

HOUSE OF LORDS

Select Committee on Economic Affairs

1st Report of Session 2013–14

**Tackling corporate
tax avoidance in a
global economy: is
a new approach
needed?**

Report

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References in footnotes to the Report are as follows:

Q refers to a question in oral evidence.

Witness names without a question reference refer to written evidence.

SUMMARY

The UK faces a serious problem of avoidance of corporation tax, due in part to the complexity of the tax regime in the UK, but mainly because the international tax system gives multinational companies opportunities to shift profits between countries in ways that reduce their liabilities in the UK. This damages the economy and undermines trust in the tax system.

Under the present international framework of corporate taxation, companies operating globally can make their taxable profits arise in low- rate jurisdictions, such as Ireland and Luxembourg, even when their customers are in the UK or elsewhere. The amount of corporation tax a company pays in any one country, such as the UK, can be determined by how aggressively the company seeks to shift its profits to other lower-taxed countries. The effect is to make corporation tax payments in a given country largely voluntary for multinational companies. Starbucks' volunteering of extra payments in the UK after bad publicity is an example.

The UK and the G8 support the Organisation for Economic Cooperation and Development (OECD)'s Action Plan to tackle base erosion, published on 19 July 2013. It sets out a two-year programme to address the most egregious forms of tax avoidance. But it is not yet clear how effective the proposed solutions will be or whether they can be achieved within the timescale.

In the meantime, the UK faces the prospect of losing much-needed revenue through avoidance of corporation tax. There are also distortions in the market place: there is no level playing field between, say, a UK-based retailer which has to pay corporation tax in this country and a global rival selling here but paying corporation tax somewhere else at a lower rate.

Public concern about avoidance of corporation tax by multinationals, some of them British-based, has been heightened by a steady stream of stories in the media about companies paying little or no corporation tax in this country despite obviously doing good business here. Examples cited include the foreign-owned Google (investigated by the Public Accounts Committee of the House of Commons), Amazon and Starbucks, and the British-based Thames Water, Vodafone and Cadbury (before takeover by Kraft).

HMRC, the only public authority which sees tax returns, has not commented on these cases since bound by its duty of confidentiality to taxpayers. The only independent assessment of the performance of HMRC has been a review by the National Audit Office (NAO) of five settlements reached by HMRC. The NAO concluded that all five settlements were reasonable and successfully resolved multiple, long-outstanding tax issues.

A recent court case shed some light on how a settlement was reached between HMRC and Goldman Sachs. Mr Justice Nicol said "it was not a glorious episode in the history of the Revenue."

We decided to carry out a short inquiry to see how matters stood and to put forward proposals to help to reduce avoidance which the Government could adopt

itself at the same time as it pursues agreement to reform the OECD framework governing where multinational companies pay corporation tax.

We take the view that, since the Government devises, imposes and collects taxes, it is mainly for the Government to take measures against avoidance. But companies have a responsibility to pay their taxes. There are signs that some corporate taxpayers and their advisers realise that blatantly contrived avoidance is less and less acceptable to public opinion, to which the Government is accountable.

All our conclusions and recommendations are listed in Chapter 7. They are summarised below.

- We recommend that Parliament should establish a joint committee—made up of MPs and Peers—to exercise greater parliamentary oversight of HMRC and the settlements it reaches with multinationals. Like the Intelligence and Security Committee, the new Committee would examine confidential evidence in private.
- We recommend that the Treasury should urgently review the UK's corporate taxation regime and report back within a year with proposed changes to be made at home and pursued internationally, especially through the OECD.
- On the international front, we recognise that the Treasury are already working for early implementation of the OECD's Action Plan to tackle Base Erosion and Profit Shifting (BEPS). We recommend that the review should also consider other approaches to the taxation of multinational companies' profits, such as a destination-based cash flow tax.
- In the UK, we recommend that the review should re-examine some fundamentals of the UK's corporation tax regime, including differential tax treatment of debt and equity and the scope for introduction of an allowance for corporate equity.
- We recognise that the Treasury will already be working on policy initiatives against avoidance already announced by the Government, such as naming and shaming promoters of tax avoidance schemes, and self-certification of compliance with tax obligations by companies bidding for public contracts. We recommend that the review should also consider a series of anti-avoidance measures for the shorter term, such as:
 - (i) regulation of tax advisers;
 - (ii) measures to penalise users of failed tax avoidance schemes;
 - (iii) a requirement on companies with large operations in the UK to publish a proforma summary of their corporation tax returns, so as to bring about greater transparency.
- We also recommend that HMRC should be better resourced to deal effectively with the tax affairs of complex and well-resourced multinationals.

Tackling corporate tax avoidance in a global economy: is a new approach needed?

CHAPTER 1: INTRODUCTION

Why this report?

1. The UK faces a serious problem of avoidance of corporation tax, especially by multinational companies, even when they do large-scale business in this country.
2. We decided to look at how matters stand and what changes are needed. We launched our short inquiry in late March in response to public concern about corporate tax avoidance. We heard evidence from late April until mid-June. We are most grateful to all witnesses who gave written and oral evidence.
3. The British tax system has become very complex. There is also a complex international framework governing where global companies pay tax. Multinationals and the digital economy have a growing share of world business. The intricacies of national and international tax rules and the global nature of business offer scope to manipulate the system and to reduce or avoid corporation tax by shifting profits to low-tax jurisdictions. This fuels reliance on professional tax advisers. National tax administrations such as HMRC often seem behind the curve.

BOX 1

How multinationals can lower their tax bills

There are many ways in which companies can shift profits from the UK to lower-tax jurisdictions by various means including:

(i) Greater debt

A multinational can reduce its taxable profit in the UK by taking on debt through its British subsidiary. Interest payments on the debt would be tax deductible from British corporation tax. Subject to anti-avoidance rules, the British subsidiary can also borrow from an overseas subsidiary within the group to achieve the same effect.

(ii) Transfer pricing

Transfer prices—the prices at which parts of a multinational buy and sell goods and services to each other—are supposed to be on an arm's length basis, that is, the same price as they would buy and sell from/to independent third parties. But they can be manipulated to cut profits in the UK and raise them in subsidiaries in lower tax jurisdictions. Provisions on the statute book against artificial transfer pricing may not be wholly effective.

(iii) Royalties

Royalties can be paid among a multinational's subsidiaries for the use of intellectual property rights and brands. Royalty fees charged to UK

subsidiaries can be raised so as to cut profits in the UK and raise them in subsidiaries in lower tax jurisdictions.

4. Exploitation of differences or mismatches between national tax codes in a global economy can make payment of corporation tax in any given country a voluntary matter for multinational companies adept at manipulating the system. Starbucks in the UK is a case in point. It reportedly stated in June 2013: “We listened to our customers in December and so decided to forgo certain deductions which would make us liable to pay £10million in corporation tax this year and a further £10million in 2014.”¹ In other words, it took advantage of the rules to reduce its corporation tax liability in the UK to the minimum, then opted to make a voluntary payment in order to head off a consumer boycott.
5. The case of Starbucks shows that payment of corporation tax in the UK is sometimes a voluntary matter for multinational companies. Voluntary payments are not a sound basis for a system of taxation.
6. The House of Commons Public Accounts Committee (PAC) has reported on tax avoidance by Google.² It notes: “Google generated US\$18 billion revenue from the UK between 2006 and 2011 ... but ... paid ... just ... \$16 million of UK corporation taxes in the same period.” In 2012 Google’s UK revenue was about 10% of its global revenue;³ if the UK share of Google’s global profits was similar, Google’s net income in the UK in 2012 would have been about \$1 billion.
7. Avoidance of corporation tax causes loss of revenue to the Exchequer. It also means an uneven playing field for business in the UK, if home-based, home-market firms pay corporation tax while multinationals escape it. Flagrant avoidance also saps trust in the tax system as a whole. Sustained effective taxation depends on consent, which requires taxes to be broadly accepted as fair. In modern democratic societies where public spending ranges up to half of GDP or more, the concomitant high levels of tax make consent more grudging and more likely to be withheld if taxes are not seen to be fair.
8. Since governments devise, impose and collect taxes, they are mainly responsible for ensuring that taxation remains fit for purpose and free from defects which cost revenue and bring the system into disrepute. As Professor John Kay put it: “This week’s Group of Eight meeting produced denunciations of secrecy and tax havens. But the sources of the problem are not to be found in Bermuda or the Channel Islands. The activities that escape taxation take place in the G8. The correct starting point is the flawed structure and implementation of corporation tax in the G8 itself.”⁴
9. **It is primarily for the Government to correct the flaws in the UK’s corporation tax regime and to pursue agreement to make the international tax framework more rigorous. We recommend that**

¹ Terry Macalister, Starbucks makes £5m voluntary tax payment, *The Guardian*, 24 June 2013.

² Public Accounts Committee, *Tax Avoidance—Google*, (9th Report, Session 2013–14, HC Paper 112).

³ Google annual results for the year ending 31 December 2012.

⁴ John Kay, Don’t blame the tax havens—tax dodging is everyone else’s fault, *Financial Times*, 18 June 2013.

HM Treasury should undertake a comprehensive review of the operation of corporation tax in the UK, taking full account of the international dimension, and the competitiveness of the UK's economy, and report back with proposals to reduce avoidance, recover revenue, level the tax playing field between UK-based and multinational firms and restore trust in the tax system. We set out in the following chapters the main issues the Treasury's review should address.

10. The regulatory inadequacies of the present national and global corporation tax framework do not absolve corporate taxpayers and their advisers from responsibility for their actions. As Professor Kay also wrote: "Avoidance is facilitated and enhanced by corporate manipulation of the prices at which capital, goods and services are transferred across borders. The resulting accounts show profit being earned in low-tax jurisdictions in which little or no real business takes place. It is disingenuous for companies to claim they pay the tax legally due when their assessments are based on accounts that defy economic and business realities."⁵
11. **The present system is not working and urgently needs reform. We recommend that the Treasury review we propose should also consider a full range of interim measures against those who persist in blatantly contrived avoidance of corporation tax. We are confident that the Treasury will bear in mind as it conducts the proposed review that no one is obliged to pay more tax than laid down by the law.**

⁵ *Ibid.*

CHAPTER 2: CORPORATION TAX IN THE UK AND ITS INTERNATIONAL DIMENSION

The UK Corporation Tax

Why tax corporations?

12. Indignation over corporate tax avoidance reflects the view that corporations should pay their “fair share” of tax, and that full compliance by corporate taxpayers lightens the tax burden on individuals. Moore Stephens LLP expressed the contrasting, more usual, view that companies cannot actually bear tax burdens, but must pass them on to individuals: “Companies are artificial constructs, with no existence apart from the individuals who make up their shareholders, directors and workforce. They cannot ultimately bear the burden of taxation (or any other burden). The burden of the tax paid by the company is borne by shareholders in the form of reduced dividends, by employees in the form of reduced remuneration, by customers in the form of increased prices, or (if the company has enough leverage in the market) by suppliers in the form of reduced prices.”⁶ Malcolm Gammie QC agreed: “There is no such thing as a “fair share” for corporate tax, because companies do not bear the tax anyway.”⁷
13. There are however good reasons to tax corporations. One is to limit the scope for tax avoidance by individuals who might otherwise have a strong incentive to incorporate so as to escape personal income tax. Another is to draw revenue from non-resident shareholders in British companies. As Professor Kay and Mr Mervyn King (now Lord King of Lothbury) pointed out: “The easiest way of extracting tax revenue from British subsidiaries of foreign-owned companies and from shareholders of British companies who reside overseas is to have an independent corporate tax.”⁸
14. **Corporation tax is a significant component of HMRC’s portfolio of taxes and makes an important contribution to the UK’s total tax revenue.**

Origins

15. A tax on company profits has existed continuously since 1937. Before 1965, profits were subject to income tax at the standard rate and to an additional “profits tax”. The old system was replaced by Corporation Tax, introduced at a rate of 40% by the Finance Act 1965.
16. Resident UK companies and unincorporated associations such as trade unions are liable to corporation tax. Partnerships, sole traders, charities and the local authorities are not. Building societies and insurance companies are subject to special rules.⁹

⁶ Moore Stephens LLP.

⁷ Q11.

⁸ J.A. Kay and M.A. King, *The British Tax System*, Fifth Edition, 1990, p 174.

