

***The Role of Accountancy Firms in Tax Avoidance: Some Evidence
and Issues**

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Abstract

As entrepreneurial businesses, accountancy firms have supplemented their traditional trade of selling accounting and auditing services by diversifying into a variety of other products and services. They have developed organisational structures and strategies to sell tax avoidance schemes to corporations and wealthy individuals. The sale of such services shifts tax burdens to less mobile capital and less well-off citizens. It also erodes the tax base and brings the firms into direct conflict with the state. This paper provides some evidence of the strategies and tactics used by accountancy firms to sell schemes that enable their clients to avoid corporate, sales and payroll taxes. Such strategies stimulate reflections upon the possible trajectories in the development of accountancy firms and social consequences of their trade.

Key words: Accountancy firms, commercialisation, tax avoidance, offshore finance.

1. Introduction

The neo-liberal economic theories facilitating globalization have so reduced territorial frontiers that capital roams the world looking for jurisdictions and networks that offer a refuge for high profits, low tax and minimal social obligations jurisdictions. The triumphant march of global capitalism may produce enormous economic activity, trade and wealth, but it is also accompanied by extreme poverty, social exclusion and huge inequalities in the distribution of income, wealth, and quality of life for everyone. The dismantling of exchange controls and trade barriers, accompanied by innovations in communications technologies, has encouraged the development of a rapacious tax avoidance industry, with ordinary citizens, equality, democracy, justice and fairness as the visible casualties.

Despite record corporate profits and economic growth, over four billion people live on less than \$2 a day; 1.8 billion people lack access to electricity. In 1960, at the dawn of large-scale tax avoidance, the richest 20 percent in the world accounted for about 70 percent of total income. However, by 2000, that figure had reached 85 percent¹. Over the same period, the fraction of income accruing to the poorest 20 percent in the world fell from 2.3 percent to 1.1 percent (Prahalad, 2004). A United Nations report estimates that in 2003, 640 million children did not have adequate shelter, 400 million do not have access to safe water, 270 million have no access to health services and 140 million had never been to school. More than 10 million child deaths were recorded in 2003 and almost half a million children aged under-fifteen died of Aids, while a further 630,000 children were infected with HIV. By 2003 some 2.1 million children under-fifteen were living with HIV/Aids, mostly infected during pregnancy, birth or through breast-feeding (UNICEF, 2004; also see International Labour Organisation, 2004).

These inequalities are also a feature of affluent countries. In Britain, world's fourth biggest and Europe's second richest economy, the share of wealth enjoyed by the poorest 50% of the population has shrunk from 10 per cent in 1986 to 5 per cent in 2002 (New Statesman, 7 March 2005). One-in-three children (3.8 million children)

¹ 400 richest American's are estimated to have personal wealth of over \$1 trillion (Forbes 2004 list of the richest Americans published on 24 September 2004). In financial terms this is bigger than the GDP of India, home to some 1.1 billion people.

live in poverty (Barnardo's, 2003). Some 16% of the population lives below poverty line and 22% of the adults are functionally illiterate. Public expenditure on education is the lowest as percentage of the GDP, since the early 1960s (The Guardian, 4 September 2001, p. 1). Due to inadequate income and resources, some 12.8 million Britons may be unable to make adequate provision for retirement (The Guardian, 12 October 2004). Currently, almost two million pensioners live in poverty, over half a million over-65s are undernourished and risk ill-health due to poor diet and over 22,000 pensioners die each year from cold and related illnesses (Age Concern press release, 21 December 2004). According to the Royal National Institute for the Blind (Daily Mail, 30 October 2001, p. 30), between 17 and 22 per cent of school-age children have poor eyesight, but have not had an eye test. The incidence of brain cancer amongst children is 36% higher than in the 1950s and the rate of acute lymphoblastic leukaemia has gone up by one-third (Daily Mail, 18 December 2001, p. 22). Unlike any other EU country, TB is on the increase in Britain. In 2002, there were 6,891 cases compared to 5,798 in 1992 (The Guardian, 3 August 2004). England and Wales have one lung specialist for every 119,000 people, compared to a European average of one for 60,000 patients (Daily Mail, 24 October 2000, p. 24). The unemployment benefit in Britain is lower than elsewhere in Western Europe and fewer people out of work in Britain receive unemployment benefits. The unemployed in Spain receive 77% of the country's average earnings. In Britain, unemployed persons only receive 30%, and this is available for only six months, after which various social assistance benefits can be obtained, but they are low enough to leave many in a poverty trap. In Sweden and Denmark, benefits adding up to 60% of the average wage can be claimed for up to five years.

People may look to elected governments to make the necessary investment in social infrastructure and eradicate social inequalities or use the taxation system to redistribute wealth and enable more people to live fulfilling lives, but such aspirations are increasingly checked by the tax avoidance industry dominated by accountants, lawyers and bankers. Britain may be losing more than £100 billion of tax revenues² each year (Lyssioutou et al., 2004; Marsden, 2004). In 2001, the US is estimated to

² The UK government has refused to publish any official estimates (Hansard, House of Commons Debates, 2 November 2004, col. 154W; 8 January 2004, col. 425; 12 March 2003, col. 285).

have lost nearly \$311 billion, up from \$32 billion in 1973 (US Senate Committee on Finance, 2004), large enough to finance a free healthcare service for all citizens. Nearly 60% of US corporations paid zero federal taxes from 1996 to 2000 (US General Accountability Office, 2004a). Developing countries may try to expand their economies to provide jobs, public goods and social investment, but the tax avoidance industry is not far away. For example, tax avoidance is depriving China of more than 30 billion Yuan (US\$3.6 billion) in lost tax revenues annually (China Daily, 25 November 2004) where almost “90 per cent of the foreign enterprises are making money under the table. most commonly, they use transfer pricing to dodge tax payments” (China People’s Daily, 25 November 2004). Developing countries are estimated to be losing more than US\$50 billion of tax revenues each year (Oxfam, 2000) whilst paying £100 million (or around US\$190 million) a day in debt repayments alone to richer countries (Oxfam, 2004). Deprived of social investment, average life expectancy in some African nations has declined to just 33 years.

