



House of Commons

Committee of Public Accounts

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# Tax avoidance: the role of large accountancy firms

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**Forty-fourth Report of Session 2012–13**

*Report, together with formal minutes, oral and  
written evidence*

*Ordered by the House of Commons  
to be printed 15 April 2013*

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## Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine "the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit" (Standing Order No 148).

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Dr Stella Creasy (*Labour/Cooperative, Walthamstow*)  
Justine Greening (*Conservative, Putney*)  
Joseph Johnson (*Conservative, Orpington*)  
Eric Joyce (*Labour, Falkirk*)  
Rt Hon Mrs Anne McGuire (*Labour, Stirling*)  
Matthew Hancock (*Conservative, West Suffolk*)  
James Wharton (*Conservative, Stockton South*)

### Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via [www.parliament.uk](http://www.parliament.uk).

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at [www.parliament.uk/pac](http://www.parliament.uk/pac). A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

### Committee staff

The current staff of the Committee is Adrian Jenner (Clerk), Sonia Draper (Senior Committee Assistant), Ian Blair and James McQuade (Committee Assistants) and Alex Paterson (Media Officer).

### Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee's email address is [pubaccom@parliament.uk](mailto:pubaccom@parliament.uk)

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## Summary

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Confidence in our tax system can only be maintained if every company and every individual is seen to be paying their fair share of tax. We held hearings last year to investigate why some multinational companies pay little corporation tax despite doing a large amount of business in the UK, and why some individuals can get away with using contrived schemes to avoid tax. We are also concerned about the role of tax advisors and in January 2013 we took evidence from Deloitte, Ernst and Young, KPMG, and PwC to understand more about the nature of the tax advice they provide.

HM Revenue & Customs (HMRC) appears to be fighting a battle it cannot win in tackling tax avoidance. Companies can devote considerable resource to ensure that they minimise their tax liability. There is a large market for advising companies on how to take advantage of international tax law, and on the tax implications of different global structures. The four firms employ nearly 9,000 people and earn £2 billion from their tax work in the UK, and earn around \$25 billion from this work globally. HMRC has far fewer resources. In the area of transfer pricing alone there are four times as many staff working for the four firms than for HMRC.

We were pleased that the four firms agreed with us that international tax rules are out of date and need to change to reflect the reality of modern business. Modern communications mean companies need as little as a computer and a handful of staff to set up a place of business in a tax haven. Under current tax rules, this can be enough to establish that they can pay their tax there, rather than where the business activity takes place. This is unfair to responsible companies based in the UK who do pay their fair share of tax. We welcome the Government's commitment to reforming international tax laws, but this will be a lengthy process and, until it happens, we are concerned that companies will continue to find ways to avoid paying tax where they actually do business.

We believe that simplicity is key to fighting tax avoidance. The four firms agreed with us that tax law is too complex and a simpler system is in everybody's interests. It is disappointing that HM Treasury's Office of Tax Simplification is working with fewer than six full time staff and as a result has so far focused on abolishing unused tax reliefs, rather than being able to take a more radical approach to simplifying tax law. Removing unused reliefs may be good housekeeping, but it does little to tackle the problem of complexity and does not prevent the continued abuse of some tax reliefs, such as those to encourage investment in films or donations to charity. We intend to examine those tax reliefs that are widely used and may be subject to abuse at a future hearing.

The four firms insisted that they no longer sell the type of very aggressive avoidance schemes that they sold ten years ago. While this may be the case, we believe they have simply moved to advising on other forms of tax avoidance which are profitable for their clients; such as the complex operating models they offer to major corporate clients to minimise tax by exploiting the lowest international tax rates. The four firms have developed internal guidelines on where the line between tax planning and aggressive avoidance lies, but these principles do not stop them selling schemes with as little as a 50% chance of succeeding if challenged in court. Clearly HMRC has to consider the risk to the

taxpayer of a protracted legal battle. It would appear that firms and tax avoiders are taking advantage of the constraints under which HMRC is obliged to operate. Furthermore, HMRC is always constrained by resources.

The close relationship that the four firms enjoy with government creates a perception that they wield undue influence on the tax system which they use to their advantage. They told us that they second staff to government to provide technical advice on changes to tax laws and that this has improved the quality of legislation. The witnesses conceded that this may give the perception that they are able to influence legislation to help their larger clients to the disadvantage of smaller UK businesses. More worryingly, we have seen what look like cases of poacher, turned gamekeeper, turned poacher again, whereby individuals who advise government go back to their firms and advise their clients on how they can use those laws to reduce the amount of tax they pay.

Since our hearing HMRC has announced that it is consulting on a set of draft rules to allow departments to ban tax-avoiding businesses from being awarded government contracts. This is a step in the right direction, but the draft rules as they stand are narrowly focused and would not cover those companies providing tax advice. The draft rules would allow firms to win government contracts whilst also advising on schemes that allow their clients to avoid tax. We will want to monitor closely what rules emerge from the consultation process and how they are applied.

## Conclusions and recommendations

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- 1. The UK tax system is too complex and a more radical approach to simplification is needed.** Nearly 9,000 of the four firms' UK employees are engaged in tax work. The four firms agree that the tax system is too complex and stated that no-one benefits from this. The Office of Tax Simplification is grossly understaffed and has focused on abolishing tax rules that are no longer necessary, rather than more radical simplification. HM Treasury and HMRC should work together to make more radical progress in simplifying the UK's tax code, and should equip the Office of Tax Simplification with the resources and influence it needs to help them do so.
- 2. There is no clarity over where firms draw the line between acceptable tax planning and aggressive tax avoidance.** The four firms stated that they would no longer engage in some of the schemes they devised ten years ago, such as the cases they have lost in court. We heard about the guidelines that firms have to govern their tax advice, but they are still devising complex schemes that look artificial and their appetite for risk appears high—selling schemes that they consider only have a 50% chance of being upheld in court. HM Treasury should introduce a code of conduct for tax advisers, setting out what it and HMRC consider acceptable in terms of tax planning. Compliance with this code should determine whether or not these firms can access both government and wider public sector work.
- 3. It is inappropriate for individuals from firms to advise on tax law and then devise ways to avoid the tax.** The four firms second staff to HM Treasury to advise on technical issues in drafting legislation. They conceded that this may give rise to a perception that they have an influence on the formulation of tax policy that smaller businesses do not have. The four firms maintained that their involvement had improved the quality of legislation, but we are concerned that the very people who provide this advice then go on to advise their clients how to use those laws to avoid tax. We were told by the four firms that the advice they offer to clients in regard to specific tax laws is in line with what Parliament intended those laws to achieve. HM Treasury should ensure that the code of conduct we have proposed for tax advisors sets out how conflicts of interest should be managed when a firm advises government on the formulation of tax law and subsequently provides tax advice to clients in related areas.
- 4. We welcome the four firms' agreement that tax laws are out of date and need revising.** We heard that international tax rules have not changed to reflect the way businesses operate globally and through the internet. It is too easy for companies to exploit these rules by setting up structures in low-tax jurisdictions, rather than pay tax where they actually conduct their business and sell their goods and services. We heard helpful examples of ways of better matching taxation with economic activity, as used in some US states. In line with the Committee's first recommendation in our Nineteenth report, the UK must take the lead in demanding the urgent reform of international tax law.
- 5. Greater transparency over companies' tax affairs would increase the pressure on multinationals to pay a fair share of tax in the countries where they operate.** We

are pleased that the four firms agree that there should be more transparency over where companies make profits and pay tax. The four firms stressed that this information needs to be readily understandable to enable fair comparisons. Tax returns are complicated documents and by themselves would not provide enough context and information for someone who is not a tax expert to interpret. In our Nineteenth report, we recommended that companies should publish more information on their tax affairs. In response, the Government told us “HMRC will continue to work in partnership with HM Treasury to ensure strong standards are developed and maintained through relevant international fora such as the OECD.”<sup>1</sup> We think HMRC and HM Treasury should push for an international commitment to improve transparency, including by developing specific proposals to improve the quality and credibility of public information about companies’ tax affairs.

6. HMRC is not able to defend the public interest effectively when its resources are more limited than those enjoyed by the big four firms. The four firms employ almost 9,000 people as part of their UK tax practice. For instance HMRC has 65 transfer pricing specialists whereas the big four firms alone have around 250. In our report on tackling marketed avoidance schemes we found that HMRC does not know what level of resource it commits to tackling tax avoidance. Government must ensure that HMRC is properly resourced to challenge the advice given by the four firms and others to companies and individuals seeking to aggressively avoid tax.<sup>2</sup>

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1 Treasury Minutes: Government responses on the Fourteenth, the Seventeenth to the Nineteenth, and the Twenty First Reports from the Committee of Public Accounts Session: 2012-13, HM Treasury, Cm 8556, 25 February 2013

2 HC Committee of Public Accounts, Tax avoidance: tackling marketed avoidance schemes, Twenty-ninth Report of Session 2012-13, HC 788, February 2013

# 1 The role of the four firms in providing tax advice

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1. Confidence in our tax system can only be maintained if individuals and companies pay, and are seen to be paying, their fair share of tax. We held hearings in November and December 2012 to investigate why some multinational companies pay little corporation tax despite doing a large amount of business in the UK, and why some individuals can get away with avoiding tax through the use of contrived schemes. This led us, in January 2013, to take evidence from four large accountancy firms to understand their role in tax avoidance.

2. Providing tax services to companies and wealthy individuals is a huge industry, worth almost £2 billion to the four firms each year in the UK, and almost \$25 billion globally (Table 1).<sup>3</sup> The four firms' estimates of how much of this was helping taxpayers to comply with legislation—such as by filling in tax returns—ranged from a third to a half.<sup>4</sup> This means that the majority of their business comes from tax advice. Some tax advice results in transactions or restructuring that are undertaken for commercial reasons and are tax neutral. However, much of the advice is aimed at minimising the tax that wealthy individuals or corporations pay.<sup>5</sup> The four firms maintain that tax advice is not consistently more profitable than their other services, but, at an average of more than a fifth of UK turnover, they are nonetheless deriving a substantial part of their revenue from tax advice.<sup>6</sup>

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3 Qq 1-33

4 Qq 8-10, 17, 28

5 Q 33

6 Qq 16, 20, 25

*Table 1: Scale of the four firms' tax practice, 2011-12<sup>7</sup>*

	<b>PwC</b>	<b>Deloitte</b>	<b>E&amp;Y</b>	<b>KPMG</b>	<b>Total</b>
<b>Global revenue from tax practice</b>	US\$7,944m	US\$5,900m	US\$6,011m	US\$4,860m	US\$24,715m
<b>UK revenue from tax practice</b>	£659m	£453m	£431m	£310m	£1,853m
<b>Proportion of UK turnover</b>	25%	19%	26%	17.5%	22%
<b>UK employees</b>	3,005	2,141	2,081	1,670	8,897

3. Large accountancy firms are in a powerful position in the tax world. They have a very good understanding of how HMRC applies tax law, which they can use to advise clients on which arrangements HMRC is likely to challenge. Through their work in advising government on changes to legislation they have a detailed knowledge of UK tax law, and the insight to identify loopholes in new legislation quickly. They also have the technical skills, knowledge and infrastructure to assist clients who come into dispute with HMRC, and the resources to sustain this challenge for the years it can take to litigate.<sup>8</sup> The four firms employ almost 9,000 people as part of their UK tax practice. By contrast, HMRC's resources are limited. For example, HMRC has 65 transfer pricing specialists, whereas the four firms have around 250.<sup>9</sup> PwC agreed they had a responsibility not to abuse their position of power.<sup>10</sup>

4. The four firms were clear that they do not provide advice which would help clients evade tax, which is illegal, although they accepted that some schemes on which they advised were ruled against by tribunal and would be unlawful to run again.<sup>11</sup> They recognised that the distinction between tax planning and tax avoidance—using tax law to gain an advantage that Parliament never intended—is difficult to define and remains a grey area.<sup>12</sup> PwC and KPMG told us that they have developed guiding principles or codes of conduct to define what advice is acceptable.<sup>13</sup> These include that advice should be supportable in law, and

7 Ev 26, 29, 30 & 31

8 Q 166

9 Qq 53-58; Ev 33

10 Q 166

11 Q 63

12 Q 78

13 Qq 34-39, 78-82

that the tax, reputational and commercial risks of suggested options should be explained fully to clients. KPMG introduced its principles in 2004 owing to concerns that some of the transactions being entered into were becoming increasingly artificial and the growing view of Government, the courts and wider society that this was unacceptable.<sup>14</sup> It has updated its principles in response to changes since, including in December 2012 in response to the Government's plans to introduce a General Anti-Abuse Rule.<sup>15</sup>

5. Maintaining the principle that tax advice should be supportable in law seems incompatible with all four firms having lost cases at Tribunal. The four firms maintain that the number of cases they lose is very low as a proportion of the advice they give, that these cases relate to advice they gave around 10 years ago, and that they would no longer advise on the use of such schemes.<sup>16</sup> However, their current principles only require their advice to have more than a 50% chance of succeeding if tested in court and there are no consequences for the firms if their scheme is rejected at a Tribunal.<sup>17</sup>

6. All four firms said that they discussed reputational risks with their clients, and that there was no longer any appetite for schemes where the sole purpose was to reduce tax. It is difficult to square this with some companies' tax practices, for example those we heard about in our hearing with Google, Amazon and Starbucks.<sup>18</sup> These tax structures do not seem to have factored in reputational risk or to be compatible with the spirit of Section 172 of the Companies Act, which requires companies to consider "the impact of the company's operations on the community".<sup>19</sup>

## Advice provided by the four firms to government

7. The large accountancy firms sit on tax advisory panels and also second staff to government to provide technical advice when tax legislation is amended or created. Ernst and Young told us that providing this advice has helped improve the quality of legislation. It acknowledged that they also benefit from the insight into Government thinking that this work gives them.<sup>20</sup>

8. There is a risk that the large accountancy firms' provision of advice to government creates a perception that they wield undue influence in the creation of legislation, in their own interests and those of their clients. KPMG emphasised that the firms provide technical advice rather than actually writing tax law.<sup>21</sup> This may be so, but few MPs are tax experts and Parliament relies on the technical advice that is provided by technical experts such as those seconded to government by the four firms.<sup>22</sup> KPMG conceded that there might be a

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14 Q 86

15 Qq 92, 93

16 Qq 44, 65, 66, 85-88

17 Qq 72, 73, 77

18 Committee of Public Accounts, *HM Revenue & Customs: Annual Report and Accounts 2011-12*, Nineteenth Report of Session 2012-13, HC 716, December 2012

19 Qq 38, 90, 94, 95

20 Qq 173-175

21 Q 150

22 Q 151

perception that big businesses, through their relations with the large accountancy firms, have special access to the design and implementation of tax policy which small businesses do not. It stressed that they represent a wide range of clients, including small taxpayers, and that they advise government on how proposed policy will impact on the commercial world as a whole.<sup>23</sup>

9. We are nonetheless very concerned by the way that the four firms appear to use their insider knowledge of legislation to sell clients advice on how to use those rules to pay less tax.<sup>24</sup> KPMG seconded staff to advise government on tax legislation, including the development of the 'Controlled Foreign Company' and 'Patent Box' rules. It then produced marketing brochures relating to both sets of rules highlighting the role its staff had in advising government. The brochure 'Patent Box: what's in it for you', suggests that the legislation is a business opportunity to reduce UK tax and that KPMG can help clients in the 'preparation of defendable expense allocation'. KPMG denied that it was advising its clients on how to use those laws in ways that Parliament did not intend, but we are not convinced by its insistence that all the advice it offers to clients seeks to fulfil the purpose of the legislation.<sup>25</sup>

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23 Qq 158, 160

24 Qq 150-156

25 Qq 150-154

## 2 The complexity of tax law

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### International tax law

10. International tax rules are out of date. We were told that the laws, treaties and principles on which international tax laws are based were not designed for the world we now live in. The treaties of the 1920s and 1930s, and the transfer pricing models of the 1970s and 1980s, were based on predominantly domestic economies, when companies were not global in nature and there were very few cross-border transactions.<sup>26</sup>

11. This business model no longer reflects the modern economy in which the global nature of companies' operations and transactions mean that countries compete for tax. Countries are increasingly using tax incentives to attract inward investment. Many create specific reliefs to encourage particular activities, and some operate as tax havens by offering very low levels of taxation.<sup>27</sup> Whilst multi-national companies take into account a wide range of factors when deciding where to locate their business, such as the available workforce and infrastructure, we are concerned that tax considerations appear to dominate their decisions and that avoiding tax has become a new source of profit.<sup>28</sup>

12. Existing international tax laws mean it is relatively easy for companies to establish a viable office for tax purposes in a low tax location, and pay their tax there, rather than where the majority of their business activity takes place. With modern communications technology, this can be done with as little as a computer and a few members of staff.<sup>29</sup> We were told that it is possible for a company to take orders over the internet from customers in the UK, fulfil those orders through UK warehouses, yet not be taxed in the UK because the website and servers are based outside the UK.<sup>30</sup> This is unfair to those UK businesses that do not use these complex international structures to avoid paying their fair share of tax and puts them at a competitive disadvantage.<sup>31</sup>

13. We asked the four firms what changes would make the international tax regime fairer. The witnesses made some useful suggestions about how to ensure tax and profits are recognised in the right place. For example, we were told that in some US states, companies are taxed by apportioning the companies' global profit based on business activity, such as the level of sales, the amount of capital or the number of people employed in that state.<sup>32</sup>

14. We were reassured that the four firms confirmed that international tax laws need changing, and welcome the Prime Minister's commitment to securing an international agreement.<sup>33</sup> The Organisation for Economic Co-operation and Development published a

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26 Q 50

27 Qq 50, 97

28 Qq 31-32, 229-230

29 Q 138

30 Q 105

31 Q 158

32 Q 170

33 Qq 60, 97

study shortly after our hearing which concluded that global solutions are needed to ensure that tax systems do not unduly favour multinational enterprises, leaving citizens and small businesses with bigger tax bills.<sup>34</sup> We are concerned, however, that this will be a lengthy process and any negotiations may take many years. In the meantime, some companies will continue to find ways to avoid paying tax where they actually do business.<sup>35</sup>

## UK tax law

15. We have previously reported on the complexity of UK tax law and the opportunities that this complexity creates for tax avoidance.<sup>36</sup> The four firms told us that nobody benefits from complexity and a simpler tax system is required. PwC said that many of the recent changes to incentives in the tax system were unnecessary, and that very few of the additions made in the last Finance Bill—almost 700 pages, plus 600 pages of explanatory notes—tackled the abuse of tax laws.<sup>37</sup>

16. HM Treasury's Office of Tax Simplification was established to provide the government with independent advice on how to simplify the UK tax system. Deloitte and PwC told us that they have seconded staff to work at the Office of Tax Simplification. The Office, however, is under-resourced and employs fewer than six full time staff.<sup>38</sup> So far it has focused on the deletion of tax reliefs which are not used. To make headway it needs sufficient resources to take a more radical approach to simplifying UK tax law.<sup>39</sup>

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34 Organisation for Economic Co-operation and Development, 'Base erosion and profit shifting', February 2013, <http://www.oecd.org/ctp/beps.htm>, accessed 14 February 2013

35 Q 60

36 Committee of Public Accounts, Tax avoidance: tackling marketed avoidance schemes, Twenty-Ninth Report of Session 2012-13, HC 788, February 2013

37 Qq 160-162

38 Qq 162-164

39 Q 165

## 3 The transparency of companies' tax affairs

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17. There is too much secrecy over the amount of tax companies pay and the way that it is calculated. We believe that companies would behave better if there was more transparency over their tax affairs. In our evidence session held on 12 November on the tax affairs of Starbucks, Google and Amazon we heard about secret 'sweetheart' deals between a multinational company and a tax authority in another country, in which the company was given a favourable tax treatment if they agreed not to reveal the details.<sup>40</sup>

18. The four firms all agreed that greater openness and transparency are key to restoring people's trust in the fairness of the tax system, but there is no consensus on how this might be achieved.<sup>41</sup> Ernst and Young told us that it did not believe that this could be achieved by requiring companies to file their tax returns alongside their financial accounts, as tax returns are too long and complex to offer transparency. It told us that the information needs to be condensed. It favoured greater information in companies' statutory accounts, consistent with an existing trend towards greater transparency and would welcome such an approach.<sup>42</sup>

19. The four firms did not support the proposition that multinational companies should report their turnover, profit and tax on a country-by-country basis. Deloitte cited FTSE 100 companies' concerns about the costs and complexity of gathering this data and commercial confidentiality. KPMG told us that even a trained tax professional would not necessarily be able to understand the tax position from this data alone. For example, a company might be paying no tax in a country because it is making significant investment and getting tax relief on those investments. Both felt there was a better way of explaining companies' tax positions.<sup>43</sup> Whatever form it takes, greater transparency needs to be provided quickly and, as recommended in our Nineteenth report, reporting should be mandatory.<sup>44</sup>

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40 Committee of Public Accounts, HM Revenue & Customs: Annual Report and Accounts 2011-12, Nineteenth Report of Session 2012-13, HC 716, December 2012, Qq 285-288

41 Qq 201-209, 215

42 Qq 210-212

43 Qq 213-215

44 Committee of Public Accounts, HM Revenue & Customs: Annual Report and Accounts 2011-12, Nineteenth Report of Session 2012-13, HC 716, December 2012, Recommendation 1

# Formal Minutes

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**Monday 15 April 2013**

Members present:

Margaret Hodge, in the Chair

Stephen Barclay  
Jackie Doyle-Price  
Meg Hillier  
Mr Stewart Jackson

Fiona Mactaggart  
Austin Mitchell  
Nick Smith  
Justin Tomlinson

Draft Report (*Tax avoidance: the role of large accountancy firms*), proposed by the Chair, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 19 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

*Resolved*, That the Report be the Forty-fourth Report of the Committee to the House.

