Tax avoidance is back, at cost to us all

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This article was commissioned by a US newspaper last week. They hadn't realised apparently they had commissioned two articles in the same theme, so this one will do quite nicely here:

Tax was at the heart of the international agenda in 2013. It dominated the G8 summit in Northern Ireland in June 2013 and went on to feature prominently at the G20. David Cameron set the tone for all this in January 2013 when addressing the World Economic Forum in Davos, *saying then:*

We want to use the G8 to drive a more serious debate on tax evasion and tax avoidance. This is an issue whose time has come. After years of abuse people across the planet are rightly calling for more action, and most importantly there is gathering political will to actually do something about it.

He added:

[T]here are some forms of avoidance that have become so aggressive that I think it is right to say these raise ethical issues, and it is time to call for more responsibility and for governments to act accordingly.

Since then the Organisation for Economic Cooperation and Development, based in Paris, has, at the G20's behest, been supposedly working flat out on what it calls its Base Erosion and Profit Shifting (BEPS) project. That is intended, as its name suggests, to shore up corporate tax revenues in countries around the world by stopping the world's multinational corporations shifting them into low and no tax jurisdictions.

In 2014, however, everything looks very different. The proposed Pfizer takeover of UK based AstraZeneca has made clear that tax avoidance is still very firmly at the heart of the global corporate agenda. That deal has brought 'tax inversions' back to public intention. Like so much in tax, the language disguises what's really happening. Tax inversion simply means that a corporation is shifting its tax residence from one country to another for the main purpose of saving tax.

Until a year ago inversion was almost forgotten, and had been since 2002 when Stanley Works Inc. (now Stanley Black & Decker Inc.) *proposed inversion from the USA to Bermuda*.

After public and government outcry it backed away from the proposal, not least because of IRS rule changes. But that's not true anymore. Just at the time that when politicians from around the world say they're tackling tax avoidance tax inversions are back with a vengeance, and the IRS rules are being worked around with a vengeance.

Already three relatively little known US pharmaceutical corporations have inverted, all destined for new Irish tax residences, and now it looks like Pfizer might do the same, except it will head for the UK, whilst there is also widespread speculation that Walgreen might, as a consequence of completing its option to acquire Swiss based Alliance Boots, head for a new tax residence in that exceptionally tax friendly Alpine location.

So, what's happening, why's it happening, and what can be done about it? What's happening is relatively easy to explain. Companies like Pfizer are sitting on mountains of cash in offshore tax havens. According to one source Pfizer have more than $73 bn offshore. Another says that sum is growing by $10 billion a year. Pfizer have money burning a hole in their pocket, but it's a pocket they can't more to the US without paying tax, so they're looking to go elsewhere.

The 'why' comes in four parts. First, this is because of the absurd nature of US corporate tax law that only charges the overseas profits of US corporations to tax if those profits are sent back to the US. Leaving profits offshore has, in that case, to be the easiest tax avoidance strategy ever created.

Second, it's because of tax haven activity by some states that aren't normally considered amongst the usual suspects when it comes to this issue, including the Netherlands and Ireland. The places when used in association with Bermuda can create what is now called the 'Double Irish' tax avoidance scheme that routes almost any non—US royalty, patent or copyright income of a US multinational into an offshore tax haven, almost tax-free. This is where offshore cash comes from.

Third, there is the almost complete failure of the US to address this, and almost any other, corporate tax issue in need of reform, which has meant US corporate tax has steadily fallen as a proportion of federal revenues, US corporate profits and in effective rate over many years.

Lastly, there's the fact that the rhetoric against tax avoidance simply does not match government behaviour worldwide. The UK provides, perhaps, the best example of this. Whilst its prime minister declared tax avoidance to be an issue of the highest priority his own government was changing UK tax law to create a territorial taxation system for UK based multinational companies. What this now in effect means is that, just like a tax haven, the UK now ignores altogether anything that happens outside its own *territory, and refuses to tax it. Before 2010 the opposite was true: the aim was to tax the worldwide income of these countries.*

What is apparent then is that, whatever the rhetoric, the world's governments now see themselves in tax competition with each other. They say that this is about attracting business and jobs, but the reality is that its only profits that move and the owners of those profits are winning low and no tax as a result. The OECD's BEPS project has no hope of a successful outcome as a consequence. Instead we should hark back to its 1998 report on harmful tax competition, another project undertaken at international request, but which failed to answer the fundamental question, which was whether a benign variety of tax competition might ever exist. At present it seems not.

So, what can be done about this? The answer, in a nutshell, is unitary taxation. This form of corporate tax, familiar in the US on an inter-state basis, could be applied to the worldwide profits of multinational corporations so that their profits are apportioned to the countries where it is likely that they arise based upon the sales made, labour costs incurred and asset investment in those places. It's not a perfect tax system, but then, none is. If, however it was matched to country-by-country reporting, an accounting system for multinational companies that I pioneered, the data to make sure that allocations were realistic would be readily available.

Curiously, David Cameron and the G8 demanded that country-by-country data be supplied to tax authorities in 2013. It looked like, for a brief moment, as if we were heading in the right direction. Then the lobbying began. The UK has now backtracked from its own demand whilst my experience of negotiation on this issue at the OECD in Paris suggests that the US are doing absolutely everything they can to destroy this proposal, precisely because it could lead to unitary taxation.

It's almost as if tax authorities based in USA and UK don't want the corporations based in those countries to pay tax. But then, on the streets, that's been known for some time. This is why the Occupy movement happened. This is why there is such cognitive dissonance, as Gillian Tett has described it, on tax right now.

So when will there be change? Only when people demand it and have the courage to back corporations down on it. It’s clear right now that politicians have backed down from that. But the time might come as yet. Those making the noise on this issue have not gone away, and nor are they likely to.