The global tax avoidance industry is attracting increasing attention by policymakers (for example, Organisation for Economic Cooperation and Development, 1998, 2000; Financial Action Task Force, 2000a, 2000b, 2000c; Financial Stability Forum, 2000; US General Accountability Office, 2003, 2004a, 2004b; UK Home Office, 1998) and scholars (for example, see Hampton, 1996; Palan, 2003), but comparatively little scholarly attention is focused upon the role of accountancy firms in facilitating tax avoidance (Mitchell et al., 2002; Sikka, 2003). Concerned legislators and opinion formers have pointed the finger at accountancy firms for devising and mass marketing tax avoidance schemes. For example, a US Senate Subcommittee concluded that “dubious tax shelter sales were assigned to talented professionals at the top of their fields and able to draw upon vast resources and reputations of the country’s largest accounting firms Whose products generated hundreds of millions of dollars in phony tax losses for taxpayers, using a series of complex, orchestrated transactions, structured finance, and investments with little or no profit potential” (US Senate Permanent Subcommittee on Investigations, 2005, p. 9, 10). In his evidence (18 November 2003) to the US Senate Permanent Subcommittee on Investigations, Senator Joseph Lieberman said that “ranks of lawyers, accountants, and financial consultants have abused the law and their own professional ethics simply for the sake

of huge sums of money to be made helping their clients evade taxes³”. Senator Carl Levin added that “accountants are cooking up these deceptive schemes, and which are then going out and mass marketing these schemes to people who had made a major amount of money or had big profits in the last year⁴”. A UK legislator stated that “Britain’s corporation tax revenues are under relentless attack from several multinational companies and the global accountancy firms’ mass production of tax avoidance” (Hansard, House of Commons Debates, 3 February 2005, col. 392).

This paper provides some evidence about the involvement of accountancy firms in developing and selling tax avoidance schemes. Such evidence can help in understanding the trajectories in the expansion of entrepreneurial accountancy firms, contrasting with their expressed claims of ethical conduct and ‘social responsibility’. This paper contains three further sections. The first of these argues that in the pursuit of higher profits and earnings, accountancy firms have diversified into selling tax avoidance schemes even though it brings them into conflict with the state and civil society. Such activities are facilitated by broader capitalist concerns about increasing profits and reducing social obligations. The second section provides evidence from publicly available sources and shows that accountancy firms are actively involved in selling schemes that enable their clients to avoid corporate, sales and payroll taxes. The third section concludes the paper by considering some social implications of this commercialisation of accountancy firms.

2. PROFESSIONALISM AND PURSUIT OF PROFITS

In societies marked by divisions of expert labour, accountants distinguish themselves from competing occupational groups by drawing attention to a number of traits or characteristics (Millerson, 1964). These include claims of theoretical and practical knowledge, high level of skills, ethical conduct and social responsibility. Appeals to such idealised self-images help to solicit trust and legitimise professional power. They are part of the politics that enable accountants to secure considerable work autonomy and define the needs of clients and society (Flint, 1988). However, accountancy firms

³http://hsgac.senate.gov/index.cfm?Fuseaction=PressReleases.View&PressRelease_id=580&Affiliation=R; accessed 25 November 2003.

⁴ <http://www.pbs.org/wgbh/pages/frontline/shows/tax/interviews/levin.html>; accessed 21 February 2004.

do not simply trade by appealing to idealised claims. As entrepreneurial businesses, they constantly reinvent themselves (Daly and Schuler, 1998) and translate their images and technical knowledge claims into fees and markets by stimulating demands for new products and services and by creating appropriate organisational cultures, structures and strategies to meet and expand them (Larson, 1977; MacDonald, 1995).

Historically, the state guaranteed monopoly of external auditing has been the making of accountancy firms. Unlike other consultancy businesses, it gives them comparatively easy access to company executives and provides an opening to impress potential clients with zeal about meeting deadlines, attention to detail, the value of surveillance, judgement, control and related implications of cutting costs and inefficiencies (Willmott and Sikka, 1997). Until, the late 1960s, accounting and auditing services formed the ‘core business’ for accountancy firms, but their relative contribution to firm profits has stagnated. In common with other capitalist enterprises, accountancy firms have sought to mobilise their technical knowledge to develop complementary products and adjacent markets, including the sale of tax avoidance schemes (Sikka and Willmott, 1995a; Financial Reporting Council, 2005). In addition to cementing jurisdictional claims (Abbott, 1988) and increasing the partners’ share of profits (Burrows and Black, 1998), the expansion into tax avoidance services exploits deeply ingrained individualist discourses claiming that “every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax” (*IRC v. Duke of Westminster (1936) 19 TC 490, [1936] AC 1*). Such discourses are amplified and an Ernst & Young partner specialising in selling tax services claimed that “We pride ourselves in being a liberal economy; the central feature of such an economy is that residents are free to undertake the activities that they wish [avoid taxes], provided the activities are not unlawful” (Irish Times, 7 May 2004).

As commercial concerns, accountancy firms prioritise private profits and encourage competitive individualism, with an emphasis on retaining clients, pleasing the customer and promoting business virtues that increase profits (Grey, 1998; Barrett et al., 2005). To sell tax avoidance and other services, firms need to develop

organisational cultures and practices that place increasing emphasis upon the commercial acumen of their staff and it is this commercial acumen, rather than the ethical conduct, or even the technical ability of the firms' staff that is increasingly promoted as the primary measure of their trustworthiness. As a partner of a major accountancy firm put it, "a firm like ours is a commercial organization and the bottom line is that first of all the individual must contribute to the profitability of the business. In part that is bringing in business but essentially profitability is based upon the ability to serve existing clients well" (Hanlon, 1994, p. 121).