*Ordered*, That the Chair make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report (in addition to that ordered to be reported for publishing on 31 January).

[Adjourned till Monday 22 April at 3.00 pm]

## Witnesses

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**Thursday 31 January 2013**

*Page*

**Jane McCormick**, UK Head of Tax, KPMG, **Bill Dodwell**, Head of Tax Policy, Deloitte LLP, **Kevin Nicholson**, Head of Tax PwC and **John Dixon**, Head of Tax Policy, Ernst and Young

Ev 1

## List of printed written evidence

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1	KPMG UK	Ev 26; Ev 33
2	Deloitte	Ev 29;Ev 32
3	Ernst and Young	Ev 30; Ev 32
4	PWC	Ev 31; Ev 32

## List of Reports from the Committee during the current Parliament

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The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

### Session 2012–13

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Third Report	Efficiency and reform in government corporate functions through shared service centres	HC 463
Fourth Report	The completion and sale of High Speed 1	HC 464
Fifth Report	The Regional Growth Fund	HC 104
Sixth Report	HM Revenue & Customs: Renewed Alcohol Strategy	HC 504
Seventh Report	Immigration: The Points Based System – Student Routes	HC 101
Eighth Report	Managing early departures in central government	HC 503
Ninth Report	Preparations for the London 2012 Olympic and Paralympic Games	HC 526
Tenth Report	Implementing the transparency agenda	HC 102
Eleventh Report	Improving the efficiency of central government office property	HC 288
Twelfth Report	Off-payroll arrangements in the public sector	HC 532
Thirteenth Report	Financial viability of the social housing sector: introducing the Affordable Homes Programme	HC 388
Fourteenth Report	Assurance for major projects	HC 384
Fifteenth Report	Preventing fraud in contracted employment programmes	HC 103
Sixteenth Report	Department of Health: Securing the future financial sustainability of the NHS	HC 389
Seventeenth Report	Department of Health: The management of adult diabetes services in the NHS	HC 289
Eighteenth Report	HM Treasury: The creation and sale of Northern Rock plc	HC 552
Nineteenth Report	HM Revenue & Customs: Annual Report and Accounts 2011-12	HC 716
Twentieth Report	Department for Energy and Climate Change: Offshore electricity transmission—a new model for infrastructure	HC 621
Twenty-first Report	The Ministry of Justice's language service contract	HC 620
Twenty-second Report	British Broadcasting Corporation: Off-payroll contracting and severance package for the Director General	HC 774

Twenty-Third Report	Department for Work and Pensions: Contract management of medical services	HC 744
Twenty-Fourth Report	Nuclear Decommissioning Authority: Managing risk at Sellafield	HC 746
Twenty-Fifth Report	Funding for local transport: an overview	HC 747
Twenty-Sixth Report	The Department for International Development: The multilateral aid review	HC 660
Twenty-Seventh Report	HM Treasury: Annual Report and Accounts 2011–12	HC 659
Twenty-Eighth Report	Department of Health: The Franchising of Hinchingsbrooke Health Care NHS Trust and Peterborough and Stamford Hospitals NHS Foundation Trust	HC 789
Twenty-Ninth Report	Tax avoidance: tackling marketed avoidance schemes	HC 788
Thirtieth Report	Excess Votes 2011–12	HC 959
Thirty-first Report	Department for Transport: Lessons from cancelling the InterCity West Coast franchise competition	HC 813
Thirty-second Report	Ministry of Defence: managing the defence inventory	HC 745
Thirty-third Report	The Work Programme	HC 936
Thirty-fourth Report	Managing Budgeting in Government	HC 661
Thirty-fifth Report	Restructuring the National Offender Management Service	HC 717
Thirty-sixth Report	HMRC: Customer Service	HC 869
Thirty-seventh Report	Whole of Government Accounts 2010-11	HC 867
Thirty-eighth Report	The impact of Housing Benefit reform	HC 814
Thirty-ninth Report	Progress in delivering NHS efficiency savings	HC 865
Fortieth Report	The London 2012 Olympic Games and Paralympic Games: post-Games review	HC 812
Forty-first Report	Department for Education: Managing the expansion of the Academies Programme	HC 787



# Oral evidence

## Taken before the Committee of Public Accounts

on Thursday 31 January 2013

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon  
Meg Hillier  
Mr Stewart Jackson

Austin Mitchell  
Ian Swales  
Justin Tomlinson

**Amyas Morse**, Comptroller and Auditor General, National Audit Office, **Gabrielle Cohen**, Assistant Auditor General, NAO, **Rob Prideaux**, Director, NAO and **Marius Gallaher**, Alternate Treasury Officer of Accounts, were in attendance.

### Examination of Witnesses

*Witnesses:* **Jane McCormick**, UK Head of Tax, KPMG, **Bill Dodwell**, Head of Tax Policy, Deloitte LLP, **Kevin Nicholson**, Head of Tax, PwC and **John Dixon**, Head of Tax Policy, Ernst and Young, gave evidence.

**Chair:** Welcome. Thank you very much indeed for coming this morning. This is part of the work we are doing on tax and tax avoidance. I shall start by declaring an interest, in that I was employed by PricewaterhouseCoopers many, many moons ago not on tax, but on public sector consultancy.

**Amyas Morse:** As a former partner of PwC, I need to declare that as well.

**Q1 Chair:** We shall start with you, Kevin Nicholson. You very kindly filled in a questionnaire, but I just want to get that on the record. I would like you just to tell us the size of your tax advice capability globally, and then the size of your tax capability nationally.

**Kevin Nicholson:** Starting with the global numbers, in today's exchange rate, the global tax revenues are just over £5 billion. There are 36,000 employees, which is about 25% of the totality of the firm. In the United Kingdom, it is £659 million. We have just over 3,000 employees and, again, that is about 25% of the UK business.

**Q2 Chair:** Because the others have given us the information, can you tell us how many partners you have working on tax advice?

**Kevin Nicholson:** Globally, I cannot.

**Q3 Chair:** Nationally, can you tell us?

**Kevin Nicholson:** In the UK at the moment, about 230.

**Q4 Chair:** 230 tax partners. It is about a quarter of your revenue. Are you able to tell us what proportion of your profit it is?

**Kevin Nicholson:** I can't, I'm afraid. We don't have that information.

**Q5 Chair:** Can you make a guesstimate?

**Kevin Nicholson:** I can't, but I am happy to respond in writing if that would help.

**Q6 Chair:** Clearly, people do not pay your fees just for you to help them fill in their tax forms. They are paying the fees to help minimise their tax bills on that spectrum of planning, avoidance, evasion. Can you tell us, for every pound in fees they pay to you—your revenue—how much, crudely, you reckon they save in tax?

**Kevin Nicholson:** I don't know. We certainly don't account that way.

**Q7 Chair:** If you were selling yourself to me as a client, I'd like to have some feel for that quantum.

**Kevin Nicholson:** We just don't account that way.

**Q8 Chair:** It must be one in 10 or 20.

**Kevin Nicholson:** I have no idea, I'm afraid. Of that £659 million in the UK, about half is on consulting work. The balance is pure compliance and processing tax returns. We process over 50,000 for our clients, but we just don't account that way. We account only in terms of revenue and the fees that we charge to individual clients.

**Q9 Chair:** Okay. We find it and I think the public would find it rather difficult to believe that people pay you just to fill in their tax forms.

**Kevin Nicholson:** No, they don't. Don't get me wrong, Madam Chair. I was just saying that of the £650 million, about £110 million is pure compliance and processing. We do not account by saying that if you pay us £1 of fees, this is the amount of tax you would save. That is not the way it works.

**Q10 Chair:** Of course you don't account in that way, and we can all interpret compliance in various ways, but I just think that is interesting. Thank you for that. We will come back to you.

We will go next to Jane McCormick. I think you were a bit concerned about putting this into the public domain.

**Jane McCormick:** Only because some of the information is not published, and it is these gentlemen

I would rather not share it with, but if you want to put it in the public domain that is fine with me.

**Q11 Chair:** Thank you. That would be really helpful. Can you tell us KPMG's global revenue, global employment and the proportion of global turnover—the same information that Kevin Nicholson kindly provided?

**Jane McCormick:** In the year to September 2012, which is our accounting year, our global tax revenue in US dollars was \$4.86 billion. We had 1,850 tax partners around the world, and 21,600 tax professionals. In terms of the UK, our tax and pensions practice had a turnover of £380 million, of which £310 million relates to tax. That was 17.5% of KPMG's total turnover in the UK. During that year we had 112 tax partners—

**Q12 Mr Bacon:** Sorry, you said £380 million of which £310 million was tax. What was the £380 million?

**Jane McCormick:** We have a pensions consulting business which accounts for the balance. We have 112 tax partners and 1,670 tax professionals in the UK.

**Q13 Chair:** Thank you. So for you it is around 20% or 21% globally and 17.5% in the UK. That is the revenue—the fees people pay you. Do you know broadly what it is in terms of profit?

**Jane McCormick:** Again, I do not have that exact number—

**Q14 Chair:** Is it more profitable doing this bit than providing other advice? We are just trying to get a feel for it.

**Jane McCormick:** I understand the question. The answer is no. It varies year by year, but if you look over a period, our tax business is not consistently more profitable than other bits of our business, specifically the audit business.

**Q15 Chair:** Can you tell us the quantum? Have you got a figure in your mind: for every pound I spend with KPMG on advice, how much will I save in tax?

**Jane McCormick:** I certainly could not give you that figure across the piece. One or two clients will have that calculation, but as Kevin said, a big majority of our business is not around—

**Q16 Chair:** We will come to that debate. Again, I don't think I would pay your hefty fees just to fill in a tax form. I think I can go to a high street accountant to do that. It would be interesting to get a feel of this from you. I have absolutely no doubt that in your negotiations to get new clients, this must be one of the ways in which you sell yourself.

**Jane McCormick:** Traditionally, no. We charge for our time, and the outcome will not be certain at the beginning of any engagement anyway.

**Q17 Chair:** Okay. We will come back. Mr Dixon, what can you tell us about Ernst and Young?

**John Dixon:** Global revenues are around about \$6 billion, with 29,000 employees, and represents around 26% of the global turnover. As far as the UK business

is concerned, it is £431 million, with just over 2,000 employers and 180 tax partners, and again with 26% of the business as a whole. The UK business is roughly one third compliance. Two thirds will be general advisory work—from Inverness to Southampton, Bristol to Hull, across the whole of the UK. The compliance services really are compliance services. They are providing tax return help to individuals, companies and employees.

**Q18 Chair:** Are you able to share with us how that contributes to your profits? For you, about 26%, both globally and nationally, of your turnover is around tax advice. How does that support your profits?

**John Dixon:** Again, unfortunately, we do not—

**Q19 Chair:** Crudely. Is it 30%; 40%?

**John Dixon:** It will be roughly 26% of the overall profitability.

**Q20 Chair:** So, this is not more profitable than the other work. I find this hard to comprehend. I thought that this was a profitable side of your business.

**John Dixon:** The question really is how you measure the profitability. At a marginal level, tax makes a bigger contribution. If you look at income per partner, the dynamic will be different, depending on the leverage model.

**Q21 Chair:** That is quite an interesting statement, and I am grateful for it. It is at a marginal level. Obviously, you share it between your partners; I understand that, but from my very limited experience of working at PwC, the accountancy firms are very rigid in how they account for people's time and cost, and then how that relates to the income and therefore profit they get in from their clients. I am pretty incredulous to hear that you guys do not know; you will know. I know you will know. I just wish you would share it with us.

**John Dixon:** To be specific, at a marginal level, tax is a profitable part of the business in the UK for Ernst and Young. At a profit per partner level, we do not have that available.

**Q22 Chair:** I understand that you will divide the spoils—the profits—between the partners in a different way, but it must be a more profitable element of your business.

**John Dixon:** At a marginal level—

**Q23 Chair:** So what does that mean? Will you define marginal for me?

**John Dixon:** Essentially, if you take our revenue and then take off our direct costs and essentially what we pay our people, that percentage is a profitable part of our business.

**Q24 Chair:** Quite. How much more profitable than other parts?

**John Dixon:** I do not have that data to hand. I can send that to you separately.

**Q25 Chair:** Okay. Can you send it to us so that we can publish it? I just believe that you have all got it,

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because I know how you account for people's time and your costs and how you measure them against your income. I just do think that is information you have, and it would be helpful for the Committee and the public if you shared it with us.

**John Dixon:** We will certainly send to you what we can.

**Q26 Chair:** Okay Mr Dodwell, Deloitte?

**Bill Dodwell:** Yes. Our global tax fees in the year to 31 May 2012 were \$5.9 billion, which is just over a fifth of our worldwide business. There were 2,050 partners globally and just over 27,000 staff. In the UK, our reported tax turnover in our audited accounts is £529 million. That includes fees that we bill to our UK clients that we receive from other firms in the Deloitte network. So the UK tax fees for the UK business are actually £453 million.

At 31 May 2012, we had 177 equity partners working in tax, and the average fee earners on a full-time equivalent basis for the year to 31 May was just over 2,300. All those figures are in our audited financial statements that are available obviously on our website.

**Q27 Chair:** Can you share with us the proportion of your profits that are made out of this business?

**Bill Dodwell:** I do not have that figure with me, but I am happy to provide something.

**Q28 Chair:** Do you agree with Mr Dixon that it is the more profitable end of the Deloitte business?

**Bill Dodwell:** No, I do not think that it is more profitable. We have some low-margin work. You alluded to tax compliance, and we think our total tax compliance is something like 40% to 45% of our business, and that is fundamentally lower-margin work than some of the more advisory work, which is the remainder of our business. Overall, we do not think that tax is significantly different, profitably, from consulting or corporate finance work.

**Q29 Chair:** Have you got an estimate of how much tax people do not pay because they take advantage of the advice you give them?

**Bill Dodwell:** I think it is completely impossible to come up with that.

**Chair:** It is possible?

**Bill Dodwell:** No, it is impossible to do that. There are lots and lots of work where there is not a sort of, "I'm starting. I'm paying £100 in tax. Let me give you this piece of advice, and you will only pay £85 in tax." Most of the work we do has no relationship to that. At the moment, for example, I am working on a de-merger of a private company. That is a big piece of work. Our fees are several hundred thousand pounds for that, but there is not a tax saving. It is simply splitting up the group because that is what the owners want us to do. There is lots of work of that sort.

**Q30 Ian Swales:** So why are they paying you all that money if there is no tax dimension? Why are you there, and why are you charging all those fees? Why would they pay them?

**Bill Dodwell:** Because they have made a business decision that they would like their group split up into various pieces. It is an international group. We are trying to fit into the specific statutory reliefs we have in the UK and elsewhere to provide that this de-merger—this split—will not cost tax. If they stayed as they were, they would not pay anything. The split is designed in such a way that it falls into the statutory reliefs.

**Q31 Chair:** You are designing it within the statute, but you are designing it in such a way as to minimise their tax. Avoiding tax has become a new way of making profits.

**Bill Dodwell:** No, I do not accept that at all. This de-merger is being done quite specifically for commercial reasons. The purpose of our law is quite clear. De-mergers are supposed to be done in such a manner that no one gets a tax advantage, but equally there are not supposed to be tax costs. Fitting into that is what we are trying to do.

**Q32 Mr Bacon:** You said something very interesting to disagree with what the Chair said, which was—to paraphrase—that tax advantages are new sources of profits. You said, "No, I completely disagree". I understand exactly what you were saying in relation to de-mergers.

Would you agree, though, that new sources of business have emerged, for example when a financial investor buys a water company? If you have a British company—a domestic company—whose activity, arrangements and tax are all domestic, if you can internationalise that, you can extract the tax that was being paid to HMG if you arrange it in the correct way by introducing it into a larger international group. At that point, even if it might not be true for de-mergers, what the Chair said becomes true, doesn't it? The pile of tax sitting there that is currently paid to HMG is available for the right kind of financial investor, like somebody buying, shall we say, Thames Water, to go at, get and then extract. That is a new source of profit, is it not?

**Bill Dodwell:** I think you are talking about the ability of a buyer of a company to raise acquisition finance. The interest on that debt will then, naturally, be offset against the profits of the business they have bought. That happens when UK companies buy something in the United States, for example. It also happens, as you say, when an overseas company buys something in the UK. We in the UK have certain rules about the amount of interest we allow to be deductible for tax purposes, and so do many other countries.

**Q33 Chair:** Right, let's get back to Mr Nicholson. We have now established—I am grateful to you for the openness of your answers—that this is a huge industry. In the UK alone, it is getting on for £2 billion; globally, we are probably talking about well over \$20 billion, so let's say it is about £20 billion. It is a massive, massive industry. You are all incredibly well paid and very sophisticated. You are also very well versed in this, and I am not, but it seems to me, looking at this, that the main purpose of what you are doing is to try to minimise the tax that wealthy

individuals or corporations pay. I would like to start with you, Mr Nicholson. How does PwC define the difference between efficient tax planning, tax avoidance—according to *The Times* today, the big four have created 79 tax avoidance schemes in the past three years between them—and evasion?

**Kevin Nicholson:** I will come back to the disclosure position in a moment, because it is more complicated than was suggested. Let me start with the main question. First of all, evasion is illegal and tax avoidance is not. That is the first thing we should say. We should park the evasion piece, because I think you want to talk about avoidance today.

**Q34 Austin Mitchell:** Advice is legal until it is struck down by a court. Many of the schemes you are selling are potentially illegal because they could be struck down.

**Kevin Nicholson:** Well, I will answer that question. All of the advice that we give, Mr Mitchell—this gets to the point of how we determine this—we provide under a code of conduct, which is on our website and which has been globally agreed since about 2005 or 2006. It has four or five main principles. The first is that advice has to be supportable in law—it has to be legal. When we give the advice, we have to believe that it is supportable in law. That is a legal position we have taken.

**Q35 Chair:** Let me challenge you on that, Mr Nicholson, on two grounds. First, let me refer to a judgment on the Greene King case, which I think was an Ernst and Young case, Mr Dixon. This is really important for our hearing. In his judgment, the judge, who found against you in that one, Mr Dixon, said: “It is common ground that the accounting treatment to be adopted in any case is dictated in part by legislation, in part by recognised accounting standards, and in part by professional judgment.” I hope there is common ground in our hearing that it is not absolutely clear that everything is black and white in the law, that judgment is involved and that judgments you often make on your tax-avoidance schemes are found, as Mr Mitchell said, to be unlawful. I hope that is common ground. This is not just a matter of saying, “We obey the law”—it is not; it is about how you interpret the law.

Can I just ask a question about your own code of conduct? Under the Chartered Institute of Taxation code, you submit a filing position only where there is a reasonable probability of its being “sustained on its own merits if challenged by the tax authority.” Would you agree with that?