⁹ See K Bain, *Corporation tax*, p2 at <http://homepages.uel.ac.uk/K.Bain/company.pdf>.

Rates

17. In recent decades rates of corporation tax have steadily declined. During the 1980s the main rate fell from 52% to 35%, then during the 1990s from 35% to 30%. In 2008 the main rate came down to 28%, in 2011 to 26% and in 2012 to 24%. The Small Companies Rate (from 2011 the Small Profits Rate) also fell over the years, remaining lower than the main rate.¹⁰ In 2013 the Chancellor of the Exchequer announced that the main rate would be cut to 21% in 2014 and to 20% in 2015. He also announced that small company and main rates would be merged at 20% to give a single UK rate of corporation tax in 2015.¹¹ The Chancellor of the Exchequer has said he aims to achieve “the largest reduction in the burden of corporation tax in our nation’s history” so as to “compete with the world in our headline rate of corporation tax.” He contrasted the UK’s 20% rate (the lowest in the G20) with corporate tax rates in Germany (29%), France (33%) and the US (40%).¹²
18. The Government has also introduced a “patent box” under which income originating from patents owned in the UK will be taxed at 10%. It has relaxed anti-avoidance rules for controlled foreign companies¹³ (the CFC rules) so that interest received in subsidiaries in low taxed countries from lending outside the UK will only be taxed at 5.75%, a rule that KPMG has stated “gives UK based multinationals an opportunity to significantly reduce their tax rate”.¹⁴

Allowances and Deductions

19. Aside from rates of tax, one significant main feature of the UK’s corporation tax regime is the low (by international standards) rate of allowances for capital spending. A report by the Oxford University Centre for Business Taxation indicates that within all OECD and G20 countries, only one country—Chile—has less generous allowances than the UK.¹⁵ The UK’s corporation tax has a low rate but a broad base.
20. A second feature is the relative generosity of tax deductions for debt interest. As the Government has stated: “OECD countries’ tax systems generally recognise the distinction between debt and equity and give deductions for interest as a business expense ... The Government remains committed to interest being relieved as a normal business expense irrespective of where the proceeds of the loans are put to use ... The UK’s current interest rules, which do not significantly restrict relief for interest, are considered by businesses as a competitive advantage.”¹⁶

¹⁰ HM Revenue & Customs, *Corporation Tax Statistics*, October 2012, p16.

¹¹ HC Deb, 20 March 2013, cols 939–40.

¹² *Ibid.*

¹³ HMRC defines a controlled foreign company as follows: “A foreign company is a CFC if it is: resident outside the UK; controlled by UK persons; and subject to a lower level of tax”. See <http://www.hmrc.gov.uk/international/cfc.htm> .

¹⁴ KPMG, *Finance Company Regime*, August 2012.

¹⁵ See Katarzyna Bilicka and Michael Devereux, *CBT Corporate Tax Ranking 2012*, Oxford University Centre for Business Taxation Report, 2012.

¹⁶ HM Treasury & HMRC, *Corporate Tax Reform: Delivering a More Competitive System*, November 2010, p 14.

Other comparable countries tend to have more severe restrictions on such relief.

Revenue Yield

21. Table 1 shows that the UK’s yield of corporation tax as a share of GDP has been fairly steady in recent years and comparable with—indeed, generally higher than—that in other comparable OECD countries, although it may be precarious because of avoidance:

TABLE 1
Corporation Tax Revenues as % of GDP

Country	2005	2006	2007	2008	2009	2010	2011
France	2.4	3.0	3.0	2.9	1.5	2.1	2.5
Germany	1.8	2.2	2.2	1.9	1.3	1.5	1.7
United Kingdom	3.2	3.7	3.1	3.4	2.7	3.0	2.7
United States	2.8	3.0	2.6	1.8	1.7	2.5	2.4

Source: OECD Revenue Statistics

Mr Richard Woolhouse of the CBI told us that in the UK “the share of corporate tax receipts to GDP [had] held up pretty well despite falling headline rates”.¹⁷ This may be partly because allowances have tended to fall over time, thereby expanding the definition of the tax base. More importantly, profit has tended to increase as a share of GDP, so that lower rates have been applied to higher levels of profit.

22. The yield from corporation tax in 2012–13 was significantly lower than the three main sources of revenue: income tax, national insurance and VAT, as Table 2 shows. Corporation tax contributed 8.7% of total revenue in 2012–13—a little lower than the previous decade, when it was generally been between 9% and 10%.

TABLE 2
Contribution by tax to total HMRC receipts 2012–3 (%)

	Percentage of total HMRC Receipts, 2012–3
Income Tax	32.2
National Insurance Contributions	21.8
VAT	21.4
Corporation Tax	8.7
Petroleum Revenue Tax	0.4
Fuel duties	5.7
Inheritance Tax	0.7
Stamp Taxes	1.9
Tobacco and Alcohol Duties	4.2
Other	2.9
Total HMRC receipts	£468, 956m

Source: HMRC

¹⁷ Q35.

23. There is also evidence that most corporation tax revenue is raised from large companies: another Oxford University Centre for Business Taxation report indicates that 81% of UK corporation tax is paid by the top 1% of companies. Using data from the accounting records of 36,000 UK companies that were part of UK-owned multinationals and 30,000 UK companies that were part of foreign-owned multinationals, the report also indicates that between 1999 and 2009 these two groups made similar aggregate payments of UK corporation tax.¹⁸
24. Representatives of corporate taxpayers and their advisers argue that the corporate sector's total tax contribution is greater than corporation tax, since companies also pay other taxes. Mr Richard Collier of PwC told us: "There are now 24 taxes that apply to businesses and in an eight-year period, the ratio of corporation tax to other taxes has gone from 1:1 to 1:2."¹⁹ These figures come from research undertaken by PwC on the taxes borne by companies that are members of the Hundred Group.²⁰ The main other taxes assessed are employers' national insurance contributions, irrecoverable VAT and business rates. In total, PwC say that Hundred Group members contributed around £8 billion in corporation tax in 2012 and a further £16.8 billion in other taxes borne. If this ratio applied to all UK businesses, the proportion of total revenues paid by companies would be around 27%. As noted in paragraph 12 above, all of these taxes are ultimately passed on to individuals.

The International Dimension

25. One key issue that faces the UK and other national governments over corporate taxation is how the profit of a multinational company should be allocated to individual countries for taxation. The existing framework is extraordinarily complex, and has many flaws.
26. The original aim of the current system, first set out by the League of Nations in the 1920s, was to avoid double taxation of profits, where a company might be taxed on the same profits by two countries, so hampering growth and investment and damaging the world economy. Nowadays concerns are more about non-taxation, where companies exploit the provisions of the system that were originally intended to prevent double taxation or mismatches between countries in provisions, in order to allocate their profits to jurisdictions with a low tax rate or to avoid taxation altogether.
27. The present international framework of corporate taxation is based primarily on two main elements: a network of bilateral double tax treaties; and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

¹⁸ Michael Devereux and Simon Loretz, *Corporation Tax in the United Kingdom*, Oxford University Centre for Business Taxation Report, 2011.

¹⁹ Q58.

²⁰ PwC, *Total Tax Contribution: Surveying The Hundred Group*, January 2013.

Double taxation treaties

28. More than three thousand bilateral double tax treaties are in force, typically based on the OECD Model Tax Convention on Income and Capital. The OECD explains:

“International juridical double taxation—generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods— has harmful effects on the international exchange of goods and services and cross-border movements of capital, technology and persons. In recognition of the need to remove this obstacle to the development of economic relations between countries, the OECD Model Convention on Income and on Capital provides a means to settle on a uniform basis the most common problems that arise in the field of international juridical double taxation.”²¹

29. The UK claims to have the largest network of treaties, covering over 100 countries, which generally follow the OECD template. HMRC regards the purpose of double tax treaties as to:

- “protect against the risk of double taxation where the same income is taxable in two states
- provide certainty of treatment for cross-border trade
- prevent tax discrimination against UK business interests abroad

Double Taxation Treaties are also drawn up to protect the UK Government’s taxing rights and protect against attempts to avoid or evade UK liability. They also contain provisions for the exchange of information between the taxation authorities of states”²²

30. Double taxation treaties seek to set out which country can tax certain income. Broadly they aim to distinguish active business income from passive income such as dividends, royalties and interest. Treaties define what is an active business operation in a given source country (a “permanent establishment”) and give that source country the main right to tax the profits of that operation. By contrast, passive income is primarily taxed in the country in which the recipient resides.

Arm’s length transfer pricing

31. The second main element of the international tax system, the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, provides that transactions between national parts of a multinational company should be priced for tax purposes as though with independent third parties.²³ The OECD summarises its guidelines (which run to over 300 pages) as providing:

²¹ OECD, <http://www.oecd.org/tax/treaties/oecdmtcavailableproducts.htm>

²² HMRC, <http://www.hmrc.gov.uk/taxtreaties/dta.htm>

²³ Transfer pricing. The existing rules for determining prices at which within-group transactions are priced depend on assessments of the functions and risks of each party within the group. Holding more risk in one company, for example, is supposed to signify that a higher rate of return would be expected in that company. Yet shifting risk, as well as ownership of intangible assets, may be relatively easy, which means that the group can make its profits appear in low-taxed jurisdictions.

“guidance on the application of the “arm’s length principle” ... on the valuation, for tax purposes, of cross-border transactions between associated enterprises. In a global economy where multinational enterprises (MNEs) play a prominent role, governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdictions and that the tax base reported by MNEs in their respective countries reflect the economic activity undertaken therein. For taxpayers, it is essential to limit the risks of economic double taxation that may result from a dispute between two countries on the determination of an arm’s length remuneration for their cross-border transactions with associated enterprises.”²⁴

32. These OECD Guidelines were first introduced into UK law in 1998. The relevant UK law is now s.164 of the Taxation (International and Other Provisions) Act 2010 (TIOPA). HMRC states this section “provides that the legislation is to be construed in a manner that best secures consistency with” the OECD Guidelines, and that “this provides a principle for interpreting the legislation, but does not permit the OECD Transfer Pricing Guidelines to override the legislation”. Professor Picciotto considers s. 164 “.. undesirable and inappropriate. The root cause of the complexity is the unsuitability of the basic arm’s length principle. However, if it had been left as a general principle, I believe that it could have been interpreted flexibly through case-law, and could have evolved into appropriate profit apportionment methodologies. Regrettably, the OECD officials have been allowed to go their own way, free from any parliamentary scrutiny, and develop the increasingly complex and inappropriate Guidelines.”²⁵

Transparency and exchange of information

33. For some years, the OECD has also taken the lead in attempting to combat harmful tax practices. In 1998, it published a report which called on OECD members to introduce legislation to eliminate preferential tax regimes, and which also set out to eliminate similar regimes in a small group of countries which it labelled as “tax havens”. The ensuing process eventually led to the creation of the Global Forum on Transparency and Exchange of Information for Tax Purposes in 2009. The OECD states that “the Global Forum now has 120 members on equal footing and is the premier international body for ensuring the implementation of the internationally agreed standards of transparency and exchange of information in the tax area. Through an in-depth peer review process, the restructured Global Forum monitors that its members fully implement the standard of transparency and exchange of information they have committed to implement. It also works to establish a level playing field, even among countries that have not joined the Global Forum.”

Flaws in the existing system

34. A multinational company is not taxed as a single entity, but as a number of legally-distinct individual enterprises located in different countries.

²⁴ OECD, <http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm>

²⁵ Sol Picciotto, supplementary note.