Accountancy firms are part of the contemporary 'enterprise culture' that persuades many to believe that 'bending the rules' for personal gain is a sign of business acumen. Stealing a march on a competitor to make money, at almost any price, is considered to be an entrepreneurial skill, especially where competitive pressures link promotion, status, profits, markets and niches with meeting business targets (Sikka, 2004). The intellectual and moral outlook of employees is shaped by socialisation and inculcation from senior staff that emphasises retention of clients. Such practices are given visibility by senior partners instructing staff that "The first requirement is to continue to be at the beck and call of RM [Robert Maxwell⁵ was chairman of the company], his sons and staff, appear when wanted and provide whatever is required" (UK Department of Trade and Industry, 2001, p. 367). In pursuit of profits, firms have been keen to retain known problematical clients on the grounds that they are "a big fee account" (Joint Disciplinary Scheme, 2004). Such a focus on private profits does not appear to be accompanied by concerns about public obligations, persuading Hanlon (1994) to conclude that within major firms the "emphasis is very firmly on being commercial and on performing a service for the customer rather than on being public spirited on behalf of either the public or the state" (Hanlon, 1994, p. 150).

The commercialisation of accountancy firms is shaping and is shaped by broader changes in contemporary capitalism where traditional values are being increasingly eclipsed by search for higher earnings and financial rewards. An official report from the UK government notes that business acumen is increasingly accompanied by "cynical disregard of laws and regulations cavalier misuse of company monies

⁵ Robert Maxwell became notorious for stealing £458 million from his employees' pension funds.

...[and] a contempt for truth and common honesty” (UK Department of Trade and Industry, 1997, p. 309). Stimulated by recurring crisis of profitability, intense competition and pressures to increase earnings, capitalist enterprises constantly seek new ways of boosting earnings by developing complex structures and by rewarding advisers who can find novel ways of increasing earnings. In part, this is also a response to the pressures upon executives whose own earnings, bonuses and rewards are linked to higher reported earnings. One of the strategies has been to cut ‘costs’ by reducing or avoiding tax obligations as unlike redundancies and factory closures such reductions remain relatively invisible. In contemporary entrepreneurial culture, tax avoidance is promoted as a natural, inevitable and a desirable pursuit. For example, an Ernst & Young tax partner claimed that “Tax is a cost of doing business so, naturally, a good manager will try to manage this cost and the risks associated with it. This is an essential part of good corporate governance⁶” (Irish Times, 7 May 2004). Accountancy firms have long been identified as key players in the ‘rules avoidance’ industry⁷ (Sikka and Willmott, 1995a) and have further enhanced their credentials by developing and marketing a variety of tax avoidance schemes to enable their audit clients and others to report higher profits (US General Accountability Office, 2005).

The opportunities to sell other services, including tax avoidance schemes, have fuelled the global growth and expansion of accountancy firms. Paralleling the expansion of multinational corporations, major accountancy firms have forged networks and organisational presence in virtually every major country and city. For example, KPMG⁸ member firms employ over 100,000 people to provide audit, tax, and advisory services from 715 cities in 148 countries; Deloitte & Touche member firms employ 115,000 people in 148 countries and 670 cities; Ernst & Young member firms employ nearly 106,000 people in 670 cities in 140 countries and PricewaterhouseCoopers (PwC) member firms employ 130,000 people in 768 cities in 139 countries. This vast network enables the firms to meet demands of local capital with global solutions i.e. their clients can choose from a variety of tax avoidance and related packages that may have initially been developed for other jurisdictions. The

⁶ Such a view is contested by Christensen and Kapoor, 2004.

⁷ As the chairman of Coopers & Lybrand (now part of PricewaterhouseCoopers) put it, "there is an industry developing, and we are part of it, in standards avoidance" (Accountancy Age, 19 July 1990, p. 1).

⁸ Information is taken from the most recent annual review of the relevant firm.

worldwide presence has enabled the Big Four firms to generate global income of \$55 billion global income and become the 53rd biggest economy in the world (Cousins et al., 2004). Firms have expanded their consultancy operations (Financial Reporting Council, 2005) and selling tax avoidance schemes is a major source of revenues (Mitchell et al., 2002). Even after public exposure of their role in selling dubious tax avoidance schemes to Enron and WorldCom (US Senate Joint Committee on Taxation, 2003; United States Bankruptcy Court Southern District of New York, 2004), major firms and their trade associations have vigorously opposed any restrictions on the sale of taxation services to audit clients. For example, a spokesperson for the American Institute of Certified Public Accountants (AICPA) said that “the institute won’t oppose legislation for a limited ban on consulting services ... won’t object to a ban on information-technology consulting or internal auditing But it will oppose one on tax related consulting⁹”. In response of intense lobbying, the US Sarbanes-Oxley Act 2002 did not place any significant curbs on the sale of tax avoidance schemes to audit clients. The UK’s revised ethical standards do not ban the sale of tax avoidance schemes to audit clients either or require accountancy firms to make any public disclosures about such activities (Auditing Practices Board, 2004). Such a regulatory climate provides the firms with numerous opportunities for developing and marketing tax avoidance schemes.

3. ACCOUNTANTS AND TAX AVOIDANCE

The intensification of commercialisation of accountancy firms is highly evident in their strategies for selling tax avoidance schemes. The sale of tax avoidance schemes is not a new phenomenon; however what is interesting is the variety of schemes and the tactics used by accountancy firms to sell them. This section provides some evidence by drawing attention to the strategies used to sell schemes that help clients to avoid corporate, sales and payroll taxes.

3.1 Corporate Taxes

The demise of US-based energy company Enron focussed worldwide public attention on organised large-scale tax avoidance. Enron, with 25,000 employees and \$50 billion assets became America’s biggest corporate bankruptcy. A US Senate report (US

⁹ http://www.aicpa.org/info/aicpa_update_3.htm; accessed 20 November 2004.