**Kevin Nicholson:** Yes. I was actually talking about our own code of conduct, though, Madam Chair. Maybe I could just finish the four points, because I think it would—

**Q36 Chair:** I just want to challenge you on this. I have talked to somebody who works in PwC, and what they say is that you will approve a tax product if there is a 25% chance—a one-in-four chance—of it being upheld. That means that you are offering

schemes to your clients—knowingly marketing these schemes—where you have judged there is a 75% risk of it then being deemed unlawful. That is a shocking finding for me to be told by one of your tax officials. I bet it is mirrored by all four accountancy firms sitting here, and I would like you to tell the Committee how you justify that approach.

**Kevin Nicholson:** First of all, I don’t know where that came from; I don’t recognise that statement. We do not mass-market tax products, we do not produce tax products, we do not promote tax products. That is the first thing I would say. But I think it is really important, if you allow me just to finish on the code—

**Chair:** I don’t think that’s true. Okay, we will let you finish, but I think we would challenge that statement.

**Kevin Nicholson:** I am happy to be challenged on that, but could I just get back to the code, because I think it deals with some of the issues that you have raised? First of all, the advice that we give has to be supportable in law. Secondly, it has to be fully disclosed, so it cannot rely on non-disclosure. The third element, which I think is very important, Madam Chair, is that in giving the advice, we have to understand the individual circumstances of the client we are giving the advice to. In other words, we are not just producing a clever idea and distributing it out. We have to understand what the client is trying to achieve.

The fourth and final area is that in giving that advice, we must explain not just the tax risks but the reputational and commercial risks in that planning. In other words, we are saying to the client, “Here are the options. If you do it this way, this is how it works. These are the tax implications. These are the reputational issues. HMRC will view it this way. Your shareholders might view it this way. If you do it this way, here are the reputational issues.” I think that is a very important thing.

**Q37 Ian Swales:** That is an interesting point. You are talking about risk. You tried to define the difference between evasion and avoidance in black-and-white terms, but all of us in the room know that it is not black and white, and that is why the Chair used the expression “reasonable probability”. You are talking about risk and reputational risk, so we should not kid ourselves that this is black and white.

**Bill Dodwell:** Sorry, but the difference between evasion and avoidance is black and white.

**Chair:** Hang on. Can we just deal with Mr Nicholson?

**Q38 Ian Swales:** I’d just like to finish this point. In terms of evaluating this—there ought to be a clear answer to this—are you now trying to evaluate the brand and reputational risk of what you are actually selling? Are you evaluating that for the client? If we think about the recent case of Starbucks, I am quite sure the cost to them of what they have done is far higher than any tax they have saved, or it will be in the long term. Are you actually factoring that in and are you evaluating it when you give advice?

**Kevin Nicholson:** To the best of our ability. Let’s say a client said, “I want to buy a business and this is the way I want to do it.” This always starts with a

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commercial piece of work. We would say, “Well, if you do it that way, here are the tax costs,” and they would say, “Well, are there any options?” We would go through the options that are legal—that are supportable in law—and then we would say, “Here are the options,” and we would talk to them about the risks of HMRC not agreeing with the position that they might take, the length of time it might take to agree something and the reputational position, particularly at the moment, around wider public concern. We would go through those. Ultimately, we provide that advice. The client will decide, based on their own circumstances, the options that they want to take.

**Q39 Austin Mitchell:** When you sell a scheme, do you calculate the probability—possibility—of it being struck down, and at what level of probability of it being struck down do you sell it?

**Kevin Nicholson:** Just to be clear again, Mr Mitchell, we are not in the business of selling schemes. We give advice—

**Q40 Chair:** Mr Nicholson, how many schemes are currently being considered under DOTAS? How many schemes have you put in currently that you have had to declare for DOTAS?

**Kevin Nicholson:** Can I just—

**Chair:** How many? You are telling us you are not selling schemes that we know—I’ve got the figure somewhere—that you have got. I’ll read it out; hang on.

**Kevin Nicholson:** It is 25 over the last three years, Madam Chair, but—

**Q41 Chair:** Twenty-five, so those are schemes—

**Kevin Nicholson:** No, they are not, Madam Chair.

**Chair:** Those are schemes that you want to sell, that you have had to declare to DOTAS.

**Kevin Nicholson:** They are not, Madam Chair. Could I just explain how DOTAS works? It is a bit of a misnomer—the tax avoidance scheme. Under DOTAS—

**Chair:** I don’t know why it’s a misnomer.

**Kevin Nicholson:** Well, it is, Madam Chair. I’ll try to explain. Under DOTAS, if you are giving a piece of advice that has certain hallmarks, within five days of giving that advice to the client you have to declare it under DOTAS.

**Chair:** We do understand; we’ve been doing this work for a bit of time.

**Kevin Nicholson:** Sorry; apologies. But they are not mass-marketed schemes. They won’t even be schemes. In the vast majority of cases, they will be bespoke pieces of advice to a client and actually quite benign. If you take the 25, in our case, 15 of them actually related to stamp duty land tax, the majority of which were seen as benign by HMRC. Two of the codes were withdrawn. The only two items of the 25 that we disclosed under DOTAS and which had a wider application, were salary sacrifice arrangements, which are recognised by HMRC in the manual as

benign, and one has been withdrawn<sup>1</sup>. These are not schemes in the way you are describing.

**Q42 Mr Bacon:** If I can paraphrase: you are saying that because they bore these hallmarks, you were legally obliged to notify HMRC and you did so. Did you then go on to obtain a letter of comfort from HMRC to the effect that, notwithstanding the fact they had had those hallmarks and you therefore had to make a notification, HMRC was satisfied with what you were proposing?

**Kevin Nicholson:** I would have to write to you if you wanted the complete details, but approximately half were not implemented at all. Remember that these were conversations with a client where we were going through options. You have to disclose that within five days. A lot of them will not result in any work or advice being undertaken.

**Q43 Mr Bacon:** To what extent is that because you get a reaction from HMRC?

**Kevin Nicholson:** No, this is because if I was speaking to you today, within five days I would have to notify HMRC. We might move on to a completely different suggestion. You might say, well actually, having thought about it, I do not want to go down that route. Circumstances change, it might never be implemented.

As to the ones remaining, HMRC then have the ability, if they want to, to challenge those in the normal way. In the case of three of the 25 we submitted, the legislation was changed. I honestly do not know whether it was changed because of the disclosure that we made or it would have been changed anyway. These are not schemes that you are disclosing because you are about to market them, but particular pieces of work with an individual. We just happen to have one of the five hallmarks.

**Q44 Chair:** Mr. Nicholson, you keep saying that. I think it is probably true that 10 years ago all four of you were devising schemes, and then DOTAS came in, and you were done over by the tribunal: they were largely found to be illegal. So you have shifted to what you call much more personalised schemes. However, I have here one scheme you offered to a company called Carlyle, and basically you devised the most complex company structure, an extraordinary company structure. This is a company called Carlyle—

**Austin Mitchell:** Carlyle Europe Real Estate Partners.

**Q45 Chair:** Yes. You devised a hugely complex structure. That is the company structure—people listening will not be able to see it, but people seeing the picture will see how complicated it is. There are two subsidiaries in Jersey, one subsidiary in Luxembourg, but isn’t the whole purpose of the complexity of this structure to, in your words, minimise tax and, in my words, avoid tax?

**Kevin Nicholson:** I do not know that structure—

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<sup>1</sup> Note by witness: Mr Nicholson was mistaken in his belief that one of the salary sacrifice schemes was withdrawn, and, having made the necessary checks, has discovered that this is not the case.

**Q46 Chair:** I know you cannot answer. But this is your personalised offer to large corporations: to create a very complex set of company structures, the purpose of which for you is minimising tax, for us is avoiding tax.

**Kevin Nicholson:** I cannot comment on that particular one. The tax law is very complex, in the UK and internationally. The Finance Bill that was just passed is 50 pages longer than any other Finance Bill.

**Q47 Chair:** Do you offer complex structures involving setting up companies in low-tax jurisdictions, such as, in this case, Luxembourg and Jersey-

**Mr Jackson:** And Delaware.

**Q48 Chair:** And Delaware. And the Cayman Islands. This one is Delaware, Jersey and Luxembourg. Do you do that for the purpose of minimising tax?

**Kevin Nicholson:** It will be one of the things taken into account.

**Q49 Chair:** Thank you. That is helpful. Let me share another document from PwC, where you say it is a very personalised, customised offer. This is a presentation to Heineken when you were trying to get business from them. In it, there are 21 separate examples of structures that you implemented for other companies that you gave them to demonstrate that you could help them minimise tax. I have one here, which concerns a Fortune Global 500 consumer goods group. PwC were trying to sell this to Heineken. PwC implemented a tax-efficient operating model, and the solution included a Swiss procurement supply chain. This comes up time and time again, so explain to me what the Swiss procurement supply chain is.

**Kevin Nicholson:** I do not know the details of that individual client, but I can answer the principle of the question—

**Q50 Chair:** The Swiss procurement supply chain comes up. There is a global information service company: “Focus in this phase is on tax and what are the organisational changes required to facilitate a tax efficient model. This was done through a ‘Location analysis’”—this is even worse—in which you compared the Netherlands to Switzerland, and you saved them, I think, €100 million. Another example describes the “Swiss Principal model”. This involves a UK-parented global engineering company with US headquarters, for which “a centralised Swiss Principal model will enable the realisation of the groups key strategic objectives...with anticipated annual tax benefits of circa USD 20 million.”

The final example of your doing this was for a leading UK-parented pharmacy group, where you again considered the Swiss model. The feasibility included corporate tax and customs implications, potential locations of tax-optimised activities, and a tax-efficient exit mechanism for a UK-headed division. It appears to me that this concept of a Swiss procurement supply chain is one of the concepts you sell across the piece.

**Kevin Nicholson:** Do you want me to answer that question?

**Chair:** Yes, please.

**Kevin Nicholson:** I think there are two different things going on there. The first is that countries are competing for tax revenue more than they ever have done. They always have, but now in doing that they will create tax regimes which are particularly attractive for particular things. It might be setting up a finance company, in the UK at the moment it might be a patent box to encourage research and development, or in the Far East it might be manufacturing. So while countries are saying that they have a tax regime which will actually benefit you if you bring that business to us, at the same time companies similar to the ones you are talking about are globalising. It is not just that they are working across borders; they are actually centralising functions, centralising procurement, for example, where they hold the finance and intellectual property. Another thing which is happening is that in the modern economy the business model changed. When the rules were designed in the treaties of the ‘20s and ‘30s and the transfer pricing models of the ‘70s and ‘80s, economies were predominantly domestic by nature, with very few cross-border transactions, and companies were not global in nature. The design of international tax rules did not, therefore, envisage the current global model and countries competing for tax. In simple terms, if a company wishes to globalise and centralise functions, you are quite right, Chair, that one thing they will take into account—but only one of them—is the most tax-efficient place to hold the financing, to hold the procurement.

**Q51 Mr Jackson:** May I just jump in there, because we know about that. That in fact, I think, reiterates the point made by the Chair. I want to come back to this issue about schemes. You dismiss the idea that schemes are designed, sold, marketed, but I do not believe that can be the case. You have a very successful global business and you have a global strategic overview, but in the way you explain it you just pop along to see your clients, you shoot the breeze for half an hour, and then, great, you have avoided lots of tax, as if you do not look at the global strategic picture. You must look at all the jurisdiction, all the legislation, and design a scheme for that, and then sell that scheme on, maybe by word of mouth. Obviously you are not selling it at LIDL or Tesco, but that scheme will be designed. It is just not persuasive or credible for you to sit there and say, “We do not really design schemes.”

**Kevin Nicholson:** The truth is that very few of these global businesses mirror each other. They are incredibly complicated, with incredibly different commercial—

**Q52 Mr Jackson:** But there are enough issues of commonality between them for you to be able to—this goes right back to the beginning of the session—use them as exemplars for other large multinational organisations. There is nothing ignoble in being good in business, but I think you are straining the credibility of your evidence if you say that you do not design schemes and that it happens organically. Clearly, that is not the case.

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**Kevin Nicholson:** I was explaining that in those three things coming together you will work with a client to work out what the best thing is for them, and there will be some commonalities: where do you hold your finance company? Currently, under the new corporate tax reforms that have come in in the UK, to take advantage of the low tax rates offered you have to have an overseas finance company, otherwise it will not work. Many businesses will set up a finance company in Luxembourg—that is quite common—to take advantage of the new regime in the UK that offers a low-rated tax. The reason why they could not do it more simply, Madam Chairman, is because of EU state aid rules.

**Q53 Mr Jackson:** Can I ask whether you have a specific, discrete, bespoke transfer pricing section?

**Kevin Nicholson:** Yes.

**Mr Jackson:** So you are in the business of obscuring where value is created—we saw that in the example of Starbucks—in order to avoid tax in this jurisdiction. That is what transfer pricing is about.

**Q54 Mr Bacon:** How many transfer pricing staff do you have, who just do that?

**Kevin Nicholson:** I am afraid I do not know, but in the UK it is probably 50.

**Q55 Mr Bacon:** Really? HMRC has 65 in total. You reckon you have got about 50 just for your firm.

**Kevin Nicholson:** I think so. I will have to check that.

**Q56 Mr Bacon:** Can the rest of you say roughly how many transfer pricing people you have?

**Jane McCormick:** Around 40.

**John Dixon:** About 50.

**Q57 Mr Bacon:** So that is 140 so far. And?

**Bill Dodwell:** I would guess 40 to 50.

**Q58 Mr Bacon:** So just under a couple of hundred already. You have already got three to four times as many as HMRC has in total. That is interesting.

**Kevin Nicholson:** On that point, we would all welcome—certainly, PwC welcomed in the last statement—the increased investment in transfer pricing resource for HMRC.

**Chair:** Yes, they are getting 20 more. It is a David and Goliath battle.

**Q59 Mr Bacon:** Where do they get them from? Do they get them from you?

**Kevin Nicholson:** I do not know. Can I deal with the other point, because it is fundamental to the wider discussion here? When the transfer pricing rules, where you attribute value, were created, they were very beneficial to countries such as the UK, because where they placed the value under the OECD principles was where there were functions carried out on risk in capital. The UK then was a capital exporter. It was very favourable for us.

One of the challenges now is that we are seeing a lot of discomfort, unrest and unhappiness around the fact that businesses are selling a lot in the UK, but they are not seeing the profit. Part of the reason for that is

the way in which the international rules were designed, which puts the value in different places, because they were designed for different purposes. One of the debates that we need to have now, whether it is at the G8 or the OECD, is about the modern world and where the best place to apportion value is. How do you get tax and profits in the right place?

**Q60 Chair:** Again, Mr Nicholson, it is fair to say we are on common ground, but that could take 10, 15 or 20 years to negotiate. In the meantime, here you are—Kevin Nicholson, head of tax in PwC—having worked with a leading UK-parented pharmacy group. You have given a UK-based group a tax-efficient exit mechanism for their UK head of division. You have deliberately taken them offshore—I think you use Switzerland probably more than the others—so that they do not pay their fair share of tax here in the UK, and that stinks.

**Kevin Nicholson:** I do not agree, obviously. I think we are giving the best advice that we can to businesses that—

**Q61 Chair:** In what context?

**Kevin Nicholson:** We are giving the best that we can to businesses that are competing internationally.

**Q62 Chair:** Best advice to them or to the collective good?

**Kevin Nicholson:** We are giving the best advice to the client on the options that they have. It is legal, fully disclosed to HMRC and open to challenge. I do not see anything wrong with that.

**Q63 Mr Bacon:** May I come in on this very point? A little earlier, Mr Dodwell was halfway through saying that there was a black and white distinction. I think you were trying to make a black and white distinction between evasion and avoidance. Can you finish that sentence?

**Bill Dodwell:** Yes, I would like to say that evasion is clearly something that is illegal. It poses the possibility of criminal prosecution, and I cannot believe that anyone from any firms here or any responsible tax adviser would go anywhere near that. There is a difference in legal interpretation, which is what I think you are talking about, before the civil tribunal and court system.

**Q64 Mr Bacon:** So you are saying that if something is found unlawful, as long as the intent at the start was not to evade tax, it is a civil offence and not criminal.

**Bill Dodwell:** It is not an offence at all to have a difference of interpretation about what the law means.

**Q65 Chair:** So when you lose a case in tribunal—how many cases have you lost in tribunal in the last 5 years?

**Bill Dodwell:** Very, very few.

**Q66 Chair:** How many cases have you lost in tribunal? There are very few cases that reach—

**Bill Dodwell:** I can think of two.

**Q67 Mr Bacon:** You lost the Deutsche Bank case. That was a scheme you ran in 2003–04 to help Deutsche Bank avoid tax and national insurance contributions by using a share scheme, and £91 million of bonuses were paid through the Cayman Islands. Lots of investment banks were doing that—Goldman Sachs was the most famous. In the end, the Court of Appeal ruled against it, and most of the banks, except Goldman Sachs, shied off. At the point that the court rules against you, it shows that what you are doing is unlawful, does it not?

**Bill Dodwell:** No, it doesn't. What it shows is that the interpretation of the tax law proved to be wrong.

**Q68 Chair:** You lost in the tribunal. Are you saying the tribunal does not find whether it is lawful or unlawful? You lost. You don't need to pussyfoot with words. You lost.

**Bill Dodwell:** There is a difference between committing a criminal offence—

**Q69 Mr Bacon:** That is indeed true, but that is not what I asked. What I asked was, at the point at which you lose in the courts, the courts have found that what you were doing was unlawful. Yes or no?

**Bill Dodwell:** Yes.

**Q70 Mr Bacon:** Right.

**Bill Dodwell:** That interpretation was wrong.

**Chair:** No. It was unlawful.

**Q71 Mr Bacon:** If you tried to do it again, it would be struck down by the courts again. You cannot do it, and you advise your clients that they cannot do it because it is unlawful, don't you?

**Bill Dodwell:** Sure. Of course.

**Mr Bacon:** So it is unlawful.

**Q72 Ian Swales:** Do you indemnify your clients from the effect of your advice? Do you say, "If this goes wrong and you end up paying a lot of money in court, we'll cover you"? Or do you just say, "We are telling you this is a risk, and it is your risk"? Which way round is it?

**Bill Dodwell:** I cannot think of any case where we would set out to indemnify a client in any scenario. Our advice—this goes back to the point that Madam Chair made—is that one is only allowed to file a tax return claiming a tax position if one has a more than 50% view that it will succeed.

**Q73 Chair:** You do it at more than 50%? That is useful. They do it at 25%. You do it at more than 50%.

**Bill Dodwell:** Yes.

**Q74 Chair:** So for half the schemes that are included and filed in tax returns there is a risk that they could be proved, later down the line, to be unlawful.

**Bill Dodwell:** No.

**Q75 Chair:** More than 50%. You used the term. You just said it.

**Austin Mitchell:** You just said it.

**Bill Dodwell:** No. I am simply saying that that is the minimum threshold at which somebody may file.

**Q76 Chair:** So that is the minimum threshold.

**Bill Dodwell:** But there is lots of filing, so there is 100%—

**Q77 Austin Mitchell:** If a scheme of yours turns out to be rejected by the tribunal, do you suffer any consequence? Are you fined?

**Bill Dodwell:** No.

**Q78 Mr Bacon:** I want to pursue a point that the Chair talked about earlier. Plainly there is a spectrum, with sensible tax planning at one end, evasion at the other and avoidance somewhere in the middle. HMRC's definition of avoidance is, "To gain a tax advantage that Parliament never intended." Jane McCormick of KPMG, in your guidance—your principles of tax advice—you state quite clearly, "We will interpret legislation in a purposive way in line with the courts. We will not advise clients to enter into transactions with the main purpose of securing a tax advantage clearly contrary to the intention of Parliament". You obviously draw a line between legitimate tax planning on the one hand, and using tax law to give an advantage that was not intended by Parliament on the other. My question is, how do you draw the line?

**Jane McCormick:** That is one of our tax principles. The tax principles were originally written in 2004 precisely to deal with this problem. There is this grey area. We have difficulty in definitions. The Oxford university centre for business taxation wrote a paper that was published last month that talks about how difficult it is to define this. The way we have chosen to do it in KPMG is to set out a set of principles. They are principles, not rules. They are benchmarks by which we judge what we do.

