How to beat corporate tax avoidance and hold global cap...

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Numerous journalists have called me asking how we should tackle the whole issue of tax avoidance by multinational corporations who right now seem to be taking the UK for a ride on this issue. We could name Google, Apple, Amazon, Starbucks, Facebook and so many more and the companies in question are paying little or no tax here on what appear to be substantial commercial operations that appear from reports that in many cases they themselves make to be profitable.

My answer to such questioning is that first we have to understand the problem, and second we have to understand the constraints on solutions. I'll deal with them in order.

Tax paid is always paid on the basis of a formula. I'll keep it simple. There are three components to this. First there is the tax base - that's the income or profit charged to tax. The second part is tax allowances and deductions - which can be offset against the income in the tax base. Personal allowances are the most obvious of these but there are, of course, many more. Third there is the tax rate - the percentage part of the remaining tax base that is to be paid in tax.

Now the problem in the cases we're talking about is not to do with the tax rate: that's always the easy bit. And it may not even be allowances and reliefs: we're not talking odd capital gains arrangements or other deals which result in aberrant corporation tax rates here. The problem in each of these cases is in the tax base.

We have to remember that the tax base for a company is always based on the profits it reports. And the reported profit in each and every case is that of each individual company within a group, and not for the group as a whole. There is no such thing (at present) as group tax accounting. Whilst it's not quite true we ignore groups for tax we do start from an assumption that they don't exist and then tweak the system to allow for them. Accounting, on the other hand, fundamentally works the other way round: the group accounts are more important than the individual accounts.

This simple differing of the order of priority in accounting and tax explains most of the tax avoidance we're looking at. Groups think globally; that means that their goals are set for the group as a whole, not for any individual company within it. On the other hand, tax works locally: it is collected by a state and from individual companies. Now whilst it is true that when a residence basis of taxation is used - where a state taxes a resident person (or company) on their worldwide income, whether sourced in that country or not - there is in a sense a global scope for a local tax system, but unless a parent company is being considered this is largely irrelevant and most of the abuse we're talking about is not by UK based groups. As such that is not an issue of concern here since the current concern is very largely with US based groups seeming to abuse the UK tax system.

They are, almost without exception, doing this by shifting their tax base out of the UK. There are (and I summarise) four ways they're doing this:

a) They're legally shifting where they record sales out of the place where they are physically contracted for and supplied or consumed: Google, Amazon, eBay, Facebook and others are all doing this, recording sales in EU tax havens even though the sales were contracted for (in the sense that a UK based sales force did the deals) in the UK to UK clients.

b) They're appearing to over pay for services supplied. The example is the Starbucks royalty. It seems high: there appears little commercial logic to a royalty that turns profit into loss in thirteen out of fourteen years. No one would reasonably do this in arm's length markets. The paying company would logically have been bust a long time ago. But it does not seem to have stopped Starbucks.

c) They are using intellectual property - an artificial legal property right - to claim that the source of profits in UK markets is derived elsewhere. The whole legal infrastructure of patents, copyright and payments for their use is used to shift profits, often to locations where those patents were never created.

d) They use secrecy to hide what they're doing, aided by tax havens and the nature of group accounting which means that no intra-group transactions have to be recorded in group accounts. It's that double whammy of secrecy that aids and abets this whole process.

The point in each case is that accounting and legal contracts has allowed the tax base to move. It is possible transfer pricing cases within tax rules could challenge some of these issues. That's true for interest rates and transfer prices for goods. It may even be true, but is much harder to do so for royalties - intellectual property is incredibly hard to price. I am not saying transfer pricing rules cannot deal with this: in all likelihood it will not do so effectively.

What transfer pricing finds virtually impossible to deal with is the whole relocation of a

sales contracting base from one country using distance selling arrangements and complex contractual arrangements that have, at the very least it is fair to conclude because of the consistency of the outcomes, the intention of reducing their group's tax arrangements. Companies know this and are exploiting it.

I am aware that it is currently being argued that this is the inevitable consequence of EU rules on the right to incorporate wherever a company wishes in support of the free movement of capital throughout the 27 countries. Now, whilst I agree that this right is embedded in EU law, I think it is quite untrue to say that the right to abuse the tax base of any country is also inherent in that right.

There is, for example, a concept within EU law of the abuse of law. This does extend to tax, and even to UK tax, where it has been applied to VAT decisions. This concept, best summarised in what is know as the Halifax case, decided in 2006, makes clear that if a right granted in EU law is abused, even if within the wording of the law, to deliver an outcome not intended by that law then the abusive use of that law can be overturned even though entirely legal. The similarity between this and a general anti-tax avoidance principle of the type I propose is, of course, uncanny and not chance.

I think the relocation of profits, artificially, is an abuse of EU law. I admit I have not seen this argued before. But that's not to mean it is not true. The essential quality of an arrangement that is abusive is that it is artificial with intent to secure an outcome not intended in law. The structures being looked at seem to meet that criteria.

That argument, however, does depend on evidence that the EU may think this way about tax - and that's not hard to find. It exists in the EU Code of Conduct on Business Taxation. Issued first in 1997, then under the direction of Dawn Primarolo, now a Labour deputy speaker of the House of Commons this made clear that the EU would be hard on state sponsored tax abuse.

