entities makes the disclosure made by one entity meaningless unless matched by that of its related parties. The only exception would be where it could be shown that voluntary disclosure of information is not allowed by the law of a territory in which an entity was registered.

Taxpayers who adopt the Code will be expected to use a tax adviser who has also adopted the Code unless there was none available.

Tax advisers

Tax advisers provide two distinct services to their clients. The first is the provision of tax planning services. These are usually intended to mitigate the tax liabilities due by the client. The second service is the provision of assistance to complete tax returns required by relevant authorities. These are called compliance services. Both are covered by the Code of Conduct.

Registration for the two types of service could be undertaken separately. This is because, for example, tax compliance services do not normally cover the issues referred to in section 1(a) and 1(b) whereas tax advisory services might include lobbying on these issues. However, since most firms provide both services to their clients it would in most cases be advantageous for registration to be combined.

Once registration has taken place the tax adviser would be expected to seek that their clients comply with the Code. Demonstration that the client had refused to do so after the firm had recommended a compliant course of action would not be an immediate cause for the registered adviser failing in their obligations. Continuing to act for a client who persistently refused to comply with such recommendations would, however, be a breach of the Code. A Code compliant firm must, therefore, seek a Code compliant client base.

The tax adviser should disclose their adherence to the Code when reporting on client work and in all correspondence to ensure that users of that information are aware of this fact, and can report non-compliance if they became aware of it to the relevant taxation authorities.

Other registrations

Registration would be encouraged from other parties. These might include:

1. **Professional bodies** including those representing:

    a. Accountants;
    b. Lawyers;
    c. Tax advisers;
    d. Bankers;
    e. Financial Advisers;
    f. Trust practitioners;
    g. Insurance practitioners.

    If they adopted the Code these bodies might also require that their members did likewise. Alternatively they might act as monitoring bodies responsible for ensuring that members who adopt the Code act in accordance with its requirement.

2. **International agencies.** International agencies, such the OECD, European Union, United Nations, International Monetary Fund and the World Bank with an interest in the effective operation of financial markets might subscribe to the Code as indication of their commitment to the principles that underpin it.

3. **Civil society groups.** Civil society might wish to indicate its commitment to the Code by adopting it as recommended good practice that it wishes countries, taxpayers and their advisers to adopt.

Explanatory Note: The Code of Conduct – Section 1 - Government

The Code requires that a government act so that:

a. The intention of legislation is clear and a General Anti-Avoidance Principle ('Gantip') is in use;
b. No incentives are offered to encourage the artificial relocation of international or interstate transactions;
c. Full support is given to other countries and taxation authorities to assist the collection of tax due to them.

Each commitment is discussed in turn below.

a. The intention of legislation is clear and a General Anti-Avoidance Principle ("Gantip") is in use

Benefits

1. Clarity provides taxpayers with the greatest possible certainty as to the liabilities they should expect to pay[17];
2. Clarity reduces uncertainty in the administration of taxation and so increases its effectiveness;
3. Clarity is usually associated with the use of straightforward language: language is frequently abused by those who place meaning upon words that it is clear that the legislative authority creating the law did not intend. A General Anti-Avoidance Principle[18] seeks to prevent such abuse by suggesting how legislation should be interpreted by the Courts to restrict abuse by governments, taxpayers and tax advisers.

Commentary

One of the most consistent themes in discussion about taxation in the twenty first century has been the increasing volume and alleged complexity of tax legislation. There have been widespread calls for simplification of tax codes and for greater clarity as to their meaning.

Clarity is a desirable attribute of good tax legislation. It helps tax payers know what their obligations are. The greater the degree of clarity there is in law the less chance there is for dispute as to its interpretation. Absolute clarity, let alone certainty, is not, however, possible in taxation legislation for the following reasons:

1. The meaning of all words is, to varying degrees, ambiguous;

[17] Smith, A, 1776, The Wealth of Nations

[18] For an explanation of General Anti-Avoidance Principles see Freedman, J 2004.

2. Taxation uses words in special ways, the interpretation of which is peculiar to its needs;

3. The meaning of words, both in general and in particular changes over time so that the way in which legislation is interpreted will also change over time since tax legislation cannot continually be amended and be effective.

In addition, the following issues impact on the clarity of legislation:

1. Governments frequently wish to provide taxpayers with choice in the way in which they can construct legitimate economic transactions e.g. the benefit of using a piece of capital equipment can be secured by building it one's self; by buying it; leasing it in the long term; hiring it in the short term; or even by barter. All have an almost infinite number of variations possible within them. All require differing rules. The sheer complexity of the real world means that taxation legislation must either seek to restrict the way in which real economic transactions are undertaken or be as complex as the reality that people create in commerce, in particular. Enlightened governments have not chosen to restrict commerce, but the consequence is increased absolute volumes of legislation, and in consequence (inevitably) increased boundaries between the way ways in which transactions can be treated giving rise for opportunity for misinterpretation that require clarification within the legislation.

2. Some accountants and lawyers abuse the boundaries of the law for their own advantage in generating fees and for the advantage of those they represent. This practice has given rise to a world-wide growth in the volume of tax legislation designed solely to tackle this issue. In the UK the Tax Justice Network has estimated that at least 40% of all UK tax legislation in the period 2004 – 06 consisted of anti-avoidance provisions[19].

3. It is accepted that this volume of anti-avoidance legislation has made it difficult to keep track of the purpose of some law, even for the experienced reader.

There are three ways to challenge this issue of complexity. The first is to change the attitude of taxpayers, their advisers and governments towards the payment of tax. It is regularly cast as a 'bad' thing. For example, the UK government promotes some of its own savings schemes on the basis of their being tax free, which is seen by implication as having merit. This is inappropriate language. Tax is essential for the functioning of democratic governments. Paying tax is an obligation imposed on the citizen (whether a person or a legal entity used by citizens to promote their interests) and the means of dealing with its appropriateness, or otherwise is by use of the ballot box. Accountants, lawyers and taxpayers do not have a right or obligation to subvert the will of government. This Code of Conduct challenges the way in which the adversarial nature of the management of tax promotes inappropriate attitudes to taxation.

[19] http://www.taxresearch.org.uk/Documents/TJNresearchnote12-06.pdf accessed 15-12-06

Secondly, some tax professionals claim they have a duty to minimise their client's tax liabilities because, they say, a company has an obligation to maximise its profit for its shareholders (or others with proprietary interest in the other forms of enterprise I have noted as being subject to this debate). This argument is wrong. Firstly, there is no legal obligation to maximise profit in most countries[20]. The claim that this is the case appears to be a myth used to justify an approach to tax management; an approach that is not rational or universal. It is not rational to maximise profit because that logic is an economic one, not an accounting one, and the two cannot be related one to another. It is not universal to maximise profit because it is not clear what profit is to be maximised: gross profit, net profit, pre tax profit, post tax profit, short term profit, long term profit and so on. The choice is enormous and in practice one choice can often conflict with another. In consequence the behaviour described as profit maximising is not identifiable, and nor are its consequences. In that case it is apparent that there cannot be a requirement to maximise profit, in which case there cannot be an obligation to minimise tax paid either. Once that is realised then it is obvious that taxation management is not a matter of following a set of rules which are designed to achieve an outcome that could be pre-determined in advance: it is instead a matter of exercising choice. This Code of Conduct seeks to provide guidance on those choices. This logic proves that it is necessary.

The resulting approach might entail adoption by tax professionals of a technique widely known in the financial services profession but which appears almost unknown in the world of the tax adviser whereby a professional adviser is required to determine what their client's objectives might be prior to advising them. If this became widespread practice, and taxpayers were properly appraised as to the risks associated with various tax practices, it might be that few taxpayers would opt to minimise their tax liabilities and the incidence of tax avoidance would fall dramatically. This might also reduce the burden of risk for tax advisers since they would no longer be required to promote tax avoidance to protect themselves from legal claims simply because they had failed to determine their client's true objectives. The benefits to both parties could be measured in reduced risk, increased certainty of outcome, reduced cost for clients seeking advice, reduced professional indemnity insurance premiums for tax advisers and a reduction in the 'expectation gap' between tax advisers and their clients.

Thirdly, governments have to embrace the idea of 'purposive legislation' in which they state the intent of the legislation they pass and couple that with a Gantip.

[20] KPMG agree with this in their publication 'Developing the Concept of Tax Governance' available from http://www.kpmg.co.uk/pubs/Tax%20Governance%20Feb%2007.pdf accessed 20-2-07. For an analysis see http://www.taxresearch.org.uk/Blog/2007/02/14/kpmg-missing-the-mark-by-miles/ and http://www.taxresearch.org.uk/Blog/2007/02/15/kpmg-a-gap-analysis/ accessed 20-2-07

[22] Capital is generally considered to be a mobile asset. For these purposes capital comprises cash and financial assets e.g. shares and debt plus intellectual property rights such as copyrights and other assets giving rise to licence income. Land is the classic immobile asset, except that when owned through a company the shares in that entity acquire mobility classical economists could not have imagined. This leaves labour as the most immobile factor of production, the vast majority of the people in the world moving little distance from their place of birth throughout their lifetime.

b. No incentives are offered to encourage the artificial relocation of international or interstate transactions;

Benefits

All states need revenues. At present many countries seek to secure for themselves revenues legitimately due to another state by offering taxation incentives to relocate transactions to their territory either through mainstream legislation or by negotiated concessions. Curtailing this practice will:

1. Increase international harmony;
2. Allow for stability in international taxation rates;
3. Allow for a fair apportionment of the taxation burden between more and less mobile assets[22];
4. Allow developing countries to access an important revenue source for their development;
5. Reduce distortions in the world economy;
6. Allow investment to be focussed on the production of those goods and services that generate a real return based on entrepreneurial activity having met all reasonable obligations to society rather than from sophisticated financial engineering to produce purely financial advantages without matching real economic gain from beneficial productive activity.