**Q79 Mr Bacon:** They were written when?

**Jane McCormick:** They were originally written in 2004. They have been updated from time to time. The bit you referred to was from a recent edition.

**Q80 Mr Bacon:** So when was it written?

**Jane McCormick:** It was written in December.

**Q81 Mr Bacon:** December 2012? So this guidance is one month old?

**Jane McCormick:** Yes, it is. The reason that we have put that in is because our guidance reflects what is happening in the legislation, the courts and wider society.

**Q82 Mr Bacon:** Hitherto, for many years, up until last month, you were perfectly happy to advise clients to do things that would secure an advantage not intended by Parliament, but now you are not. That is right, isn't it?

**Jane McCormick:** No. The principles form part of a bigger governance process and actually, for some considerable time, our governance process has not allowed us to undertake planning that breaches that principle, not least because, the way that the courts are thinking, we do not think that a tax position like that would succeed in the courts. So we have been doing that for some time, but now was the time we

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needed to write it down. The reason we did it specifically then was in contemplation of the introduction of the GAAR, which will come into place in the summer. We specifically wanted to make it absolutely clear to our clients that we would not advise them to try and enter into a transaction that had, if you like, slipped under the GAAR before it came in.

**Q83 Mr Bacon:** Have you ever sacked or disciplined any staff for breaching your guidelines?

**Jane McCormick:** I am pleased to say no, because they do not.

**Q84 Chair:** Have you lost any cases in the tribunals?

**Jane McCormick:** We have occasionally, yes.

**Q85 Chair:** So when they lose a case, do they not breach the guidelines?

**Jane McCormick:** Any cases that I can think of that we have lost relate to transactions entered into some very considerable time ago—

**Q86 Chair:** So in the past you misbehaved, but you think you do not misbehave now.

**Jane McCormick:** The reason we introduced the principles is that we felt at the time—this goes back to 2004—that some of the transactions that people were starting to enter into were becoming more artificial. We could see that Government, the courts and wider society were moving away from that, so that is absolutely why we introduced the principles.

**Q87 Mr Bacon:** I have a question for Ernst and Young, specifically about artificiality, which was prompted by what Jane McCormick just said. Mr Dixon, you—Ernst and Young—ran a scheme for Greene King, which you ended up losing in the courts. Basically, it involved lending £300 million to a subsidiary, and the subsidiary that received the loan offsetting the interest paid on the loan against its tax bill, but there was a series of complicated transactions that meant the loan income was not taxable. You have now lost in the courts against HMRC with this. David Milne, QC, representing HMRC, described the arrangement as “a scheme for making what would otherwise be taxable income vanish into thin air”—now that is purely artificial, is it not?

**John Dixon:** It is difficult, frankly, for us to talk about the Greene King case, specifically because it is ongoing litigation and an appeal is pending, so I cannot talk specifically about the circumstances.

**Q88 Mr Bacon:** Well, talk about artificiality.

**John Dixon:** If you think about the size of the business that we talked about earlier and the number of clients—thousands of clients, thousands of engagements, day in, day out—tribunal cases are a very small proportion of the outcome of the work that we do. We are talking about a couple of cases for each firm. For each of those cases, however, we have thousands of very happy clients who receive first-class advice from our firm.

**Q89 Mr Bacon:** I just want to go back to Jane McCormick for a second. Would you like to comment a little further about artificiality?

**Jane McCormick:** I am sorry, in what sense?

**Q90 Mr Bacon:** In the sense of schemes being created for no other purpose than to make what would otherwise be taxable income vanish into thin air.

**Jane McCormick:** Things were done like that in the past. First, I think that the collection of legislation and the way that the courts are thinking will probably mean that those things would fail anyway. More importantly, there is no appetite—certainly among the clients I deal with—to do that sort of thing. What they are actually looking for is a sustainable tax position that supports their business, and it is recognised that doing that sort of thing will generally not achieve that.

**Q91 Mr Bacon:** You have suggested that you are updating this guidance, and you used an interesting phrase and said that you had decided that now was the time to write it down. When exactly in December was this written down?

**Jane McCormick:** I could not say exactly. It was under discussion, I imagine, from about the middle of December—

**Q92 Mr Bacon:** From the middle of December.

**Jane McCormick:** Yes. It was about the time that we started to see what the GAAR, the general anti-avoidance rule, was going to look like.

**Q93 Mr Bacon:** So it was literally just before Christmas—very recent indeed. Was it written in response to the invitation to appear in front of the Committee?

**Jane McCormick:** No, it was written in response to the GAAR.

**Q94 Ian Swales:** I suppose we are talking ethics here, and in this area, section 172 of the Companies Act says that—

**Chair:** Who are you directing this at?

**Ian Swales:** All of them—I want a yes or no answer to this question if possible. Section 172 of the Act says that directors must have regard to, amongst other things, “the likely consequences of any decision in the long term”, “the impact of the company’s operations on the community”, and “the desirability of the company maintaining a reputation for high standards of business conduct”. Have any of you ever mentioned section 172 of the Companies Act in the context of talking to directors about tax, and specifically, their duties under the Act? Yes or no?

**Kevin Nicholson:** I think I answered earlier that that is part of our code—not specifically mentioning section numbers, but it is stated, globally available, on our website. It is part of our code.

**Jane McCormick:** I cannot recall ever quoting a section number, but the contents of it absolutely are things that we discuss every time we give advice to clients.

**John Dixon:** Exactly the same position. It is part of the ongoing work that we do with our clients to help them manage their tax affairs and talk about all of

the influences they need to take into account around this issue.

**Bill Dodwell:** Likewise, I agree with those points.

**Q95 Ian Swales:** The reason I mention that is because it is company law in the UK. A lot of what we are talking about here, I think, breaches not necessarily the absolute letter, but the spirit of the Companies Act. With some of these schemes, such as exporting your pay to the Cayman Islands, how on earth can you say that that is maintaining a reputation for high standards of business conduct? I think what we are hearing this morning is that you are advising directors to breach the spirit of the UK Companies Act.

I would like to come back to the picture that the Chair held up earlier. Mr Nicholson, you were talking about globalisation, people bringing functions together, and so on. We all understand that, and we know that it is a fast-moving world, but there is a big difference between deciding to locate an activity somewhere, and screwing a brass plate to a wall in a remote country and routing £9 billion worth of profit, in the case of Google, to a West Indian island. That is very different, because who can pretend that they actually have their management, intellectual property, and so on, on that particular island? They do not. It is a device.

I would like your comments about this point: in terms of the principle that profits and tax should be where business activity is located, how do you justify routing money through tax havens? Between you, I think you have 200 offices in tax havens. How do you justify not putting business activity there, but routing money through those places? Again, I do not believe that that is in the spirit of how business should be organised.

**Kevin Nicholson:** If there is no substance there, that planning—that particular structure would not work. There has to be substance there. If you have a finance company in Luxembourg, the Cayman Islands or Bermuda, and you haven't got people, the loans and the agreements there, I do not understand how that would work.

**Q96 Ian Swales:** So are you telling me that you have never advised a company and drawn one of those pictures involving a tax haven? You have never advised the use of a tax haven as a device, and you have always said, "You have to move those 30 people to Jersey or Bermuda", or wherever. Is that what you say to clients?

**Kevin Nicholson:** If there is no substance—we would always advise that, whatever it is that you say you are doing, you have to be doing there.

**Q97 Chair:** That is a nonsense, Mr Nicholson. It is such a nonsense.

**Ian Swales:** The population of Luxembourg is half a million, so if that was the case, every single person would have to be working in finance.

**Mr Bacon:** They are. That's why they are all so rich.

**Ian Swales:** It is absurd. We do not believe it.

**Kevin Nicholson:** If that was the case, that is open to challenge. I do not believe it is the case. Can I deal with the tax haven issue, as you have raised that? It goes back to the heart of competing for business. If

you are a small country—forget which particular one—without natural resources or an economy, the only way you are going to attract tax revenues is by having, let's be honest, an attractive tax regime that encourages businesses to go there to do certain things. On the back of that, yes, you will get infrastructure, company law and banking arrangements, but it often starts with tax. Those countries rely on tax treaties with countries like the UK and the US. Parliament has the power to change how international tax works. If you are a company in a capitalist environment competing with other companies, you will follow the incentives that are created.

**Chair:** Can I just say two things to you, Mr Nicholson? First, we all recognise that there is a role for Parliament. We also all understand and welcome the Prime Minister's commitment to find an international agreement. That is going to take him a long time. We are dealing with the here and now. Your advice, I think it is called tax-efficient supply chain management. It is on all your brochures. I'd like you to define it. That might be helpful. What does it mean?

**Q98 Ian Swales:** Let's give an example. Let's take the Swiss example. If you say to a company, "It is good to have your procurement function in Switzerland", how real is that? Would you literally say, "You have to move all your people to an office there."? What about the actual, physical routing of materials?

**Kevin Nicholson:** It depends on what you mean by all your people. One of the challenges about the new business model, which is why the international tax system needs to be reviewed, is that in the modern world, you can buy and sell items without having hundreds of people in a particular location. The supply chain that you talk about, Madam Chair, is simply saying, if you are a global business, "Where do I set up where I procure things from all over the world, so I have contracts for raw materials and other things from all over the world, and I can place that in a country?" It happens to be Switzerland. But that does not work if there are no real people there doing a real job.

**Q99 Chair:** When "Panorama" did their programme, they knocked on various doors in Luxembourg—I think it was the Desmond empire—and they hadn't even heard of them. One of you would have been the accountants for that empire, but there was no presence there.

Ernst and Young, you audit Google. Did you help them come up with a sort-of curious structure, whereby their UK sales are reported and claimed in Ireland, and then the Irish company pays most of the turnover and fees to an entity in Bermuda? Did you help them with that?

**John Dixon:** Unfortunately, Chair, I am not able to comment about the specifics—

**Q100 Chair:** Would that be the sort of structure that you assist with? I knew you'd do that answer, but you were there. You sign off their accounts. They have this extraordinary structure where their UK businesses are

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not accounted for here. Do you help design those sorts of structures, in theory?

**John Dixon:** Generically, we help clients manage their tax affairs globally—

**Chair:** So you would help.

**John Dixon:** Sorry, if I could just continue, Chair. The OECD principles, as Mr Nicholson has already explained, do have the effect, as far as the in-bound part of the supply chain is concerned into the UK, that a small amount of the profit under OECD principles is currently allocated to that activity. That is what the OECD needs to address. Certainly, my recommendation to Mr Cameron through the G8 is to encourage the OECD—

**Q101 Chair:** Yeah, put it off for 10 years for you all, so you get another 10 years of income.

Can I just say to you, Mr Dixon, when you do Google, for example—I don't know what they call themselves—do you, the auditor, walk around their office to see whether or not what you sign off as fair and true is what is actually happening in the UK base? Do you walk around that office? Do you sign it off in that way?

**John Dixon:** Generically, if we are looking at a tax-planning structure that has been adopted, then yes.

**Q102 Chair:** You actually walk around the office, and hand on heart you can tell us that all, or Amazon—I can't remember who does Amazon now. Which of you does Amazon?

**John Dixon:** Ernst and Young audits Amazon.

**Q103 Chair:** That's an even better example. So you have walked around Amazon's office, looked at their warehouses in the UK and at what I get and still get every day, although I have stopped buying from them—their e-mails—and you have understood the whole nature of their business, and you were able to sign off and say that there is no economic or business activity here for which they should pay tax. You'd sign that off as true and fair?

**John Dixon:** Again, without being specific to that particular client, yes. If a planning device requires substance and requires people to be located in a particular location, we will make sure that the advice that has been given has been properly conducted and properly followed through.

**Q104 Ian Swales:** How can you argue that Amazon does not have a permanent establishment in the UK?

**John Dixon:** Sorry, but I don't know the specific circumstances.

**Q105 Ian Swales:** Or a company doing physical retail trading in the UK from offshore—how can you argue that they do not have a permanent establishment?

**John Dixon:** This gets to the OECD difficulty that we are in at the moment. The situation is that a warehouse of itself is not a permanent establishment. An internet-based business, where essentially the website and servers are based outside the UK, is also not a UK permanent establishment. The OECD needs to look very carefully at whether these rules need to change,

and that needs to happen on a multilateral basis, rather than a bilateral basis.

**Q106 Ian Swales:** If you buy on a website, where do you think the contract is being agreed? Is it being agreed where the server is, or where the person is sat?

**John Dixon:** In the context of whether that creates any taxing rights, the question is whether or not a PE is created. If the server is out of the UK—

**Q107 Chair:** A what is created?

**John Dixon:** A permanent establishment. Sorry, it's jargon.

**Q108 Ian Swales:** Let us just think back to the pre-internet days. If I had my contracts printed in Switzerland, but then brought the paper to the UK and signed them, it would not matter where the contract was printed, would it? Surely the point is that if I am sat in the UK, concluding a piece of business with a company, I do not care where it is printed, and a server is like a printer. So how can you argue that I am not doing a piece of business in the UK?

**John Dixon:** In modern parlance, the way that contracts are made is usually online, essentially through the mechanism of the internet.

**Q109 Ian Swales:** No, my question is: where do you think the location of the contract signing is?

**John Dixon:** In the context of a server that is based outside the UK, where that is the mechanism by which the business is conducted, it doesn't make any difference where the contract is actually made.

**Q110 Ian Swales:** So you are saying that somebody who has never been to Luxembourg—I have been, actually—is signing a contract in Luxembourg when they buy from an internet retailer that is based there?

**John Dixon:** If the contract is made online and the server is outside the UK, that is not creating a taxable liability in the UK.

**Q111 Mr Bacon:** Even though the website is .co.uk and the warehouse is in the UK?

**John Dixon:** Absolutely.

**Q112 Mr Bacon:** So it means that, if you buy an iPad or whatever—something that attracts VAT—Amazon cannot provide a VAT invoice.

**John Dixon:** The question of where VAT is due is a different issue, but in the context of corporation tax, it is the location of the server. That is the issue that the OECD is currently addressing. There is a working party looking at this specifically and the recommendation is going to come through in the course of the next couple of weeks. We need to look at what they are going to say and look at multilateral changes.

**Chair:** In the meantime, you have helped them to exploit a loophole.

**Q113 Ian Swales:** I do not accept your interpretation, but obviously that is the way that it seems to be interpreted. On another point, we won't name names, but if an offshore retailer is selling a VAT-able item in

the UK, how does it account for its VAT? You must all have advised an offshore retailer that sells in the UK—we know that you have, Mr Dixon. How do they account for VAT on the items that they sell in the UK?

**John Dixon:** It will usually be VAT-able, so VAT will be charged.

**Mr Bacon:** So why can't they generate a VAT invoice?

**Q114 Ian Swales:** Just let me pursue this. You are all accountants—how do they calculate and do VAT returns when they do not have a business or a permanent establishment here? Can you give me an example?

**Bill Dodwell:** I suspect that none of us are full VAT experts, but my understanding is that an overseas company is required to register for VAT in the place where it is delivering goods, even though it is not physically present here. It then accounts monthly or quarterly, as is appropriate for VAT.

**Q115 Ian Swales:** So if a large internet retailer tells you that they don't even have a VAT registration number for the UK, can we assume that they are not paying VAT in the UK?

**Bill Dodwell:** It would surprise me to hear that.

**Q116 Ian Swales:** We know that one of the large online retailers does not have a VAT registration number in the UK. If that is the case, do you think they are paying VAT? Are they calculating in their offshore location the VAT that they should pay and then sending a cheque to HMRC that it was not really expecting, but is very pleased to receive? Do you think that is what happens?

**Bill Dodwell:** I believe, as I said before, that an offshore retailer supplying goods in the UK needs to register even though they are not physically present here.

**Q117 Ian Swales:** Do you think that, Mr Dixon?

**John Dixon:** I believe that to be the case

**Q118 Ian Swales:** Just to finish, I do not know whether any of the rest of you can comment, but we are starting to believe that some online retailers are selling in the UK and not paying their fair share of VAT. This is another form of corporate tax avoidance. The more you get into this, the less convincing it is that they are doing—let us remember that the subtext of all of this is not just tax collection but business competition. As we watch retailers fall every week in the UK, we believe that one of the reasons is that some of these offshore companies are not doing the right thing.

**Bill Dodwell:** I have discussed this with one of our VAT partners, and I do not think that that is possible to do legally. If you are selling goods here—you may be aware that there was something called low-value consignment relief.

**Q119 Ian Swales:** Yes, which Tesco has exploited—no doubt advised by one of yourselves.

**Bill Dodwell:** Various people did. That has now been stopped for the Channel Islands. If the goods are of

very low value—less than £15 or £18 I think—they can come in without a VAT levy. Anything above that—I assume that we are talking about businesses supplying goods worth a lot more than that—then VAT must be accounted for.

**Q120 Ian Swales:** How can the authorities here police that when the companies themselves are not here and do not have a VAT registration? How can they police it?

**Bill Dodwell:** The answer within the EU is that there is a mutual assistance directive, whereby the UK can enforce liabilities in the country where that person is registered.

**Q121 Ian Swales:** What would the rate be? If the VAT rate is 5% lower, would it be the UK—

**Bill Dodwell:** We are talking about goods here. The rate would be 20%—the UK VAT rate—or 0% if you are dealing with a book, because they are zero-rated.

**Ian Swales:** I understand that.

**Q122 Mr Bacon:** For the sake of clarity, if you are dealing with a UK VAT-able item, such as an iPad or something that is not a book, you are saying that the rate that should be paid is the UK 20% rate.

**Bill Dodwell:** I do not think that there is any doubt about that.

**Ian Swales:** I want to get this on the record. You are telling us that that is how it works, but we are telling you that this Committee was told by one such company that they did not even know their sales in the UK. That is on the public record. So how on earth they are paying the right level of VAT is absolutely beyond me.

**Q123 Mr Bacon:** What would be your view of the collection from a customer—we all know that they are merely acting as a collection agent and that VAT is paid by the customer—

**Bill Dodwell:** VAT is borne by the customer. It is paid over by the company.

**Mr Bacon:** “Paid by the customer” is what I thought I said. If the money is collected and has VAT on it, but it is not paid over, what would you characterise that as?

**Bill Dodwell:** A fraud.

**Q124 Mr Bacon:** Fraud?

**Bill Dodwell:** Yes.

**Q125 Chair:** A criminal offence.

**Bill Dodwell:** Yes.

**Q126 Mr Bacon:** It would be a criminal offence. If you collected VAT from a customer and did not hand it on, it is a criminal offence.

**Bill Dodwell:** It would be a thing like missing-trader fraud, which is a well-known VAT concept.

**Chair:** I hope you are advising your client well, Mr Dixon.

**Q127 Mr Bacon:** You were nodding then, Mr Dixon, but unfortunately *Hansard* does not show nods. Can you confirm that your view is the same as Mr

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Dodwell's? If you collect VAT from someone, but it does not end up being handed over to HMRC, then is that criminal fraud?

**John Dixon:** I believe that to be fraud, yes.

**Q128 Chair:** And you do sign off Amazon's accounts as true and fair.

**John Dixon:** As a firm, we audit Amazon, yes.

**Q129 Chair:** The other thing is that you say that they do not have a permanent establishment in the UK, but they have a head office in Slough.

**John Dixon:** Sorry, I did not say that at all. I was talking generically about internet business. I was not talking specifically about Amazon at all.

**Chair:** Well, they are signed off as not having a permanent establishment in the UK for tax purposes. They have a head office in Slough.

**John Dixon:** With respect, Chair, I did not say that. I said that they are signed off. We were talking about internet trade and whether—

**Q130 Chair:** Mr Dodwell, you are dealing with a multinational coffee company, whose accounts I think you are responsible for. They have set up a structure whereby they buy their coffee beans via Switzerland. Would you consider that legitimate supply-chain management, which is a service that you advertise for your clients, or do you consider it tax avoidance?

**Bill Dodwell:** I think, as other people have talked about, there are reasons why multinationals centralise activities. Instead of, for example, having the people in all the countries where you operate go and buy things, you say, "We want an economy of scale here. We are buying so much of these commodities, let us do that in one place. We will employ a lot of people in that place to do that." Then there is a value to the business, and ultimately to the customer, in having that done as effectively as possible.