Senate Joint Committee on Taxation, 2003) found that the company operated through a global web of 3,500 domestic and foreign subsidiaries and affiliates, including 441 registered in the Cayman Islands tax haven¹⁰, many of whom never traded but enabled the company to structure its transactions and avoid taxes. Enron's highly complex tax avoidance schemes were designed by Arthur Andersen, Deloitte & Touche, Chase Manhattan, Deutsche Bank, Bankers Trust and several major law firms, who according to the Senate report received around \$88 million in fees. Enron's published accounts showed net income of \$2.3 billion for the period 1996 to 1999, but for tax purposes claimed to have a loss of \$3 billion. It paid no tax for 1996 to 1999. For the year 2000, it reported taxable income of \$3.1 billion, but for tax purposes it claimed a loss of \$4.6 billion, a calculation now disputed by the US tax authorities. Many of the transactions had no commercial substance and were designed solely to avoid taxes not only in the US but also in places such as India and Hungary. So complex were the tax avoidance schemes that a 2,700 page report by the US Senate was barely able to introduce them (US Senate Joint Committee on Taxation, 2003).

The demise of WorldCom, another US giant, also focused attention on tax avoidance or what was internally referred to as a 'tax minimization program'. A report by WorldCom's bankruptcy examiner concluded that "WorldCom likely avoided paying hundreds of millions of dollars in state taxes in 1998-2001 based upon the accrual of over \$20 billion in questionable royalty charges. The cornerstone of this program, which was designed by KPMG Peat Marwick LLP ("KPMG"), the classification of the "foresight of top management" ("management foresight") as an intangible asset, which the parent company could license¹¹ to the subsidiaries in return for massive charges" (United States Bankruptcy Court Southern District of New York, 2004, p. 3). The "foresight of top management" is unlikely to be found as an 'intangible asset' in any accounting text-book¹². However, it could be conceptualised as management's strategy to create a horizontally and vertically integrated corporate structure to provide a range of service to customers, something any company would strive for. To

¹⁰ Cayman Islands, in common with many other tax havens, do not levy any tax on income and profits.

¹¹ A variety of trademarks and trade names were also licensed to WorldCom subsidiaries.

¹² In accounting, something is considered to be an asset if meets a number of tests, including its severability and ability to be sold to third parties for cash.

minimise taxes, a WorldCom company registered in a favourable tax jurisdiction claimed ownership of the newly designed asset. Since the whole WorldCom group relied upon management abilities, all companies had to pay a royalty for its use. For the period 1998-2001, these companies paid \$20 billion in royalty fees. The paying companies got tax relief on the payment of royalties, but since the receiving company was located in a favourable tax jurisdiction it paid little or no tax on most of its income. The transaction was internal to the WorldCom group and had no net effect on its global profits but saved millions in taxes. KPMG collected nearly \$10 million in fees. The bankruptcy examiner added that the company's royalty programs "lacked economic substance the "management foresight" that KPMG identified was not an intangible asset The company and KPMG apparently failed to explain the true nature of the Royalty Programs to taxing authorities "(pp. 37-41).

Revelations at Enron, WorldCom and other scandals persuaded the US Senate Permanent Subcommittee on Investigations to closely examine the tax avoidance industry. Major accountancy firms, law firms and banks confirmed that were major sellers of tax avoidance schemes. In the words of an Ernst & Young partner, "The stock market boom and the proliferation of stock option awards in the 1990s created an unprecedented number of individual taxpayers with large gains and significant potential tax liabilities We and other firms looked for legitimate and appropriate tax planning ideas. Perhaps, reflecting the tenor of the times these efforts rapidly evolved into competitive and widespread marketing of those ideas¹³". PricewaterhouseCoopers' senior tax partner told the subcommittee that "In the 1990s there was increasing pressure in the marketplace for firms to develop aggressive tax shelters that could be marketed to large numbers of taxpayers regrettably, our firm became involved in three types of these transactions¹⁴". However, the Senate Subcommittee homed in on KPMG because in the words of one of its members, "this was one of the worst perpetrators they were involved more heavily than any other firm that we could find¹⁵".

¹³Testimony by Mark Weinberger on 18 November 2003; http://govt-aff.senate.gov/_files/111803weinberger.pdf; accessed 21 November 2003.

¹⁴ Testimony by Richard Berry on 18 November 2003; http://govt-aff.senate.gov/_files/111803berry.pdf; accessed 21 November 2003.

¹⁵ <http://www.pbs.org/wgbh/pages/frontline/shows/tax/interviews/levin.html>; accessed 21 February 2004.

KPMG¹⁶ told the Senate Committee that it had over 500 “active tax products¹⁷” and that the firm’s strategy was to become “an industry leader in producing generic tax products” (US Senate Permanent Subcommittee on Investigations, 2003, p. 2 and 25). Some of these products were developed in collaboration with the firm’s audit clients¹⁸ and also sold to a number of audit clients (p.15, 55). The ‘tax products’ were marketed and executed through a network of law firms, banks, investment advisory firms and charitable organisations. Just four of these schemes, three of which may have been illegal, may have netted the firm \$180 million in fees and helped to swell its fees for tax services from \$829 million in 1998 to \$1.2 billion in 2001 (New York Times, 11 February 2005). At the same time the US Treasury may have lost \$85 billion of tax revenues (US Senate Permanent Subcommittee on Investigations, 2003, p. 21; USA Today, 18 November 2003; New York Times, 11 February 2005). The Senate report concluded that “none of the transactions examined by the Subcommittee derived from a request by a specific corporation or individual for tax planning advice on how to structure a specific business transaction in a tax efficient way; rather all of the transactions examined by the Subcommittee involved generic tax products that had been affirmatively developed by a firm and then vigorously marketed to numerous, in some cases thousands, of potential buyers” (p. 2).

KPMG had an elaborate organisational structure for developing and marketing tax avoidance schemes, including a ‘Tax Innovation Center’ whose sole mission was to develop new tax products (p. 30). It operated a “Tax Services Idea Bank” and invited staff to submit new ideas for tax products on an internal form which also asked submitter to explain the revenue potential, typical buyer and key target markets. The ‘center’ operated as a profit centre and was subjected to a performance monitoring regime. KPMG maintained an extensive marketing infrastructure to sell its tax products, including a telemarketing centre staffed with people trained to make cold calls to find buyers for specific tax products. The Senate reports stated that the firm

¹⁶ The firm has close relationship with the UK state and has advised the government on possible reforms of tax havens (UK Foreign and Commonwealth Office, 2000).