Commentary

This objective matches those of both the OECD and the EU with regard to tax competition. As the EU says in Section B of its Code of Conduct on Business Taxation[23]:

> *"tax measures which provide for a significantly lower level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"*

The OECD defined "harmful preferential tax regimes" as having the following key features[24]:

> *i) No or low effective tax rates*
> *ii) "Ring-Fencing" of Regimes*
> *iii) Lack of transparency*
> *iv) Lack of effective exchange of information*

Other factors the OECD thinks indicate such practices include:

[23] Resolution of the Council and of the Representatives of the Governments of the Member States meeting within the Council on 1 December 1997 on a code of conduct for business taxation published in the Official Journal of the European Communities 6.1.98.

[24] OECD, 'Harmful Tax Competition – an Emerging Global Issue', OECD, Paris, 1998

v) An artificial definition of the tax base
vi) Failure to adhere to international transfer pricing principles
vii) Foreign source income exempt from residence country tax
viii) Negotiable tax rate or tax base
ix) Existence of secrecy provisions
x) Access to a wide network of tax treaties
xi) Regimes which are promoted as tax minimisation vehicles
xii) The regime encourages purely tax-driven operations or arrangements

It is transactions of these types that the proposed Code targets. In doing so it is, of course, accepted that States may compete for the location of real economic activities on the basis of the relative economic merits they have to offer. This is not an issue of taxation concern. What is of concern is the attempt made by many states to create taxation systems of the types noted by the OECD and EU. These undermine international harmony when combined with the activities of the international tax adviser attracted to those territories by the existence of such regimes. This Code seeks to promote harmony in international relations by requiring those who subscribe to it to remove this cause of stress and in so doing recognises existing and widely endorsed international sentiment on this issue.

c. Full support is given to other countries and taxation authorities to assist the collection of tax due to them.

Benefits

There has been, until recently, a convention that the tax authorities of one country will not assist the tax authorities of another country to collect tax due to it. Nor, in most cases, will a court in one country take action to assist a tax authority of another country to recover tax due from a person currently resident outside the country in which the tax is due. There has, in effect, been a convention of international non-cooperation with regard to tax due. This makes no sense. It encourages tax exiles, universal disregard for the rule of law and international contempt for the right of the state to protect its own property rights when action to the contrary would in each case enhance universal wellbeing. This element of the Code proposes to reverse this behaviour in international taxation.

Commentary

International taxation was not an issue of significant concern before the First World War at which time the world was divided between a small number of empires, many of which had internally consistent taxation laws, and most international trade took place within rather than between empires.

This situation changed after the First World War. There were more nation states, partly as a result of the breaking up of some of the previous empires. There was also more international trade as a result of improved communications. Methods of ensuring that international double taxation as well as international non-taxation occurred had to be negotiated. The result was agreement at the League of Nations (the inter-war period predecessor of the United Nations) on a number of key issues, most particularly being the notion that international taxation should be primarily on the basis of the residence of the tax payer with credit being given for tax paid on any source of income taxed in another territory prior to receipt in the country of residence. Taxation at source was commonplace at the time for many types of mobile income including interest, dividends, royalties and licence fees.

The consequence was a presumption that a country need only have powers to assess and collect tax within its own geographic domain because it was only assessing its own residents who should, presumably, be located there. This logic assumed that tax due in other countries by those residents would have already been subject to deduction at source before remittance to the country of residence took place and as such no further overseas liability could arise.

This logic was appropriate until well after the Second World War for several reasons. Firstly, trading remained confined to relatively limited economic blocs. Secondly, tax withholding remained the norm for all forms of mobile capital. Thirdly, exchange control legislation strictly limited the opportunities for overseas investment and sharply curtailed the opportunity for it without official consent. Finally, many western countries held to a reasonable degree of consensus on taxation issues and rates so that, for example, tax withholding rates showed a high degree of international conformity. In these circumstances, neither the power to collect tax from overseas, or the right to exchange of information on sources of income arising outside the country of an individual's residence was seen to be important since any additional tax that might have been raised would have been of limited extent, and was unlikely to justify the effort in administrative procedures required to facilitate it.

This situation has changed in several ways:

1. International trade is now commonplace;
2. 60% or more of world trade is intra-group trading, meaning that transfer pricing issues are of much greater concern[27];
3. 50% of world trade passes through tax havens, at least on paper[28];
4. The opportunities for individuals and corporations to undertake personal tax planning have increased enormously since the abolition of many exchange controls

[27] p72, Groupe de travaile sur les nouvelles contributions financieres internationals, (The Landua Report), English Edition, Republic of France, 2004.

[28] French finance minister D Strauss-Kahn, in a speech to the Paris Group of Experts in March 1999, quoted in J Christensen and M Hampton, "All Good Things Come to an End," The World Today vol 55, no. 8/9, 1999 (Royal Institute of International Affairs).

around 1980. The likelihood that an individual or corporation might have foreign source income has therefore increased markedly;

5. The number of companies offering international tax planning services has increased significantly;
6. At the same time the number of occasions when tax has to be deducted at source from payments made to a person outside a country has decreased significantly. For example, in the UK most payments of dividends, interest, royalties and licence fees which were once subject to tax withholding at source are now paid free of tax withholding. The EU Interest and Royalties Directive[29] provides for the elimination of all source taxation on interest and royalty payments between associated companies in different member states, and is further indication of this trend.

The outcome of these changes is that increased tax cooperation is required:

1. To identify taxable income of people, corporations, charities, trusts and other entities who earn their income in one state but are resident in other states;
2. To ensure that liabilities are enforced when it is possible to transfer income and assets between countries at ease;
3. To ensure that tax evasion is effectively tackled under money laundering and anti-corruption laws which now exist in many states.

The proposed Code of Conduct requires a commitment to these tasks. This is likely to be manifest in the following ways:

1. The automatic exchange of information between states as to income earned in one and believed to be attributable to a person (whether an individual, corporation charity or other entity) resident in the other[30];
2. The provision of specific additional information on request with regard to such sources of income, whether or not criminal liability is in evidence, but only where unpaid tax is an issue of concern[31];
3. The exchange of data on transfer pricing issues and other related matters where the appropriate basis for the computation of income is in doubt or dispute;
4. Making available the tax collection procedures of one nation state to the tax authorities of another state, maybe in exchange for a reasonable fee (as is, for example, implicit in the EU Savings Tax Directive where countries and territories operating a withholding tax system are entitled to retain 25% of all tax collected otherwise due to other nation states to recompense them for their efforts).

[29] Directive 2003/49/EC of 3 June 2003, having effect from 1 January 2004

[30] The EU Savings Tax Directive is a welcome step forward in this respect since it does include a commitment to exchange information which should be fully implemented between member states, if not their protectorates, by 2011, by which time alternative rates of withholding tax will reach 35% in those states that fail to comply. A description of the European Union's "Savings Tax Directive" can be found at http://europa.eu.int/scadplus/leg/en/lvb/l31050.htm

[31] This can be an issue of concern at present as countries such as Switzerland do not consider tax evasion a crime. They therefore restrict information exchange in pursuit of tax due and payable for reason that evading tax can only give rise to a civil penalty in that country. Information exchange needs to be consistent whether or not civil or criminal penalties arise with regard to tax evasion in the countries exchanging information.

Explanatory Note: The Code of Conduct – Section 2 - Accounting

The Code requires that:

a. *Transparent recording of the structure of all entities is available on public record;*
b. *The accounts of all material entities are available on public record;*
c. *Taxable transactions are recorded where their economic benefit can be best determined to arise.*

Each commitment is discussed in turn below.

a. Transparent recording of the structure of all entities is available on public record

Benefits

Transparency and accountability are the accepted bases of good governance[32]. Secrecy is their antithesis. In the interests of good governance full disclosure of the ownership and management of all entities created by or under the law of any state must be registered in any country in which that entity operates.

Commentary

There is no company, charity, trust or other entity in the world that is not run by people. With the exception of charities it is commonplace for those people associated with it by ownership or another form of legal entitlement to be the major beneficiaries of its activities. However, in many parts of the world:

1. The ownership of companies need not be disclosed or that ownership may be disguised by the use of nominees;
2. The names of those who manage companies, charities, trusts and other entities need not be disclosed or the true identity of those fulfilling those roles can be disguised by the use of nominees;
3. In the event that a corporation, charity, trust or other entity is controlled by another entity, the ultimate ownership of the entity and how that association is made is not disclosed.

This has the consequence of making accountability for many transactions very difficult to prove, and liability to taxation hard to determine.

