5 steps to tackling tax avoidance now

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I've been challenged to suggest five steps that could be taken now to tackle tax avoidance, given that the topic is in the news.

First of all, let's be clear why this issue is important. I estimate tax avoidance costs the UK £25 billion a year. I stress, that's an estimate. That means it's an informed guess - I'm not saying this figure is right. What we do now know though is that it is substantially more realistic than the government's own estimate of £5 billion. That is why this issue is now under discussion. When George Osborne now admits that just 20 taxpayers may be avoiding £145 million between them we know that this issue is of enormous economic consequence.

So, these are my top five ways of tackling tax avoidance, each if them in short summary:

1. Introduce a proper general anti-avoidance rule

This is a perennial demand of mine and is absolutely essential if we are ever going to be tax avoidance.

A general anti-avoidance rule is essential once we realise that all tax regulation is written and it is an inevitable fact of life that words have uncertain meanings, however much we like to deny it and however hard Parliament works to try to define them in taxes acts. That means all tax law is open to abuse if the only basis on which it can be interpreted is the strict meaning of words, which cannot be known until a judge has ruled on the issue. So, we need a better basis for interpretation and that is to look at the purpose of the law, and the intention of the taxpayer and then decide if the two coincide. If they do, then everything is fine. If they don't then quite clearly action needs to be taken.

Now, no one wants a general anti-avoidance rule which gives a tax authority complete right to decide when, if, and how somebody should pay tax. There is obviously massive uncertainty in that as well. But thankfully we have a precedent for such a general anti-avoidance rule, and it was, curiously, created by the House of Lords. In 1982 the House of Lords ruled upon a case and their resulting decision came to be known as the Ramsey principle. In order for the Ramsay principle to apply, there had to be:

1) a series of transactions; which are

2) pre-ordained; and

3) into which there are inserted steps that have no commercial purpose apart from tax avoidance.

Under Ramsey the artificial step inserted for tax avoidance was ignored when calculating the tax due— effectively delivering a general anti-avoidance principle.

Unfortunately, the Ramsey principle was largely overturned in a subsequent decision of the House of Lords in 2001, and that is one reason why tax avoidance has become so rampant in the last decade. Now we need it back, and a general anti-avoidance rule that would put it into UK law is now essential.

I stress of the current proposal from the government for a general anti-avoidance rules nothing like this at all **and I explain why here.**

2. Country-by-country reporting

A very welcome development over the last few weeks has been the increase in discussion of the impact of transparency upon tax avoidance. There seems to be almost universal agreement that most people are embarrassed about being found to be tax avoiding. As a result there also seems to be near universal agreement that the more information there is on public record about a tax payer's affairs the less chance there is that they will undertake tax avoidance activity.

My estimate of tax avoidance splits into two near equal parts. One half relates to the activities of individuals and the other to the activities of large companies. By definition there are many fewer large companies than there are individuals and each of those companies also pays (or should usually pay) a great deal more tax than any individual, and so also has a great deal more opportunity to tax avoid. As a consequence, demanding transparency from multinational companies who have greatest opportunity to use tax havens and their associated arrangements to avoid their tax obligations in the UK is the obvious place to start with a transparency agenda.

Large companies do, of course, have to prepare and publish their accounts, but those accounts do not at present include any indication at all of what a multinational company does in each and every country in which it operates. So we have no idea of what its sales are, what its profits are, how many people it employs or at what cost, and most importantly of all, of course, how much tax it pays in each and every country in which it operates.

Country by country reporting by multinational companies would solve this problem. Those companies would then have to publish a profit and loss account showing all the above noted information for each and every country in which they operate. As a result we will know precisely what they do in the UK, how much tax they pay here and how much in addition that they don't pay here because we will know how much of their profit is shifted into tax havens.

There is an official proposal for a form of country by country reporting before the European Parliament at present, but it only relates to the extractive industries. This is not therefore something that is now on the fringes of debate. The OECD is looking at it, the International Accounting Standards Board is looking at it and so is the European Union. In that case it is time to put pressure on all these bodies to introduce a comprehensive country by country reporting requirement to reduce the tax avoidance activity of multinational corporations to the benefit of this all. There is more information on this issue here.

3. Increasing the number of staff at HM Revenue & Customs

A lot of tax avoidance is complicated. It takes time to investigate it, time to assess it, time to react to it and time to push through the resulting demand for additional tax due. All that time has to be undertaken by real people, sitting in real offices, doing a real days work on behalf of the UK. They are employed by H M Revenue & Customs, and yet right now far too many of the people employed by our tax authority are facing the risk of redundancy.

I'm well aware that the government says that it is investing up to £900 million in additional funds to tackle tax avoidance but that has to be set against the background of £3 billion of total cuts to the budget of HM Revenue & Customs over the life of this Parliament. You cannot tackle tax avoidance and cut the resources available to address this issue at the same time. As a result it's now essential that we change our attitude towards spending on staff at HM Revenue & Customs and not see them as a cost, but to see them as a revenue generation opportunity, with the people in question being gainfully employed to ensure that there is a level playing field on which all business in the UK operates where no one gets an advantage by tax cheating to give them an unfair benefit in the marketplace. There is in this a double benefit. We get a more efficient, fairer, competitive and vibrant market and we have more tax paid at the same time. This is a pro-business tax policy for the UK.

4. Reforming small business taxation

One of the first objectives of any tax avoider is to get their income out of their hands, where it might be subject to income tax rates of up to 50% present and potentially to national insurance charges as well, and into the hands of another person who will pay tax at a lower rate, possibly with no national insurance paid. That obvious 'other person' is a limited company, and anyone can form such a company for a tiny outlay of under £100 at this point of time in the UK.