**Q131 Chair:** Ah, the beans don't go to Switzerland. You would consider it supply chain management, not tax avoidance.

**Bill Dodwell:** It is a commercial concept. The question of where that commercial activity is located will be affected by a lot of factors.

**Q132 Chair:** It is a supply chain management issue in your view. It is not tax avoidance. I am just trying to get at what you think it is.

**Bill Dodwell:** I do not think it is tax avoidance, but I would not—

**Q133 Mr Jackson:** Could I just ask a hypothetical question on that? If the beans of this company are roasted in Holland but the coffee is sold by cups in the UK, surely the value is created in the UK, the point of sale? That could be argued. The value is created here. You are looking quizzical, but it is not that complicated, Mr Dodwell. You are a man with a large brain, so I am sure you can follow my line of argument.

**Bill Dodwell:** There is a range of values here.

**Mr Jackson:** Purchased in Switzerland, sent to Holland—by this fictional company that we all know about.

**Bill Dodwell:** It can't be that fictional if it has got a roaster there, can it?

**Q134 Mr Jackson:** Surely the value is created at the point of sale. I don't see it—it is a tautology. It is only valuable if you can sell it. You can only sell it at the point of sale.

**Bill Dodwell:** There is a multiplicity of values to look at. We have identified three different activities. One is the really important thing of sourcing a gigantic amount of commodity globally, and that is valuable. Commodity trading is something that the United Kingdom invented. We designed a legal system around things such as bills of lading, so that we could trade things before they had arrived. You didn't just say, "Here are the goods." You said, "You pay me and under the contract I will let you do that." We don't necessarily have to trade and take physical delivery at that moment. That is commodity trading. That is a valuable activity.

Roasting beans, I am sure, is also a perfectly sensible activity that will be carried on. I have no idea if you can get your beans roasted by third parties, but it is an activity.

**Mr Bacon:** Yes, you can.

**Bill Dodwell:** Selling commodities, selling coffee in a shop is also an activity.

**Q135 Chair:** What fascinates me about this is that the fictional multinational coffee company that we are talking about has now voluntarily said it will pay some corporation tax. Does that mean that when you signed off its accounts that it was not a true and fair view of the state of the company's affairs?

**Bill Dodwell:** I am not anything to do with the audit team for that client that we are talking about.

**Chair:** Your company audits its accounts.

**Bill Dodwell:** Yes, they do. Deloitte is the auditor of Starbucks.

**Q136 Chair:** So, they have now voluntarily agreed to pay some corporation tax. Does that mean that when you signed off their accounts it was not a true and fair view of the state of the company's affairs?

**Bill Dodwell:** No, it does not, for several reasons. First, as I understand it, the company's announcement relates to the future and those accounts have yet to be considered. No doubt that matter will be looked at when, for example, the 2013–14 accounts are filed.

**Q137 Ian Swales:** Would you describe that more as marketing expenditure rather than tax, then? That their tax is correct but they feel now that they have to buy—

**Bill Dodwell:** I don't think I can comment on that specific case.

**Q138 Chair:** Amyas?

**Amyas Morse:** I want to ask a little more about the location of activities. I understand what you are saying, but would it be fair to say that, with modern communications technology, creating a credible

activity in a place is relatively straightforward, compared with what it might have been before? To have a viable office somewhere, we are not talking about having loads of people, you might have just a few. You could say you have a buying operation somewhere, but it might be half a dozen people and a computer.

I am not saying that is artificial, I am just saying that as a matter of fact it is really not difficult to create such a thing. The difference between a credible presence and no presence is quite slight in today's world, because it is all virtual. It is all driven by information exchanges and virtual activity. Is there something in that?

**Kevin Nicholson:** I think that we are all violently agreeing that the way that these laws, treaties and principles were designed did not envisage the world we live in, and we have to change them.

**Amyas Morse:** I was not asking to be oppositional, but just to illustrate it.

I have one question that might be a little different. When you are preparing clients' tax returns, do they routinely claim a deduction for tax advice?

**Bill Dodwell:** Yes, it is a tax deduction.

**Amyas Morse:** So, normally, they would get a reduction of their taxes for the advice that you were giving them on how to reduce their taxes.

**Q139 Mr Bacon:** That means that the more advice you give them, the more tax they can deduct. Is that right? If you give them a very complicated piece of tax advice, then they have a larger deduction. That is right, isn't it, Mr Dodwell? You are grinning.

**Bill Dodwell:** There are some cases where, as I think Mr Nicholson was about to say, it is disallowed because it is a capital cost, but normal advice about operating the company is tax-deductible. Yes, it is. I think that you will find that we pay tax on it, though, when we get the money.

**Q140 Mr Bacon:** Mr Nicholson, did Mr Dodwell correctly interpret what you were about to say?

**Kevin Nicholson:** I was, but he is doing so well that I shall leave him to it.

**Q141 Austin Mitchell:** We have got on to general issues, but I want to go back to Mr Nicholson. He has given us very honest answers, and has had to sit there silently for such a long time that I have some sympathy for him.

**Kevin Nicholson:** I don't mind; don't worry.

**Austin Mitchell:** It is clear that the big four use their audits—they audit more than 90% of plcs in this country—as a base from which to sell other services. In fact, there was an example from PwC a few years back, which I wrote up in one of these pamphlets I did with Prem Sikka. It is still available from the Association for Accountancy and Business Affairs at a price of £8.95. PwC put in a bid to do the audit for, I think, the Prudential, and said that it would do it for a lower price and benefit the company by providing other advice, tax or whatever—so I called you, “Cut-Pricewaterhouse” at that particular stage. If you are using the audit to sell services—particularly tax advice—and you sell them a scheme that they

adopt, how is it legitimate for the same firm that does the audit to audit the tax scheme that they have sold to the firm? How is that legitimate?

**Kevin Nicholson:** First, we do not enter into audit arrangements at discount prices on taxation—

**Austin Mitchell:** No, I am sure that you don't, but it is a useful platform for selling services.

**Kevin Nicholson:** And 70% of our revenue in PwC, as an example—I do not know about the others—is to non-audit clients; that is a figure. The current way of working is that we have strict rules about what we can and cannot do for an audit firm. On top of that, certainly for the larger corporates, the audit committee will scrutinise the work that we are doing, and it has to agree whether or not we are engaged.

To get to the point of your question, if we undertake tax advice for an audit client, we have for every one of those clients an independent partner who reviews the tax for that audit. It is not the person who has provided the advice; it is independent. Those audits are scrutinised by the external audit regulator and are subject to all that scrutiny. There is no question but that we have a Chinese wall—a divide between the person who is giving the advice and advice of the audit partner.

**Q142 Austin Mitchell:** Is that true of the others?

**Jane McCormick:** Yes.

**John Dixon:** Yes.

**Bill Dodwell:** Yes.

**Q143 Austin Mitchell:** Let me move on to the weight of odds in this game. It is a game in which you and HMRC are trying to outwit each other, and in which you are winning. You are winning because you are employing some of the best brains—you have the weight of talent—the best-paid, and in large numbers. I did a rough calculation as you gave us the numbers in the opening phase: there are 9,000 people in the four firms dealing with tax advice, tax avoidance or whatever it turns out to be, as against less than 100 in HMRC dealing with these areas. You must win, because even if the case goes against you, it takes years and years.

I have just looked at some of the schemes that have been turned down. There was PwC's scheme for Mr Schofield and his millions: he had to go to Spain to avoid paying tax. That was a scheme that you sold to 200 other people, and there was only a ruling against it in July 2012. In 2003, Deloitte had a scheme for Deutsche Bank, which was also struck down some years later. Ernst and Young created a tax avoidance scheme for Greene King, which we have heard about, and that was only struck down some years later. There was the Drummond case with KPMG, which created that scheme in 2000; it took years to rule against it. When a scheme is ruled illegitimate, you do not suffer any consequences. Nothing falls back on you. This is a game in which you are battling a slower-moving HMRC, which has fewer staff and possibly smaller brain power; I wouldn't make that judgment, but certainly you are better paid than they are. It is a game you must win—an illegitimate game, to outwit the taxpayer, isn't it?

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**Kevin Nicholson:** No. I will try to break down my answer to cover most of the points. First, in terms of numbers of people, there are just over 3,000 in PwC in tax, but a lot of those people are doing things like pensions advice, or rewards strategy—all sorts of things. Secondly, I am not sure where the figure of 100 comes from for HMRC; they have a significantly larger number of staff than that. In terms of the work that we do, remember that we have 13,000 clients across 31 offices, including in Hull. We are working with clients small and large every day.

I will try to address the question around the tax cases. You mentioned Mr Schofield; that planning was undertaken and that advice was given in January 2003. We would not advise on that particular type of planning now.

**Austin Mitchell:** Well, you wouldn't because it has been ruled out.

**Kevin Nicholson:** Further than that, Mr Mitchell, which I am happy to deal with—

**Q144 Austin Mitchell:** But it was legitimate when sold.

**Kevin Nicholson:** Exactly. There was then a discussion with HMRC, I understand, around settling that case. It was decided not to, and the taxpayer decided to litigate and then defend. All the way through to the appeal to the Supreme Court, which was, as you say, in 2012, there was presumably—I am sure there was—legal opinion to say that the case was not clear. That is why those cases take so long.

In terms of powers, as Jane referred to earlier, we not only have the DOTAS rules, which you talked about earlier, Madam Chair; we now have the general anti-abuse rule coming in. Also, the companies that we have talked about today are known companies. They are not sitting away in a cupboard somewhere that HMRC do not know about. HMRC can go and challenge them, they can ask them questions—they have many, many powers to investigate these people. I do not recognise the “game”, as you referred to it, Mr Mitchell.

**Q145 Austin Mitchell:** You are all engaged in a game of “Risk”, in which the odds are that you will win because the opponent is less powerful, less effective and certainly less well paid than you lot. Yes?

**John Dixon:** I think, with respect, you are underestimating the skills and quality of HMRC.

**Q146 Chair:** Are you all on seven-figure sums? Taking salary and bonuses—are they seven-figure sums? Yes.

**Bill Dodwell:** I'm not, no.

**Kevin Nicholson:** Yes.

**Chair:** Jane?

**Jane McCormick:** Six.

**Chair:** Are you seven or six?

**John Dixon:** Seven.

**Bill Dodwell:** Six.

**Q147 Austin Mitchell:** You are making money for your partnerships by playing a game of “Risk” in which the odds favour you.

**Bill Dodwell:** I don't think that is true at all. We are in the business of giving commercial advice to companies and individuals. We are certainly not—

**Q148 Austin Mitchell:** It could be bad advice, because it could be ruled out. You suffer no consequences; they do.

**Bill Dodwell:** Very occasionally that does happen, but it is extremely rare, as others have noted.

**Q149 Chair:** I want to turn us on to another issue. We are very interested in the relationship between all of the big four and Government. I am not talking about the actual contracts you do for Government, but your relationship. You sit on a number of things. For example, there is the tax professionals forum, which meets with David Gauke: Jane, you sit on that; Chris Sanger from Ernst and Young sits on it; the head of tax at Grant Thornton sits on it; a senior tax partner at one of the magic circle law companies sits on it; a QC sits on it. You are all in there, and my view is—I want to put these questions to Jane McCormick—that you used that close relationship in an inappropriate way. I will give you a specific example. Jonathan Bridges works for you, doesn't he?

**Jane McCormick:** *indicated assent.*

**Q150 Chair:** He was the lead policy adviser to HMT—on secondment—on tax and innovation, which included the development of the Patent Box. He gave the technical advice, advice which the IFS says will cost us £1 billion in tax relief. That is what we are told. KPMG then produced a marketing document, “Patent Box: What's in it for you?”. One of the team that is supporting you in that work is the very Jonathan Bridges who wrote the legislation.

What you suggest there is that the legislation becomes a business opportunity to reduce the UK tax burden. You will help clients to make “more economical use” of their tax losses, and so on. That document says that KPMG can help develop “best use of streaming—preparation of defensible expense allocation.” What seems completely inappropriate and wrong to me is that the guy who helped write the law goes back to you and supports your clients in using that law for a purpose for which it was never intended. The law was not intended to avoid tax; it was intended to support innovation. You are a poacher turned gamekeeper, and then you go back and you are a poacher again. That is shocking. I do not know what you want to say about it.

**Jane McCormick:** I would say a number of things. We are frequently asked by both Treasury and HMRC—it is not just KPMG; it is all of us—to provide technical support in various areas, but in particular where new legislation is being looked at. We do that, and it is useful. The people who do that do not set legislation, and ultimately they do not write the legislation.

**Q151 Chair:** You do. That is naive, if I can say that. I knew that you would say that you do not do the legislation. Of course in the end the legislation is agreed by Parliament—let us take that as common ground and accept that—but the so-called technical

support is you guys writing the legislation. I am not a tax expert. Very few of my colleagues around the table and very few of the people sitting in Bill Committees are tax experts. You guys are. You write the technical stuff and you then use the very stuff you have written to advise your clients on how to use the law and find loopholes in it to avoid tax. That was not the legitimate purpose for which this was intended.

**Jane McCormick:** In all of the work that we are currently doing on a Patent Box, we are working on a real-time basis with HMRC.

**Q152 Chair:** What does that mean?

**Jane McCormick:** Our clients, these days, are generally not taking a tax position and then arguing about it—this goes to your point, Mr Mitchell, about the length of time taken to agree things—because HMRC is moving towards real-time working for large businesses, which means discussing issues in real time, rather than after the event. Where we are talking about Patent Box, we are talking with HMRC in real time. The really big impact of Patent Box, which I am pleased to mention and which Jonathan has been very helpful in, is the amount of new business that it is attracting into the UK. That is exactly the purpose for which the legislation was put in place.

**Q153 Chair:** Are you sitting here and telling us that you are not selling this to your clients in the way that is suggested in what is, in effect, a sales leaflet? Are you saying that you are not selling it to a client as yet another opportunity, not to encourage innovation, but to use a loophole to avoid tax?

**Jane McCormick:** The purpose of the legislation is to—

**Q154 Chair:** I know what the purpose of the legislation is. I am completely clear on that. There is total universal support for the purpose of the legislation. My suggestion to you is that you exploit the purpose as yet another loophole and opportunity for people to pay less tax.

**Jane McCormick:** I would say that we are seeking to apply the legislation with our clients to fulfil the purpose of the legislation.

**Q155 Ian Swales:** But it is the spirit of the legislation, not just the letter, which is the key. We had an example in front of the Committee recently where a perfectly valid policy put in by the previous Government to encourage UK film production was being used in all kinds of ways. One adviser said that 50% of his schemes were for American films, so that had nothing to do with what Parliament intended. The Chair's concern is that we, having done something—perhaps naively—which we thought would encourage innovation, find people like yourselves riding a coach and horses through it and cleverly doing things that we never intended. What is your defence for that?

**Jane McCormick:** I appreciate your concern. The issue is that the legislation was intended to tax income arising from patents at a lower rate. Actually, how you get there is quite complicated; businesses taking advantage of that need quite a lot of support to do so.

**Q156 Chair:** Stewart, come in; but I will come back to you because you have also helped. There is another brochure here—Stewart, shall I deal with this first and then come to you?

**Mr Jackson:** Yes.

**Chair:** There is another brochure, the “Controlled Foreign Companies” sales document, where you invite clients to “Discuss with your auditors”—you—“their approach to reviewing your CFC position” with a view to reducing tax. Robert Edwards, who is a senior manager for corporate tax, was seconded to the Treasury, where he helped to develop the new CFC rules. Now he is back with you at KPMG and is a member of the team advising you on how to use these rules. I will quote from this document: “The Finance Company Exemption is an opportunity for additional tax efficiency”—I would say tax avoidance—“that is set out in legislation and should therefore not add UK tax risk to your group.” That is yet another area where Mr Edwards was seconded to the Treasury, wrote the rules and then went back to KPMG where he is now a member of the team who advise about how to use those rules as an opportunity to pay less tax.

**Jane McCormick:** Again, as I said, he provided technical advice. That gives him an insight—

**Q157 Chair:** He wrote the law.

**Jane McCormick:** As a matter of fact, no. But he gave technical advice to the team who did.

**Q158 Mr Jackson:** David Gauke is an intelligent chap; I believe that he was once awarded the title of “tax personality of the year”, which is something that I have never aspired to. I am sure, however, that he does not get out of bed in the morning and think that he is going to write a new tax law. Nor do most other Ministers and civil servants in the Treasury.

The problem is that there is an asymmetry here; as constituency MPs, we deal with small and medium-sized enterprises who often have tax disputes but cannot get through to HMRC. They do the right thing, though; they pay tax. Your clients—

**Ian Swales:** Some SMEs may well be competing with their clients for business.

**Mr Jackson:** Yes. One of the most egregious issues with Amazon was the fact that their lorries trundle around the UK delivering books to people, not paying any tax on our roads that have to be maintained, while small book sellers who do the right thing and pay tax are going out of business. That is one of the issues, and this is a similar issue. There is an asymmetry here in that your clients have, effectively, privileged access to the Treasury for you to go in and, at the margins, write some tax policies that benefit your clients.

Let's be honest: you do not have any vested interest in reducing the size of the tax code—turkeys do not vote for Christmas—whereas SMEs do want a smaller tax code. My specific question is, to go back to the word that Mr Nicholson used: are there Chinese walls between the collaborative role that you all have in working to develop tax policy with the Treasury, and the other, completely different, relationship you have in the regulatory and legal field, where you are effectively on different sides of the fence? I think it is very important, in ethical terms, that there is a

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distinction there, and that there is not too cosy a relationship between yourselves and HMRC and the Treasury.

**Jane McCormick:** The answer is that we have a very wide range of clients. I cannot remember the exact numbers, but well over a third of our business in the UK is what we call our national markets business. It is not the multinationals; it is UK business. Clearly we represent their interest as well. In terms of tax policy, there will always be tax and there will always be a need for tax advisers. When a tax rule changes there are very often winners and losers, so some people are better off and some people are worse off. It is for that reason that we do not normally have a particular vested interest in which way that goes. The advice we give in terms of tax policy is to inform Government about our view of how the proposed policy will impact on the commercial world. We represent small taxpayers—including, for example, the National Federation of Fish Friers—as well as multinationals.

**Q159 Mr Jackson:** But those small companies do not have direct access to the writing of tax policy. That is the issue. It may be all well and good that you support innovation, which was the principal determinant of this policy that the Chair made reference to, but it is also quite a nice, lucrative income stream for you. I think that is the issue of fairness across all business. Some people are perceived to have special access to the design and implementation of tax policy and others are not. You must concede that that is a concern in terms of public policy.

**Jane McCormick:** I must concede from what you are saying that there must be a perception of it, yes.

**Q160 Mr Bacon:** It is not just a perception. I had a bookkeeper come to see me in my surgery. He was a technical accountant—I think an ACCA cost and management accountant rather than a chartered accountant—but he ran a successful business with other partners. He advised people from corner shops and fish and chip shops up to retailers with a turnover of £15 million, so it was quite a wide range of businesses. He came to see me specifically to complain, and to let me know, that he had seen HMRC tightening the terms on his clients and making life tougher and rougher than he had seen previously in his career. It is not just a perception; there is something going on there that is real.

At the same time, there is not only a cosy relationship—arguably too cosy—between a lot of corporates and HMRC, but a cosy relationship that is mediated by you guys going backwards and forwards. So it is not just a perception. Mr Nicholson, you said earlier on, almost with a sigh of resignation in your voice, that if you look at the tax code it is 50 pages longer than ever before. I meant to ask you at the time, although there was not time to do so, whether you regard that as a problem. It is of benefit to your business, isn't it?

We sat down with a professor of tax at Harvard earlier this year, who was doing a symposium of several days with people from large corporates all over the US.

He said that the most depressing section of the entire symposium was when a tax partner from one of the big four came along—for all I know, one of you has been there and done it; Mr Dodwell, your eyebrows are going up and down.

**Bill Dodwell:** *indicated dissent.*

**Mr Bacon:** He said that the most depressing section of the entire symposium was when they set out how one of the big tax authorities such as HMRC or the IRS had introduced a new tax code or 500 pages of new legislation, and the tax partner from the big four firm explained to the attendees on the course what the firm did about it. The partner said, “We just add another circle to our decision tree, that's all.” There are so many decisions within any given tax arrangement, and that is why there are often disagreements for different reasons between first and second-tier tribunals and the Court of Appeal and all the rest of it. It just makes it more complicated. Whom does it benefit—there is a question here—when it becomes more complicated?