Taxation of profit is very broadly where economic activity takes place. But that means that tax differentials between countries can affect the location of real economic activity. A recent survey found that a one percentage point fall in the cross-border tax rate faced by a company would lead to a 2.5% rise in inbound foreign direct investment.²⁶

35. In addition, multinational companies have some discretion as to where to locate profit for tax purposes. We received evidence that, on average, a one percentage point increase in tax rate difference leads to a 0.8 per cent fall in average reported pre-tax profits, as profits are shifted to other countries. The authors estimate that around 25% of this effect comes through financial channels.²⁷
36. Stories in the British media about corporate avoidance often refer to multinationals with US headquarters, reported as exploiting hybrid entities under the US “check-the-box” rules. But multinationals with UK headquarters have used similar devices—for example, the *Financial Times* has recently set out some of the devices used by Cadbury before it was acquired by Kraft.²⁸ Nevertheless, multinational companies—whether based in the UK or elsewhere—that aggressively manipulate their affairs to reduce tax may gain a competitive advantage over other companies that do not, as some of those disadvantaged have emphasised. For example, the Managing Director of John Lewis plc, Andy Street, recently stated publicly that “You have got less money to invest if you’re giving 27% of your profits to the exchequer than, clearly, if you’re domiciled in a tax haven and you’ve got much more. So they will out-invest and ultimately out-trade us.”²⁹
37. **The present international corporation tax system offers great scope for multinational companies to shift their profits between countries to reduce their tax liabilities and creates an uneven playing field.**

Compliance

38. The Government is committed to an internationally competitive low corporation tax rate, in order to promote inward investment and economic growth in the UK. It is also committed to ensuring taxpayers pay the tax that is due. Combating corporate tax avoidance, especially by multinationals, is already high on the political agenda. The Prime Minister said in January: “We want to use the G8 to drive a more serious debate on tax evasion and tax avoidance. This is an issue whose time has come. After years of abuse people across the planet are rightly calling for more action and most importantly there is gathering political will to actually do something about it.”³⁰ The G8 summit in June agreed several anti-avoidance initiatives, including support for the OECD’s work to

²⁶ Lars Feld and Jost Heckemeyer, “FDI and taxation: a meta-study”, *Journal of Economic Surveys*, 25.2, 233–272, April 2011.

²⁷ Heckemeyer and Overesch.

²⁸ Jonathan Ford, Sally Gainsbury and Vanessa Houlder, “Cadbury: The great tax fudge”, *Financial Times*, June 21, 2013.

²⁹ David Batty, John Lewis chief calls on government to tax multinational companies properly, *The Guardian*, 15 November 2012.

³⁰ Prime Minister, Speech to World Economic Forum, Davos, 24 January 2013.

tackle base erosion and profit shifting, work to create a common template for multinationals to report to tax authorities where they make their profits and pay their taxes across the world and agreement to publish national Action Plans to make information on who really owns and profits from companies and trusts available to tax collection and law enforcement agencies, for example through central registries of company beneficial ownership.³¹ G20 Finance Ministers and Central Bank Governors also fully endorsed on 20 July 2013 the OECD's Action Plan for Base Erosion and Profit Shifting (BEPS) published on 19 July.

Anti-avoidance measures already taken in the UK

39. Over the last decade, HMRC has been instrumental in introducing several specific anti-avoidance measures in the UK. These include a requirement on tax advisers to give notice of new avoidance schemes: Disclosure of Tax Avoidance Schemes (DOTAS), in 2004, which we heard has "... been effective across the board,"³² the introduction of measures to restrict cross-border arbitrage in 2005, and a General Anti-Abuse Rule (GAAR) in the Finance Act 2013.
40. Before examining these measures, it is useful to be clearer what is meant by "tax avoidance" Professor Judith Freedman and Dr John Vella distinguished three types of activity:
 - A. Ineffective avoidance, which can be combated under existing laws provided the activity is discovered and action is taken.
 - B. Effective avoidance, which reduces tax payable due to use of a defect in the legislation or other failure in the way that the legislation is written, that cannot be corrected by purposive interpretation.
 - C. Using legislation or the international tax system to one's advantage; although these cases have been described as avoidance, they do not involve the type of exploitation of defects in the implementation and presentation of legislation that come under category B."³³
41. The DOTAS rules require promoters of certain types of tax avoidance schemes, or in some cases users of the schemes, to disclose them to HMRC. The DOTAS regime has two objectives. Primarily, it is intended to ensure that HMRC becomes aware of potential avoidance schemes as early as possible. It is also intended to act as a deterrent to more egregious schemes. These rules are therefore primarily targeted at schemes falling into category A (paragraph 40 above), although they may also help to shift some schemes from category A to category B. HMRC claim DOTAS as a successful part of their multi-pronged strategy for dealing with tax avoidance. In 2011, Mr Dave Hartnett, then Permanent Secretary for Tax, described DOTAS as "our key and crucial tool for dealing with avoidance".³⁴ Most of the professional firms and the tax directors of large companies agreed that DOTAS had proved important,

³¹ G8 2013 Lough Erne, Leaders' Communique, 18 June 2013.

³² Q15.

³³ Professor Judith Freedman and Dr John Vella

³⁴ Economic Affairs Committee, *The Finance Bill 2011*, (4th Report, Session 2010–12, HL Paper 158), p. 33.

and that the number of disclosures in which they had been involved was now small.³⁵

42. Professor Freedman and Dr Vella point out however that the evidence in support of DOTAS is largely anecdotal; statistical evidence is limited. They argue: “HMRC’s claims that this is highly successful have to be set against the frequency with which DOTAS is being amended to make it more robust against avoidance, which suggests some concern as to its scope and operation. Further information is required to make a more meaningful assessment.”³⁶
43. Other witnesses pointed to the new GAAR as being an important new weapon in the armoury against tax avoidance. Under GAAR, when a tax arrangement is deemed “abusive” then HMRC can increase the amount charged to the taxpayer.³⁷ For example, Mr Frank Haskew of the ICAEW stated that the GAAR “is a decisive break with the past with regard to aggressive tax avoidance schemes, and that is clearly stated in the introduction to the guidance. People need to read that because it is a watershed.”³⁸ Mr Haskew reminded us that the GAAR was not designed to deal with exploitation of arbitrage opportunities in the international tax system: “The introduction also makes clear that the GAAR is aimed at abusive tax avoidance schemes but will not catch everything.”³⁹ The GAAR may address categories A and B set out in paragraph 40 above, but not C.
44. The anti-arbitrage provisions introduced in 2005, and now included in the Taxation (International and Other Provisions) Act 2010, are intended to combat tax arbitrage that exploits inconsistencies between provisions in different countries on, for example, the concept of residence or the definition of debt.
45. The 2005 anti-arbitrage provisions have been described as “probably the single most sustained legislative attack on international tax arbitrage that has been seen in this country”.⁴⁰ The rules primarily work by disallowing deduction which are not matched by a taxable receipt or where there is another deduction allowed for the same item of expenditure. When introduced, they drew criticism from professional bodies such as ICAEW and CIOT for taking on the role of global policeman.
46. In 2004, the UK also became one of the founder members, with Australia, Canada and the USA, of JITSIC (Joint International Tax Shelter Information Centre), which aims to deter promotion of an investment in abusive tax schemes, by sharing information, experience and best practices. Membership has since expanded to include China, France, Germany, Japan and Korea. In 2009, the then permanent secretary of the HRMC, Dave Hartnett, estimated that the sharing of

³⁵ Q65, Q97.

³⁶ Judith Freedman and John Vella.

³⁷ HMRC’s GAAR Guidance, page 6.

³⁸ Q37.

³⁹ Q37.

⁴⁰ Mark Boyle, Cross-border tax arbitrage—policy choices and political motivations, *British Tax Review*, 2005, 5, 527–543.

information by JITSIC members had “saved or prevented the loss of more than £1 billion for the UK alone in four years.”⁴¹

47. **HMRC maintain that new measures introduced over the last decade have had a significant impact on the tax avoidance industry in the UK. That view is broadly shared, although statistical evidence is limited. We welcome anti-avoidance measures such as Disclosure of Tax Avoidance Schemes (DOTAS), the anti-arbitrage rules and the General Anti-Abuse Rule (GAAR). The GAAR in particular has a relatively narrow focus. As we recommended in our recent report, “...every effort should be made to communicate, particularly to the press and the public, why the GAAR is not an appropriate mechanism to address all problems with the tax system.”⁴² We welcome HMRC’s revised guidance which makes the intended scope of the GAAR clearer.**⁴³

Corporate Tax Payers

48. Witnesses from major companies generally took the view that, although there was scope for improvement, corporation tax was an effective tax fairly applied and that use of tax avoidance schemes was in decline. Ms Helen Jones, senior Vice President, Global Tax, GSK, said “... corporation tax is not a voluntary tax”⁴⁴ ...“the UK system is certainly now a very good one.”⁴⁵ Mr Paul Morton, Head of Group Tax, Reed Elsevier, said “... the introduction of the [DOTAS] scheme has had a positive impact on reducing the number of avoidance schemes implemented”.⁴⁶ Mr John Bartlett, Group Head of Tax, BP, said “... the fundamentals of the system are not broken ...”⁴⁷ “... we are on the right path at the moment with corporation tax.”⁴⁸ Mr Bartlett denied that foreign-based multinationals enjoyed any tax advantage over home-based rivals in the UK: “... the rules here apply equally to domestic and overseas companies and my belief is that HMRC applies them fairly. BP does not harbour any view that overseas companies are getting any unfair advantage.”⁴⁹ Mr Richard Woolhouse of the CBI said “... having achieved a very attractive package in terms of attracting mobile activity to the UK, to start unpicking that now would be very damaging. We need to bed it down and we need stability around that system.”⁵⁰

⁴¹ <http://www.ion.icaew.com/TaxFaculty/16978>

⁴² House of Lords Select Committee on Economic Affairs, First Report of Session 2012–13, *The Draft Finance Bill 2013*, 13 March 2013.

⁴³ HMRC Guidance Note, 15 April 2013.

⁴⁴ Q18.

⁴⁵ Q29.

⁴⁶ Q25.

⁴⁷ Q18.

⁴⁸ Q32.

⁴⁹ Q29.

⁵⁰ Q41.

Tax Practitioners

49. We referred in Chapter 1 to the complexity of the UK tax system, which has fostered demand for professional tax advisers. Mr Bartlett said they were
“... advising us on how to do compliance in a more efficient way ...”⁵¹
We heard evidence from tax practitioners in law and accountancy and from tax specialists in the three main accountancy professional bodies. Like the large corporate taxpayers, they regard UK corporate taxation as broadly fit for purpose: Mr Steve Edge of Slaughter & May said “On the corporation tax regime, we have landed in a good general place where the system is attractive to people who want to bring investment into the UK.”⁵² Mr Chris Sanger of Ernst & Young said “We need to be careful not to undermine the sustainability of corporation tax because it is a tax that is here to stay.”⁵³ Ms Elspeth Orcharton of the Institute of Chartered Accountants of Scotland (ICAS) said there was “a need for the rules to be brought up to date rather than be reinvented”.⁵⁴ Mr Frank Haskew said: “Over the past ten years the incidence of tax avoidance has reduced.”⁵⁵
50. Mr Haskew emphasised that tax accountants operated ethically and responsibly according to a pan-professional Code of Conduct, now being updated.⁵⁶ Section 7 of the Code addresses tax avoidance, but is largely limited to a consideration of the difference between avoidance and evasion, and to identifying what is meant by “artificial arrangements”. It does not contain any suggestion that ethical behaviour by a tax adviser would require foregoing advising on aggressive or abusive tax avoidance.
51. The ICAEW offers advice to its members that appears to go well beyond the Code of Conduct. It states, for example, that “Although tax avoidance may be legal, whether something is within the law isn’t the only thing that matters. You are under a duty to take into consideration the public interest and at all times to comply with ICAEW’s Code of Ethics. This includes the requirements to uphold the reputation of the profession and do nothing to bring it into disrepute. You should act with considerable care when you advise clients in this area, particularly where tax avoidance schemes are involved. Beware of the potential reputational damage to the profession and the likelihood of problems developing further down the line. The boundary between legal tax avoidance and illegal tax evasion is not always clear and there’s a danger that what starts out as legal tax avoidance may slip into illegal tax evasion.”⁵⁷
52. Mr Haskew said however that aggressive avoidance schemes were often promoted by a small number of boutique firms not regulated by any professional body.⁵⁸ In the absence of any formal professional or

⁵¹ Q25.

⁵² Q80.

⁵³ Q50.

⁵⁴ Q42.

⁵⁵ Q39.

⁵⁶ Q45. The Code is at <http://www.icaew.com/en/members/regulations-standards-and-guidance/tax/professional-conduct-in-relation-to-taxation?utm=widget#ICAEW4>

⁵⁷ ICAEW Help Sheet, Aggressive tax avoidance schemes—what you need to bear in mind, July 2012.

