Funding the Future

What can we do to tackle tax abuse? A social science pe...

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I am speaking at the All Party Parliamentary Group for Social Science and Policy in the House of Lords this morning, discussing 'what can policymakers do to reduce tax avoidance by large companies?'. I expect to say:

The last year or so has seen an extraordinary outbreak of concern about tax avoidance by multinational corporations. Having worked for a decade, on my own account, with the Tax Justice Network and with many NGOs and other activists, as well as with most journalists working in this field to create that concern I am delighted it has happened but the question is now, quite rightly, what can be done about it. I want to make several suggestions about why this problem has appeared so intractable, and to then suggest solutions that I hope we can develop in the Q & A.

The first reason why this problem has been so difficult to challenge is that microeconomists are in denial about its existence. That is because under the influence of microeconomic theory it has become commonplace over the last few years for many to argue that companies really don't pay tax and that, as a result, we shouldn't really worry about this issue and should be looking to tax others instead.

Let me be blunt. That's wrong. Companies change who pays tax, where tax is paid, at what rate tax is paid, when it is paid, if at all, and who therefore enjoys the benefit of that tax paid. The argument about whether or not companies pay tax is, in that case, almost irrelevant. Since companies do, by their very existence, seriously impact upon the tax system taxing them appropriately is a matter of the highest priority in terms of socially just outcomes of any tax system. To suggest then, as microeconomic theory does, that the best way to tackle this issue is to just pretend companies are mere agents for their members is clearly no place from which to start discussing this issue — especially when that same theory ignores the reality that we have no clue who the members of most companies are.

I am sorry to say that I believe that most tax lawyers and accountants have also got their perspective in this issue wrong. If their opinion on it were to be believed each company is not only real, having a legal persona and a life of its own, but it is also *distinct and separate from all other companies, even if it is wholly owned and controlled by a multinational corporation.*

The unfortunate result is that for eighty odd years tax law has pretended that groups of companies don't exist when it is precisely because they do that the problem we are looking at arises.

The consequence of this error is as bad as that made by the microeconomists. Whereas microeconomists by making one wrong assumption would have anyone but companies taxed, the tax profession by making another wrong assumption ensures that groups of companies are always under-taxed. This happens because the tax profession has insisted that we must adjust the profits of every company in a group so that we only tax that income that might have arisen if all companies were independent. However, groups exist because they make more money than separate companies and this adjustment process therefore means that it is guaranteed that we under tax group entities — missing out entirely their group related income. No wonder the tax profession and CBI don't want the existing tax system changed.

Bizarrely though the tax profession is at odds on this with accountants — who take yet another view. Through the International Accounting Standards Board accountants now make very clear that they think that groups of companies are entirely independent of their shareholders — who they consider just one provider of capital — correctly shooting the microeconomists argument to pieces on the way. The accountants also take a pot shot at the tax profession at the same time, in this case by refusing to recognise the separate entities within a group by completely removing all the trading between those companies from view in consolidated accounts. However, the result is that accountants rather conveniently as a result help completely hide from view what multinational corporations do in tax havens — almost none of which shows up in their accounts or in local company registries.

And that's the problem. We have not tackled this issue of multinational corporation tax abuse because we have in existence three failed theories of the firm and corporation tax which have when combined, usually at whim, created massive opportunity and cover for tax abuse. And that is where civil society has come into this equation because we have offered a fourth and new perspective on this issue that has both exposed that the problem of tax abuse exists — which would not have happened without us — and how to solve it. Based largely on theories of political economy and behavioural economics I have, and we have, argued five things.

First we argue that companies really do exist as what are, for all practical purposes, separate entities.

Second, we argue that where groups exist then they are also real — and have to be treated as such — which simply does not happen for tax right now.

Thirdly, whilst recognising groups are real we also argue that whilst they may be multinational they do not, as they would have us believe, float in the ether over the world. Their impact is real, and local, and has to be accounted for in that way, but isn't at present.

Fourth, we argue that it is intra-group trading — which represents some 60% of world trade -that provides the opportunity for most tax abuse. And we say accountants, lawyers and micro economists have all, collectively, been wrong to ignore it — as they all have.

Fifth, we have argued that it has been secrecy — both of the consolidated accounts of multinational corporations that ignore subsidiaries — and of tax havens that provide complete opacity for those same subsidiaries — that have have let this abuse occur, especially when used in combination.

The result has been obvious. Encouraged by the arguments of many in academia and the professions the directors of multinational corporations have increased their own rewards through executive bonus arrangements triggered by low tax payments secured through tax abuse that has as a result been motivated by their own self- interests at cost to society at large.

A few have spotted this in academia, where Profs Prem Sikka, Ronen Palan and Sol Picciottio lead the pack in the UK. The professions have, however, flailed on the sidelines. And in civil society we have been tackling the issue — drawing it to the attention of the press, with considerable success - and by proposing three solutions that will, vitally in our opinion, change behaviour.

First we suggest the shattering of tax haven secrecy by requiring the disclosure of the beneficial ownership of all companies and trusts. A bill for this purpose will be tabled in the Commons on Wednesday. The G8 are moving towards it, as is our government.

Second, we have proposed automatic information exchange — that ensures that data from a tax haven is automatically sent to the tax authority of the place where a person using that location is really resident.

And third we must have country-by-country reporting — which is the one thing that the G8 really promised and which I first proposed a decade ago. This is a tool for investors and tax authorities alike that by publishing a separate profit and loss account for each place in which a multinational corporation trades shows with a very high degree of probability whether the self declared profits of a multinational corporation in a jurisdiction is supported by the underlying indicators of economic activity — based on sales, people employed and capital invested in tangible assets.

Together these three measures that shatter opacity — and others, like our proposal to move from arm's length pricing to a profit split basis for profit allocation by default *when using OECD transfer pricing guidelines - suggest there are real ways forward for beating tax abuse by creating the right incentives for corporations and their directors to change behaviour. But notably, as I've said, they've all come from civil society — and it is in these ideas that investment is now needed if this problem is to be solved.*

Thank you.