**Kevin Nicholson:** I am going to disappoint you, because I actually think that we should have a simpler tax system. The reason I say that, and I accept that it may sound strange, is that we grow as a business when our clients are growing. When they are successful there are transactions and there is business coming to the UK. That will be achieved by having a simpler tax system.

**Q161 Mr Bacon:** Hang on a minute. What is the answer to my question? Who benefits when it is complicated?

**Kevin Nicholson:** Nobody.

**Q162 Mr Bacon:** Well, hang on. Mr Dodwell is the chairman of the Chartered Institute of Taxation's technical committee. He has many jobs, as well as being on the panel advising on the general anti-abuse rules, which I am sure he performs very valuably with his great technical expertise, but they would not be there to perform were it not for this enormous complexity. That is the point. You all benefit in your businesses from complexity. Surely the reason you have hundreds of millions of pounds of revenue in the UK is that it is also complicated. At a philosophical level, I can quite believe that you are utterly genuine in what you say. Many of us share your view that a simpler, flatter tax system would promote economic growth and that we would all be better off. But there is a specific group of people who are getting the £659 million that you are getting, the £453 million that Deloitte is getting and roughly the same for Ernst and Young, and the £310 million that KPMG is getting—this nearly £2 billion in the system is from fees, some of which is compliance and some of which is from more complex advice—who would not benefit from simplicity. Those fees for advising on the complexity would go down, wouldn't they?

**Kevin Nicholson:** I would rather have the simpler system. Of the 686 pages of the last Finance Bill with another 600-plus of explanatory notes, very little was around people using the law wrong. It was about new incentives, so the Corporation Tax Reform, the Patent Box, which we welcomed as well, and the pasty tax.

I am talking about lots of changes in incentives to the tax system that are unnecessary.

**Mr Bacon:** Unnecessary?

**Kevin Nicholson:** Some of them would be, yes. Can I give you one example? Say we had in there a sunset clause so that every new piece of legislation had a finite time, and at the end of that time, say three or five years, it was reviewed, and if it was working as it was intended, it continues merrily, and if it wasn't, it was cut out. There is a start. Tinkering will not help us; it has to be something more radical.

**Ian Swales:** Presumably, you have heard of the Government's new Office of Tax Simplification.

**Chair:** It is a PwC guy who heads it up.

**Q163 Ian Swales:** Right. Do you know how many people it employs?

**Kevin Nicholson:** Too few.

**Q164 Ian Swales:** Do any of you know how many?

**Kevin Nicholson:** Is it two or four?

**Ian Swales:** I think it is six.

**Chair:** Some of whom are part-time.

**Ian Swales:** Okay. Perhaps four. Have any of you ever seconded anybody into there?

**Bill Dodwell:** Yes, we have, and I have just been asked to send somebody else. When we second someone, we get absolutely nothing back. There is no fee.

**Chair:** No, because you make a load of money in the way that Jane McCormick does out of then flogging it because you understand it, and understand the loopholes.

**Bill Dodwell:** The project we worked on was abolishing unnecessary legislation, so nobody made any money.

**Q165 Ian Swales:** What we have seen from that office is not what I hoped for, which was radical approach. What we are seeing is the deletion of reliefs that nobody uses. That seems to be what they are doing most of the time. Mr Nicholson, would you second somebody of weight and seniority into that office? If what you say is right, you should be prepared to invest some effort into it.

**Kevin Nicholson:** I would, as long as I was not then criticised for having had someone on the inside helping to change the legislation.

**Ian Swales:** Well, somebody helping to simplify things might be a good idea.

**Q166 Chair:** Amyas? Let us get in Amyas, and then I want to ask Mr Dodwell a question.

**Amyas Morse:** I think you are answering the questions very well and very openly. As I was listening, I was jotting down what I thought—I hope this does not sound like I am helping you with your advertising—you were bringing to your clients. I thought that with these interactions and secondments, you have a very good understanding of how HMRC at a senior level thinks about and addresses how it will apply all of the tax laws—is that fair? It is not wrong, but it is very major benefit to your clients that you can tell them exactly where the margin is, what is going to work and how it will work and what the

likely reaction will be so that they can gauge it exactly to the right point that they do not get into trouble and get as much advantage as possible. You understand, as we have established, the details of the legislation from the get-go. You know that if there is a loophole you will be in a position to take action on it quickly, because you know about it in advance. You understand the global tax system. It is a huge effort to understand all that. You can see where that is and steer people through it. Finally, if they get involved in fighting a tax case, you have the technical skills, knowledge, infrastructures and so forth to take on the Revenue over years and during that to support the legal teams that are doing it. Again, we know from our work with the Revenue that its capacity to take on these cases is really quite finite. It has only a small budget for fighting cases, so you know that it is not in a big hurry to take cases, are they? You know this because you are an ex-Revenue man.

**Kevin Nicholson:** Yes.

**Amyas Morse:** All I am saying is that you shouldn't be modest about just how powerful you are in the tax world, because you bring all these benefits to your clients. Am I summarising it fairly?

**Kevin Nicholson:** I would not agree with everything you have said, but I think you are saying that what we have comes with some responsibility. I agree with that.

**Q167 Mr Bacon:** I think you are being modest, and I share Mr Morse's view that you have been very candid. As you think tinkering will not work—something with which I completely agree, because I think this is an area where we need something more akin to a flame-thrower—would you go and work in the Treasury and be that flame-thrower for a year or two?

**Kevin Nicholson:** I don't know whether I have the skills.

**Q168 Chair:** At less than the salary the Prime Minister enjoys.

**Kevin Nicholson:** Mr Dodwell seems to have a few spare jobs going.

**Q169 Mr Bacon:** Perhaps he might give you one of them.

**Kevin Nicholson:** On that point, the reason I say I do not agree is that if you look at the short-term revenue shortfall—we all talk about that—there are long-term structural deficits. I think we in the UK—forget international—must be really clear about where the revenue will come from, will it be business tax, income tax, sales taxes, industry taxes, health taxes, or all those, and have a strategy around them rather than saying in three, four or five years we need some more revenue, we will add to this here and change that one slightly. It is very difficult in Parliaments with four or five-year elections. I understand that, but that is where we need to get to somehow.

**Q170 Meg Hillier:** Some of my points have been dealt with, but rather pertinently on that, I am the MP for Tech City. Mr Nicholson, you touched on the challenges of the modern world, and I represent

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emerging businesses. Google has a campus close by and a lot of work is done there, and with other new emerging businesses. In the current model, they can legitimately, whether or not it is a good thing, base themselves in Bermuda or wherever. If you have looked at the 20-year plan, what do you think could happen in the next five years that would make a fairer regime, as we would see it, for those modern internet-based companies where transactions are done in a completely different way? Have you any tips or suggestions for the Government?

**Kevin Nicholson:** One that is more commonly talked about and seems on the surface to be compelling is some form of formulaic apportionment. In other words, you take the global profit of a business and apportion it in some way. A common way of doing that, which the US uses for state taxes, is around three areas: employment, sales and capital. It is a system we should look at. It might work. The problem is that you still need international agreement unfortunately. You cannot do that without international agreement. Secondly, if you look at the US as a model, what tends to happen, depending on your state, is that if you employ a lot of people, you prefer to have more attributed to employment, and if you have a lot of sales, you have more attributed to sales. So you have to have some common view of what works, but that is an alternative that is being looked at. The OECD—John talked about this earlier—is another example of where we probably need to put more investment if we really want an answer. Bill may correct me, but I think the Government have put £150,000 into that project. We need to gear that up, because if we want quicker action and quicker advice, we need to give the OECD the power to do that.

**Q171 Chair:** Maybe if your clients paid a little bit more tax the Government would have a little bit more revenue with which to do lots of things with a tax bias, whether better advice on tax, schools, or hospitals. That is what it is all about.

**Q172 Meg Hillier:** May I finish on that, Chair? No one has made any comments, and I do not know whether they have anything to add. We look at what HMRC does, and I think whole chunks of Government are not up to speed with the way the modern world works. I look at the way businesses in my area—the Shoreditch tech businesses—work. They are fleet of foot doing a completely different business model not just in tax, but in other ways. Do you think HMRC has the skills—clearly not much money is going in? Is it possible to skill up—Mr Nixon, you raised America as an example—and are there other countries we could get good practice from?

**Bill Dodwell:** I think HMRC has improved substantially over the last five to eight years. Clearly, it has had to struggle with the merger of the two organisations, but I do not think there is much doubt that things like the large business service work very well. They have been effective at getting money in, and they have a decent understanding of the businesses with which they work.

The transfer pricing side of HMRC referred to is much more efficient and effective than it used to be. It

probably has room to be more strategic in what it looks for. Lots of data are no use, but trying to get to grips with what the key points are and then investing in bigger cases is the best approach, as one would expect.

**Q173 Austin Mitchell:** I wanted to raise the issue of principle. You in the big four kind of permeate HMRC and the Treasury. You provide staff to work there, and you have representatives on all the Treasury's tax development committees, including the general anti-avoidance measure, on which you are advising. You are not doing that just out of charity and a desire for public service; you are doing it so you can learn the mind of HMRC and know how it works—its faults, its problems and its inertias—so you can then go back and advise clients on what the problems are and which way to go about approaching HMRC. I can believe in gamekeepers turning poachers, because you buy up a lot of people from HMRC, and I can believe in poachers becoming gamekeepers, but I cannot believe in poachers becoming gamekeepers and then going back to poaching with an honest mind.

**John Dixon:** I think there are benefits in the work that we do with Government and with—

**Q174 Austin Mitchell:** Benefits to you.

**John Dixon:** No, benefits to the country at large. If you look at the quality of the legislation that we now have in front of us, recognising it is complicated, it is a lot better than it was 10 years ago. Why is that? Because we are actively working with Government, at our cost, to make sure that the legislative footprint we are working with is as clear and concise as it can possibly be. With respect, I do not think it is a one-way street.

**Q175 Austin Mitchell:** But there is also a gain to you, isn't there?

**John Dixon:** Absolutely. The more we can understand the mind of Government, the more we can help shape policy. It means that policy will be attuned to our clients, essentially, who are simply the businesses of this country. Therefore, it is hopefully win-win for everybody.

**Q176 Chair:** But it is worse than that, Mr Dixon. You sit on the Tax Professionals Forum, which oversees the implementation of tax policy, and you have audit clients such as ConocoPhillips and Talisman. It is on the record that you had a meeting with Ministers in September 2011 to lobby against the supplementary charge. You used your position on the Tax Professionals Forum to criticise the tax. You are pursuing your client interest and abusing the privilege of having an insider's role in the development of policy.

**John Dixon:** I am sorry, I don't agree with that perspective. That was covered in the press fairly recently, and I think our position on it is very clear. We are acting for the industry group in making representations to Government—

**Q177 Chair:** But you are using your position—a position that was opened to you by your membership

of a forum—to pursue the interests of clients who are paying you money.

**John Dixon:** No, we are actually acting for the group as a whole, and making sure that that group's views were heard in Government.

**Q178 Chair:** I don't agree. Can we move on to the issue of tax havens? You all have offices in most of the well-known tax havens: the Bahamas, the British Virgin Islands, the Cayman Islands, Luxembourg, Guernsey and Jersey. Why?

**Bill Dodwell:** Because there is legitimate and straightforward business taking place in those locations, and we—

**Q179 Chair:** The Virgin Islands have a population of 23,000. How many people have you got there?

**Bill Dodwell:** I have no idea. I don't even know if we have an office in that location.

**Q180 Chair:** The Cayman Islands have a population of 56,000. Perhaps you know the answer there.

**Bill Dodwell:** We have an office in the Cayman Islands, yes.

**Q181 Chair:** How many people do you have there?

**Bill Dodwell:** I do not know. I suspect it may be on our website.

**Q182 Chair:** How many do you reckon? You must know vaguely. Come on; it is not that big.

**Bill Dodwell:** Honestly, I have no idea. No, it is not that big, but what you find is—

**Chair:** But you are not taking business from—I have been to the Cayman Islands—all the people working in the hotels and restaurants there, are you?

**Q183 Austin Mitchell:** Can I just add that there are 3,389 directorships in the British Virgin Islands per 100 population. All those directors are going to need a hell of a lot of advice, aren't they?

**Bill Dodwell:** The only British Virgin Islands company I have ever come across was resident for tax purpose in a wholly different place.

**Q184 Chair:** What are you doing there? Come on, a little bit of honesty. Not economical with the truth, please.

**Bill Dodwell:** Start with the Channel Islands, close to home. The Foot report commissioned by the Treasury reported on the value of the Channel Islands in raising funds internationally.

**Q185 Chair:** What are you doing there? What are you doing there? What are you doing there?

**Bill Dodwell:** We are helping to audit those firms.

**Q186 Chair:** What, the local firms or the global firms that have a presence there?

**Bill Dodwell:** Both.

**Q187 Chair:** Are you there because of the local people, or are you there because of the global firms that you structure in such a way that they have a presence there?

**Bill Dodwell:** To support both.

**Q188 Ian Swales:** So 98 of the FTSE 100 companies have a subsidiary in a tax haven.

**Bill Dodwell:** Yes, that is a misleading statistic from ActionAid, and it is actually wrong. The reason it is wrong is that the biggest tax haven they allege is Delaware, which is one of the states in the US. All Delaware companies, like all US companies, are liable to US federal tax at 35%.

**Q189 Chair:** We have found the figures. It is wonderful, the internet. You have 160 people in the Cayman Islands, with a population of 56,000. What are the 160 staff doing? They are very high-paid people.

**Bill Dodwell:** They won't be doing tax work, will they? It will be auditing.

**Q190 Chair:** Auditing what—the hotels?

**Bill Dodwell:** The financial institutions there, and the funds that have their top structure there. Many hedge funds, as you may know, have a Cayman Island company at the top of the hedge fund.

**Q191 Mr Bacon:** It does not surprise me at all that you have 160 people there. I used to live in the Cayman Islands when I was a student. I spent three months working for the Government water project office, knocking on doors, asking people how often they flush their loo—only to be told that they didn't have one. I digress.

What was very clear to me was that, even then when there was only a population of 20,000—this was in the early '80s—there were over 500 banks there. It is probably significantly more than that now, with many, many other companies and law firms. That you have 160 people, I have to say, does not surprise me very much at all. It is also the richest place in the Caribbean, with a very high standard of living and a high standard of education, as a result of all the activity and the people who have gone there.

**Q192 Chair:** I put it to you that you are there to support those global companies and, sometimes, UK-based companies in ensuring that their taxable business is located in a tax haven. That is what you are there for, to help support that.

**Bill Dodwell:** The tax haven structures that you have been referring to before are a peculiarity of US multinationals and the way in which US law is designed to do it. I think, as Mr Nicholson said, under UK law—both the new law we have dealing with foreign companies and also the old one—you cannot escape UK tax if you have no presence in a location. Absolutely.

**Q193 Ian Swales:** "Panorama" showed just the other day the point that Mr Mitchell raised about all the companies over there. I think that they found somebody who had 12,000 directorships—the whole

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brass plate syndrome. My question goes back to something I asked earlier: in terms of the ethics of your organisation, would you recommend that a company sets up a structure there, even though they have absolutely no staff, no presence and it is a brass plate operated possibly by some of the 160 people who you employ there? Would you recommend that a UK company uses such as structure?

**Bill Dodwell:** No.

**Q194 Chair:** Do they? Do UK companies use tax havens? Do your UK clients use tax havens?

**Bill Dodwell:** Some UK clients will definitely use tax havens, yes.

**Q195 Ian Swales:** It has been well reported in the press. That figure of 98 out of the FTSE 100 companies, you actually said was wrong. Why did you say it was wrong?

**Q196 Chair:** It is an ActionAid report.

**Bill Dodwell:** It is, and when you look at it, the largest number of supposed tax havens are people using Delaware companies in the United States, which, by US federal law, pay tax at 35%. That is not a tax haven. The second biggest number of companies are people based in the Netherlands. We know that the Netherlands has some privileged tax regimes, some low tax regimes. Its basic rate is about 25%. It regards itself not as offering tax havens, but essentially offering facilities to businesses to base employment, jobs and development there. The third one is Ireland. Again, you will probably know that US multinationals use Ireland a great deal. They directly employ some 5% of the Irish work force and indirectly probably another 15%. Without that contribution, Ireland would probably be in even more trouble than it is.

**Q197 Ian Swales:** I actually accept that. I used to work for a company in and have visited Delaware quite a lot in the past, so I understand that point. I would like to know, however, how many of the FTSE 100 companies have subsidiaries in the tax havens such as the ones that the Chair mentioned. Not EU countries and not Delaware, but the type of places that the Chair was outlining: the Channel Islands; the Isle of Man; the Cayman Islands; Bermuda—

**Chair:** The British Virgin Islands—we know you have a presence there.

**Ian Swales:** You have obviously analysed this data. How many of the FTSE 100 companies have subsidiaries in countries that people in the room would regard as primarily there to be tax havens? How many?

**Bill Dodwell:** Places like the Isle of Man and Guernsey are commonly used by multinationals for something called captive insurance. That is a process where the multinational insures some of its risks and then places that risk in the general reinsurance markets. In order to have access to that, you need to approach it through an insurance company.

**Q198 Ian Swales:** Why do they do it there? Why would they want to do that in the Isle of Man?

**Bill Dodwell:** Because the regulatory aspects in the UK are so onerous that a wholly owned insurance company cannot easily operate—

**Chair:** Mr Dodwell, don't be naive. They do it to avoid tax.

**Q199 Ian Swales:** You are a tax expert and you appear to know a lot about this, so are you saying that this is entirely a matter for insurance?

**Bill Dodwell:** Can I just say, the profits of those captive insurance companies are specifically taxed back in the UK under the controlled foreign company rules.

**Mr Jackson:** Can I come in?

**Q200 Ian Swales:** Hold on. We must look at that comment. Won't the recent change in controlled foreign company legislation have the effect of not having that tax in the UK?

**Bill Dodwell:** It will if the risks they are insuring are wholly outside the UK. It will not be the case if they are insuring UK-based risk. If they are insuring UK-based risk, the profit will be directly taxed in the UK.

**Mr Jackson:** You notice that we are getting on famously with our coalition partners this week, Chairman.

**Mr Bacon:** Today anyway.

**Q201 Mr Jackson:** Yeah, today.

On that point about the onerous regulatory regime, Mr Dixon said recently that "the UK seems close to achieving its ambitions of becoming one of the most competitive corporate tax regimes in the G20. We know of more than 40 multinational companies that are looking to undertake global and regional headquarter...relocations into the UK, with 20 expected to complete in the next 12 to 18 months. And the momentum is building." I am therefore unsure that I am totally bought in to what you said about the market moving against the UK in terms of the tax regime.

I have a simple question. In earlier hearings, we heard about secret sweetheart deals between tax authorities in various jurisdictions, particularly the Dutch jurisdiction but also in Switzerland. Commendably, you have made some very progressive and interesting suggestions for greater transparency. Would you say that openness and transparency are key to restoring people's faith and trust in the system in that bilateral and multilateral agreements might in future oblige tax authorities to publish the specific relationships they have with companies such as Starbucks and Amazon?

**Bill Dodwell:** I think greater transparency would make a useful contribution. Absolutely.

**Q202 Chair:** Do you all believe that?

**Witnesses:** Yes.

**Q203 Mr Jackson:** Are there secret sweetheart deals between big multinationals and HMRC?

**Bill Dodwell:** The UK does not operate the type of ruling system that you referring to.

**Chair:** There are deals.

**Q204 Mr Jackson:** Has it hitherto?

**Bill Dodwell:** It has never entered that sort of ruling system.

**Q205 Mr Jackson:** But other European countries do.

**Bill Dodwell:** Yes.

**Q206 Chair:** Hang on a minute, I want to challenge that because we spent a lot of time on that. It depends how you define it, but I think it is very difficult to say that the Goldman Sachs negotiation was anything other than a sweetheart deal.