Too often this then means that the income that an individual has earned is artificially diverted into making payment to someone else, or that income from unemployment that should be subject to national insurance is converted into what looks like investment income paid in the form of dividends to which no national insurance applies. We now know that thousands of people are paid in this way by the government each year, and there will be tens, if not hundreds of thousands, of people paid in this way in the private sector each year as well. All of this is tax motivated.

I have no desire to impede small-business because it is in many ways the backbone of our economy. Nor do I want to put an impediment in the way of those businesses that really need to raise capital through a limited company, and to retain profits to reinvest in their enterprise. But let's be clear, that is a small minority of companies these days. The vast majority of small limited companies are owned by just one person, have a share capital of under £10, do not retain profit for investment in the business, and are basically the incorporated persona of their owner/manager. We need to recognise this fact and create appropriate structures for limited liability entities for use in the 21st-century economy when at present we are struggling with the legacy of a structure designed in the 19th century.

I **explored this issue in much greater depth here, but what we need to do now is change the format of incorporation for most small businesses in the UK so that something much like a limited liability partnership, which has been available in UK law since 2000, becomes the standard format for the small limited liability business. This means that they enjoy limited liability, but at the same time the owners are taxed upon the profits arising in the business each year under income tax rules as if they were partners in an unincorporated business. This means that the opportunities for tax avoidance are limited, national insurance at self-employed rates is paid (and this is lower than on employment income) and many of the admin burdens that exist in the management of a limited company are eliminated because the taxation rules of limited liability partnerships are at present much simpler than those of companies.**

There are enormous advantages to making this change. It will reduce the admin burdens on small business, it will reduce tax avoidance, it wil differentiate between those companies which are setting out to establish larger scale enterprises and those which are always intended to be small-scale operations (not that there is anything wrong with that) and it will help create a level playing field between smaller companies of all types who would then be face broadly consistent tax rates whether they are incorporated or not. That has to be good for fair competition in the UK

economy as well.

5. Tackling tax havens

Tax havens are often associated with tax evasion activity, where a person simply hides their income, gains or wealth from the view of H M Revenue & Customs, but that is not always the case. They can also be used for tax avoidance. Some of this will be easily undertaken by those who are not domiciled in the UK (and tackling the domicile rule remains an important issue in the tax avoidance agenda) but they are also widely used by those who are resident as well. iIn many cases this happens because people think that such activity will not be found out, whether the transactions undertaken is legitimate or not. Certainly, keeping such activity out of the public domain is a key objective of those who use tax havens, which is why I so frequently refer to them as secrecy jurisdictions.

The UK has more tax havens under its care than any other country in the world. The Channel Islands, the Isle of Man, the Cayman Islands, the British Virgin Islands, Gibraltar and others are all ours. We have a duty, first of all, to make sure that these places are as open and transparent with us as we expect financial institutions in the UK to be, not least because most of the financial institutions located in these tax havens are owned by UK-based organisations.

We have to go further than that though. International cooperation to stop taxing the people is essential, and the European Union has been extremely important in this process. Currently the UK is undermining the EU's initiatives to tackle tax havens by signing a deal with Switzerland. That deal must be cancelled because it will at the very least seriously delay and will quite possiby ultimately completely prevent progress on the upgrade of the European Union Savings Tax Directive which would, if implemented in the form currently proposed be the best weapon to shatter tax haven secrecy that the world has ever seen.

I am, of course, aware that the Austria and Luxembourg are siding with tax cheats and tax criminals in opposing this upgrade to this European directive. However, it is essential that the UK commits itself to tackling tax avoidance by siding with the European Union against such tax cheats and the governments that help them, including Switzerland, which has for all practical purposes joined the existing European Union Savings Tax Directive. We must now proactively demand that those countries that help people avoid their obligation to pay UK tax must be transparent with us in ensuring that everyone who owes tax in this country has their affairs made known to us so that demands for payment can be made.

6. Just in case you want some more

I could of course have suggested some other items for inclusion in the above list. I will give no great detail on them here but would suggest they might include:

a. Renegotiating the basis on which multinational companies allocate their profits between states. The OECD's arm's-length principle which has been the basis for this calculation for well over half a century is now completely outmoded, and a new basis of allocation is now essential. The UK could lead this process.

b. Aligning the income tax and capital gains tax rates for individuals. Nigel Lawson did, of course, do this with great success. It immediately eliminates an obvious route to undertake tax avoidance, and that is why the rates should be aligned again.

c. Some moves have been already put in place to cut the value of allowances and reliefs available to the wealthiest taxpayers but the measures in question may not have gone far enough. Consideration of further restrictions is an essential part of addressing the problem of tax avoidance because in some areas the opportunity for continuing avoidance is far too easy to locate within our tax system.

d. The USA has for a long time had what it calls an 'alternative minimum tax rate' which has had the intention of limiting tax abuse. We need to investigate the same sort of system in the UK.

e. There is a paradox in the UK tax system that income earned from employment (by the proverbial " hard-working family") is much more heavily taxed because of the application of national insurance than is income earned from investment. Avoiding national insurance has as a result become the tax accountants first port of call as a consequence. There is an obvious way to remedy this, and to create a level playing field for all taxpayers whatever their source of income, and that is to introduce an investment income surcharge on investment income (for everyone but pensioners, I suggest) with investment earnings of, say, more than £5,000 a year being subject to that additional charge that is equivalent to national insurance.   Yet again the object is to create a level playing field, and when there is a level playing field the opportunity to tax avoidance is greatly reduced.