¹⁷ They are also referred to as “tax solutions” or “tax strategies” (US Senate Permanent subcommittee on Investigations, 2003, p. 26)

¹⁸ These included Deutsche Bank, HVB and Wachovia Bank, and inevitably raise some questions about auditor independence and possible conflict of interests.

“utilized confidential and sensitive client data in an internal database containing information used by KPMG to prepare client tax returns in order to identify potential targets for its tax products” (p. 9). Tax professionals and audit staff were required to work together to sell and implement the product and internal communications told staff that the tax product is a “collection of assurance and tax services designed to assist companies in realizing value from intellectual property delivered by joint team of KPMG assurance and tax professionals to increase KPMG’s market penetration of key clients and targets by enhancing the linkage between Assurance and Tax professionals” (p. 54)

In the secretive world of tax avoidance and concerns about intellectual property, KPMG required some potential purchasers to sign “nondisclosure agreements” (p. 14). Client presentations were done on chalkboards or erasable whiteboards, and written materials were retrieved from clients before leaving a meeting. KPMG staff were advised to clean out their files and not to retain some information. The Senate Committee was also unhappy in that it believed that contrary to professional rules and regulations, the firm charged “contingency fees” for selling tax avoidance schemes to audit clients (p. 15).

Over the years, thousands of corporations had been approached by KPMG to aggressively sell its tax products. Extensive pressure was placed on staff, including professional accountants and lawyers, to sell the firm’s generic tax products. One internal e-mail asked staff to “temporarily defer non-revenue producing activities” and concentrate for the “next 5 months” on meeting revenue goals for the year”, and added “Listed below are the tax product identified by the functional teams as having significant revenue potential over the next few months.....”. Another senior person said, “We are dealing with ruthless execution - hand to hand combat - blocking and tackling.’ Whatever the mixed metaphor, let’s just do it.” (pp. 8-9) “you must respond aggressively at every opportunity” (p.50). Staff were advised to tell some clients that some products were no longer available, “apparently hoping that reverse psychology would then cause the client to want to buy the product” (p. 9). There was guidance on how to convince sceptical clients (p. 58) with phrases such as “Many of the [KPMG] specialists are ex-IRS employee; Many sophisticated clients have implemented the strategy in conjunction with their outside counsel; call the client

and say that the firm has decided to cap the strategy ... and the cap is quickly filling up” p. 59). Some clients were worried about possible future litigation by the tax authorities and such uncertainties were mediated by securing ‘opinion letters’¹⁹ from selected lawyers and by telling buyers that they could purchase suitable insurance cover from named insurance companies.

The US Inland Revenue Service (IRS) requires firms to register certain kind of tax products, but the Senate report noted that “Despite its 500 active tax product inventory KPMG has never registered, and thereby disclosed to the IRS the existence of, a single one of its tax products” (p. 13), possibly because it believed that its products were beyond the scope of the legislation. However, the Senate report refers to an internal e-mail, in which a senior KPMG official suggested that the firm should not register its tax products with the IRS, even if required by law because the IRS was not vigorously enforcing the registration requirements and that the penalties were much less than the potential profits. The KPMG calculated that based ‘upon our analysis of the applicable penalty sections, we conclude that the penalties would be no greater than \$14,000 per \$100,000 in KPMG fees. ... For example, our average [OPIS²⁰] deal would result in KPMG fees of \$360,000 with a maximum penalty exposure of only \$31,000.” The senior tax professional also warned that if KPMG were to comply with the tax shelter registration requirement, this action would place the firm at such a competitive disadvantage in its sales that KPMG would “not be able to compete in the tax advantaged products market” (p. 13).

A KPMG tax partner told the Subcommittee that the tax strategies “represent an earlier time” and that the firm now does not sell “any aggressive tax strategies specifically designed to be sold to multiple clients²¹”. After the Senate hearings, the firm announced a number of organisational and personnel changes (The Observer, 25 January 2004) and Senator Carl Levin stated that the Subcommittee “investigation

¹⁹ The Senate report states that “KPMG had drafted its own prototype tax opinion letter supporting the product and used this prototype as a template for the letters it actually sent to its clients. In addition KPMG arranged for an outside law firm to provide a second favourable opinion letter” (p. 11).

²⁰ This is an acronym for a tax product.

²¹ Evidence given on 18 November 2003 by Philip Weisner; http://govt-aff.senate.gov/_files/111803weisner.pdf; accessed 21 November 2003.

revealed a culture of deception inside KPMG's tax practice. If the changes announced by KPMG today represent a real reform of that culture, they are welcome²².” However, a number of newspapers, citing new internal e-mails of the firm released by the Subcommittee, reported that the firm’s “efforts to create and sell dozens of tax shelters appear much more rigorous and extensive than detailed in documents made public [in 2003] by the Senate Permanent Subcommittee on Investigations” (New York Times, 26 August 2004; also see International Herald Tribune, 26 August 2004; Washington Times, 26 August 2004). The firm reaffirmed its commitment to reform.

Though the Subcommittee initially focused upon KPMG, other major firms were also found to be deeply involved in the tax avoidance industry. For example, a further report (US Senate Permanent Subcommittee on Investigations, 2005) stated that Ernst & Young “sold generic tax products to multiple clients despite evidence that some were potentially abusive or illegal tax shelters” (p. 6) and may have netted the firm \$27.8 million in fees (p. 87). An internal e-mail of the firm noted “we have great inventory of ideas. Let’s keep up the R&D to stay ahead of legislation and IRS movements” (p. 83). Likewise, the Senate Subcommittee found that PricewaterhouseCoopers also sold generic tax products which were “potentially abusive or illegal tax shelters” (p. 7 and 93).