A commitment made under this part of the Code of Conduct by a government would require it to:

1. Create a public register of companies and to record on it:

[32] Section V of the OECD Principles of Corporate Governance issued in 2004 is, for example, dedicated to this issue. http://www.ecgi.org/codes/documents/principles_en_final.pdf accessed 27-09-06.

a. A list of all incorporated companies;
b. Detailed information for each company concerning:
    i. Its registered office at which official contact can be made with it;
    ii. Its constitution;
    iii. Its membership and their identifiable addresses at which they can be contacted, updated at least annually, and if those members are nominees or corporations the names of the persons for whom they ultimately act shall be given;
    iv. The details of the person or persons (whether individuals or a corporation charity trust or other entity) that controls the corporation shall be stated and if there are 5 or fewer connected persons[33] who ultimately control the corporation then the means of establishing control shall be shown and the country of location for each individual, corporation, charity, trust or other entity involved in that process of control shall be disclosed, in each case with an identifiable contact address being given;
    v. Its directors or other officers and if such persons are nominees the identities of those on whose instructions they are required or are accustomed to act, including the country in which such persons are located and the reasons by which they obtain their authority to issue instruction, in each case with an identifiable contact address being given;
    vi. The holders of any debt or other financial instruments that it has issued which does, or might foreseeably, afford control of the company, including full details of beneficial ownership if nominees are used.
c. A list of all companies, charities, trusts or other entities controlled directly or indirectly by the company, in each case with sufficient identification details and an address being given so that the entity can be identified in its country of incorporation or registration.
d. Its annual financial statements.

2. Create a register of charities containing all that information required of companies, with in this case provisions with regard to directors and other officers extending to trustees and other such officials and with the addition that in this case:

    a. The names of those promoting the charity should be disclosed;
    b. The names and identifiable addresses of any individual, corporation, charity, trust or other entity who, with their connected parties, provides more than 10% of the income of the charity in a year should be disclosed;

[33] A connected person is generally considered to be a person's parent, step-parent, sibling, step-sibling, child, step child or greater issue or step-issue, aunt or uncle, first cousin, spouse and former spouses for a period of five years from the time of divorce having taken place and those spouses' connected persons and all corporations, trusts, charities or other entities owned or controlled by such persons, all business partners and those of connected persons and all trustees, nominees and agents appointed to undertake business on behalf of any such connected party, whether the person in question be a natural person or a corporation, charity, trust or other entity created under legislative powers anywhere in the world.

   c. The names of the beneficiaries receiving more than 5% of the income of the charity in any year should be disclosed;
   d. The reason why the income of the charity has not been distributed shall be disclosed annually if less than 75% of its income has been applied to its stated charitable purpose.

3. A register of trusts should be created containing all that information required of companies, with in this case provisions with regard to directors and other officers extending to trustees and other such officials and with the addition that in this case:

   a. The name of the settlor or settlors of the trust should be disclosed and all those contributing a sum more than 10% of previously gifted trust property shall likewise be disclosed together with their identifiable addresses, at least annually;
   b. The trust deed should be disclosed as should all side letters, letters of wishes and other communications of any form (including written summaries of verbal instructions or communications issued in non-reproducible electronic format) that give indication to the trustees or those who instruct the trustees as to the way in which the funds under their care should be used;
   c. In the event that the trust is of a discretionary nature then a list of all those who have benefited from more than 5% of the income of the trust in any year in the previous ten years should be supplied with identifiable addresses.

4. A register of other entities created under statute should be created containing all that information required of companies, and with such other information as is appropriate to ensure that information of the type required for charities and trusts is also available, if appropriate.

Each of these registers should be available for free public searching, on the internet and at public buildings at any time.

Such a commitment would require an extension of disclosure rules for almost every government in the world. The advantages would be:

1. A reduction in secrecy;
2. An increase in the efficiency of identifying assets under the control of any person or other entity;
3. An increase in the tax yield;
4. Greater openness and transparency in commercial transactions leading to benefits for all stakeholder groups including enforcement agencies of all sorts, employees, those with environmental concern, commercial creditors of organisations, banks and other suppliers of capital, consumers, and civil society at large.

It should also be noted that in practice the requirements are not onerous. Under the 'know your client rules' that are an integral part of the financial services culture and which are expected to be in operation in all tax haven states monitored by the IMF's Reports on the Observance of Standards and Codes[34], such information has to be secured as a matter of course together with the additional information noted as to proof of ultimate beneficial ownership and the means by which such connections can be established. As such the public disclosure of this information should not impose an onerous administrative burden on any business which is in possession of a bank account, no matter where located.

For an individual, corporation, charity, trust or other entity making commitment to this part of the Code the requirement is to disclose the information requested. If this is not possible by way of disclosure on a public register then it should be made available on a web site on which the name of the entity can be clearly identified and which is structured in such a way that easy access from web search engines is possible.

For a tax adviser making commitment to this part of the Code the following requirements might arise:

1. That they seek this disclosure by their clients and that they cease to act for those clients who refuse to make such disclosure after a reasonable time period for adoption of the Code has passed;
2. That they seek to disclose all nominee, trustee and other such appointments that they hold;
3. That they ensure that all communications to companies, trusts, charities and other entities registered at their address are dealt with promptly, completely and openly both by their firm and by the entities in question;
4. That they ensure full and accurate disclosure is made by their clients in accordance with the Code.

b. The accounts of all material entities are available on public record

Benefits

In one of the most far reaching reviews of the need for and benefit of corporate reporting of accounts[35], published as long ago as 1975[36], the benefit of publishing company accounts was defined to be the ability to appraise information on:

1. the performance of the entity;
2. its effectiveness in achieving stated objectives;
3. evaluating management performance, including on employment, investment and profit distribution;

[34] See http://www.imf.org/external/np/rosc/rosc.asp for additional information.

[35] The term accounts is used here to cover a range of disclosures, which might vary. So, for a company it is likely to include a director's statement and operating and financial review, a statement of profit and loss or income and expenditure, a statement of recognised gains or losses, a cash flow statement and a balance sheet, plus such notes and explanations as are required to ensure meaningful information is conveyed. For a charity, for example, the emphasis will be different. For unincorporated entities such as trusts and material partnerships the structure of the report will be different to reflect that status, albeit that the objective of full and appropriate disclosure remains.

[36] Accounting Standards Steering Committee, 1975, 'The Corporate Report', London, pages 26-27

4. the company's directors;
5. the economic stability of the entity;
6. the liquidity of the entity;
7. assessing the capacity of the entity to make future reallocations of its resources for either economic *or social purposes* or both;
8. estimating the future prospects of the entity;
9. assessing the performance of individual companies within a group;
10. evaluating the economic function and performance of the entity in relation to society and the national interest, and the social costs and benefits attributable to the entity;
11. the compliance of the entity with taxation regulations, company law, contractual and other legal obligations and requirements (particularly when independently identified);
12. the entity's business and products;
13. comparative performance of the entity;
14. the value of the user's own or other user's present or prospective interests in or claims on the entity;
15. ascertaining the ownership and control of the entity.

This Code of Conduct seeks to address some of the outstanding issues within the above list and to provide:

1. Guaranteed access to accounting information for shareholders and other investors and suppliers of capital;
2. A reduction of risk for employees, suppliers, customers and others who transact with a company and wish to appraise their exposure from doing so, especially when the company enjoys limited liability;
3. The ability to better appraise the impact of a company on its environment (in the widest possible sense) for all agencies of government and civil society.
4. A chance for companies to demonstrate their commitment to corporate responsibility.

It is likely that the above benefits will also accrue if 'other entities' (such as limited liability partnerships, unlimited companies and material partnerships) are also required to be filed on a register with open access. For these purposes 'material' might mean an entity employing at least 25 people and with sales or assets in excess of an agreed sum, likely to be in the order of €5 million in 2007. At this level the right of stakeholders to know information about an organisation exceeds the owner's right to privacy.

The benefits arising from the disclosure of accounting information of charities include, in addition to the above:

1. Increased confidence that donations to charities are used for their intended purpose;
2. Increased assurance that income generated by the charity is being distributed as intended;
3. Increased likelihood of the recipient of assistance from a charity being able to appraise whether the commitment it has made can be fulfilled;

4. Enhanced pressure on a charity to reduce its costs to ensure maximum benefit is being passed to recipients;
5. Enhanced opportunity to ensure that tax reliefs are not being abused.

The benefits of trusts reporting their accounts online are:

1. Such arrangements are increasingly used to disguise the ownership of corporations and other assets. Secrecy always restricts accountability and transparency which are essential for good governance. As such this information is needed to prevent this abuse;
2. Trusts are frequently used for tax planning. Access to trust accounts is essential if such planning is to remain within legitimate fields of activity;
3. The use of a trust is a privilege granted by society: open accounting for the use of that privilege is the corollary of the benefit given.

This Code of Conduct does not propose that the tax returns of individuals be made publicly available although it is noted that this does happen in some Nordic countries.

Commentary

A culture of secrecy pervades many societies and there is no doubt that privacy is valued by many, for which reason this Code does not call for the disclosure of private tax return information.

The benefits of the use of artificial legal structures, such as companies, trusts and charities are however granted by society. The privilege is granted in exchange for the obligation that they be properly used, and that requires accountability. Accountability cannot be demonstrated without publicity and as such the disclosure of information by these entities is a necessary corollary of the privilege their use affords.