⁵⁸ Q34.

registration of tax advisers “Even a turf accountant can provide tax advice” in the words of Mr Chas Roy-Chowdhury.⁵⁹

The Critics

53. Corporate taxpayers’ and their advisers’ broadly favourable view of the corporation tax regime in the UK looks self-serving. Critics took a very different view. They see a framework open to manipulation by multinationals to reduce their tax payments. Mr Richard Murphy of Tax Research LLP said: “The global taxation system is not workingif the state cannot charge tax on these companies, it has lost its power ...we are seeing ... a crisis of the taxation system.”⁶⁰ Mr Richard Brooks said: “The long-term solution has to be ... far more openness ... and the release of the tax authorities and the Treasury from the embrace of the large corporations, which are effectively driving the law.”⁶¹

The broader picture

54. While we were hearing the evidence of witnesses from business and its professional advisers that corporation tax in the UK is basically sound and fair, with broad compliance raising substantial revenue, and fewer tax avoidance schemes, there continued unabated a stream of allegations in the media about large, prosperous companies with substantial business in the UK which nevertheless paid little or no corporation tax, primarily by exploiting the international tax system. As well as the usual foreign-based multinational suspects, such as Google, Amazon and Starbucks, they include British-based firms like Thames Water, Vodafone (which Mr Richard Brooks also cited to us)⁶² and Cadbury (pre-takeover by Kraft). We do not know the full facts of these cases nor how typical they may be, because all firms’ dealings with HMRC (and with their tax advisers) are confidential. The reasons for low tax liabilities in these and other cases are therefore difficult to determine. But whatever the merits of individual cases, in the absence of convincing rebuttal public outrage and distrust of the tax system continues to be fuelled by stories of large-scale corporate tax avoidance.
55. **Business tax payers and their advisers share an interest in fostering the view that a complex but none-too-onerous corporation tax regime is for the best. But while companies are required to comply with tax laws in the UK and elsewhere, ways are open, especially for multinationals, to shift profits between countries so as reduce their overall tax liabilities, and to make UK corporation tax to a considerable extent voluntary for multinationals. This severely undermines public trust in the tax system, is clearly inequitable and threatens a serious loss of much-needed tax revenue.**

⁵⁹ Q34.

⁶⁰ Q66

⁶¹ Q66

⁶² Q74.

CHAPTER 3: WHAT CHANGES SHOULD BE MADE IN THE UK?

56. We set out here unilateral measures the Government could introduce to address the problems identified in the previous chapter. We begin with reform to the UK tax system itself, and then address issues of compliance by companies and their advisers.

Tax reforms

Reform treatment of debt & equity

57. As noted in the previous chapter, OECD countries' tax systems generally recognise the distinction between debt and equity and give deductions for interest as a business expense. This raises two questions. First, and more immediately, what anti-avoidance measures are required to combat excessive use of debt as a means of shifting profit out of the UK? Second, and in the longer run, there is an issue of principle: should debt be given preferential treatment over equity, and if not, how should the treatment of financial costs be reformed? Appendix 5 of this report discusses these issues in more detail.
58. There is a general view, shared by the Government, that anti-avoidance provisions with respect to interest relief are weaker in the UK than in comparable countries. In 2010, the Treasury stated: "The UK's current interest rules, which do not significantly restrict relief for interest, are considered by businesses as a competitive advantage and it is the Government's view that this advantage outweighs potential benefits from moving towards a more territorial system for interest."⁶³
59. In principle, a more territorial system would give relief only for borrowing that financed activity in the UK, reflecting the regime introduced in 2009 which aims primarily to tax only income generated in the UK. The Government sees the UK's relatively generous tax deductibility of interest payments as an important plank of British competitiveness in corporation tax. Many other features may also be important, including the patent box, generous treatment of expenditure on research and development, CFC rules, and above all the planned reduction of the corporation tax rate to 20%.
60. **The Treasury review should consider whether the international competitive position of the UK's corporation tax regime needs to be bolstered by generous tax relief on interest payments, which can lead to British businesses taking on excessive debt. It should also examine whether, and if so, how the Government should limit excessive use of debt, especially where it is used to finance foreign activities or to shift profits away from the UK.**
61. Beyond the immediate issue of profit shifting out of the UK there is a question of whether debt finance should be more favourably treated than equity finance. Tax practitioners favour retention of relief for interest

⁶³ HM Treasury & HMRC, Corporate Tax Reform: Delivering a More Competitive System, November 2010, p 14.

payments.⁶⁴ But critics believe it encourages excessive reliance on debt over equity financing, and makes corporation tax avoidance easier. They advocate reform of the tax treatment of debt and equity.

62. The IFS Mirrlees review advocated introducing an “allowance for corporate equity” (“ACE”) for equity finance. Broadly, this would equalise the treatment of debt and equity by giving a similar relief for equity finance, based on a notional return on equity invested. Professor Bond said: “The ACE allowance would provide tax relief for costs associated with using equity to finance investment: that is both retained profits and new equity issues. The basic idea is to level up the treatment of equity and debt sources. That obviously deals with the differential treatment of debt and equity.”⁶⁵ The cost of introducing such an allowance could however be large. The Mirrlees review estimated the cost as around one quarter of corporation tax revenue.⁶⁶
63. An alternative approach would be to give the same, but partial, relief for the costs of both debt and equity finance. In this case, introducing a partial relief for the costs of equity finance could be financed by an appropriate reduction in the rate of deduction for interest payments.
64. **In principle there is a case for harmonising the treatment of the costs of debt and equity finance. A full allowance for corporate equity is too expensive to introduce now given the current state of the public finances. But the revenue cost of partial relief for equity finance could be offset by a reduction in the rate of relief for debt finance. We recommend that the Treasury review we propose should investigate whether and if so how the treatment of debt and equity finance could best be harmonised.**

Other Unilateral measures

65. As outlined above, HMRC has a good record of introducing anti-avoidance measures. The OECD BEPS work aims to make coordinated progress on some areas in which the shifting of profits is particularly severe, such as arbitrage opportunities arising through mismatches in legal definitions between countries. There may also be scope for the UK to act unilaterally in two ways.
66. First, it may be possible to build on the specific initiatives that HMRC has introduced over the last decade—such as the DOTAS scheme, the anti-arbitrage provisions and the GAAR. We are aware that the new CFC provisions were introduced after extensive consultation, but they may have weakened the armoury in the fight against avoidance. **We recommend that the Treasury should review the statutory measures available to HMRC to combat tax avoidance and arbitrage arrangements, with a view to strengthening these where possible.**

⁶⁴ Q52.

⁶⁵ Q1.

⁶⁶ IFS Mirrlees Review, *Tax by Design*, p.449.

67. Second, it has been suggested that even within existing rules, HMRC could be more aggressive in dealing with large companies. Professor Picciotto said:

“If you take, for example, Google, ... HMRC could adopt an aggressive approach and say that Google’s UK entity is operating as, in effect, a branch of the Irish entity and reattribute profit to the UK. That would be ... possibly arguable under the rules, but [HMRC] is too genteel to do that, and it would also rather upset the apple cart of the existing system of rules which HMRC and Treasury people have done a lot to erect.”⁶⁷

He argued that other countries, such as India, China and Brazil, “are adopting aggressive approaches”.⁶⁸ He also accepted however that taking a more aggressive unilateral stance could lead to more cases being challenged: “The result is conflicting interpretations of the rules, so you can see in a way why HMRC has not wanted to go down that route If the system is broken, you do need to fix the rules, so in that sense I agree ... that it is better to fix the rules”.⁶⁹ Professor Freedman agreed, saying that although HMRC

“perhaps does not have enough transfer pricing experts, it does have some of the best transfer pricing experts ... The aggressive approaches that have been taken by the BRIC countries have caused difficulty. We are talking about double taxation agreements, so if one country unilaterally grabs more, then another country could get less ... you have to do this in an international and not unilateral way while you have a transfer pricing system.”⁷⁰

Addressing compliance

Naming & shaming

68. Public outrage can affect corporate behaviour, especially where reputational damage might lead to consumer action. It has been widely reported that Starbucks is to pay £20 million extra corporation tax in response to public indignation. On the other hand, Google’s response to being named and shamed by the Public Accounts Committee⁷¹ has been simply to call on governments to change the international tax rules.⁷² Nevertheless, mainstream tax advisers like Deloitte recognise that there is “pressure on taxpayers to demonstrate their contribution to society” and emphasise “management of taxes ...to deliver sustainable outcomes that are right for the business and that would still feel right should the media spotlight settle on them”.⁷³

⁶⁷ Q125.

⁶⁸ Q125.

⁶⁹ Q125.

⁷⁰ Q125.

⁷¹ Public Accounts Committee, *Tax Avoidance—Google*, (9th Report, Session 2013–14, HC Paper 112).

⁷² Eric Schmidt, Why we need to simplify our corporate tax system, *Financial Times*, 16 June 2013.

⁷³ Deloitte, *Responsible Tax, Sustainable tax strategy*, May 2013.

69. The Chancellor of the Exchequer announced in March 2013: “We will name and shame the promoters of tax avoidance schemes.”⁷⁴ The form, content and timing of the planned new measure are not yet known. Meantime, some doubt that promoters of aggressive avoidance schemes feel shame.⁷⁵ Some think naming and shaming legally questionable.⁷⁶ There is a question over the basis for any case of naming and shaming while only HMRC has the full facts and is bound by a duty of taxpayer confidentiality. There is also the general point that an on-the-ball government would normally change ineffective rules and penalise infringements rather than simply name avoiders.
70. **Where the Government sees a threat to the public interest from the manipulation of the existing legal and regulatory framework, the best response is for it to tighten up that framework. Naming and shaming is bound to be to a degree arbitrary and challenging to justify when the activity is within the law. So far as tax advisers and promoters are concerned, we await publication of the Chancellor of the Exchequer’s plans to name and shame promoters of tax avoidance schemes. We believe that an alternative to the Chancellor’s proposals is the establishment of a regulatory system, as outlined in paragraph 76 below.**
71. **So far as companies are concerned, public exposure did succeed in getting Starbucks to offer to pay more tax. The threat of naming and shaming represents a reputational risk to companies; and may therefore have the effect of encouraging boards to make sure that the companies they run are not using inappropriately aggressive tax avoidance strategies.**

Code of Conduct and Regulation of Tax Advisers

72. We welcome the prospect that the mainstream tax advisers’ Code of Conduct is soon to be updated to contain much more guidance on tax avoidance and to recognise public concern.⁷⁷ But we are sceptical that the revised Code will address our concerns about the need to combat aggressive and abusive tax avoidance.
73. The existing code does not apply to tax advisers who are not members of the relevant public bodies. At present, there is no requirement for tax advisers to be registered. Mr Roy-Chowdhury said: “You do not have to be registered. We professional bodies have been looking for a long time to have much greater recognition for professionally regulated tax advisers.”⁷⁸ HMRC issued a consultation paper on the role of agents in 2011,⁷⁹ and is currently reviewing how it deals with tax agents.⁸⁰

⁷⁴ HC Deb, 20 March 2013, col 940.

⁷⁵ Q34.

⁷⁶ Q87.

⁷⁷ Q45.

⁷⁸ Q34.

⁷⁹ HMRC, Establishing the future relationship between the tax agent community and HMRC, May 2011.

⁸⁰ See <http://www.hmrc.gov.uk/agents/strategy/overview.htm> for The Tax Agent Strategy.

74. HMRC state that “HMRC data suggests that there are approximately 43,000 firms in business providing support and advice to taxpayers. HMRC also works with ‘families and friends’ who act for an individual taxpayer and with various voluntary sector organisations who support those who would otherwise find it difficult to comply with their obligations. Together, these amount to up to a further 80,000 ‘agents’ who are authorised to act on behalf of another person”.⁸¹
75. The Public Accounts Committee proposed: “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.”⁸² The Government has stated its disagreement with the PAC proposal,⁸³ citing the CBI statement of principles⁸⁴ and the ICAEW Code of Ethics.⁸⁵
76. **We consider that a new system of regulation of tax advisers could be valuable in helping ensure that advice on tax matters is in accord with a strengthened code of conduct. We recommend that the Treasury and the professional bodies should urgently examine how such a system of regulation might be established and function, bearing in mind the many practical issues involved, including the form of a regulatory body and suitable sanctions for falling short of the standards required, which might include loss of the right to act as a tax adviser.**

Public procurement

77. The Government has proposed that companies seeking contracts for public procurement should self-certify that they had complied with their tax obligations. The Government published the results of its consultation on this proposal in March. It suggests that:

“for central government contracts advertised in the Official Journal of the European Union on or after 1 April 2013, potential suppliers to Government would have to self certify that they had complied with their tax obligations. Criteria were set out which, if satisfied, would indicate that a taxpayer had failed to fulfil such an obligation and could be excluded, or not selected. The criteria included a tax return being found to be incorrect by reason of the new general anti-abuse rule (GAAR), any targeted anti-avoidance rule (TAAR) or the “Halifax” abuse principle or because the taxpayer was involved in failed tax avoidance scheme to which the disclosure of tax avoidance schemes (DOTAS) rules apply.”⁸⁶

⁸¹ HMRC, *Establishing the future relationship between the tax agent community and HMRC*, May 2011, page 12.