Now I am well aware that this is a Code - not law. But let's also be clear there is good reason for this. The Code has worked because it has been enforced not by law courts but by a Code of Conduct Group of antions representatives that has been rigorous, even if too secretive, in upholding the principles inherent in the Code that no country may promote tax systems designed to undermine those of another state within the EU.

Have no doubt this has worked: I have had some interaction with the Code, using it successfully to challenge the tax systems of Jersey, Guernsey and the Isle of Man. Jersey has still to recover: its latest report on how it plans to comply with the demands of the Code will be issued tomorrow, and will reveal they still do not know how to do so.

I make the point for good reason. In 1997 the political willingness to take on this issues, most especially in tax havens, but in other states too (most countries had some changes to make in their tax law to comply) it is fair to say that willingness has declined

since then; that I cannot deny. But, the fact that the Code continues in operation and effectiveness in some cases proves that such a structure works, and not only works but has significant backing.

In that case is it reasonable to think that there was never the intention that the conflict between accounting form and tax reporting of transactions should result in the abuse of the tax base of a country, and that if it does there might be abuse of EU law? I suggest so. I cannot see how it was ever the intent that countries themselves should exploit that law to secure their own advantage and yet, of course, that has happened, and in the process a significant number of companies have been unfairly advantaged, almost entirely at cost to domestically based corporations.

I say all this to answer a point I have seen made time and again in the last few days, which is that first of all the EU intended that tax abuse of the sort perpetrated by many US corporations operating in Europe right now. I don't agree. And it's not because I don't understand that I don't agree: it is because I do think I understand that I don't agree. I cannot see any way EU law on tax or the right of incorporation can be intended to firstly all the abuse of law and secondly permit breaches of what would not, I think, be in the Code of Conduct if only the political will were present.

So, having explained how abuse takes place and why I think the EU cannot permit it let's talk about what can be done about it. Some of these I have already summarised in other blogs.

First, very obviously, we need to invest much more heavily in collecting tax. There are only 2,000 or so fully qualified tax inspectors in the UK. That is ridiculously few. And let's recall that total staff in HMRC will have fallen from 100,000 in 2005 to 55,000 in 2015. I can agree some streamlining may have been possible, but if that had been 20,000 staff I would have been amazed. We have 65,000 staff at HMRC now and a crisis in collecting all taxes. 20,000 staff will change that, but more high quality, highly paid staff to challenge abuse by the largest corporations is vital. Nothing less will do if we are to beat this problem. Right now companies and their lawyers are running rings round the Revenue.

Second, having these people will let us uphold existing law. We aren't doing enough on transfer pricing. And we aren't doing enough to challenge the whole structuring of some deals. The law to let us do much of this exists, but we can only do it with people.

Third, we have to be honest about the scale of the problem we face. Not a penny of the abuse the press and parliament are rightly worried about is in the HMRC tax gap figure. That's ludicrous. It suggests that they and their political masters are in denial about what is happening. That cannot be the way to deal with this. An honest assessment of the tax gap and what should be in it is vital. I'll suggest my own

work is the right direction for travel here.

Fourth, the political mood music on corporate tax has to change. We have reached the absurd point where politicians have joined in the race to bottom in international tax regulation that began in tax havens and was first promoted by lawyers, accountants and bankers. Surely we should expect politicians to stand up for the states we vote them to run? And ye now they don't. We have current politicians in the UK who pride themselves on having abandoned our residence basis of tax so suitable to a country that hosts large numbers of parent companies. Instead they promote the whole notion of turning a blind eye to what happens outside the UK by adopting a territorial basis of tax that only taxes income arising in the UK, and asks few questions of how that income arising is determined. That is, politically, exactly the sentiment that the multinational companies now not paying tax in the UK are exploiting. We have to expect a political change on this point.

Fifth, our politicians have to go to the EU and argue that we must have change on the lines I have outlined above: I believe we can demand that the Code of Conduct be revisited to attract this issue, but more than that, we now must demand that the idea of the abuse of law in these cases must be tested.

The OECD is also a target. The arm's length pricing model of transfer pricing does not work and everyone knows it. The FT has promoted the unitary model of taxation this week that I and others in the Tax Justice Network have long promoted. This allocates group profit to countries using a formula based on where the destination of sales is, where people are employed and where real physical assets are. These are the real and only drivers of economic value. This reform is now essential if we are to demand that global capital is to be accountable locally for tax.

And we must have country by country reporting in accounting as well. We have to know where corporations are and what they do, and how much tax they pay in each and every country in which they trade. Nothing else will also hold companies to account - and force them to change their behaviour under the glare of pubic, investor and regulator (including tax inspector) scrutiny.

I am convinced that the corporate tax base can be captured and taxed. I agree it's not straightforward. And it will not happen without political will. Many of us have campaigned to create that will: I'd suggest it's momentum is becoming unstoppable. Now we need to transform that into action to deliver results. I think what I've suggested here is a plausible way to do that.

Comments are welcome from those interested in serious debate.

And please accept apologies if there are editing issues in this blog: it has been written in haste.