The administrative burden of filing this data would be small: the data should already exist and the costs of creating the current parallel databanks to replicate it for credit checking and other purposes are high, and inefficient. In countries such as the UK the annual costs of filing accounting and other data are modest at £30 or less a company. Making the resulting database free-to view would result in little increase; less than 17% of the income of the responsible agency came from those wishing to access the database in 2005/06, the rest of its income being provided from the fees of companies and other entities filing documents as required by law[37].

For those who fail to comply with disclosure requirements the penalties must be high, including a loss of limited liability and, ultimately, a forfeiture of property.

[37] Data from the 2005 – 06 annual report of Companies House available from http://www.companieshouse.gov.uk/about/pdf/annrep2005_6.pdf accessed 21-12-06

c. Taxable transactions are recorded where their economic benefit can be best determined to arise

Benefits

If income and profits are declared in the location where it can be best determined that they are earned based on their underlying economic substance, the society that supported the generation of that income will benefit from the taxation revenues flowing from that transaction, thus enhancing the well being of all within that community.

Commentary

As has already been noted, it has become common for incentives to be offered by some states to entice individuals, corporations, charities, trusts and other entities to declare income and profits in locations other than that in which it would appear that the economic activity giving rise to the declared income occurred. This does in effect mean that some societies that generate economic well being are denied the benefit of the taxation revenues that should flow from that activity and have had, instead, to shift the burden of taxation onto less mobile bases of tax including poorer people.

Sometimes such relocation is simply of cash balances which are 'booked' by banks as being owned in offshore locations which are clearly unable to generate the interest yield paid on such accounts from the economic activity undertaken, which returns must therefore be generated by the loan back of those funds to the major economies from which they almost always came. Jersey provides an example of this. On average more than £175 billion[38] of funds are now on deposit in Jersey, or roughly £1.9 million for every man, woman and child officially on the island. Quite clearly the island cannot use capital of that amount. The reality is that these funds 'booked' in Jersey are actually invested on the London money markets and those of other major 'real' financial centres and that the interest paid is likewise generated in the UK, Germany and elsewhere, but those territories lose the tax on that interest since it is paid tax free in Jersey, and is usually untaxed elsewhere thereafter. This also happens when countries specifically seek to attract group financing companies, as do, for example, the Netherlands and Ireland[39].

An alternative method of relocating profits is by way of locating the ownership of intangible assets giving rise to royalty and copyright income in a tax haven. Such assets might be patent rights, the copyright of films or recordings, or the right of ownership of

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[38] Source, Jersey Finance quarterly report to September 2006 available from their website http://www.jerseyfinance.je/_support/uploadedFiles/Quarterly%20report%20for%20period%20ended%2030th%20September%202006%20-%20Final.pdf accessed 21-12-06.

[39] One estimate is that in the year 2000 there were more than 400 such firms (50% from North America) located in Ireland at the Irish Financial Services Centre (IFSC). On average they had no employees. In a survey presented by Jim Stewart of Trinity College, Dublin to the Tax Justice Network conference in 2006 41 such firms with available accounting data were identified. The median size in terms of gross assets in 2002 was $379 million, median profits in 2002 were $5.9 million ($7.9 if those reporting losses are excluded) but the median number employed was zero. It is hard to see how companies employing on average no people are doing anything but relocating profit, and on paper only, with the primary aim of avoiding tax. See http://www.taxresearch.org.uk/documents/jimstewart2006.pdf accessed 21-12-06

designs including the logos used on group products, for which a licence fee is paid to an offshore company. It is exceptionally unusual for any of these products to have actually been created in the offshore territory where the asset is located.

More mundanely, transfer mispricing achieves the same aim. Transfer pricing occurs whenever two entities under common control sell to each other across an international boundary[41]. The Code of Conduct questions the validity of practices designed to reduce the tax rate charged by relocating the place in which the benefit of a transaction is recorded. What is instead required is a decision process that is intended to truthfully and fairly report where profits are earned. In this Code such relocation is unacceptable.

There is sound economic logic to support this argument. Many relocated assets such as trademarks, logos or other intellectual property rights have no value if the product to which they relate are not sold. Those sales takes place where the end customer is located. It is they who add the value to the brand, in the country in which they are located. As such it is there that the profit resulting from the premium they are willing to pay should be taxed. This is precisely why tax withholding used to be commonplace on the payment of royalties and licence fees. Under this Code of Practice no profit should be allocated to a tax haven licencing company owning such assets unless it undertakes real services for the group of companies that owns it for protecting the intellectual property, which in practice is rare, such services usually being undertaken under the direction and control of the parent company, which is usually located in a major financial centre. As such it is rare that any profit is actually generated in the tax haven state and an accounting allocation of profit to that territory does not therefore represent a true and fair view of the economic transactions of the group of companies which undertakes that exercise.

In the case of transfer pricing the apportionment of income between the states that have interest in the transaction should take account of the location of the source of value added in the transaction as a whole.

There are no hard and fast rules on this issue, but when a transaction appears to have profit allocated to it and both sides to the transaction are intra-group and there is no obvious management or third party input into the transaction in the location where the transaction is recorded, then it is almost certain this Code has been contravened.

If a company allocates profit using the method suggested by this Code of Conduct then it is also vital that the company (or, less likely, the charity, trust or other entity) reports that it has done so. This can be done by appropriate segmental reporting. The trend in

[41] For an explanation of transfer mispricing and other ways in which corporations and individuals seek to reduce and relocate their reported taxable incomes see chapters 4 and 5 of 'Closing the Floodgates' edited by Richard Murphy for the Tax justice network and available from http://www.innovativefinance-oslo.no/pop.cfm?FuseAction=Doc&pAction=View&pDocumentId=11607 accessed 9-3-07.

[43] See for example IFRS 8 on 'Operating Segments' issued by the International Accounting Standards Board in November 2006 at http://www.iasplus.com/standard/ifrs08.htm accessed 21-12-06

segmental reporting is for that reporting to be on the basis of the management decision making structure of the group company[43], a structure that is claimed is increasingly moving away from national decision making towards to product based decision making. This may be valid reporting for some purposes, but there remain very many good reasons why nationally based information is essential for the stakeholders (including the shareholders) of multinational corporations. These arguments have been made in the submission of the Publish What You Pay Coalition to the International Accounting Standards Board on its proposals for segmental reporting[44]. Most importantly, what it says is that the following information should be published by all multinational companies with regard to all states in which they operate:

1. Turnover in total;
2. Third party turnover;
3. Third party costs excluding those of employment;
4. Intra-group costs excluding those of employment;
5. Interest paid split between third parties and group payments;
6. Profit before tax;
7. Tax charge on profits split between current and deferred tax;
8. Other taxes or equivalent charges due to the government of the territory in respect of local operations;
9. The actual payments made to the government of the country and its agencies for tax and equivalent charges in the period;
10. The liabilities owing locally for tax and equivalent charges at the beginning and end of each period as shown on the balance sheet at each such date;
11. Deferred taxation liabilities for the country at the start and close of the period;
12. Gross and net assets employed;
13. The number of employees engaged, their gross remuneration and related costs;
14. The names of all subsidiaries working within the territory;
15. Comparative data where appropriate in each case.

If this data were published then it would be possible to determine:

1. Where, and under what name a multinational corporation operated;
2. To what extent it traded with third parties, either with regard to its sales or purchases, and therefore how likely transfer pricing abuse was;
3. How dependent it was on local employment for added value;
4. To what extent profit is being transferred within the company by way of payment of interest;
5. The tax charge, and to what extent if at all this could be correlated with group reallocation of profit;
6. When the group expected to make a contribution to the societies in which it operates, and where.

[44] Available from http://www.taxresearch.org.uk/Documents/IAS14Final.pdf accessed 9-3-07

Such disclosure would make it possible for a multinational group of companies to give positive indication of its commitment to this Code of Conduct. This disclosure listing will also achieve many of the objectives of 'The Corporate Report' issued in 1975.

Explanatory Note: The Code of Conduct – Section 3 - Planning

The Code requires that:

a. Tax planning seeks to comply with the spirit as well as the letter of the law;
b. Tax planning seeks to reflect the economic substance of the transactions undertaken;
c. No steps are put into a transaction solely or mainly to secure a tax advantage.

a. Tax planning seeks to comply with the spirit as well as the letter of the law;

Benefits

If tax planning complies with the spirit rather than the simple letter of the law the following benefits arise:

1. The taxpayer, or in the case of an entity, those who benefit from it either by ownership or through the fulfilment of its charitable or other aims, have substantially reduced risk in the conduct of their affairs, so affording these further immediate benefits:
    a. Greater certainty in management of the resources of the business, none of which need to be diverted to cover contingent risks in tax management;
    b. More assured future cash flow;
    c. Reduced tax compliance costs;
    d. Reduced costs of securing and implementing tax advice, the outcomes of which are not known;
    e. Increased confidence in the reporting of the asset base, and so value of the person or entity making the declaration.
2. Reduced burden on society at large from the imposition of increasingly complex tax legislation;
3. Reduced costs of administering the taxation system of each nation state;
4. Reallocation of the intellectual resources of management, accountants, lawyers and others to the creation of value rather it being absorbed by tax planning;
5. More assured revenue streams for government (without, necessarily seeing an increase in their absolute value) meaning an increased quality of management of the public sector.