3.2 Sales Taxes

With pressure on corporate taxes, some states have shifted taxes to consumption²³ (or sales). However, this too has attracted the attention of the tax avoidance industry. In common with other members of the European Union (EU) Britain raises tax revenues by levying Value Added Tax (VAT) on the supply of most goods and services²⁴. In essence, the supplier charges tax (“output tax”) at a statutory rate (currently 17.5%) on sales. The supplier can offset the VAT paid on purchases (“input tax”) against the output tax and the difference is settled with payments/receipts to the Customs & Excise Department. This way the business acts as a tax collector and the net effect of

²² <http://levin.senate.gov/newsroom/release.cfm?id=217068>; accessed 15 January 2004; also see The Observer, 25 January 2004.

²³ Such policies are regressive and tend to hurt the less well-off.

²⁴ There are a number of exemptions (e.g. food, children’s clothing, books, newspapers) and lower rates for power and household fuel.

the tax falls on the ultimate consumer. However, there is a potential for increasing corporate earnings if companies can claim relief for the 'input tax' and somehow forego the payment of 'output tax' to the authorities. A scheme to achieve this was devised by KPMG and contested by the UK Customs authorities (London Tribunal Centre²⁵, 2002). The scheme hinged around interpretations of the EU Directives (e.g. Sixth Directive, Thirteenth Directive) incorporated in to the UK law. The Thirteenth Directive contains provisions for VAT on expenses to be refunded to businesses that are established outside the EU but supply goods and services to UK entities. If a business entity established outside the UK could show that it bought goods and services in the UK and thus had 'input tax' but is not involved in the sale of goods and services in the UK, and is thus not liable to register for VAT purposes, it could then seek to recover the amount of 'input tax'. The KPMG scheme involved setting up skeletal operations and control structures on Guernsey, part of the Channel Islands, to show that the UK operations were controlled from Guernsey²⁶. The idea was to show that the Channel Islands resident company is incurring VAT on its purchases in the UK, but is not making taxable supplies and nor is it established in the UK²⁷. Thus it did not have to register for the collection and payment of 'output tax' to the UK Customs and Excise authorities.

The scheme flowed from a cold-call (6 January 2000) from KPMG, which had no previous relationship with the company, to Mr Garland, a director of UK-based RAL Holdings Group. The firm offered to make a presentation of a possible VAT savings in respect of gaming and amusement machines subject to a confidentiality undertaking being given (London Tribunal Centre, 2002, para 9). On 28 January the presentation titled "KPMG's VAT Mitigation Proposals for Gaming and Amusement Machines" was given to company directors. It contrasted £4.2 million VAT then payable with a nil liability using a Channel Islands company ("CICo"). CICo would recover VAT on the site rental, if opted for tax, and on the machines. KPMG would charge £75,000 for an evaluation report and counsel's opinion and a fee of 25 per cent of the first year's

²⁵ A transcript of the case, details and judgement is available on <http://www.financeandtaxtribunals.gov.uk/decisions/seldecisions/decision/v17914.htm>; accessed 28 February 2004.

²⁶ The Channel Islands (including Jersey, Guernsey, Alderney and Sark) are UK Crown Dependencies but are neither part of the UK nor the European Union.

²⁷ In many ways the position is no different from that of a tourist who visits London, buys goods and then seeks to reclaim the VAT paid on those purchases.

VAT savings, 15 per cent of the second and 5 per cent of the next three year's savings. The biggest benefit of the scheme was claimed to be "enhanced shareholder value" (para 70). The "predominant aim is to increase group profitability by reducing the amount of VAT paid by the group after taking account of VAT recovered by the group" (para 70(18)).

In March 2000, KPMG were formally appointed advisers to the company and in due course presented a 16 page report (15 Jun 2000) containing details of the scheme. The scheme, as explained to the London Tribunal, related to gaming machines operated in the UK by companies in the RAL Holdings Ltd group. Under the scheme gaming machines in 127 amusement arcades in the UK were to be leased to a newly formed Channel Islands subsidiary company, which was granted licences by a group company in the UK to use the arcades. Another UK subsidiary contracted with the Channel Islands company was to provide the staff at the arcades. Under the plan, all the gaming machine operations would take place in the UK except accounting and "machine management" and complaints handling which would take place from Guernsey in the Channel Islands. The UK operations had 600 staff compared to two full-time staff and two part-time directors in Guernsey. The basis of the scheme was that the place of supply of gaming machine services to customers would be shown to be in Guernsey and that the Channel Islands company would be entitled to repayment of input tax on supplies made to it without being liable to any output tax. Before the scheme, a single UK subsidiary made the supplies and output tax was paid to the Customs authorities.

The KPMG 'action plan' listed 83 steps necessary to make the scheme work. These included matters such as the creation of the appropriate group structures, appointment of directors, place of board meetings, details of employee contacts and details of operations. The 16 page KPMG report also acknowledged possible challenges from the UK authorities and stated that "In our view HM Customs & Excise ('Customs') will regard these planning arrangements as 'unacceptable tax avoidance' and will seek to challenge the arrangements. However, a similar concept for telecommunications ran for nearly four years in most Member States of the EU before the UK, French and German Governments secured the unanimous agreement of all 15 Member States to

amend the primary legislation and stop the concept” and added “Since at the moment we are not aware of any widespread use of these planning arrangements, and the fact (*sic*) that some EU Member States do not charge VAT on gaming machine income, unanimous agreement to amend the EC legislation could be difficult to achieve” (para 22 of the Tribunal judgement). The report also stated that prior advice from KPMG must be taken on VAT and direct tax issues before new sites or businesses are acquired to ensure the benefits of the new arrangements are not prejudiced.

After implementing the tax avoidance scheme, refunds of nearly £6.6 million were sought and refused by the UK Customs authorities. The decision hinged on whether the taxable supplies (or sales) were made by “fixed establishments” in the UK or in Guernsey. The VAT Tribunal dismissed the claim for refunds because it considered that the fixed establishments at the arcades in the UK constituted the place of supply. The company and KPMG²⁸ subsequently appealed to the European Court of Justice and a preliminary decision by the EU Advocate General declared the avoidance scheme to be 'unacceptable' on the ground that such a state of affairs would distort competition within the EU (The Observer, 30 January 2005).