**Bill Dodwell:** I cannot, as you will appreciate, comment on a specific—

**Q207 Chair:** You can; it is all in the public domain: *Private Eye* and others did a very good job of that.

**Bill Dodwell:** I did read the report. The question I was dealing with covered advanced rulings where a company goes to a country, like the Netherlands, and says, “We’d like to do this. We would like an advanced ruling from you as to how this will be taxed.”

**Q208 Chair:** That happened with Starbucks. That is what they told us. That is what happened.

**Bill Dodwell:** Yes, and I am saying that that does happen, but the UK does not offer a similar such advanced ruling system.

**Q209 Mr Jackson:** The Dutch tax authorities get the tax income, but on the basis that they never reveal it, and therefore they are not accountable for their decision.

**Q210 Ian Swales:** On transparency, in the debate we had in the House on 7 January, Nigel Mills, I think it was, who is a tax accountant and MP—he was stood at the back of the room earlier, but he has gone now—proposed that corporation tax computations should be filed in Companies House along with the accounts of companies. Would you support such a move?

**John Dixon:** No.

**Q211 Ian Swales:** Why?

**John Dixon:** Simply because I am not sure a huge amount would be achieved. Tax returns are complicated documents. They are lengthy. We think there is a simpler way of providing greater transparency. I think we do need greater transparency in terms of information that is provided in the statutory accounts that actually condenses some of the information that would appear in the return, so we get the same benefit without the burden of clogging up the system with lots of—

**Q212 Chair:** Just explain that more, Mr Dixon. I do not understand that. I am a simple soul.

**John Dixon:** If you look at some of the work that the extractive industries for example are doing at the moment, and my colleague from PwC will recognise this, you will see that there is a trend looking at greater transparency appearing in statutory accounts, which actually tries to condense and provide information about the tax profile of a business in a

much bigger way than historically has been the case. That is something that we would welcome and recommend in preference to filing tax returns at Companies House.

**Chair:** Why? I would like to see tax returns.

**Q213 Ian Swales:** Do you think that global—we are now into the vision part—companies should have to report their turnover, profits and tax in each country in their reports?

**Bill Dodwell:** No, we do not support that.

**Q214 Ian Swales:** Why would you not support that?

**Bill Dodwell:** Really for the reasons that I think many of the chief executives and chairman of FTSE 100 companies have covered in their replies to, I think, Stephen McPartland. Essentially, they are pointing out the huge cost of it, the complexity and, in some cases, the commercial confidentiality, but I do think it is possible to reach a better system.

**Q215 Ian Swales:** I do buy the commercial one, but I do not buy the rest of what you said, because it is a bit like Amazon saying that it does not know its sales in the UK. You are not telling me that there is any global organisation that does not know its sales, profit and tax in the countries in which it operates. I do not believe it. It just cannot be true.

**Jane McCormick:** They clearly do know it, but gathering the data, particularly if you are relating them to cash tax, takes some time. The point there is that the problem with that proposal is that it is data, not information. Actually, even as a trained tax professional, looking at the raw numbers coming out of that would not necessarily give you a real picture of what is going on. For example, in a country where a lot of investment is going in, you may not be paying any tax because of the investment reliefs. I think there must be a better way of coming up with an explanation of what is going on.

**Ian Swales:** It is something that we will keep returning to, because transparency does drive behaviour and secrecy drives another kind of behaviour. In the tax world, we are way along the secrecy end of the spectrum, so even HMRC is not prepared to talk about cases.

**Q216 Chair:** On information, we have the Prudential HMRC judgment. This one is a real yes or no question: are you all going to reveal all the information you have now to HMRC?

**Kevin Nicholson:** I can give you an answer, but it is not yes or no, I’m afraid.

**Q217 Chair:** You are going to say no.

**Kevin Nicholson:** I do not think that yes or no is a helpful answer. I am happy to answer the question. The issue about Prudential was whether legal privilege should be applied to accountants and whether there was a fair playing field. It was not about disclosure of what had been done, but about the client’s advice—and it was the client’s advice. That case highlighted that Parliament needs to look at that inequality.

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**Q218 Chair:** Well, you want the law changed so you get the same legal privilege as lawyers. I understand that. I am saying that at the moment, the courts found that you do not have that legal privilege, so if HMRC ask you for information, are you now, in the interests of transparency, going to provide that information?

**Kevin Nicholson:** They have those powers now under section—

**Jane McCormick:** The answer to that is that we do not have legal privilege. It has never bothered me that we do not have legal privilege, precisely because if HMRC ask us for information, we give it to them.

**Q219 Chair:** So why did the Prudential case ever occur?

**Jane McCormick:** That was the client taking their position—

**Kevin Nicholson:** To be fair, it was around whether the privilege itself was a fair and equitable playing field for professionals. That was what the issue was about; it was not about whether the client wanted or did not want to reveal certain information.

**Q220 Chair:** Okay. I want to turn to another thing, then we will come to some general questions. I cannot remember exactly, but I think Danny Alexander, George Osborne and the Prime Minister are all looking at whether or not—I cannot remember his phrase, but I think the Prime Minister called you an army of something-or-others in his Davos speech—those companies that deliberately set about ensuring that tax is avoided should get contracts from the public sector. PwC have told us that their income from services provided to the public sector is £162 million. Deloitte's is £159 million, Ernst and Young's is £72.6 million, and KPMG's is £94.5 million, so you all get a not-insubstantial amount of money from the taxpayer, yet your main purpose in your tax businesses is to cut the tax that is paid to the Treasury for the common good. Do you think that you should be excluded from providing services to the public, funded from the taxpayer? Jane, why don't you start on that one?

**Jane McCormick:** Our main purpose is to help our clients calculate and pay their tax. It is generally—

**Q221 Chair:** I have just got to say that that is laughable. Nobody would pay your fees if they did not think you would help them pay less tax.

**Jane McCormick:** Well, I would happily take you through the breakdown of our income and where that actually comes from.

**Q222 Chair:** I wouldn't come to you—you'd be jolly expensive. I'd go to the accountant round the corner, who would be much cheaper. They come to you to minimise the tax, to put it politely—in my view, to avoid tax. Should you therefore be getting business from Government that is paid for out of the taxpayers' pound?

**Jane McCormick:** As I say, I cannot subscribe to the first part of the proposition. Absolutely, the Government come to us for advice where they need it and where we have the relevant expertise.

**Q223 Chair:** The Audit Commission abolition gives you all a tidy sum in audit fees, no doubt. Do you all think you deserve to get the business? Don't you come into that category of people who are deliberately devising aggressive tax avoidance and therefore should not be getting public contracts?

**John Dixon:** Our position, Chair, is that we feel that we are a professional, responsible organisation that advises clients on a whole range of issues. Between us, we are one of the biggest contributors to the UK Exchequer in the amount of taxes that we pay. We are experts and I think we have a valuable role to play in helping Government shape their policy.

**Q224 Ian Swales:** Are any of you financed from offshore? Is your UK business financed by controlled foreign companies?

**Witnesses:** No.

**Chair:** Does anybody else want to contribute? My view is that it is questionable whether you should be getting public—we talked about Chinese walls. I do not think that people who audit should be giving tax advice. I do not think people who give advice to cut the tax payable should be getting Government business. It is quite simple.

**Kevin Nicholson:** I am quite happy to say, as well, that I do not think we "deserve" it. I think that is the wrong word. We have an equal right to go through the procurement process. If we are the right people to add value to the Government, we should be chosen. We, the Treasury, HMRC and the OECD have all recognised that the role that we play makes the tax system work. Without the tax system working, there would be no revenue coming into the Exchequer, and we pay our taxes. As you heard, we disclose, in our accounts, our effective tax rate—47%. We paid a cheque for nearly £1 billion last year. I do not see any reason why we should not be able, if we are the right firm, to work on government contracts.

**Q225 Chair:** I think you are a bunch of really clever people. You are clever, well remunerated and very experienced, I have no doubt of that. What depresses me is that you could contribute so much to society and the public good and you all choose to focus on an area that reduces the resources available for us to build schools, hospitals and transport infrastructure. You choose that, and I do not get it. I do not know why you do it.

**Kevin Nicholson:** I cannot agree with that, as you will not be surprised to hear. I am proud of the work that our 3,020 people do—

**Q226 Chair:** You are proud of helping people avoid paying their tax?

**Kevin Nicholson:** And the 16,000 people, We help clients every day: help their businesses to grow, to employ new people, to invest in the UK economy—

**Q227 Chair:** You do not create these terribly complex structures which are all about avoiding tax?

**Kevin Nicholson:** I'm sorry, Madame Chairman, I don't agree.

**John Dixon:** I totally agree with Kevin. I am incredibly proud of my firm. I think we make a

fantastic contribution to our society, and therefore I disagree.

**Bill Dodwell:** We do it responsibly, I believe.

**Q228 Mr Bacon:** Does it ever occur to you that there is a moral basis to what you do: if your clients pay all this extra tax, you know full well, as we read in the newspapers this morning, that it will be used to compensate train operating firms for government cock-ups in the way franchises were awarded, or it will be used on computers that do not work; therefore, morally, by lessening the Government's ability to spend the money in these stupid ways, you are a placing a greater onus on Government to use the money it does have a bit more carefully?

**Jane McCormick:** Particularly at the moment, I think we probably all agree it would be good to collect more tax from business. Where we are perhaps disagreeing is how you do that. As for where we go with the UK regime, we are competing on a global stage to become the location where people put their business. If we can attract more business here, even if there is a lower corporation tax rate, and that results in more business and, even more importantly, more jobs, I hope everybody around this table would be happy.

**Chair:** I think everybody should pay their fair share, that's all, and paying one tax does not mean you do not pay all taxes. We all pay lots of taxes.

**Q229 Mr Bacon:** You mentioned a lower corporation tax rate. If I were sitting in a large worldwide corporate thinking what to do and I heard an announcement that the corporation tax was 24%, now it is going to be 23%, or it is 23% and now it is going to be 22%, I would hear that the direction of travel is a good one—it is going down rather than up—but at that tiny incremental level, would it make much difference to my decisions, given that in the end I am going to be paying a rate of probably a quarter or a fifth of that? Would it really make a lot of difference or is it just mood music?

**Jane McCormick:** It is. We are actually seeing that.

**Q230 Mr Bacon:** It does make a difference? It is good mood music that has an effect?

**Jane McCormick:** Yes, and the point is that businesses will not necessarily choose the option that is the lowest possible rate of tax. They will put the tax into the overall equation, and because the UK, I am pleased to say, has a lot of other advantages—our workforce, our infrastructure and so on—we do not necessarily have to go down to the lowest possible rate. The balance can be struck and we are seeing it.

**Q231 Ian Swales:** I would like to explore one area before we finish, which is about how you must work when you are in dispute. We get the public declarations where there are cases in court, and some get won and some get lost. I would like to know about the next tier, when you are getting close to litigation and you decide to settle. Ms McCormick, maybe you could think about such a case. I do not want to hear names of clients, I want to hear about the process. Your client owes a lot of money to HMRC, they say; it has been in dispute for five years or so, and you

start to think they are going to lose the case. Talk me through what actually happens—I am sure this must have happened, if not to you, then to somebody else.

**Jane McCormick:** I am sure it has. As a dispute goes on, we would be sitting with the client regularly reviewing where we are. As we say, the law, and particularly case law, changes, so it is quite possible that events will happen—cases will be decided—that have a direct bearing. So yes, that does happen. If we get to the position where we think that things have changed, we would advise and give our best advice, and often the client may choose to get a second opinion from someone else. Then the client will take a view, based on that advice, about whether they should proceed or not.

**Q232 Ian Swales:** Would you personally accompany the client to discussions at HMRC at that point? Is that a thing a tax partner would do?

**Jane McCormick:** If my client asked me to, but actually, most of my clients do not. They are big organisations and do not feel they need an adviser if they have to talk to HMRC.

**Q233 Ian Swales:** Have you ever been in one of those discussions?

**Jane McCormick:** I have been, yes, on occasions.

**Q234 Ian Swales:** Have you ever been in a “The amount in dispute is this, but they will settle for that” kind of discussion? In other words, has HMRC ever said, “If you pay us this, we'll stop litigating”?

**Jane McCormick:** No. Normally in these cases, you are into a complicated area of tax law, which is why there is a dispute in the first place. What you nearly always find is that there are not just one or two interpretations of the law, but three or four. So you sit there and work out the answer to “What can we agree is the best interpretation of the law?” and then you will assess what is the cost implication of that. That might come out as a number between—you know, there could be a whole range of numbers, depending on which analysis is correct.

**Q235 Ian Swales:** So you are trying to interpret the law and there are different sums. This may seem like a grey area, but surely it is an area where, if you agree that the law will win in court, why would it not be a black-and-white sum? Why would it not be zero or another sum?

**Jane McCormick:** I wish it was, but often it isn't, because there is not either this interpretation or that interpretation; there can often be three or four different interpretations.

**Q236 Ian Swales:** Have you ever been involved in a case where two items have been traded with HMRC? “We'll accept that interpretation, but we don't like that. Okay, let's agree on a trade here.”—that sort of thing?

**Jane McCormick:** No, there may be a number of matters outstanding and what you might agree in terms of the overall settlement is, “We can agree that that one, we are not going to dispute, because we think HMRC will win. This one, we will dispute, because

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we think we will win.” Everyone takes advice and then takes their position on whether that particular item would be won or lost. They agree on that particular item and then, obviously, you add up the total number.

**Q237 Ian Swales:** The key point here is: does the agreement of one item influence behaviour on the other items?

**Jane McCormick:** No, it doesn't.

**Q238 Mr Bacon:** How can it not? You are in a negotiation; in these cases, you go along with your client and say, “We've got a number of outstanding matters. There are three or four different interpretations. If we went for interpretation A, we would assign the following sets of values to the various matters under dispute. Under interpretation B, we would assign these values.” So you have, as you say, a range of numbers—an aggregate number that relates to interpretation A, and so on. You've got three or four different aggregate numbers, and in the end you cannot look at them in isolation. You way you are talking about it is holistically.

**Jane McCormick:** You are talking about settling a number of matters at the same time.

**Mr Bacon:** Yes.

**Jane McCormick:** But quite often, if you are in a situation where you are trying to settle a number of matters at the same time, you may say, “There are four outstanding issues. Actually, we could settle those three, but we can't settle that one. We'll take that one away,” and then you might litigate or do something else.

**Q239 Ian Swales:** The reason for the question is that, in these hearings HMRC steadfastly tell us that they do not do deals. I am just interested to know, from your point of view, whether it appears they do do deals. You are suggesting—

**Jane McCormick:** That they don't. I do not know what Goldman Sachs was, but—

**Q240 Austin Mitchell:** Two questions. One has just come in—somebody is obviously listening to this. “Dodwell is not telling the truth. Numerous court cases show that firms share a percentage of the tax dodged.” Is that right?

**Bill Dodwell:** There are some cases where a contingent fee is paid because the client wishes to do so, yes. That is true.

**Q241 Austin Mitchell:** Do any of you share a percentage of the tax dodge, or does the fee take that into account?

**Jane McCormick:** It does occur very rarely.

**Q242 Mr Bacon:** When you say, “wishes to do so,” do you mean that it is agreed in advance that, should you succeed in achieving x, your cut will be y?

**Bill Dodwell:** The cases I am aware of are where there is a claim for the recovery of tax overpaid and the question is whether that tax was indeed overpaid—what the legal principle on that is. If the court agrees,

I have seen cases where a percentage has been paid, but they are recoveries of tax overpaid.

**Q243 Austin Mitchell:** I think we should be grateful to you for subjecting yourselves to such a lengthy interrogation, and we are grateful. I walk in every day past the BIS building on Victoria Street. It is festooned with signs at the moment saying how great Britain is. It says that the universities are great, that innovation is great, that Richard Branson is great—it does not actually say that, but there is a picture of him—that companies are great and all the rest of it. You are a British industry. Why aren't all your faces up there saying that tax-fiddling is great or, if you care to put it another way, that tax avoidance is great, tax advice is great, or tax evasion is great? They all elide into one another.

Mr Nicholson has already given us a good answer on the morality of it, and he is proud of what he is doing, but the point is that there is still a massive effort on the part of those who can best afford it—rich companies and rich accountancy houses—to pay as little tax as possible. Is that really a worthwhile use of so much of the talent, ability and brain power in Britain?

**Kevin Nicholson:** Those signs on BIS are about companies coming to the UK. I spend a lot of my time competing not with the three colleagues alongside me, but with my counterparts in Ireland, Holland and other jurisdictions to encourage business to come to the UK. You say “rich clients”, Mr Mitchell, but we have 13,000 clients across the UK, including in your constituency or not far from it. We employ 70 people in Hull who work with local businesses that employ your constituents. That is the success of our business.

**Austin Mitchell:** Mr Desmond is not an incoming business.

**Chair:** He is outgoing.

**Austin Mitchell:** Very outgoing.

**Q244 Chair:** I want to ask the final question, because I think we have been around the houses enough. In your evidence and what you have said outside it, you often say that some of the activity that you engaged in 10 years ago was wrong—stuff that was found in the tribunals to have been wrong. I think it is fair to say of all of you that you accept that, and you will not repeat it.

**Bill Dodwell:** It was judged appropriate at the time it was entered into. With today's view, we would certainly not do it any more.

**Q245 Chair:** It was wrong. It was found to be unlawful. We agreed that. If we are sitting here in 10 years' time, as we all hope to be, don't you think you are going to be saying exactly the same about what you do now?

**John Dixon:** I do not think so, because the advice that we give is based on substance and facts. We try to make it as enduring as we possibly can. We stand by the values that are part of our firm. I think the world that you refer to has gone. That does not mean to say that tax is static; it is an ever-changing environment.

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31 January 2013 KPMG, Deloitte LLP, PwC and Ernst and Young

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**Ian Swales:** You are still using words such as “risk” and “probability” and those words have come out this morning. You are still talking about the risk and probability of things being okay, so some of them are not going to be. It will not be the same schemes; it will be something else in 10 years’ time. That is what you are saying, isn’t it?

**Chair:** In a way, it was a rhetorical question, Mr Dixon. I think you will.

I am going to stop it there. Thank you very much indeed for giving us the information and for helping us to put a bit of a spotlight on the work that you do.

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### Written evidence from KPMG UK

Thank you very much for your letter of 22 January.

In addition to the specific information requested we have included, as an appendix, some information about our internal governance procedures. We have also attached a copy of our internal UK Principles of Tax Advice (Tax Principles).

In view of the subject matter of the hearing we have also attached as an appendix some views of the current debate which may be of interest to you.

Some of the information provided is confidential in nature and we would be grateful if you would exclude the following from this written evidence before making it public.

- The second and third sentences of the answer to question 2.
- The answers to questions 3, 4, 5 and 6.

#### 1. *What was the scale of KPMG’s tax practice globally in 2011–12?*

- In financial terms.
- In terms of the number of employees.
- As a proportion of turnover.

In the year to September 2012 the aggregate reported income of the tax practices of KPMG International’s member firms was US\$4.86bn which was 21.1% of KPMG’s global turnover. There were approximately 1,850 tax partners and 21,600 tax professionals.

#### 2. *What was the scale of KPMG UK’s tax practice in 2011–12?*

- In financial terms.
- In terms of the number of employees.
- As a proportion of turnover.

In the year to September 2012 the reported income for KPMG<sup>1</sup>’s tax and pensions practice was £380 million. The turnover relating to tax was £310 million which was 17.5% of KPMG’s total turnover. There were 112 tax partners and 1,670 tax professionals.

#### 3. *What income did KPMG receive in aggregate from providing tax advice to multinational companies in 2011–12?*

KPMG is organised by function (Audit, Tax and Advisory) and market (financial sector, large corporates and regions). Within each of those markets there is a mixture of domestic and international clients. For example, many inbound multinationals are managed from regional offices because their UK headquarters are often outside of London. Therefore the income information which you have requested is not available, although we can advise that approximately £33 million of KPMG’s tax income relates to advice on international corporate taxation and transfer pricing. Of the remainder of tax income from corporate clients, approximately £100 million relates to tax compliance and the balance covers advice on indirect taxes, employment taxes, transactions and domestic tax.

#### 4. *What income did KPMG receive in aggregate from providing tax advice to high net worth individuals in 2011–12?*

The income from personal tax clients was £21.5 million of which £11.5 million is for compliance services. We cannot separately identify revenue from high net worth individuals.