⁸² Public Accounts Committee, *Tax avoidance: the role of large accountancy firms*, (44th Report, Session 2012–13, HC Paper 870).

⁸³ HM Treasury, *Treasury Minutes*, CM 8652, June 2013.

⁸⁴ See www.cbi.org.uk/media/2051390/statement_of_principles.pdf for Statement of Tax Principles.

⁸⁵ www.icaew.com/en/members/regulations-standards-and-guidance/ethics

⁸⁶ HMRC, *Tax and Procurement—Summary of Consultation Responses*, March 2013.

78. **We broadly welcome as a first step the Government’s proposals to exclude from bidding for public procurement contracts companies whose tax affairs are not in good standing. But we have concerns that they would apply only to companies that seek public contracts rather than treating companies equally under the law, and that procurement officers would have discretion over which companies to exclude. As with naming and shaming, there is no substitute for improving the tax code to reduce tax avoidance.**

Penalties

79. As things stand companies or their advisers run few risks in undertaking tax planning at the boundaries of the law, with an uncertain outcome, generally seen as aggressive or abusive tax avoidance.
80. A more direct sanction than e.g. naming and shaming would be to introduce penalties in cases where such planning was not accepted by the courts, even though fraud was not suspected: “where there is no trace of any concealment of the true facts of arrangements for which there is a respectable technical case, it is hard to imagine how a criminal offence can have been committed”.⁸⁷
81. The introduction of the GAAR may be useful in identifying where a case is not respectable. Where tax planning is deemed not to be reasonable under the GAAR, there may be a case for introducing a penalty. The proposal by Graham Aaronson QC for a GAAR stated: “In some jurisdictions there are provisions applying special penalty or rates of interest regimes to tax recovered under a GAAR. Including similar measures in a UK GAAR would certainly increase its deterrent effect, and may be regarded by a significant proportion of taxpayers as no more than just retribution for schemes designed to avoid paying a fair share of tax.”⁸⁸ Mr Aaronson nevertheless did not recommend penalties. One argument against them is that they could make the courts less likely to decide against a particular form of tax avoidance. On the other hand, the deterrent effect of a penalty could be useful in against aggressive and abusive behaviour. Some other countries that have a GAAR already use penalties.⁸⁹
82. **It is important that the GAAR should be effective. If the range of sanctions envisaged proves ineffective, we recommend consideration of the introduction of penalties for all taxpayers in cases that are found by the courts not to meet the “double reasonableness” test in the GAAR.**

Transparency

83. We asked witnesses whether legislation for companies to make public more information about taxes paid would help allay public concern (before publication of the Lough Erne G8 summit’s leaders’ communiqué, including its commitment to make extractive industry

⁸⁷ HMRC, *New Criminal Offence of Tax Fraud*, Inland Revenue Tax Bulletin, October 2000, page 783.

⁸⁸ Graham Aaronson, GAAR Study, 11 November 2011, par 5.47.

⁸⁹ See, for example, the case of Australia at <http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Large-business-and-tax-compliance-publication/?default=&page=67>

payments more transparent). Mr Steve Edge of Slaughter & May had doubts:

“My fear with transparency has always been that if you impose transparency for transparency’s sake but it does not really inform, you just impose administrative costs on people; and that you again create potential concerns for companies based in the UK that they are being required to put a lot of their confidential information out in the public domain, on profits made in particular areas. I am sure foreign predators or potential predators would love that.”⁹⁰

84. It seems unlikely that information made public on a company’s tax affairs would be full enough to enable, say, campaigners to second-guess HMRC on whether a company had paid enough UK tax. Even if full information were released, it would be extremely costly for anyone to use it to challenge an HMRC judgement.
85. Automatic exchange of information between tax authorities seems more likely to reduce scope for tax avoidance by multinationals. The recent G8 communique stated:

“Comprehensive and relevant information on the financial position of multinational enterprises aids all tax administrations effectively to identify and assess tax risks. The information would be of greatest use to tax authorities, including those of developing countries, if it were presented in a standardised format focusing on high level information on the global allocation of profits and taxes paid. We call on the OECD to develop a common template for country-by-country reporting to tax authorities by major multinational enterprises, taking account of concerns regarding non-cooperative jurisdictions. This will improve the flow of information between multinational enterprises and tax authorities in the countries in which the multinationals operate to enhance transparency and improve risk assessment.”⁹¹

86. **We recommend that the Government should actively promote implementation of the G8 proposals for improving the flow of information between tax authorities. As regards public disclosure, we recommend that large companies operating in the UK should make public disclosure of their UK corporation tax returns. We also recommend that the Treasury review should look at practical ways to require companies with large operations in the UK to publish a pro-forma summary of their UK corporation tax returns. This would help enable Parliament and the public to see if a fair level of corporation tax was being paid and when action against avoidance was needed. It might also act as a deterrent to aggressive tax avoidance by companies.**

⁹⁰ Q86.

⁹¹ G8 2013 Lough Erne, Leaders’ Communique, 18 June 2013.

CHAPTER 4: INTERNATIONAL REFORM

The OECD Base Erosion and Profit Shifting project

87. The OECD is working towards reform of its existing framework, based firmly on existing principles. Its first report on “Base Erosion and Profit Shifting” (BEPS) was presented to a G20 meeting in February 2013. That report lists some of the ways multinational companies use to avoid tax, notably on more aggressive forms of avoidance that can lead to non-taxation.⁹² It acknowledges that “the international common principles drawn from national experiences to share tax jurisdiction may not have kept pace with the changing business environment”, that “there is no question that BEPS is a pressing and current issue for a number of jurisdictions”⁹³ and that “it is also important to revisit some of the fundamentals of the existing standards”⁹⁴ of international taxation. The OECD’s plan of action for the next two years was published on 19 July 2013, after we completed our inquiry.
88. Mr Pascal Saint-Amans, Director of the OECD’s Centre for Tax Policy and Administration, told us “whatever the economic debate on the value of corporate income tax, there is no political maturity to move out of corporate income tax”⁹⁵, which we understand to mean a tax broadly in its existing form. He said:
- “That is the fundamental approach: taking nothing for granted, just revisiting the basics. Those basics include: the way you eliminate double taxation in the tax treaties; key definitions such as permanent establishment definitions, beneficial ownership definitions, and some others; the transfer pricing rules; and the arm’s-length principle—how does it work? Is it fine or not fine?”⁹⁶
89. Business witnesses broadly supported the OECD’s approach. Mr Paul Morton, Head of Group Tax of Reed Elsevier, said:
- “The OECD is supportive of refining and improving the current system based on the arm’s-length standard and the current definition of ‘taxable presence’, rather than starting afresh. Within that context, the suggestion is that we look carefully at ‘permanent establishment’, the attribution of profits to individual countries, the deductibility of some kinds of expenditure and other design features of corporate tax systems. For our part, we entirely agree that these areas should be looked at, particularly the definition of ‘permanent establishment’ and the allocation of profits between countries. The processes at the OECD are conducive to doing so in a thoughtful way, engaging the tax authorities of all members and non-members, as well as the business community through business organisations.”⁹⁷

⁹² Examples from OECD, Addressing Base Erosion and Profit Shifting February 2013, pp 40–42.

⁹³ *Ibid.* page 5.

⁹⁴ *Ibid.*, page 8.

⁹⁵ Q105.

⁹⁶ Q106.

⁹⁷ Q30.

Ms Helen Jones, Head of Tax at GlaxoSmithKline, said: “We should continue to support the OECD in giving more clarity to the international allocation of profits.”⁹⁸

90. Others were more cautious. Mr Bartlett of BP said:

“The fundamentals of the system are not broken. The arm’s-length transfer pricing still secures us an answer in 99 cases out of 100. Yes, there are uncertainties but usually, through the efforts of HMRC with other overseas taxing authorities, we reach a sensible outcome. Yes, there are sometimes uncertainties as to whether we are creating a taxable presence in some countries but, again, we normally reach a conclusion on these matters. The fundamentals still work for us.”⁹⁹

Mr Roy-Chowdhury feared reform might reintroduce double taxation: “We probably need to incrementally change the way that we tax profits but there are going to be winners and losers. Which jurisdictions are going to be willing to be losers? We need to ensure that we do not end up with double taxation for those businesses.”¹⁰⁰

91. Some witnesses did not agree that the OECD BEPS approach was the best way forward. Professor Bond said:

“There are some fundamental problems with [the OECD] approach ... it is a very artificial activity to seek to allocate the profits of a global business to different territories. It is not typically the way that businesses manage their affairs. In extreme cases, there is no right answer: if the only way profits are generated is the result of multiple activities taking place in two or more locations, and without each of the activities there would be no profits, then there really is no logically correct answer as to how you divide up the profits between the different activities in the different locations.”¹⁰¹

92. G8 leaders agreed at Lough Erne on 18 June 2013 to “support the OECD’s work to tackle base erosion and profit shifting. We will work to create a common template for multinationals to report to tax authorities where they make their profits and pay their taxes across the world”.¹⁰²

93. **We agree that fundamental reform of the international tax framework should be pursued in the OECD. As things stand, there are too many opportunities for multinational companies to manipulate their affairs to reduce their global tax payments. Corporate manipulation of the system so as to avoid taxation reduces governments’ revenues, undermines public trust in the tax system. We recommend that the Government should continue to play its full part in encouraging the OECD’s reform agenda to an early successful conclusion. At the same time the Government—and the Treasury review we propose—should explore the scope for more radical alternative approaches to corporate tax.**

⁹⁸ Q32.

⁹⁹ Q18.

¹⁰⁰ Q42.

¹⁰¹ Q8.

¹⁰² G8 2013 Lough Erne Leaders’ communiqué, 18 June 2013, paragraph 3.

Options for radical change

94. Even if the OECD BEPS project is eventually successful in reducing—or even eliminating—the most aggressive aspects of multinational tax avoidance, many problems surrounding the international taxation of companies will remain. By allocating taxing rights for different forms of income—retained earnings, dividends, interest and royalties—differently, and by having complex and arbitrary rules for the allocation of profit between countries, the system will always invite multinationals to take taxes into account in their decisions where to locate. Differential rates and tax bases between countries will affect the location of real economic activity and of taxable profit. This chapter considers two possible alternative options to the present international framework: a unitary tax, and a destination-based tax.

Unitary taxation

95. A unitary tax is perhaps the best known radical alternative to the existing system. Professor Sol Picciotto of Lancaster University said:
- “What is needed is a new perspective, a new way of looking at multinational companies ... When you think of a company like Google, it looks like a unitary entity. But from a legal point of view, they actually consist of hundreds of different individual companies. Instead of trying to treat them as if they were independent entities in different countries, the perspective should be to accept that they are unitary entities and build on that.”¹⁰³
96. The European Commission’s proposal for a Common Consolidated Corporate Tax Base (CCCTB) would be a form of unitary tax. Mr Philip Kermode of the European Commission said: “We take it as a single economic entity. The multinational is an entity and therefore the attribution of the profits is done in a formula way.”¹⁰⁴
97. CCCTB would work on the basis of formula apportionment. Instead of complex rules to identify profit arising in each country, a multinational company’s global profits would be divided between countries for taxation purposes according to an agreed formula. Professor Picciotto wrote: “It should be stressed that this approach [formula apportionment] does not seek to *attribute* profit, since it assumes that the profits of an integrated firm result from its overall synergies, and economies of scale and scope. It *allocates* profits according to the measurable physical presence of the firm in each country.”¹⁰⁵
98. In the CCCTB proposal, EU member states would be free to charge tax at any rate of their choosing on their allocation of profit. The most commonly favoured formula is based on the location of tangible assets, employment and the destination of sales. Some have argued that intangibles, such as intellectual property, patents and brands, by their nature highly mobile, should be part of the formula. But including them in the allocation formula of a unitary tax would be to invite multinational

¹⁰³ Q116.