Commentary

Accountants and lawyers frequently argue that all that matters in taxation are the words of the law. This is, of course true; tax cannot be collected unless the law allows it. However, as the preamble to this report notes, an equitable rather than a legal approach to interpretation of taxation law would considerably change the use of law in this respect. The resulting purposive approach to taxation management and legal interpretation would mean an ethical choice would have to be made by any taxpayer and any tax adviser when it comes to the tax planning they undertake. Planning could fall into one of several categories:

1. The claiming of a relief or allowance which it is so obvious that a government intended the taxpayer to enjoy that they really have no choice but enjoy the benefit of it. An example might be receiving the tax free annual allowance that most governments intend that their resident populations enjoy each year;

2. The claiming of a relief or allowance which it is clearly intended be given if certain necessary pre-conditions are met. For example, this might at a personal level be a claim for tax relief for reason of being married if such a relief is available in the country of the taxpayer's residence. In a business context an alternative example might be claiming relief for a cost necessarily incurred in the course of earning the profits of the enterprise.

3. The claiming of an allowance or relief where the intent of the law is uncertain. This is acceptable if full disclosure of the uncertainty is made at the time that claim for the relief is made. No attempt at claiming an inappropriate expense can then be suggested to have occurred. If the claim is rejected there can be no suggestion that penalty is due (in any reasonable tax system). This places a burden of responsibility on taxation authorities to provide timely clearance to taxpayers on what those authorities think appropriate.

4. The claiming of an allowance or relief where it is known that the validity of the claim is uncertain. This uncertainty might arise for a number of reasons:

    a. The income or expense for which the relief is claimed is not of the type envisioned by legislation, and eligibility for the relief is in doubt;
    b. The income or expenditure was not incurred in the circumstances envisioned by legislation and as such the applicability of the allowance or relief is in doubt;
    c. The relief is only obtained because steps have been included in the transaction for the sole purpose of securing the relief, which would otherwise be unavailable. As a result there is doubt about whether the allowance of relief is appropriate given that the underlying transaction does not accord with circumstances envisioned by legislation, and only does so by reason of the form of the transaction adopted.
    d. The transaction appears to qualify for the allowance or relief but only because certain steps within it are disguised as to their true nature. These steps may be artificial transactions between apparently independent parties, or they may involve individuals and entities in more than one country; the transaction may be obscure because of the use of a trust.

5. The planning might involve mis-declaration, which moves into the realms of evasion.

These situations might arise every day in larger businesses; they certainly can arise every day for tax practitioners. They represent situations where decisions have to be made.

Those decisions require the exercise of judgement. Judgement requires the use of ethical discretion, which is underpinned by moral judgement. This is why it is not correct to argue that ethical judgement has no place in taxation.

Of course, some decisions should be easy. In the case of options 1 and 2 above, the choice is straightforward. The allowance or relief should be claimed. It is the unambiguous intention of the authority creating the law that these reliefs be available. To claim them is to comply with the law. In contrast, option 5 breaks the law and should always be rejected.

Options 3 and 4 are harder to differentiate. The boundaries between what is legal and what is illegal are frequently blurred, especially when:

a. The only guidance available as to legality are the words of statute. These are notoriously difficult for judges, let alone lay people to interpret. Sometimes they fail to convey the appropriate meaning of those who legislate.
b. The legislation is not purposive i.e. it does not state its intent. If all legislation (even to the extent of sub clauses of clauses) had a purposive preamble written in language in common usage (Plain English to use the description used in the United Kingdom) then the intention of that legislation would be clearer, and the potential for error reduced.
c. There is no 'prior clearance' mechanism so that a taxpayer can clarify the meaning of the law with regard to a particular circumstance before undertaking it or before submitting a tax return referring to it.

To remedy these problems the following must happen:

a. Interpretation should be specifically undertaken within the context of the stated purpose of those who introduced the legislation. For example, if a relief is given for a specific purpose or for the benefit of a particular industry or group in society then this should be made clear when the legislation is introduced in support notes and in statements made in and to the relevant parliament. It should also be made clear that these statements are intended to have force in interpreting the use of the legislation.
b. A general anti-avoidance provision should be in use so that taxpayers and their adviser would know that not only is compliance with the letter of the law required, compliance with the spirit of that law is also required as indicated by its purposive preamble; accompanying explanatory notes published at the time it was promulgated; any later published advice on interpretation; and, of course, court decisions on the issue.
c. Courts must be instructed to interpret statute within the context in which it was created i.e. taking into account the pronouncements made at the time by ministers, taxation authorities and in any legislative authority as to its intent, as well as taking into consideration the legislative preamble (if available) and subsequent interpretations provided by the tax authorities (see below).
d. To ensure that the taxpayer can undertake their affairs in an atmosphere of reasonable certainty it is vital that taxpayers have access to a 'prior clearance' system with a tax authority so that reasonable doubt about a transaction can be

resolved, as far as possible before it either takes place or before a tax return dependent upon an interpretation is submitted. It would be quire reasonable for a fee to be charged for this service for two reasons:

   i. Taxpayers already pay for such opinions from accountants and lawyers, which are not binding upon tax authorities;
   ii. This will deter timewasters who might otherwise abuse the system with questions that can be easily answered from public domain resources.

e. These enquiries, suitably anonymised, should be published to ensure ease of public access to such opinion.
f. Once the purpose of legislation has been published any new purpose to which a tax authority intends to apply it should be subject to notification and approval by legislative authority (and not just tax authority announcement). This prevents the use of legislation by tax authorities in ways unintended by a legislative authority, which is as much an abuse of legislation as is the similar practice when undertaken by taxpayers.

If these conditions exist a remedy is available for a taxpayer facing the situation outlined in circumstance (3) above. They can seek guidance as to the meaning of legislation. Taxpayers who fail to avail themselves of that possibility and proceed in one of the circumstances outlined in circumstance (4) above without full disclosure of the facts, have moved beyond 'acceptable' tax planning into the category of 'unacceptable' tax planning. This remains the case even if it subsequently transpires that the transaction they entered into was legal. They have relied upon risk and concealment to claim a credit to which they may not be entitled; to do so is to exercise a moral judgement even if the outcome is legal, and that is unacceptable if the relevant tax authorities have created a system of prior clearance of transactions.

b. Tax planning seeks to reflect the economic substance of the transactions undertaken

Benefits

Much tax planning is artificial. Examples include:

1. The creation of trusts where the assets supposedly gifted into trust remain under the effective control of the settlor;
2. The creation of corporations in tax haven states which notionally own assets from which benefits flow but where the substance of the transactions and the management of the company effectively take place elsewhere;
3. The re-designation of transactions to be other then they are, e.g. capital expenditure re-categorised as a revenue expense to enhance a tax deduction, or (as in the case of Enron) loans being categorised as income.

If such transactions were to be eliminated, tax would be paid within the community where the economic activity giving rise to that liability took place, thereby supporting the community to fulfil its social objectives paid for from taxation revenues. Those social objectives might include the creation of a legal and infrastructure system in which commerce can thrive through the protection of property rights and the creation of transport, communications, education, health, and social welfare systems which support business by bearing its external costs in exchange for taxation revenue received to the mutual benefit of both parties.

Commentary

This part of the Code of Conduct will be a challenge for the tax planning industry, many of whose 'products' have deliberately sought to change the form or location of a transaction so that it is taxed in a different way to that which the substance of the deal would suggest appropriate.

The requirement for this change of approach is twofold:

1. Firstly, governments must remove any legal or other impediments that suggest a tax adviser is under a legal obligation to minimise the tax liability of their client if they consider this involves unethical or inappropriate practices[45].

2. Secondly, accountants, lawyers, bankers and others need to reappraise their professional codes of ethics to make it clear that it is the ethical duty of a professional person to ensure that:

    a. Taxation is paid where the economic substance of a transaction arises;
    b. No transaction is redesigned so that its form differs from its substance with the intention of securing a tax advantage, such redesign to include relocating the transaction;
    c. Subject to these constraints the accountant, lawyer or other adviser has a duty to advise their client how to minimise tax due within the constraints of this Code of Conduct.

At present it appears that no professional institute requires its members to act in this way, but if this change were to be made the entire environment of taxation management could be significantly improved.

c. No steps are put into a transaction solely or mainly to secure a tax advantage.

Benefits

The concept of 'look through' has been well known in taxation law for more than three decades: a transaction which has been inserted for the sole aim of securing a taxation

[45] There is, for example, a need to overturn a precedent in UK law that suggests that a UK tax adviser who fails to advise that their client can use an offshore structure when that is technically possible, even if of dubious ethical validity, is liable to their client for any tax paid to the UK government that could have been avoided by using that mechanism. This, quite clearly makes no sense legally or ethically. For a discussion of this duty by the head of tax at PricewaterhouseCoopers UK see http://www.pwc.com/uk/eng/ins-sol/publ/tax/Rcollier-keywood.pdf accessed 24-1-07 and especially the discussion of Slattery v Moore Stephens [2003] STC 1379.

advantage can be ignored for the purposes of taxation. Accountants and lawyers have sought to challenge this action in recent years, with some success; courts now being more willing to follow the contractual form of transactions if properly documented even if a tax advantage is the primary aim of the transaction in question[46] [47].