3.3 Payroll Taxes

With globalisation and the nesting of corporations and wealthy individuals in ‘fictitious spaces’ facilitated by tax havens (Roberts, 1994), many states have been obliged to increase taxes on less mobile capital and employment. In the UK, all employed persons are obliged to pay two types of direct taxes. These are ‘income tax’ and ‘National Insurance Contributions (NIC)’. The NICs act like tax on earnings but their payment entitles individuals to certain social security benefits and a state pension. Above a pre-defined threshold, all employed persons, including the self-employed, are required to make payments. Generally, higher earners are expected to pay more.

²⁸ Many Non-Governmental Organisations (NGOs) are also becoming concerned about organised tax avoidance and its social consequences. In January 2005, KPMG was awarded an international prize, awarded by the world’s leading NGOs, for “corporate irresponsibility” for promoting aggressive tax avoidance (The Guardian, 27 January 2005). The related press related press release is available on the AABA website (<http://visar.csustan.edu/aaba/DAVOS.pdf>) together with the speech justifying the selection of KPMG (<http://visar.csustan.edu/aaba/Davosspeech.pdf>).

However, the NIC also functions as an employment tax in that the employer is obliged to pay an amount per employee, determined by the salary of the employee, to the Inland Revenue. Thus the typical total cost of employing a person consists of salary, NIC and any pension contributions. Since this increases the employment costs for companies, the tax avoidance industry has developed a variety of schemes to enable companies and high earners to avoid payroll taxes.

For many years, directors and owners of a major UK mobile phone distributor paid themselves mostly in gold bars and fine wine to avoid paying NIC (Mail on Sunday, 15 February 2004). In 1997, the government introduced legislation to plug these tax loopholes. However, following an Ernst & Young inspired scheme, the higher paid employees and directors could avoid NIC and taxes by securing payments through offshore employee benefit trusts (UK Inland Revenue Special Commissioners, 2002). Under the scheme²⁹, companies paid money into the trusts, which qualified as a business expense and were thus tax deductible. The 'trust' then 'lent' money to the employees. As long as the loan carried interest, no tax was paid by the company or the employee. In 2003, the UK government plugged some of the loopholes, but the Inland Revenue lost its High Court appeal to clawback the loss of earlier tax and contributions.

Many UK banks and financial institutions paid bonuses to high earning employee in currencies that are likely to decline in value. For a considerable period they chose the Turkish lira, the Argentine peso and the Brazilian real to avoid taxes. A Grant Thornton partner said, "We chose the Turkish lira because it is virtually guaranteed to fall in value and it has not disappointed. Many of my clients use this scheme". An Ernst & Young partner added that a "large proportion" of financial institutions had adopted the scheme. "Since the government started hiking National Insurance payments there has been a rush to think up ingenious avoidance schemes" (The Times, 1 December 2002). Under the scheme staff are given loans in foreign currencies that are likely to fall in value against pound sterling. For example, a currency trader expecting a bonus of £1 million receives a loan of 4,778 billion

²⁹For details, see <http://www.financeandtaxtribunals.gov.uk/decisions/seldecisions/decision/spc00331.htm>; accessed 15 December 2004.

Turkish lira³⁰, which is equivalent to say £2m. The trader converts the lira into sterling and if the value of lira declines, he gains. Suppose the value of lira falls by 50%, then the trader would only need to spend £1 million to buy 4,778 billion lira and repay the loan. In the process, the trader makes a gain of £1 million and his employer can offset any loss on loans against its tax liability. Neither the employee nor the employer has to pay an NIC on the bonus secured by the trader.

Another scheme, marketed by PricewaterhouseCoopers, involved the use of offshore companies for the benefit of high earners (Daily Telegraph, 14 November 2002). Under the plan, staff invited to join the scheme are required to forego the traditional annual discretionary bonus awards. Instead they are given awarded units or shares in offshore companies based in Jersey and the Isle of Man, priced at one pence each, which are redeemable at £100. Staff are granted ten separate series of units and each series matures on a different anniversary of the date the units were granted, over a period of ten years and thus defers the tax liability for ten years. PwC has marketed the scheme to a number of leading investment banks (Daily Mail, 15 November 2002) and it is estimated to save the participating companies around 12% of their payroll costs. A UK Treasury minister told parliament that “for too long some employers and employees with the benefit of sophisticated tax advice have sought to avoid their responsibilities and to pass more of a burden onto the rest of us” and that despite “extensive reforms to the tax legislation in 2003, employers and their advisers are continuing to devise and operate ever more contrived avoidance schemes. One such example of which Inland Revenue has learnt involves payment of a bonus to an employee in the form of dividends on shares in a specially constructed company. This avoids tax at 40 per cent. And employer and employee NICs” (Hansard, House of Commons Debates, 2 December 2004, col. 45WS).

4. DISCUSSION AND SUMMARY

In the sociological literature, accountancy firms are regarded as a profession and assigned baggage of social responsibility and ethical conduct. However, this overlooks that major firms are a ‘fraction’ of capital with global presence and

³⁰ This example used the old exchange rates for the Turkish lira. In January 2005, Turkey launched a revalued currency.

networks (Hampton, 1996). As fractions of capital, firms have always operated in intensely competitive arenas, competing with both other fractions of capital and also amongst themselves to sell products and services. This competition generates pressure on profitability and the need to continually develop new products and find commercial ways of selling their services. To increase profits, major firms mobilise individualist discourses and encourage their clients to report higher earnings, often with little regard for the collective social consequences. They have created elaborate corporate structures, and marketing techniques to sell tax avoidance schemes to corporations and rich clients. These are developed and marketed through a network of banks and lawyers and sold with considerable emphasis on secrecy and confidentiality.