¹⁰⁴ Q105.

¹⁰⁵ Professor Picciotto, paragraph 18.

companies to hold them in low-taxed jurisdictions. Mr Kermode said: “We examined the idea of putting intangibles in the formula, but if you do that, you create the opportunity to manipulate it.”¹⁰⁶

99. Tax practitioners expressed reservations about unitary taxation with formula apportionment, for example that the nature of the corporate entity would be altered by its tax treatment. Mr Chris Sanger of Ernst and Young said: “Whether you insource or outsource the activity, that would change the allocation.”¹⁰⁷ And formula apportionment is criticised as unlikely to reflect the “true” location of profit. Mr Steve Edge of Slaughter & May argued: “The thing you can say about apportionment is that it will produce a consistent answer but consistently the wrong answer.”¹⁰⁸ That view assumes the existence of a “true” location of profit. A different view is that multinationals make higher profits because they operate internationally and the benefits cannot be allocated directly to any location. As Mr Kermode put it: “The group is more than the sum of its parts.”¹⁰⁹
100. The Government is sceptical of the EU Commission’s proposals for CCCTB. Mr Fergus Harradence, HM Treasury, said: “We have a number of concerns about it which we have expressed to the Commission and other member states. ... The first problem ... you in effect require countries to operate two tax systems with different rules... also very unclear exactly what the formula would be ... real scepticism about the benefits of this initiative.”¹¹⁰ Mr Edward Troup of HMRC said: “Formula apportionment... has not been a great success even in those countries which have sought to apply it ... The challenges ... are how you design the CCCTB formula apportionment basis and also how you get there from here, given how established the transfer pricing approach is in most of the countries of the world.”¹¹¹
101. Whatever the benefits of moving to a unitary system, Professor Freedman identified three significant obstacles: “First, you have to agree the base, then you have to agree the allocation, then you have to agree who is going to administer this.”¹¹² It seems clear that reaching agreement on all three would be formidably complex and difficult within the EU, let alone more widely, raising tricky issues ranging from accounting standards to the scope for manipulation of formula apportionment based on sales, as Professor Picciotto,¹¹³ and Professor Auerbach noted.¹¹⁴ Problems could also arise from a mismatch of skills and resources between national tax authorities administering a unitary system, even if the obstacles to setting one up could be overcome. Even then, if some countries stay outside the system, rules would be needed as to how profit would be allocated between the unitary area and other countries, probably based on the

¹⁰⁶ Q112.

¹⁰⁷ Q53.

¹⁰⁸ Q83.

¹⁰⁹ Q112.

¹¹⁰ Q141.

¹¹¹ Q141.

¹¹² Q122.

¹¹³ Professor Picciotto, paragraphs 15 & 17.

¹¹⁴ Professor Auerbach, paragraph 8.

existing arm's length approach. As Mr Ashley Greenbank noted: "You would not escape having to transfer price into and out of the area."¹¹⁵

102. **A unitary tax system treating multinational companies as single entities in a global economy is attractive in theory. But there would be formidable difficulty in reaching global agreement, or even within the EU, on a common tax base, let alone on the appropriate allocation.**

Destination-based tax on corporate cash flows

103. Another radical reform would be to tax corporate profit where goods and services are sold to a third party. A tax levied on profit in the customers' country would mean that companies could not easily shift their tax base. As Professor de la Feria stated: "Customers are not easy to move and there is nothing that a company can do to move the customer: the customer base is where the customer base is."¹¹⁶ This is generally known as a destination-based tax, as proposed in a submission to the IFS Mirrlees Review.¹¹⁷
104. A destination based tax would be broadly similar in effect to VAT, in that VAT is levied in the country of the consumer (the destination country) rather than the country of the supplier (the source or origin country). As with VAT, exports would be zero-rated for the tax, but imports would be taxed. This introduces an asymmetry, common also to VAT: income would be taxed in the country of residence of the customer to whom the good or service is sold, while expenditure would be allowed against tax in the country in which it is incurred. Under such a tax, cross-border transactions within a multinational would not ultimately affect the company's tax base.¹¹⁸
105. Proponents of a destination-based tax argue it should be enhanced by also switching the tax base from profit in company accounts to cash flows on real activities: that is the tax would be levied on all income from real transactions less all expenditure on real transactions. This would make the tax even more similar to VAT—the main distinction is that the cost of labour would be deductible from the tax base, whilst it is not deducted for VAT. The effect would be to reduce the tax base to economic rent only—i.e. profit over and above the minimum required to undertake an investment. In economic terms, this is similar to the effect of giving an allowance for corporate equity, described in Appendix 5.
106. In principle, such a tax would have several advantages. First, since no tax is levied on investment that just earns the minimum required rate of return, the level of investment should be unaffected by the tax. Second, the location of real activity would be unaffected by the tax, since although the extent of tax relief on real expenditure would differ between countries

¹¹⁵ Q83.

¹¹⁶ Q123.

¹¹⁷ See Alan Auerbach, Michael Devereux and Helen Simpson, *Taxing Corporate Income, Reforming the Tax System for the 21st Century: the Mirrlees Review—Dimensions of Tax Design*, Oxford: OUP, 2009.

¹¹⁸ Auerbach, par 11.

depending on the tax rate, prices would adjust to offset this effect.¹¹⁹ Third, since there is no explicit relief for the cost of finance, there is no incentive to use debt, rather than equity, as a source of funds. Fourth, there would be considerably less scope for shifting profits between countries. Professor Auerbach gave two examples where profit shifting would no longer be possible:

“Example one: Suppose a UK company shifts reported profits abroad by understating the value of sales to a foreign subsidiary. Under the proposed tax system, such sales would be ignored and hence would have no impact on the UK tax base.

Example two: Consider a UK company that borrows from a related foreign party, overstating the interest rate on the loan to increase domestic interest deductions and increase interest receipts reported abroad. Because the interest paid abroad would not be deductible ... this transaction would have no impact on the UK tax base.

In both of these examples, the shift of a pound of income from the UK would have no UK tax consequences.”¹²⁰

107. Since the tax would be based on the location of the consumer rather than the location of production or ownership, the pressure of tax competition between countries would be diminished or eliminated. Countries could therefore levy higher rates of tax without fear that economic activity would move elsewhere. However, if only some countries introduced such a tax, they would be more attractive as a location of real productive activity compared to countries with conventional taxes. For example, if the UK alone introduced such a tax, then as Professor Auerbach wrote: “With new investments facing a zero rate of corporate tax in the UK, they will be taxed less heavily than in countries that impose positive tax rates, even low ones, on corporate income [profit].”¹²¹
108. Which countries would gain or lose from a destination-based cash flow tax? Mr Mike Lewis of Action Aid feared that a destination-based tax would lead the tax base to move from developing countries, where goods are produced, to developed countries, where the sales take place.¹²² But this effect would only occur in some cases. The overall impact for each country would depend on its balance of payments position. Broadly under the current system, a country taxes the value of exports but does not tax the value of imports. This would be reversed under the first step—a switch to a destination-based tax. A country would therefore raise additional revenue if it had a trade deficit (as many developing countries do), and vice versa. But since a destination-based tax would reduce pressures for tax competition between countries, any country which lost out could raise its corporation tax rate to offset the lower tax base.
109. As with VAT, implementation of a destination-based cash flow tax would require the “destination” of the good or service sold to be defined. And

¹¹⁹ See Alan Auerbach and Michael Devereux, *Consumption and Cash-Flow Taxes in an International Setting*, Oxford University Centre for Business Taxation 12/14, February 2010.

¹²⁰ Professor Auerbach, Paragraphs 15, 16 and 17.

¹²¹ Professor Auerbach, par 28.

¹²² Q68.

also like VAT, there are difficult issues such as how tax can be collected on digital products, and on the profits of banks.

110. Broad international agreement would be helpful for introducing a destination-based cash flow tax—but not necessarily essential. Given that such a reform would give more favourable tax treatment for investing in a particular location, there would be some advantage for companies to locate in countries which had reformed their system. This in turn would give governments in unreformed countries an incentive to reform. These incentives suggest that if even a relatively small number of countries implemented such a reform, then others would also seek to do so.¹²³
111. **A destination-based cash flow tax could dramatically reduce the scope for profit-shifting and tax rate competition between countries. It might also be much easier to implement than a unitary tax as agreement from many countries might not be needed to begin implementation. We recommend that a detailed study should be undertaken, alongside other options, by the Treasury review we propose to investigate reform of corporate taxes, including the scope for wide international adoption of a destination-based tax and whether the UK could bring in a destination-based tax unilaterally.**

¹²³ Rita de la Feria and Michael Devereux, Designing and Implementing a Destination-Based Corporate Tax, paper presented at Oxford University Centre for Business Taxation symposium, June 2013, see <http://www.sbs.ox.ac.uk/centres/tax/symposia/Pages/AnnualSymposium2013.aspx>

CHAPTER 5: HM REVENUE & CUSTOMS (HMRC)

Enforcement

112. The House of Commons Public Accounts Committee accused HMRC of not being “sufficiently challenging of multinationals’ manifestly artificial tax structures”.¹²⁴ The Committee recommended: “HMRC needs to be much more effective in challenging the artificial corporate structures created by multinationals with no other purpose than to avoid tax.”¹²⁵
113. HMRC’s defence is that it is simply collecting the tax it can under the rules as they stand, a point acknowledged by the Public Accounts Committee.¹²⁶ Mrs Lin Homer, chief executive and permanent secretary of HMRC, said: “We pursue the tax that is due under our laws as opposed to the tax that people might wish was due.”¹²⁷
114. When dealing with complex multinationals there is however scope for judgment as to how much tax is due under the law. Since the tax affairs of companies are confidential, it is difficult to make a judgment whether HMRC is assertive enough in its enforcement of the rules. Mrs Homer said: “If you talk to many of the big businesses that have a customer relationship manager [at HMRC], they might feel that is more a technique by which we hold their feet to the fire than the more cosy description that some people seem to apply to it. We would see that as a robust relationship rather than anything else.”¹²⁸
115. Much of the evidence to our inquiry supported this view and was positive about how HMRC approaches multinationals—it was variously described as “amongst the best in the world”¹²⁹ and “successful”¹³⁰ with “many significant improvements” in recent years.¹³¹ Those who praised HMRC are however mainly multinationals and their advisers. Their evidence is first-hand since they deal with HMRC directly. But they clearly have an interest in HMRC not becoming tougher. Other witnesses were more sceptical. Mr Richard Brooks, a journalist and former tax inspector, told us that HMRC in general “needs to be tougher and to stand up to the aggression on the other side”. He added: “When you get across the table from them [multinationals] and their lawyers on a tax avoidance scheme, they do not always play nicely. Tax inspectors need to be able to deal with that.”¹³²
116. There is some independent evidence of HMRC’s effectiveness from the National Audit Office (NAO). It asked a former tax judge, Sir Andrew Park, to examine five recent tax settlements between HMRC and

¹²⁴ Public Accounts Committee, *Tax avoidance—Google* (9th Report, Session 2013–14, HC Paper 112), page 5.

¹²⁵ *Ibid.*

¹²⁶ *Ibid.*

¹²⁷ Q144.

¹²⁸ Q149.

¹²⁹ GlaxoSmithKline.

¹³⁰ Moore Stephens.

¹³¹ BP.

¹³² Q76.

multinationals. The report concluded that all of these settlements were “reasonable ones for [HMRC] to have reached in the circumstances” and “at least one may have been better than reasonable”.¹³³ ¹³⁴ The NAO had full access to all information about the settlements which totalled £3.6 billion,¹³⁵ but did not reveal the identity of the multinationals concerned, respecting HMRC’s duty to maintain taxpayer confidentiality.