If this principle were explicitly enshrined in law as part of a Gantip and as the basis for legal interpretation in courts and was adopted as the ethical basis of tax planning then substantial savings in transaction costs would arise for many taxpayers, the administration of taxation would be simplified, the time spent in agreeing taxation matters would be considerably reduced and greater certainty would exist in taxation management.

Commentary

The addition of artificial steps into tax planning to secure a tax advantage is commonplace. For example, group finances are supposedly arranged through offshore finance subsidiaries which do little more than operate offshore bank accounts managed remotely from another country. The holding of board meetings of companies where the directors are nominees who rarely have real decision making ability supposedly justifies such transactions legally, but in reality the arrangement is a charade used to secure a tax advantage. Likewise, trusts and other arrangements are used to trigger capital gains at a person's convenience when no real change of beneficial ownership has taken place. Alternatively the ownership of assets within a family or group of companies is reorganised shortly before a disposal takes place to use tax reliefs in what is called 'optimal' fashion when in practice the restated ownership is a sham, the benefit always accruing to the person who has had long term benefit from the asset. Finally, in many family controlled companies benefits of notional employments are frequently paid to people who provide little or no return in exchange for their payment but such transactions do reduce the overall tax rate for the family in question.

The Code of Conduct forbids the use of such artificial arrangements by those who claim compliance with it. Tax authorities should be encouraged to challenge them. Where transactions have real substance the taxpayer should not be penalised, but taxpayers and their advisers would need to be aware of the need to prove this when inserting steps into transactions that risk appearing artificial.

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[46] In the UK, for example, this 'looking through' an artificial step in a transaction was established in law using the rules of legal precedent, but not statute, in two cases in the House of Lords: The Ramsey case (Ramsay v. IRC [1982] A.C. 300) and Furniss v Dawson ([1984] A.C. 474). The Westmorland case has seen the precedents set diminished. For a discussion see http://www.taxation.co.uk/Articles/2004/07/01/43288/Certainty+and+Clarity+are+Needed.htm accessed 9-3-07. Recent rulings from the European Court of Justice suggest the principle still has value, as is shown in the Halifax case (for a discussion see http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=21603&SID=622016&TYPE=20 accessed 9-3-07) . But, it should be noted that the legal form of the transaction is still respected in this case; it failed because it was deemed to constitute 'community abuse'. In other words, the result was contrary to the outcome intended by legislation. Some have suggested that this concept, derived from French law does in effect create a form of General Anti-Avoidance Principle, although this may be a little optimistic.

[47] See also discussion in the preamble on how an equitable construction of tax law would help on this issue.

Explanatory Note: The Code of Conduct – Section 4 - Reporting

The Code requires that:

a. *Tax planning will be consistently disclosed to all tax authorities affected by it;*
b. *Data on a transaction will be consistently reported to all tax authorities affected by it;*
c. *Taxation reporting will reflect the whole economic substance and not just the form of transactions.*

a. Tax planning will be consistently disclosed to all tax authorities affected by it

Benefits

Tax planning schemes that abuse the spirit or, on occasion, the letter of the law continue to be sold without requirement arising to notify any taxation authority of the planned course of action. This gives rise to the non-payment or deferral of taxes, excessive costs arising for tax authorities in investigating such arrangements and an onerous burden of legislation and administration being placed upon compliant taxpayers. This section of the Code seeks to limit this practice.

Commentary

Tax planning has traditionally been a game of 'cat and mouse' between taxation advisers and tax authorities where tax advisers create and market tax schemes[48] and tax authorities do, if they were lucky, find about them when investigating tax returns quite often submitted some years after the transaction took place. This remains the case in many parts of the world. In some others, such as the USA and the UK, details of sophisticated tax planning schemes have to be registered with taxation authorities at the time they are first marketed or used[49]. This has, without doubt, cut down the use of abusive tax schemes, especially amongst larger firms of taxation advisers (all of whom are fearful of sharing the reputation damage inflicted on KPMG as a result of its activities). However, the arrangements have not stopped the sale of such schemes by smaller firms and abuse continues[50].

[48] KPMG heavily promoted tax schemes in the USA in the late 1990s. According to published investigations available at http://www.senate.gov/~govt-aff/_files/sprt10834tax_shelters.pdf '.Although KPMG denies being a tax shelter promoter, the evidence establishes that KPMG has devoted substantial resources to, and obtained significant fees from, developing, marketing, and implementing potentially abusive and illegal tax shelters that U.S. taxpayers might otherwise have been unable, unlikely or unwilling to employ, costing the Treasury billions of dollars in lost tax revenues'.

[49] The UK introduced such rules in 2004 and has expanded their scope steadily since then due to the effectiveness of the approach.

[50] See for example comments by Dave Hartnett, Director General of the UK's HM Revenue & Customs on this practice at http://www.financialdirector.co.uk/accountancyage/news/2173419/hmrc-director-general-bashes accessed 9-3-07.

The schemes introduced by those countries that have followed the lead of the USA in requiring registration of tax planning schemes have been successful in curbing abuse. The Code requires all governments to introduce similar registration arrangements.

It is essential that all taxpayers and tax advisers using the Code of Conduct register all schemes they create with taxation authorities without seeking to use loopholes in the rules with regard to registration to avoid disclosure for the supposed benefit of their clients. Registration of schemes should be required by the codes of ethics of bodies supervising professional tax advisers.

Even if these changes were to take place it would remain the case that much tax planning is undertaken beyond the scope of these schemes, being of smaller scale than that which requires registration or supposedly lacking sufficient innovation to require registration by the processes currently in use. In these cases it remains vital that tax planning be disclosed to tax authorities as part of the tax return declaration process so that an informed view can be taken by those authorities on the transactions they are being asked to review. This places an obligation on all taxpayers and tax advisers using this Code to declare such planning.

The logic of this is to use the 'all cards face up on the table' test developed by Mark Lee, a UK chartered accountant and former chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales. His test forms the first part of the following three stage test:

Test 1

Does the scheme pass the following test?:

- Can you make disclosure with all your cards placed face up on the table and still think the scheme will be acceptable to all relevant tax authorities within the constraints of current thinking?

If the scheme passes this test you might as well disclose it anyway as part of any tax return. There is no risk from doing so.

Whether or not the planning passes this test this Code suggests the use of the following two additional tests:

Test 2

Does the planning also pass the following tests?:

- Does it comply with your values?
- If you did it would it look acceptable to the majority of people if a newspaper disclosed that you had done so?

These two questions address the fact that the legality of an action does not necessarily make it desirable. A taxpayer has to decide to undertake legal tax planning.

In addition, for tax advisers a further test is needed:

Test 3

- If the planning fails Test 1 but passes Test 2 does the client know the risks and want to take them subject to full disclosure being made?

In this unusual case, which reflects the uncertainty that exists in tax systems without prior clearance arrangements for transactions, it is possible to proceed with caution, and with all cards on the table, knowing that a challenge is likely but that the planned action is within the boundaries of uncertainty described as circumstance (3) on page 45. This is ethical so long as the legal uncertainty being addressed is genuine in nature and not an attempt to be exploitative.

In all cases, it is essential that the planning is disclosed.

b. Data on a transaction will be consistently reported to all tax authorities affected by it

Benefits

Full disclosure to a tax authority is vital. This is the basis for a relationship of trust, which is fundamental in taxation. It is, however, as important that the same information is disclosed to all taxation authorities affected by a transaction. This is of particular importance within groups of companies. The benefits are:

1. Reduced compliance costs;
2. Faster dispute resolution on issues such as transfer pricing;
3. Reduced risk for the taxpayer;
4. The reallocation of resources by management to more productive activity;
5. Lower administration costs for governments.

Commentary

It is often forgotten that groups of companies are not taxed. The individual companies that make up the group are taxed. Likewise an individual and the entities they control, be they companies, trusts, partnerships or whatever are not taxed as one; they are taxed as separate entities. It is, therefore, relatively easy for a group of companies or for an individual operating through a wide range of different entities, quite possibly in different countries, to supply quite different information to different tax authorities about two or more sides of one transaction where these are in fact related, e.g. by way of transfer pricing.