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<sup>1</sup> References to KPMG in these responses refer to KPMG LLP, the UK member firm of KPMG International except as where otherwise specified.

5. *How many schemes has KPMG disclosed under the DOTAS rules in each of the last three financial years?*

KPMG made eight disclosures in 2009–10, four in 2010–11 and eight in 2011–12. To date, no disclosures have been made in the current financial year.

6. *What was KPMG's income from all the services it provided to the UK public sector in 2011–12?*

In the Government's 2011–12 financial year (ie April 2011 to March 2012), KPMG's revenue from all the services provided to the UK public sector was £94.5 million. This includes all revenue earned from central government (and related) bodies, local and regional government bodies, educational institutions and NHS trusts.

Since you asked us about our financial position we thought you would like to know KPMG's tax contribution in the UK. In the year ended 30 September 2012, KPMG paid £122 million in corporation tax, employers' national insurance and business rates. A further £184 million was paid to HMRC on account of income tax liabilities of the partners and £443 million of PAYE, employees' NIC and VAT was collected as agent for HMRC. In the interests of increased transparency on these matters this information will be published on our website later this year.

*Jane McCormick*  
Head of Tax and Pensions  
KPMG UK

## APPENDIX I

### KPMG TAX GOVERNANCE AND PRINCIPLES

#### 1. EXTERNAL REGULATION

1.1 In the UK the provision of tax advice is not a regulated activity and is provided by accountants, lawyers and those with relevant experience. However many of the professional bodies have a role in regulating the activities of their members. KPMG is regulated by, amongst others, the ICAEW. The ICAEW code of conduct requires that professional advisers act with integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. The ICAEW together with other professional bodies such as the CIOT and ICAS have developed a code specifically covering the provision of tax services and KPMG is in compliance with this code.

#### 2. GLOBAL CODE OF CONDUCT

2.1 In addition to external regulation KPMG member firms internationally apply a common Global Code of Conduct (Global Code) which govern how we run our business.

2.2 The Global Code lays out the expectations of ethical behaviour that KPMG expects of its people. At the heart of the Global Code are the KPMG values which define KPMG in the UK and KPMG member firms internationally; that we lead by example, work together, respect the individual, seek the facts and provide insight, are open and honest in all our communication, are committed to our communities and, above all, act with integrity.

2.3 The Global Code encourages KPMG partners and staff to act as role models, promoting ethical behaviour and ensuring that their actions reflect and reinforce the values. The Global Code constantly evolves in line with changes in regulation, law and professional ethics.

#### 3. TAX PRINCIPLES

3.1 In 2004, KPMG introduced the UK Principles of Tax Advice (Tax Principles) which codified and enhanced existing governance procedures. This was prompted in part by the ongoing investigation by the Department of Justice into the US member firm of KPMG International in relation to the sale of tax shelters in the US between 1996 and 2002.

3.2 The Tax Principles are KPMG's own code of conduct in relation to tax advice. They are a core element of our internal tax governance procedures. All advice that is given has to stand up to scrutiny in the context of these principles. They provide a framework for our UK tax professionals to assess the wider implications of our advice and promote consultation and discussion within the practice. The Tax Principles are regularly reviewed to ensure that they stay relevant and appropriate. In 2011 all KPMG International member firms adopted the global Principles for a Responsible Tax Practice to which the UK firm's Tax Principles were aligned.

3.3 Most recently in December 2012 a new principle was added to the UK firm's Tax Principles to recognise the importance of the intention of Parliament and the increasingly purposive approach by the courts.

3.4 Our Tax Principles are enclosed with this letter and will shortly be published on our website.

## APPENDIX II

### THE CURRENT DEBATE

#### 1. TAX AVOIDANCE

1.1 The issue of tax avoidance and what constitutes legitimate tax planning as opposed to aggressive tax avoidance is not a new one. The difference between the two is acknowledged as difficult to define. A recent paper by Oxford University Centre for Business Taxation encapsulates this complexity, “*Tax avoidance has no fixed legal meaning, although courts have sought to elucidate it in some cases and, for example, to distinguish tax avoidance from tax planning or tax mitigation. Matters are often complicated but not usually clarified by the addition of adjectives such as ‘aggressive’ ‘abusive’ or ‘unacceptable’.*”<sup>2</sup>

1.2 Ten to 15 years ago there was a demand for what are now clearly perceived to be “aggressive” tax strategies both at a corporate and personal level.

1.3 Corporate scandal, the resulting increased regulation and disclosure, together with public demands for accountability and socially responsible behaviour have changed this, we believe, permanently. In particular:

- Increased focus on corporate governance.
- A heightened awareness of the wider responsibility of business to society.
- Adverse publicity resulting in damage to corporate and personal reputations with the associated financial damage.
- OECD work on tax intermediaries and tax transparency.
- Initiatives such as the Joint International Tax Shelter Information Centre and bilateral sharing of information between countries.
- The Disclosure of Tax Avoidance Schemes (DOTAS) regime.
- The 2009 Banking Code of Practice.
- Other laws such as Senior Accounting Officer.

1.4 Tax planning has become a matter of reputational risk, for both the tax adviser who is perceived to be marketing tax avoidance schemes and for the taxpayer who implements them, particularly since such action is often or even inevitably described in the media as “aggressive” regardless of the substance of the arrangements. The reputational aspects of tax avoidance were recognised by Lin Homer in her evidence at the Public Accounts Committee in December.<sup>3</sup>

1.5 Looking ahead, the scope of the existing DOTAS regime is being extended which will provide HMRC with more real-time information about tax planning. Also, and probably of more significance, a General Anti-Abuse Rule is being introduced under which planning which is abusive will fail to deliver the intended tax benefits.

#### 2. INTERNATIONAL TAXATION

2.1 A critical part of the current debate is the perception that multi-nationals are not paying tax where the visible economic activity happens. Globalisation and new technologies have resulted in business models which were not anticipated by existing international protocols. We support the Government prioritising improvements to this part of the international tax system as part of its presidency of the G8.

2.2 There is a trend in international business to centralise business functions and asset ownership in one location. The choice of location is ultimately a decision for the corporation concerned but, in our experience, tax will be influential but will not be the determining factor.

2.3 HMRC recently stated that “*Globalisation means that multinationals have the opportunity to structure their business to take advantage of beneficial tax rules in different countries. Provided that this results in profits being taxed in line with where genuine economic activity is carried on, this does not amount to tax avoidance.*”<sup>4</sup>

2.4 Tax administrations introduce specific reliefs and incentives to attract international investment. The UK is part of that international competition for investment and recent law changes, such as the Patent Box regime have started to increase the UK’s competitiveness. In fact, many of our clients are looking at bringing more business activity to the UK.

2.5 The taxation of international transactions is complex and the interaction of different tax codes can create double taxation as well as double non-taxation. The UK has a raft of anti-avoidance rules which seek to ensure profits stay in the UK.

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<sup>2</sup> Tax Avoidance, Oxford University Centre for Business Taxation, 3 December 2012

<sup>3</sup> Uncorrected Transcript of Oral Evidence before the Public Accounts Committee on Tax Avoidance Schemes, 6 December 2012, responses to Q286, Q334 and Q335

<sup>4</sup> Taxing the Profits of Multinational Business, Issue Briefing, HMRC, October 2012

2.6 However, the transfer pricing rules, in particular, have not caught up with the technological age in which we now live, especially in the area of intellectual property, brands and the internet. HMRC's recent announcement of further investment in this area is welcome and necessary although this also needs action at a global level to be fully effective. The OECD has started work in this area but has warned that lack of co-ordination or collaboration could lead to *"increased possibilities for mismatches, additional disputes, increased uncertainty for business, a battle to be the first to grab taxable income through purported anti-avoidance measures, or a race to the bottom with respect to corporate income taxes"*.<sup>5</sup>

### 3. COMPETITIVENESS

3.1 The CBI has stated that in 2010–11 businesses operating in the UK contributed over a quarter of all tax collected.<sup>6</sup> Businesses generate employment and sales income which gives rise to PAYE and VAT. These taxes are collected on behalf of the Government but providing employment also creates additional costs in the form of Employer's National Insurance contributions which are borne directly by the business concerned.

3.2 We believe it is important that the Government maintains a competitive tax environment that offers both predictability and certainty and continues to encourage business to invest in the UK. The UK's tax code has a vital role to play in helping economic recovery through international competitiveness.

3.3 In 2010 the Coalition Government announced its aim was to create the most competitive corporate tax regime in the G20. The Government has done some valuable work in attracting international investment through new legislation and initiatives such as the new Controlled Foreign Companies and Patent Box regimes as well as a steady reduction in the headline corporation tax rate. The success of these initiatives is evidenced by the repatriation of a number of businesses which had previously re-located overseas. KPMG fully supports these aims and has been actively involved in HMRC consultations developing these initiatives.

### 4. TRANSPARENCY

4.1 Tax is complex and it is important that it is demystified. We welcome the current debate and the need for greater transparency that it has identified. As a firm we have been active in raising this issue with our clients and encouraging voluntary disclosure.

4.2 There are already some industries which proactively publish enhanced tax information, particularly the extraction industry. However, mandatory country by country reporting without explanation or context will not help address the issues or move the debate forward. We consider the way forward is for business, the tax profession and other relevant stakeholders to develop an approach that addresses the concerns but also improves understanding of the UK and international tax system and so rebuilds public confidence and trust in that system.

#### Written evidence from Deloitte

As requested, I set out below answers to the questions in your letter of 22 January 2013.

Deloitte draws up financial statements to 31 May; all information below is for the year ended 31 May 2012.

1. Globally, Deloitte member firms reported total revenues for 2011–12 of US\$31.3 billion. Our Global Report is at: [http://public.deloitte.com/media/0564/pdfs/DTTL\\_2012GlobalReport.pdf](http://public.deloitte.com/media/0564/pdfs/DTTL_2012GlobalReport.pdf)

Global tax revenues for 2011–12 were \$5.9 billion, and therefore represented just under 19% of global turnover. Worldwide, Deloitte member firms had 2,050 tax partners and 27,283 tax staff in 2011–12.

2. Deloitte's UK revenues, across all service lines, in 2011–12 were £2.33 billion. Our 2012 financial statements are available here: [http://www.deloitte.com/view/en\\_GB/uk/about/annual-reports/index.htm](http://www.deloitte.com/view/en_GB/uk/about/annual-reports/index.htm)

The reported turnover from UK Tax is £529 million, which includes fees billed by Deloitte UK to clients on behalf of other Deloitte member firms and out of pocket expenses. The fees earned by the UK Tax practice were £453 million.

3. The average number of UK tax fee-earners (partners and employees) during 2011–12 was 2,318. At 31 May 2012 there were 177 UK tax partners.

4. Deloitte derived aggregate UK tax revenues of £260 million from non-UK head quartered companies, the FTSE 100 and the FTSE 250 in 2011–12, which we think broadly approximates to multinational corporations.

5. Deloitte derived aggregate tax revenues of £22 million from private individuals in 2011–12 (which excludes any tax revenues earned for providing tax advice to companies controlled by entrepreneurs and other individuals).

6. Deloitte disclosed six schemes under the DOTAS regulations in the year ended 31 May 2010; seven schemes in the year ended 31 May 2011 and four schemes in the year ended 31 May 2012. We have disclosed one scheme since 1 June 2012.

<sup>5</sup> BEPS—A Background Brief, OECD, 20 November 2012

<sup>6</sup> HMRC, CBI Analysis, Tax and British Business: Making the case, CBI, 2012

7. Total UK net revenues earned from the UK public sector in 2011–12 were £159 million. Of these, £11 million, or 7%, were tax revenues.

Please let me know if you require any further information. I look forward to attending the Committee's evidence session on 31 January.

*W J I Dodwell*  
Tax Policy Group  
24 January 2013

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#### Written evidence from Ernst and Young

We refer to your letter of 22 January 2012 and set out below the information requested using your numbering for ease of reference.

In answering your questions we should like to bring to the Committee's attention that our management reporting systems do not segment clients into multinational companies, high net worth individuals or public sector. Accordingly, it is not possible to directly extract from our financial systems the figures for income received from these segments. We have not been able to perform a detailed analysis given the time constraints, but have used best endeavours to sensibly estimate the numbers requested and we provide some additional detail to aid your understanding.

Due to the global nature of our business, we deal mainly with large and medium sized and/or complex clients. Accordingly, the figures provided below assume that all income earned from corporate clients is in respect of organisations that have an international dimension to their business, ie they will all qualify as "multinational companies". Similarly, we have not attempted to split our income from individuals into high net worth and others, since high net worth is not a defined term.

For this purpose, multinational companies include UK headquartered or parented companies and UK businesses of foreign headquartered or parented groups. Furthermore, income from multinational companies includes income we earn from those companies in respect of services that relate to their employees, some of whom could be regarded as high net worth individuals.

Income earned from individuals as set out below relates solely to income earned directly from clients who are individuals and not companies.

The income quoted below for UK public sector includes central government departments, local public sector bodies and health trusts.

Responses to your specific questions are as follows:

1. *What is the scale of Ernst & Young's tax practice globally in 2011–12: The following figures relate to the 12 month period ending 30 June 2012*

(a) In financial terms: global tax revenues were \$6,011 million.

(b) Number of employees: tax employees globally were 29,118. Total employees globally were 151,841.

(c) As a proportion of Ernst & Young's global turnover: Global revenues were \$22,880 million, tax revenues therefore represented 26% of the total.

2. *What is the scale of Ernst & Young's UK tax practice in 2011–12: The following figures relate to the 12 month period ended 29 June 2012*

(a) In financial terms: UK tax fee income was £431 million.

(b) Number of employees: UK tax employees were 2,081, plus we have 180 Tax Partners.

(c) As a proportion of Ernst & Young's UK turnover: Total UK fee income was £1,631 million, tax thereby being 26%.

3. *Aggregate UK fee income for the 12 month period ended 29 June 2012 from providing tax advice (we have interpreted this term broadly to include both compliance and advisory services) to companies, the majority of which will have an international dimension to their business: £408 million*

4. *Aggregate UK fee income for the 12 month period ended 29 June 2012 from providing tax advice to individuals: £16 million*

5. *How many schemes has Ernst & Young disclosed under the DOTAS rules in each of the last financial years*

- (a) y/e 31 March 2010—seven disclosures.
- (b) y/e 31 March 2011—three disclosures.
- (c) y/e 31 March 2012—seven disclosures.
- (d) For completeness, since 1 April 2012 we have made two disclosures.

6. *What was Ernst & Young's income from all services it provided to the UK public sector in 2011–12: UK fee income for the fiscal year ended 31 March 2012 was £72.6 million*

*John Dixon*  
Partner  
UK&I Head of Tax  
25 January 2013

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#### Written evidence from PwC

Thank you for your letter of 22 January. My responses to your questions are below.

1. *What was the scale of PwC's tax practice globally in 2011–12?*

- In financial terms?  
Revenues for the year ended 30 June 2012 were US\$7,944 million (£5,027 million at today's exchange rate of 1.58).<sup>7</sup>
- In terms of numbers of employees?  
36,000.<sup>8</sup>
- As a proportion of PwC's global turnover?  
25%.<sup>9</sup>

2. *What was the scale of PwC's UK tax practice in 2011–12?*

- In financial terms?  
Revenue for the year ended 30 June 2012 was £659 million.<sup>10</sup>
- In terms of the number of employees?  
3,005.<sup>11</sup>
- As a proportion of PwC UK's turnover?  
25%.<sup>12</sup>

3. *What income did PwC receive in aggregate from providing tax advice to multinational companies in 2011–12?*

£322 million.<sup>13</sup>

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<sup>7</sup> Rethinking the future: PwC Global Annual Review p.43

<sup>8</sup> Ibid p.48

<sup>9</sup> Ibid p.43

<sup>10</sup> PwC UK Annual Report 2012 p.10. This figure consolidates our UK and Middle East practices and PwC Legal

<sup>11</sup> Closing headcount 30 June 2012 (FTE)

<sup>12</sup> PwC UK Annual Report inside front cover

<sup>13</sup> Combined tax practice revenues of our FTSE100 and Inbound segments including tax compliance and HR services.

<sup>14</sup> Private client tax practice revenues. Please note that this covers all personal tax advice and compliance and makes no distinction between High Net Worth Individuals (this is an HMRC definition) and other private clients.

4. What income did PwC receive in aggregate from providing tax advice to high net worth individuals in 2011–12?

£35.6 million.<sup>15</sup>

5. How many schemes has PwC disclosed under the DOTAS rules in each of the last three financial years?

Year ended 31 March 2010	10
Year ended 31 March 2011	9
Year ended 31 March 2012	6

6. What was PwC's income from all the services it provided to the UK public sector in 2011–12?

£162 million.

If you have any queries or would like to discuss the questions before the Hearing then please do not hesitate to call me on 01509 604232.

Yours sincerely

Kevin Nicholson  
UK Head of Tax  
25 January 2013

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#### Supplementary written evidence from Deloitte

At the evidence session yesterday, I promised to write with details of the profit Deloitte LLP's UK tax practice earned in the financial year to 31 May 2012. The figures below come from Note 3 to our audited accounts.

The UK firm's total Operating Profit was £633 million and the operating profit from tax services was £183 million—29% of this total. The profitability of the different service lines varies year-on-year. The Profit before Tax and provision for partner annuities was £560 million.

W J I Dodwell  
Tax Policy Group  
1 February 2013

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#### Written evidence from Ernst and Young

In response to Q24–25.

As set out in our response to Q22, we confirmed that the tax service line is a profitable part of the business. We can confirm that, having reviewed actual results, our tax service line is as profitable as two of our other service lines. Our fourth service line is currently less profitable than the other three.

John Dixon  
Managing Partner  
Tax UK & Ireland  
February 2013

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#### Written evidence from PwC

Question 4–5: Profitability of PwC (UK firm)'s tax business as a proportion of PwC (UK firm)'s profit

We confirmed to the PAC at the hearing that the revenue of our tax business represents 25% of the revenue of PwC (UK firm). We can confirm that the tax business of PwC (UK firm) represents 32% of PwC (UK firm)'s profit.

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<sup>15</sup> Private client tax practice revenues. Please note that this covers all personal tax advice and compliance and makes no distinction between High Net Worth Individuals (this is an HMRC definition) and other private clients.

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Question 55: *Number of transfer pricing specialists in PwC (UK firm)*

The number of transfer pricing specialists that we have in PwC (UK firm) is 115 FTE.

*Kevin Nicholson*  
Head of Tax

*February 2013*

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**Supplementary written evidence from KPMG**

Q34/Q36/Q44/Q67/Q69/Q70/Q71

On several occasions members of the committee seemed to think that there is no clear ground between tax avoidance and evasion. There also seemed to be some confusion over the legal consequences of a tax case being lost in court. Some members of the committee thought this meant that the taxpayer, and by inference the advisor, had acted in an unlawful manner.

There is a clear line between avoidance and evasion. Evasion involves deliberately concealing or misrepresenting facts and is a criminal offence. It would be a breach of the ICAEW's Code of Ethics, KPMG's Global Code of Conduct and our own tax principles.

If a tribunal or court finds against a taxpayer it means that the scheme in question was ineffective but not unlawful. The only consequence is the intended tax benefits do not arise. If, of course the position taken was negligent, tax geared penalties may apply. However, losing a court case does not mean the taxpayer or the advisor has been engaged in unlawful conduct.

Q56

I stated at the hearing that we had approximately 40 people in our transfer pricing group. This was the London based team. Across the UK there are six partners and 54 staff.

Q218

In relation to Q218, KPMG believes that issues are best resolved through openness and our policy is to provide information in response to reasonable requests from HMRC. We do not therefore see "legal advice privilege" as a common problem in practice.

We would always seek client consent before releasing our advice and any other client confidential information. The only exception to this is if we were under a clear legal obligation to do otherwise.

*February 2013*

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**Further supplementary written evidence from KPMG**

The table below ranks the relative profitability of our UK tax and pensions business for the last five years against our other business lines ie audit, transactions & restructuring, risk consulting and management consulting.

1 indicates the most profitable part of the UK business and 5 the least.

	<i>FY08</i>	<i>FY09</i>	<i>FY10</i>	<i>FY11</i>	<i>FY12</i>
Tax and pensions	3rd	5th	3rd	1st	3rd

*February 2013*

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