117. A subsequent legal challenge brought against HMRC by the pressure group UK Uncut gave a rare insight into the process leading to one of these settlements, which was revealed to be with Goldman Sachs. During the negotiations, the investment bank “threatened to withdraw” from a code of practice on the taxation of banks in order to win a concession from HMRC.¹³⁶ Such a withdrawal would have been embarrassing for the Chancellor of the Exchequer and HMRC, according to an email by Mr David Hartnett, the then Permanent Secretary for Tax at HMRC.¹³⁷ Although Mr Justice Nicol ruled in HMRC’s favour that the settlement with Goldman Sachs was lawful,¹³⁸ he described it as “not a glorious episode in the history of the Revenue”.¹³⁹
118. **We welcome the National Audit Office’s assurance that the five settlements it reviewed were “reasonable”. But we remain concerned by the evidence we received that HMRC’s approach to multinationals was not assertive enough, and the Commons Public Accounts Committee’s critical findings of HMRC that the tax collector is not “sufficiently challenging” of multinationals.**

Oversight

119. Given concerns about HMRC’s assertiveness with multinationals, effective oversight of the tax collector may be needed to maintain confidence. But the need for taxpayer confidentiality makes this difficult to achieve. Rt Hon Margaret Hodge MP, chair of the Commons Public Accounts Committee, told us:

“The problem at the moment is that HMRC will never give us any evidence—will never tell us anything. Whenever you ask them a question, it is always, ‘We cannot discuss that because of confidentiality of taxpayers’ interests’. HMRC is also a non-ministerial department, so it is in a very odd situation, in that it also

¹³³ National Audit Office (13 June 2012), *HM Revenue & Customs—Settling large tax disputes*, page 6.

¹³⁴ The NAO stated their criteria for determining whether a settlement value is reasonable: “Does the settlement represent fair value for the Exchequer and the taxpaying community generally, rather than being favourable to the taxpayer? This includes considering whether the settlement was as good as, or better than, the outcome that might be expected from litigation, considering the risks, uncertainties, costs and timescale of litigation. Are the terms of the settlement lawful and is the settlement value within the range permitted by tax law?” National Audit Office (13 June 2012), *HM Revenue & Customs—Settling large tax disputes*, Page 16.

¹³⁵ National Audit Office (13 June 2012), *HM Revenue & Customs Settling large tax disputes*, Page 14.

¹³⁶ UK Uncut Legal Action Ltd v HMRC (2013).

¹³⁷ *Ibid.*

¹³⁸ *Ibid.*

¹³⁹ *Ibid.*

cannot satisfy a Minister in confidence as to whether or not the action it has taken on an individual case is appropriate.”¹⁴⁰

120. Ms Hodge proposed a committee of MPs akin to the Intelligence and Security Committee that would take evidence on multinationals’ tax affairs in private: “What this [proposed] Committee might do would be to be able to question and see the details which we have not been able to see—the Vodafone deal, the Goldman Sachs deal, the Google deal. How does HMRC come to the judgment that Google is acting lawfully?”¹⁴¹
121. But Mr Edward Troup, Tax Assurance Commissioner and Second Permanent Secretary of HMRC, argued there was already independent oversight:
- “The NAO can look at any aspect of our businesses. It looks at our annual report and it can have complete access to any taxpayer information in the course of doing so, although it is precluded, subject to some statutory restrictions and limitations, from disclosing it further Parliament has not seen fit to go any further than to allow the NAO that independent scrutiny, but we believe that the arrangements which we have set up and my role provide a very significant degree of additional assurance to Parliament, the public and the media that we are doing things in a consistent, even-handed way.”¹⁴²
122. But Professor Freedman said if the NAO were to be involved in greater scrutiny of HMRC more resources would be needed: “Although the National Audit Office advises the PAC and does a very good job on value for money, it does not have a lot of tax experts. So one thing you might want to think about is whether that could be something that could be boosted . . . or there could be a separate organisation like an inspector general of taxation.”¹⁴³
123. As HMRC’s dealings with taxpayers are normally confidential, Parliament and the public are prevented from assessing how effective and robust is HMRC’s pursuit of tax compliance by multinationals.
124. **Parliament should have greater oversight over HMRC. We recommend that Parliament should establish a joint committee—made up of MPs and Peers—along the lines of the Intelligence and Security Committee. HMRC should be required to give members of this new committee private access to the details of individual settlements with multinationals so as to provide effective parliamentary oversight of HMRC while maintaining taxpayer confidentiality. The new committee could be advised by the National Audit Office which would need to recruit more tax experts for this role. We request both Houses to consider this recommendation as soon as possible.**

¹⁴⁰ Q98.

¹⁴¹ Q98.

¹⁴² Q146.

¹⁴³ Q127

Resources

125. There was general agreement amongst our witnesses that HMRC needs more resources to deal with multinationals. The Association of Chartered and Certified Accountants (ACCA) argued for more funding for HMRC: “Regrettably the long term decline in funding and staffing levels, and with it morale and then inevitably performance, has been a consistent feature of the past decade.”¹⁴⁴ Mr Brooks argued that: “The resource problem is of long standing; it has not just come about because of recent cuts. Jobs were being cut from a very small base in the first place and the Revenue has been cut to the bone; it does not have the resources.”¹⁴⁵ The Association of Revenue and Customs (ARC), a union for HMRC employees, also estimated that further investment of £312m into HMRC would deliver £8bn of additional tax revenue.¹⁴⁶
126. Both the Institute of Chartered Accountants of Scotland (ICAS) and the ARC raised concerns about HMRC’s shortage of transfer pricing experts.¹⁴⁷ ARC estimated that HMRC’s transfer pricing experts are “barely four times that of a single multinational corporate” of which HMRC deals with hundreds.¹⁴⁸ Mr Jim Harra, Director General of Business Taxation at HMRC, said that with extra funding announced last December 100 extra people would be recruited to risk-assess large businesses and that another 15 people would join HMRC’s transfer pricing specialist team.¹⁴⁹ He added: “We do not have a significant issue with retaining skills, and indeed possibly almost uniquely in the public sector we are in the lucky position of being able to recruit new people, so we are recruiting 200 graduate entrants this year to make the tax inspectors of tomorrow.”¹⁵⁰
127. Further increases in funding will not however be forthcoming. In the latest Spending Round, HMRC’s budget is to be cut 5% in 2015–16 from the previous year to £3.1 billion.¹⁵¹
128. **HMRC needs sufficient high quality staff with deep expertise in corporate tax to deal effectively with the tax affairs of complex and well-resourced multinationals. In order to achieve this, we recommend that HMRC should be better resourced.**
129. Concerns have been expressed that HM Treasury and HMRC lack sufficient in-house expertise to design and implement appropriate tax legislation. According to the Public Accounts Committee, the Big Four professional firms second staff to HM Treasury to advise on technical issues in drafting legislation.¹⁵² The “firms maintained that their involvement had improved the quality of legislation, but we are

¹⁴⁴ ACCA.

¹⁴⁵ Q76.

¹⁴⁶ Association of Revenue and Customs.

¹⁴⁷ ICAS, Association of Revenue and Customs.

¹⁴⁸ Association of Revenue and Customs.

¹⁴⁹ Q150.

¹⁵⁰ Q151.

¹⁵¹ HM Treasury (June 2013), Spending Round 2013, Cm 8639.

¹⁵² Public Accounts Committee, *Tax avoidance: the role of large accountancy firms* (44th Report, Session 2012–13 HC Paper 870), page 4.

concerned that the very people who provide this advice then go on to advise their clients how to use those laws to avoid tax”.¹⁵³ The Public Accounts Committee concluded: “It is inappropriate for individuals from firms to advise on tax law and then devise ways to avoid the tax.”¹⁵⁴

130. For HMRC, Mr Harra told us: “It is very rare for us to buy in professional advice.”¹⁵⁵ Mrs Homer said it would be uneconomic to keep certain experts on staff: “Sometimes you need a very deep expert for a particular area at a particular time, and it would be foolish to waste resources maintaining all those types of expertise for the moment when you need them. I think a mixed economy is sensible, but we have some very deep experts in HMRC. We keep some of them in cupboards, really.”¹⁵⁶
131. **The use of staff seconded from the Big Four accountants by HM Treasury and HMRC to help design taxes is counterproductive. The risks are two-fold: that those on secondment will not have any incentive to design robust, hard-to-avoid taxes and that when they return to private practice they will be better placed to advise how to exploit loopholes. We recommend that the Treasury and HMRC should be better resourced to design and implement taxes, without undue dependence on short-term professional advisers.**

¹⁵³ *Ibid*, page 5.

¹⁵⁴ *Ibid*.

¹⁵⁵ Q153.

¹⁵⁶ Q153.

CHAPTER 6: TREASURY REVIEW

132. Corporate tax avoidance by multinationals is a serious problem and fixing it will be complex. The Government is free to set the rate and the main features of corporation tax in the UK but when dealing with multinationals also works within the internationally agreed OECD framework.
133. All our witnesses, including the tax practitioners, believed that the OECD framework needs to adapt to the challenges of globalisation and the digital economy. Most supported international efforts now under way in the G8, G20 and OECD to reform and update the system. But some took the view that the present system, based on the arm's length principle, could not be made fit for purpose and should be replaced by something else, perhaps a unitary tax or a destination-based tax.
134. **Reforming the present system or replacing it with something new is likely to be a lengthy process requiring international consensus. Meanwhile governments, including our own, are introducing initiatives such as that on transparency at the G8 or the Chancellor's promised measure to name and shame promoters of avoidance schemes.**
135. **Given the complexities involved in reducing corporate tax avoidance we recommend that the Treasury should urgently review the UK's corporate taxation regime and report back with proposed changes to be made at home and pursued internationally, especially through the OECD. We consider that this important review should have an independent chairman. We recognise that the Treasury are already working towards implementation of the OECD's Action Plan to tackle Base Erosion and Profit-Shifting (BEPS) and on Government proposals to name and shame promoters of tax avoidance schemes and that companies seeking contracts from the public sector should self-certify their compliance with tax obligations. Among the issues the Treasury review should examine are:**
 - **alternative tax structures (such as destination-based cash flow tax) to curtail avoidance, promote investment and to maintain international competitiveness**
 - **the tax treatment of debt and equity and the scope for introducing an allowance for corporate equity**
 - **regulation of tax advisers with suitable penalties for falling short of the standards required**
 - **the scope for penalising companies engaged in aggressive tax avoidance**
 - **the scope for requiring companies with large operations in the UK to publish a proforma summary of their corporation tax returns to help enable Parliament and public to understand better how tax has been computed and to see when action against avoidance is needed**

- **adequate resourcing of HMRC to challenge the tax arrangements of large UK corporations and multinationals**

The Treasury review should report within one year.

CHAPTER 7: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Chapter 1

136. It is primarily for the Government to correct the flaws in the UK's corporation tax regime and to pursue agreement to make the international tax framework more rigorous. We recommend that HM Treasury should undertake a comprehensive review of the operation of corporation tax in the UK, taking full account of the international dimension, and the competitiveness of the UK's economy, and report back with proposals to reduce avoidance, recover revenue, level the tax playing field between UK-based and multinational firms and restore trust in the tax system. (Paragraph 9)
137. The present system is not working and urgently needs reform. We recommend that the Treasury review we propose should also consider a full range of interim measures against those who persist in blatantly contrived avoidance of corporation tax. We are confident that the Treasury will bear in mind as it conducts the proposed review that no one is obliged to pay more tax than laid down by the law. (Paragraph 11)

Chapter 2

138. Corporation tax is a significant component of HMRC's portfolio of taxes and makes an important contribution to the UK's total tax revenue. (Paragraph 14)
139. The present international corporation tax system offers great scope for multinational companies to shift their profits between countries to reduce their tax liabilities and creates an uneven playing field. (Paragraph 37)
140. HMRC maintain that new measures introduced over the last decade have had a significant impact on the tax avoidance industry in the UK. That view is broadly shared, although statistical evidence is limited. We welcome anti-avoidance measures such as Disclosure of Tax Avoidance Schemes (DOTAS), the anti-arbitrage rules and the General Anti-Abuse Rule (GAAR). The GAAR in particular has a relatively narrow focus. As we recommended in our recent report, "... every effort should be made to communicate, particularly to the press and the public, why the GAAR is not an appropriate mechanism to address all problems with the tax system."¹⁵⁷ We welcome HMRC's revised guidance which makes the intended scope of the GAAR clearer.¹⁵⁸ (Paragraph 47)
141. Business tax payers and their advisers share an interest in fostering the view that a complex but none-too-onerous corporation tax regime is for the best. But while companies are required to comply with tax laws in the UK and elsewhere, ways are open, especially for multinationals, to shift profits between countries so as reduce their overall tax liabilities, and to make UK corporation tax to a considerable extent voluntary for

¹⁵⁷ House of Lords Select Committee on Economic Affairs, First Report of Session 2012–13, *The Draft Finance Bill 2013*, 13 March 2013.