This practice is unacceptable. Agreement to taxation affairs secured by way of differing disclosures means that there has been a failure to place all cards 'face up on the table' simultaneously. This is tantamount to non-disclosure and could constitute tax evasion. As such those persons seeking to comply with this Code should ensure that consistent information is supplied to all countries affected by the trading of a group. It is suggested that this would entail disclosure of the following data, all of which would, however be available to the Group, and no doubt to its auditors since without it being available it is unlikely that they could form a true and fair view of its taxation affairs:

1. Group structure

    a. Parents
    b. Subsidiaries
    c. Associates
    d. Investment holdings
    e. Related parties

2. Individual company accounting

    a. Turnover
        i. Third party
        ii. Group
    b. Expenses
        i. Third party
        ii. Group
        iii. Highlight tax sensitive items
    c. Stock (Inventory)
        i. Opening and closing data
        ii. Inter group profit contained in valuation, opening and closing data
    d. Labour costs
        i. Salary
        ii. Social security
        iii. Pensions
    e. Licence fees and royalties
        i. Third party
        ii. Group
    f. Interest payable
        i. Third party
        ii. Group
    g. Fixed asset costs
        i. Depreciation
        ii. Amortisation
        iii. Profit or loss on disposal
        iv. Inter group transfers
    h. Provisions
        i. By type
        ii. Reconciliation of balance sheet movement
    i. Currency exchange differences

i. Third party
ii. Inter group
iii. On consolidation
iv. Reconciliation of balance sheet effect

j. Directors fees
k. Management charges
   i. Third party
   ii. Group
l. Profit pre tax
   i. Arising from third party transactions
   ii. Profits to be eliminated from consolidation on inter group transactions
   iii. Profits arising from the use of non-historic cost based accounting
m. Tax
   i. Current tax charge and all calculations and accounting entries supporting it
   ii. Prior year adjustments to tax charge
   iii. Reconciliation of taxable and accounting profits
   iv. Tax paid and reconciliation of the payment with cash flow data either published or used in the group consolidated cash flow statement
   v. Deferred tax charge
   vi. Reconciliation of opening and closing deferred tax liability
n. Income or expenditure not recognised in the profit and loss account
   i. Movements in reserves
   ii. Charges made in the statement of recognised gains and losses

3. Group accounting

   a. Details of the group consolidation
      i. Details of any company excluded from the consolidation, and why
      ii. Reconciliation of the reported financial statements of each subsidiary prior to and after the application of consolidation journals to declared Group profit
   b. Overview by country
      i. Turnover intra group and third party
      ii. Third party expenditure
      iii. Inter group expenditure
      iv. Labour costs
      v. Interest costs, third party and intra-group
      vi. Other provisions
      vii. Profit reported in financial statements
      viii. Profit included in the group financial statements

It is stressed that this list is indicative, not prescriptive. A Code requires disclosure of all relevant information determined to suit the particular circumstances of the Group in question.

c. Taxation reporting will reflect the whole economic substance and not the just the form of transactions.

Benefits

Disclosure of tax planning is essential at two stages; the first is when it takes place, the second when it has happened. This requirement relates to the second of these occasions.

The benefit of reporting reflecting the economic substance of transactions undertaken is straightforward. If the substance of a transaction is reported it can be best determined where, how and in what value it is to be taxed. This saves company and tax authority time and provides the taxpayer with the greatest possible certainty.

Commentary

The importance of disclosing the tax planning of a company, charity trust, individual or other entity has already been discussed. That benefit continues to flow when reflected in its tax reporting. That is why compliance with this requirement is important.

Explanatory Note: The Code of Conduct – Section 5 - Management

The Code requires that:

a. *Taxpayers shall not suffer discrimination for reason of their race, ethnicity, nationality, national origin, gender, sexual orientation, disability, legal structure or taxation residence; and nor shall discrimination occur for reason of income, age and marital or family status unless social policy shall suggest it appropriate.*
b. *All parties shall act in good faith at all times with regard to the management of taxation liabilities;*
c. *Taxpayers will settle all obligations due by them at the time they are due for payment.*

a. Taxpayers shall not suffer discrimination

Benefits

Taxation is dependent upon the existence of a relationship of trust. The state has a duty to ensure that this relationship of trust is upheld. The avoidance of discrimination is key to that relationship.

Commentary

The biggest complaint in life is 'it's not fair'. This is often heard with regard to taxation. Such complaint is most often made on the basis of comparison. As with most social comparisons, it is not absolute levels of tax that matter; it is relative payments that matter. The issues that differentiate people are the issues that cause concern.

There may, of course, be valid reason for difference and these are reflected in the Code. Tax rates might differ for different levels of income and allowances and reliefs may vary depending upon age, marital or family status, for example. Some differences, such as targeted reliefs and allowances for certain economic activities may not be discrimination at all; they are incentives. But, these issues apart, the tax system must be seen to run fairly. As such, one resident person must be treated the same as another, people of different gender should have the same tax liability on the same income and so on. In addition, the choice of medium used to undertake a transaction should not, within reason, alter the tax paid upon it.

If this principle is followed many of the current frustrations within the existing tax codes of the world would be eliminated.

b. All parties shall act in good faith at all times with regard to the management of taxation liabilities

Benefits

This part of the Code extends the principle of mutual respect inherent in the previous section. If such respect is offered the prospect of effective management of taxation for the benefit of all parties is increased.

Commentary

Complaints arise from both tax authorities and tax payers about the actions of the other. Mutual respect is vital to the smooth operation of the tax system.

This element of the Code applies equally to all parties. Taxpayers have to respect the right of tax authorities to receive information, make enquiry and to establish proper liabilities. If these rights are respected and cooperation is offered when the tax authority is undertaking them it is likely that the tax authority will resolve issues more quickly, and often with greater benefit to the taxpayer. Indeed, some countries quite explicitly ensure that this is the case[51].

Any taxpayer is entitled to the same respect in return. Many tax authorities have adopted too tough an approach to tax investigations. They should accept that people can make mistakes whilst acting in good faith, and not penalise them for it. They should deal promptly and courteously with requests for help, and should provide it wherever possible. And when it appears that wrong doing has taken place they should follow generally accepted standards of enquiry rather than automatically assuming guilt.

Tax agents have a particular obligation to pursue their work in a fashion that is, and can be seen to be, ethical.

c. Taxpayers will settle all obligations due by them at the time they are due for payment

Benefits

An unpaid tax liability is the same as an evaded tax liability. The state has not benefited when it should. This commitment is, therefore, an essential recognition of the obligation of a taxpayer.

Commentary

The ethical obligation to report taxable income correctly requires that:

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[51] For example, in the UK a discount is given on any taxation penalty due upon the close of an enquiry into a taxpayer's affairs depending upon the degree of cooperation the taxpayer offered to those investigating their affairs.

1. Reporting correctly states the time when the consequences of the transaction arose,
2. Reporting takes place at the required time,
3. The resulting tax liability is settled when due for payment.

These obligations fall upon the taxpayer. They cover duties arising when tax planning (where deferral of liability is almost as high an objective as cancelling liability) and tax administration with regard to making returns on time and management, with regard to making settlement.

These commitments complete the obligation of the taxpayer by ensuring that the cycle of obligation with regard to tax is concluded for the benefit of all within the state in which the liability arises, including the taxpayer themselves.

Explanatory Note: The Code of Conduct - Section 6 - Accountability

The Code requires that:

a. *Governments shall publish budgets setting out their expenditure plans in advance of them being incurred, and they shall require parliamentary approval;*
b. *Governments shall account on a regular and timely basis for the taxation revenues it has raised:*
c. *Governments shall account for the expenditure of funds under its command on a regular and timely basis.*

Benefits

Each of these provisions is related and as such they will be considered together.

It is frequently argued by those disaffected by taxation that the governments to which they make payment are unaccountable for it. It is important that this issue is addressed: sound government accounting is essential if the payment of tax is to be appreciated as appropriate and justified.

This part of the Code requires that a government puts in place sound systems of financial management and accounting. This is as important as reporting by corporations and other entities.

There are at present significant weaknesses in many aspects of reporting by governments. The most basic questions are hard to answer. For example, the UK government seems determined not to publish easily accessible data on the size of UK GDP, but publishes almost interminable data on percentage changes within it, all of which are meaningless without a base determinant. Likewise, although the same government's official statistics web site has a section national accounts[52] the note relating to it was last amended in 2002 and the data to which it refers appears misleading, incomplete and in the case of the 'Blue Book' national accounts incomprehensible to anyone but a trained economist. Such arrangements are unacceptable when government expenditure always absorbs a significant proportion of national income, averaging for example around 37% in the OECD[53].

It is, therefore, vital that a government:

1. Publishes its budget in a clear and transparent format;
2. Has that budget approved by its parliament;
3. Has all revenue raising measures approved by that parliament;
4. Accounts for all revenue received, specifying the tax giving rise to the revenue and causes of major trends in them;

[52] http://www.statistics.gov.uk/cci/nugget.asp?id=55 accessed 21-12-06

[53] http://www.oecd.org/dataoecd/6/1/33826979.pdf accessed 21-12-06

5. Publishes estimates of revenue not received, provide explanation for non-receipt and set out strategies for remedy of such non-receipt;
6. Accounts for expenditure in a clear and transparent format by purpose and type of expenditure (e.g. health and labour costs, respectively) and by geographic area when that is material to the population of the territory as a whole;
7. Makes this information widely available in a form that a reasonably educated person without formal training in either economics or accountancy might understand. This might include:
   a. Internet dissemination, with links to the data being widely publicised;
   b. Printed publications;
   c. Access in all official languages and those of significant minority groups.
8. Provides opportunity for discussion of the accounts;
9. Those accounts should be audited. The identity of the auditor should be known and that auditor should be allowed to receive and act upon information supplied by the public. Their reports should be published;
10. This duty should extend to government owned entities e.g. nationalised industries, semi-autonomous agencies and trusts used to facilitate delivery of government initiatives.

Only by showing that it is committed to working to the highest standard of accountability and transparency can a government expect the same of those whom it governs. As such these commitments are an essential component of any Code of Conduct on Taxation.

Explanatory Note: The Code of Conduct - Enforcement[54]

Background to the enforcement issue

A Code of Conduct is of no value if it is not enforced. As such arrangements would have to be made to ensure that those who committed to this Code meet their obligations under it, and receive the benefits they expect from it in return. Such a review process would have to cover the three parties who might comply with the Code, namely states, taxpayers and tax advisers.