The publicly available evidence cited in this paper shows that major firms deploy elaborate techniques for cold-calling and reassuring sceptical clients. At least one firm performed a private cost-benefit analysis to decide that the profits for marketing a scheme considerably exceeded the likely penalties for selling dubious schemes and then proceeded to sell the tax avoidance schemes. On occasions, firms themselves have suspected that they may be engaged in 'unacceptable tax avoidance', but nevertheless sold the schemes. The so-called 'Chinese Walls' do not seem to prevent the firms from selling tax avoidance schemes to audit clients and then claiming to independently attest the resulting transactions. In selling tax avoidance schemes, the firms regard company directors as clients rather than other stakeholders who may have to suffer the possible consequences of lower social investment. Within highly commercialised accountancy firms there is a fundamental shift "from providing one-to-one tax advice in response to tax inquiries to also initiating, designing and mass marketing of tax shelter products" (US Senate Permanent Subcommittee on Investigations, 2005, p. 9).

The highly commercialised tax avoidance industry operates in most countries. As Enron and other episodes show, developing and transitional economies countries are also affected and are deprived of vital revenues for their social investment. Due to lack of social investment, many fellow human beings are unable to secure the basic essentials of healthcare, education, transport, sanitation, clean water, pensions and other public goods. Tax avoidance also distorts 'fair competition' so beloved by neo-

liberals. It enables major corporations and their rich patrons to avoid making social contributions, something smaller capital or less mobile capital cannot. The obvious logic to this is that all businesses should avoid taxes. However, this also poses major dilemmas in that without adequate revenues, the necessary social order and legitimacy that is so necessary for the smooth accumulation of profits cannot be maintained.

Organised and aggressive tax avoidance raises major questions about the assumed social responsibility and ethics of accountancy firms and their rich clients, but such issues attract little attention in the burgeoning corporate social responsibility and accounting literature (Christensen and Murphy, 2004) even though some of the episodes are regularly reported in newspapers (Bougen et al., 1999; Mitchell et al., 2002). Through tax avoidance, accountancy firms are engaged in direct transfers of wealth and bring them into direct conflict with the state and civil society. Their trade results in ordinary citizens having to accept inferior public goods, lower quality of life and for this worsening scenario, ironically, end up paying higher taxes, often for crumbling social infrastructure whilst corporations demand more public subsidies and the rich exclude themselves physically from society by retiring to private gated estates. The result is a fundamental shifting of tax burdens. For example, the UK income tax take of £48.8 billion for 1989-90 increased to £114 billion in 2003-2004³¹ whilst for the same period, despite record company profits and average rates of return of 11.5% against an annual inflation rate of 3-4%, the take from corporate taxes increased from £21.5 billion to only £28.1 billion³². Corporate share of total UK tax take has dropped from 11.5 per cent in 1997/98 to 7.7 per cent in 2003/2004 (BDO Stoy Hayward, 2004) and amounts to less than 2.5% of the British GDP, the lowest ever (Mitchell and Sikka, 2005). Some 65,000 rich individuals are estimated to have paid little or no income tax (The Independent, 28 October 2004) and top fifth of earners pay a smaller proportion of their income in tax than the bottom fifth (New Statesman, 7 March 2005). In the US, corporate tax receipts have dropped from an average of 4.8 percent of GDP during the 1950s to 1.3 percent of GDP in 2003³³.

³¹ Nearly four million individuals, the highest ever, are paying income tax at the highest rate of 40% which begins to bite at taxable earnings of around £30,000.

³² http://www.inlandrevenue.gov.uk/stats/tax_receipts/table1-2.pdf; accessed on 11 November 2004.

³³ <http://www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=45142>; accessed 11 April 2004.

Sociological literature draws attention to a close (but complex) relationship between the state and accountancy profession (Johnson, 1972, 1980) which enables the state to manage and displace its crisis of legitimacy (Sikka and Willmott, 1995b). Such theories now face additional layers of complexity as accountancy firms develop and market tax avoidance schemes that have a potential to deprive the state of large amounts of tax revenues. The erosion of tax revenues can threaten the legitimacy of the state by undermining its ability to provide public goods and the carefully propagated belief that it addresses common social interests (Hampton and Christensen, 2002). The global tax avoidance industry poses serious challenges to the future of democracy and the nation-state itself. Elected governments may be mandated by citizens to raise and spend tax revenues on healthcare, education, pensions, clean water, transport and other essentials, but the highly commercialised tax avoidance industry is no respecter of such mandates. In appeasing major corporations and rich individuals, the tax avoidance industry may market dubious avoidance schemes that erode tax revenues and thus prevent governments from carrying out their democratically agreed mandate. The tax avoidance industry thus effectively vetoes the will of the people and in the process undermines public confidence in the democratic process. Major accountancy firms have used their financial and political resources to oppose major curbs on the sale of tax avoidance schemes although periodically - in an attempt to 'catch up' - some states revise anti-avoidance legislation and have held inquiries to expose some blatant tax avoidance schemes. This may bring some temporary relief but has so far failed to check the distorted enterprise culture which values private profits more highly than social investment through taxes. The possibilities of curbing the tax avoidance industry are further complicated because "globalisation and technological change has made it easier to avoid paying taxes so you have to introduce more anti-avoidance measures just to stand still [and] government's attempts to raise revenues by tackling tax avoidance will inevitably be countered by the tax planning industry" (Financial Times, 9 March 2005). Indeed, anarchy of the markets only recognises financial rewards and a partner of a major accountancy firm has stated that "No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken" (The Guardian, 18 March 2004).

A sustained focus upon the tax avoidance industry offers rich possibilities for interdisciplinary research (Hasseldine and Li, 1999) as it provides a window for studying some of the major questions facing the world today and opens up fresh perspectives on the role of accounting, accountants, other professionals (e.g. lawyers and bankers), trajectories of entrepreneurial culture, corporate social responsibility, poverty, corporate power, world trade, corporate governance, ethics, limits of law, futures of the state, democracy, corporate power, global geopolitics, and reconstitution of global political economy and much more. The evidence can also help us to revise theories of the state, globalisation and the professions and enable development of new vocabularies, public policies and agendas to highlight the predatory nature of capitalism and anti-social activities of professions.

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