This is a notoriously difficult issue, and those promoting this Code are under no illusions as to the complexities and problems that any Code faces in becoming credible as a result[55].

Reasons for using a Code

Despite this the authors believe that a Code has greatest prospect of success in this area because:

1. There seems only limited prospect of any international regulation of taxation issues for a considerable period henceforth;
2. There is evidence that Codes that relate governments, civil society and enterprise have more success than those that only concern one or two of those parties[56];
3. Codes established with government backing have had success in the taxation area e.g. the EU Code of Conduct on Business Taxation[57], which whilst not involving any party but governments has not been legislatively backed and has enjoyed some marked success, as also have Financial Action Task Force Initiatives, which have a similar status[58];
4. There is, has been noted above, a suggestion that some of the biggest firms of accountants are in favour of a Code[59];
5. Suggestion has been made to the author of this report by senior tax officials in a number of countries and administrations that they believe a Code is a suitable way of exploring regulation of international taxation, if only to act as a filtering mechanism to identify the complaint and so focus legislatively backed action on those likely to be in breach of its principles. This logic is accepted as valid by the author.

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[54] Thanks are noted to Prof Sol Picciotto for comments that assisted development of this section.

[55] For a detailed discussion of the issues see http://www.thecornerhouse.org.uk/pdf/briefing/26codes.pdf accessed 20.4.07

[56] ibid, page 4

[57] See http://ec.europa.eu/taxation_customs/resources/documents/primarolo_en.pdf accessed 20.4.07

[58] http://www.fatf-gafi.org/ accessed 20.4.07

[59] http://www.kpmg.co.uk/pubs/beforepdf.cfm?PubID=1744

Enforcing the Code

States seeking to comply with the Code would be required to submit themselves to annual evaluation of their Conduct to be overseen by a committee of independent experts appointed with a considerable period of tenure by the states participating in the process. This is, in effect, peer review but by using an independent panel of experts there is less chance of pressure being brought to bear on those persons. The experts undertaking the review should represent a wide cross section of society and not just those within the taxation area. Civil society would need to be represented.

Peer review is not unusual, although care is always needed to ensure that it does not result in lowest common denominator standards. It is for example used by the Financial Action Task Force[60]. It says:

> *The mutual evaluation process represents a central pillar of the work of the FATF over the last ten years. Through this process, the FATF has monitored the implementation of the FATF Forty Recommendations and has assessed the effectiveness of the anti-money laundering systems in FATF member jurisdictions.*[61]

The FATF started a third round of mutual evaluations for its members in January 2005.

In addition some tax haven states now participate in the review process of the IMF on a voluntary basis[62]. They do so because they perceive it to be in their interests. Almost all of them agree to the findings being published. Having participated once it appears they have all agreed to do so again.

There is, therefore, a clear precedent for international co-operation in monitoring standards of government behaviour for mutual benefit. The process appears successful in resolving disputes. As the FATF notes:

> *As of 13 October 2006, there are no Non-Cooperative Countries and Territories.*[63]

In that case it would seem likely that this arrangement could be applied to larger states as well as smaller ones without creating fears of new world wide regulatory bodies. But it would be important that any peer review have the power to call for information, and to publicise its non-receipt. Publicity is key to the effectiveness of this process.

The issue for taxpayers and agents is different. Realistically most taxpayers will have little incentive to subscribe to the Code, although it should be possible for them to do so. This is because for a person with a relatively simple range of income sources (and that is true of most people, worldwide) any benefits from joining would be minimal.

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[60] http://www.fatf-gafi.org/ accessed 23.4.07

[61] http://www.fatf-gafi.org/pages/0,2966,en_32250379_32236982_1_1_1_1_1,00.html accessed 23.4.07

[62] See for example http://www.imf.org/external/np/ofca/ofca.asp accessed 13.9.06

[63] http://www.fatf-gafi.org/document/4/0,2340,en_32250379_32236992_33916420_1_1_1_1,00.html accessed 23.4.07

As a taxpayer's affairs become more complicated then the benefits of joining would increase. There are two reasons. Firstly, taxpayers who seek to comply with the Code should be presumed to do so by all relevant tax authorities. It is likely in consequence that their tax affairs will be more readily agreed. Secondly, for those taxpayers for whom good citizenship (and especially good corporate citizenship) is an issue, compliance would carry with it the benefits of publicity. This in turn might be used for commercial advantage e.g. by carrying an approved logo on literature, in corporate reports, on web sites and so on. Indeed, this should be encouraged by national tax authorities and members of the public who should, by reviewing information published by the taxpayers in question have a clear indication of their commitment to the processes of transparency inherent in the Code, and an opportunity to report apparent breach to national tax authorities if they do not find it. Establishment of a complaints procedure to investigate such issues will be central to its success.

This monitoring process is essential as any Code can be abused. That risk has to be acknowledged. The consequence of abuse should be that any benefits provided to a taxpayer for cooperation during a tax investigation should be withdrawn if deliberate breach of the Code is found to have occurred with the intent of seeking advantage from it, and any tax penalty due should be doubled. This would have a substantial deterrent effect.

Finally, monitoring will be an issue for tax agents. In fact, it might most particularly be an issue for agents since they probably have most to gain from this Code. The Code should be seen as an extension of the Code of Ethics of the professional bodies dealing with taxation. At present no professional body deals with issues in the way summarised by the Code, but that is the distinct advantage that the Code offers, in two ways.

Firstly the Code could be adopted by a professional body on behalf of its members who wished to comply, but without compulsion. In that case the professional body would be expected to have a professional monitoring process of sufficient rigour to ensure that those claiming to comply with the Code were actually doing so. This would be vital, and any firm found to be claiming to, but not actually complying would then be in breach of their duty to their professional body and be subject to professional discipline.

Secondly firms might join, whether or not their own professional body did and in that case they should expect to pay a fee to a peer review body established for the purpose and to subject themselves to an annual self assessment process on compliance and to expect a review on a periodic basis in exchange for the commercial benefit that the status of complying with the Code (and the likelihood of improved relationships with tax authorities that this might afford) might confer. Professional firms are used to such procedures. Non compliance in this case would result in well reported adverse publicity, including automatic referral to tax authorities which may expose their client base to taxation investigation.

By use of these mechanisms it is likely that any Code could be policed effectively, for the benefit of all.

About the author

Richard Murphy is a chartered accountant. He studied economics and accountancy at Southampton University and trained with Peat Marwick Mitchell & Co in London, qualifying in 1982. He set up his own firm of chartered accountants in 1985, which partnership grew to have 800 clients when he resigned as senior partner in 2000. In addition he has been chairman, chief executive or finance director of ten SMEs since 1985.

Since 2002 Richard has worked on taxation and accounting policy issues. He is director of Tax Research LLP. His clients include major NGOs, government agencies, think tanks, unions, campaign organisations and overseas governments. He is senior tax adviser to the Tax Justice Network. His research has covered issues as diverse as the impact of international financial reporting standards on development; tax and corporate responsibility; the impact of the offshore economy on development and why flat taxes are not simple.

Richard has written widely on taxation, accounting and corporate responsibility issues for newspapers and professional and academic journals and contributes to BBC television and radio documentaries on a regular basis.

Richard is a research fellow at the Tax Research Institute, Nottingham University Business School and a visiting fellow at the Centre for Global Political Economy at the University of Sussex.

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(ii) to facilitate critical scrutiny of professional bodies, regulatory bodies, employer organisations, employee organisations, government departments and business organisations with a primary concern with regard to those related to the accountancy profession

(iii) to campaign for such reforms as will help to secure greater openness and democracy, protect and further the rights of stakeholders and to make disclosures where necessary;

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The Tax Justice Network (TJN) brings together organisations, social movements and individuals working for international tax co-operation and against tax evasion and tax competition. In an era of globalisation, the Tax Justice Network is committed to a socially just, democratic and progressive system of taxation. TJN campaigns from an internationalist perspective for a tax system which is favourable for poor people in developing and developed countries, and finances public goods and taxes public bads such as pollution and unacceptable inequality. TJN's objectives are detailed in the TJN declaration (www.taxjustice.net).

TJN is a pluralistic, diversified, non-governmental, non-party and multilingual network. Local, regional and national civil society and social movement organisations as well as tax justice campaigners, researchers, journalists, development specialists, trade unionists, concerned business people, tax professionals, politicians and public servants are members and supporters of the network.

TJN is campaigning for social change through public debate and education. Public understanding of tax matters is the precondition for international tax justice. The network makes information available through mass media as well as through conferences and seminars, the internet, newsletters, publications in print, symbolic actions, demonstrations and advocacy. We base our activities on expertise and sound research.

TJN facilitates co-operation, communication and information sharing between its members. The network organises international exchange and policy debates in order to harmonise the views and concerns of our members. This process forms the basis for powerful global campaigns in international tax policy.

TJN is run by its member organisations as well as individual supporters. The network functions on the principles of participatory democracy, empowerment, transparency, accountability and equal opportunity. TJN encourages and where necessary supports member organisations and individuals to participate in the decision making. The network supports the building of national TJN campaigns in particular in developing countries. An international secretariat coordinates the network's activities.