¹⁵⁸ HMRC Guidance Note, 15 April 2013.

multinationals. This severely undermines public trust in the tax system, is clearly inequitable and threatens a serious loss of much-needed tax revenue. (Paragraph 55)

Chapter 3

142. The Treasury review should consider whether the international competitive position of the UK's corporation tax regime needs to be bolstered by generous tax relief on interest payments, which can lead to British businesses taking on excessive debt. It should also examine whether, and if so, how the Government should limit excessive use of debt, especially where it is used to finance foreign activities or to shift profits away from the UK. (Paragraph 60)
143. In principle there is a case for harmonising the treatment of the costs of debt and equity finance. A full allowance for corporate equity is too expensive to introduce now given the current state of the public finances. But the revenue cost of partial relief for equity finance could be offset by a reduction in the rate of relief for debt finance. We recommend that the Treasury review we propose should investigate whether and if so how the treatment of debt and equity finance could best be harmonised. (Paragraph 64)
144. We recommend that the Treasury should review the statutory measures available to HMRC to combat tax avoidance and arbitrage arrangements, with a view to strengthening these where possible. (Paragraph 66)
145. Where the Government sees a threat to the public interest from the manipulation of the existing legal and regulatory framework, the best response is for it to tighten up that framework. Naming and shaming is bound to be to a degree arbitrary and challenging to justify when the activity is within the law. So far as tax advisers and promoters are concerned, we await publication of the Chancellor of the Exchequer's plans to name and shame promoters of tax avoidance schemes. We believe that an alternative to the Chancellor's proposals is the establishment of a regulatory system, as outlined in paragraph 147 below. (Paragraph 70)
146. So far as companies are concerned, public exposure did succeed in getting Starbucks to offer to pay more tax. The threat of naming and shaming represents a reputational risk to companies; and may therefore have the effect of encouraging boards to make sure that the companies they run are not using inappropriately aggressive tax avoidance strategies. (Paragraph 71)
147. We consider that a new system of regulation of tax advisers could be valuable in helping ensure that advice on tax matters is in accord with a strengthened code of conduct. We recommend that the Treasury and the professional bodies should urgently examine how such a system of regulation might be established and function, bearing in mind the many practical issues involved, including the form of a regulatory body and suitable sanctions for falling short of the standards required, which might include loss of the right to act as a tax adviser. (Paragraph 76)
148. We broadly welcome as a first step the Government's proposals to exclude from bidding for public procurement contracts companies whose tax affairs are not in good standing. But we have concerns that they

would apply only to companies that seek public contracts rather than treating companies equally under the law, and that procurement officers would have discretion over which companies to exclude. As with naming and shaming, there is no substitute for improving the tax code to reduce tax avoidance. (Paragraph 78)

149. It is important that the GAAR should be effective. If the range of sanctions envisaged proves ineffective, we recommend consideration of the introduction of penalties for all taxpayers in cases that are found by the courts not to meet the “double reasonableness” test in the GAAR. (Paragraph 82)
150. We recommend that the Government should actively promote implementation of the G8 proposals for improving the flow of information between tax authorities. As regards public disclosure, we recommend that large companies operating in the UK should make public disclosure of their UK corporation tax returns. We also recommend that the Treasury review should look at practical ways to require companies with large operations in the UK to publish a pro-forma summary of their UK corporation tax returns. This would help enable Parliament and the public to see if a fair level of corporation tax was being paid and when action against avoidance was needed. It might also act as a deterrent to aggressive tax avoidance by companies. (Paragraph 86)

Chapter 4

151. We agree that fundamental reform of the international tax framework should be pursued in the OECD. As things stand, there are too many opportunities for multinational companies to manipulate their affairs to reduce their global tax payments. Corporate manipulation of the system so as to avoid taxation reduces governments’ revenues, undermines public trust in the tax system. We recommend that the Government should continue to play its full part in encouraging the OECD’s reform agenda to an early successful conclusion. At the same time the Government—and the Treasury review we propose—should explore the scope for more radical alternative approaches to corporate tax. (Paragraph 93)
152. A unitary tax system treating multinational companies as single entities in a global economy is attractive in theory. But there would be formidable difficulty in reaching global agreement, or even within the EU, on a common tax base, let alone on the appropriate allocation. (Paragraph 102)
153. A destination-based cash flow tax could dramatically reduce the scope for profit-shifting and tax rate competition between countries. It might also be much easier to implement than a unitary tax as agreement from many countries might not be needed to begin implementation. We recommend that a detailed study should be undertaken, alongside other options, by the Treasury review we propose to investigate reform of corporate taxes, including the scope for wide international adoption of a destination-based tax and whether the UK could bring in a destination-based tax unilaterally. (Paragraph 111)

Chapter 5

154. We welcome the National Audit Office's assurance that the five settlements it reviewed were "reasonable". But we remain concerned by the evidence we received that HMRC's approach to multinationals was not assertive enough, and the Commons Public Accounts Committee's critical findings of HMRC that the tax collector is not "sufficiently challenging" of multinationals. (Paragraph 118)
155. Parliament should have greater oversight over HMRC. We recommend that Parliament should establish a joint committee—made up of MPs and Peers—along the lines of the Intelligence and Security Committee. HMRC should be required to give members of this new committee private access to the details of individual settlements with multinationals so as to provide effective parliamentary oversight of HMRC while maintaining taxpayer confidentiality. The new committee could be advised by the National Audit Office which would need to recruit more tax experts for this role. We request both Houses to consider this recommendation as soon as possible. (Paragraph 124)
156. HMRC needs sufficient high quality staff with deep expertise in corporate tax to deal effectively with the tax affairs of complex and well-resourced multinationals. In order to achieve this, we recommend that HMRC should be better resourced. (Paragraph 128)
157. The use of staff seconded from the Big Four accountants by HM Treasury and HMRC to help design taxes is counterproductive. The risks are two-fold: that those on secondment will not have any incentive to design robust, hard-to-avoid taxes and that when they return to private practice they will be better placed to advise how to exploit loopholes. We recommend that the Treasury and HMRC should be better resourced to design and implement taxes, without undue dependence on short-term professional advisers. (Paragraph 131)

Chapter 6

158. Reforming the present system or replacing it with something new is likely to be a lengthy process requiring international consensus. Meanwhile governments, including our own, are introducing initiatives such as that on transparency at the G8 or the Chancellor's promised measure to name and shame promoters of avoidance schemes. (Paragraph 134)
159. Given the complexities involved in reducing corporate tax avoidance we recommend that the Treasury should urgently review the UK's corporate taxation regime and report back with proposed changes to be made at home and pursued internationally, especially through the OECD. We consider that this important review should have an independent chairman. We recognise that the Treasury are already working towards implementation of the OECD's Action Plan to tackle Base Erosion and Profit-Shifting (BEPS) and on Government proposals to name and shame promoters of tax avoidance schemes and that companies seeking contracts from the public sector should self-certify their compliance with tax obligations. Among the issues the Treasury review should examine are:

- alternative tax structures (such as destination-based cash flow tax) to curtail avoidance, promote investment and to maintain international competitiveness
- the tax treatment of debt and equity and the scope for introducing an allowance for corporate equity
- regulation of tax advisers with suitable penalties for falling short of the standards required
- the scope for penalising companies engaged in aggressive tax avoidance
- the scope for requiring companies with large operations in the UK to publish a proforma summary of their corporation tax returns to help enable Parliament and public to understand better how tax has been computed and to see when action against avoidance is needed
- adequate resourcing of HMRC to challenge the tax arrangements of large UK corporations and multinationals

The Treasury review should report within one year. (Paragraph 135)

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

The Members of the Committee who conducted this inquiry were:

Baroness Blackstone
Lord Forsyth of Drumlean (until April 2013)
Lord Hollick
Baroness Kingsmill (until April 2013)
Lord Lawson of Blaby
Lord Lipsey
Lord McFall of Alcluith
Lord MacGregor of Pulham Market (Chairman)
Lord May of Oxford
Baroness Noakes
Lord Rowe-Beedoe
Lord Shipley
Lord Skidelsky
Lord Smith of Clifton

Declarations of Interest

Members of the Economic Affairs Committee declared the following interests as relevant to the inquiry:

Baroness Blackstone
None

Lord Hollick

Directorships

Director, Honeywell International Inc (diversified technology)
Director, ProSieben Media Group AG (TV)
Director, Gogo Inc (in-flight internet provider)
Director, We Predict (predictive analytics)

Lord Lawson of Blaby

Fellow of the Chartered Institute of Taxation (CIOT)

Lord Lipsey

None

Lord McFall of Alcluith

None

Lord Forsyth of Drumlean

Directorships

Non-executive Director, J & J Denholm Ltd (parent company of Denholm Group which has five divisions: shipping; logistics; seafoods; industrial services; oilfield services)
Non-executive Director, Hyperion Insurance Group Ltd
Non-executive Director, Denholm Logistics Ltd
Shareholdings (b)
Safor Ltd (designs and retails handbags and other fashion accessories)

* left the Committee in April 2013

Baroness Kingsmill

Directorships

Independent non-executive Director/Board Member, International Consolidated Airlines Group SA (airline group formed by merger of British Airways and Iberia)

Senior Independent Non-executive Director, APR Energy plc (global temporary power market)

Non-executive Director and Member of Supervisory Board, E.ON AG (power and gas)

* left the Committee in April 2013

Lord MacGregor of Pulham Market

Remunerated employment, office, profession etc.

Chairman, British Energy Pension Fund Trustees

Chairman, Eggborough Power Ltd Pension Fund Trustees

Lord May of Oxford

For the past 5 years, my academic research (at Oxford University) has been, in part. On what might be called “the dynamics of banking/financial systems”. This work has been collaborative with people at the Bank of England.

Remunerated employment, office, profession etc.

Member, Corporate Sustainability Board HSBC (previously Corporate Social Responsibility Committee)

Advisor to Tesco’s “Sustainable Consumption Institute” at Manchester University

Member, UK Climate Change Committee

Published academic research on various issues concerning environmental/conservation questions

Baroness Noakes

Directorships

Carpetright plc

Severn Trent plc (water)

Director, Royal Bank of Scotland Group plc

Shareholdings

Shareholdings in a wide range of listed companies as listed in the Register of Members’ interests

Lord Rowe-Beddoe

None

Lord Shipley

None

Lord Skidelsky

None

Lord Smith of Clifton

None

Specialist Adviser

Professor Michael P. Devereux, Director, Oxford University Centre for Business Taxation, Associate Dean of Research, Saïd Business School, acted as Specialist Adviser for this inquiry.

The Oxford University Centre for Business Taxation is an independent research centre of the Saïd Business School. The Centre is funded from a

number of sources, including donations from some companies, listed on the Centre's website at

<http://www.sbs.ox.ac.uk/centres/tax/about/Pages/Funding.aspx>.

Professor Devereux is also Research Director of the European Tax Policy Forum, which commissions independent academic research into the impact of tax policy on business in Europe, and is funded by donations from a number of companies listed at <http://www.etpf.org/sponsors.html>.

He is also a Member of the Board of Academic Advisors of the International Tax Policy Forum, which sponsors nonpartisan academic research and conferences to promote an informed dialogue on international tax issues, and is funded by donations from a number of companies, listed at <http://www.etpf.org/sponsors.html>

A full list of Members' interests can be found in the Register of Lords' Interests:

<http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at www.parliament.uk/hleconomicaffairs and available for inspection at the Parliamentary Archives (020 7219 5314).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with * gave both oral evidence and written evidence. Those marked with ** gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

Oral evidence in chronological order

**	(QQ 1–17)	Professor Steve Bond and Malcolm Gammie CBE QC
*	(QQ 18–33)	British Petroleum (BP), GlaxoSmithKline (GSK) and Reed Elsevier Group
*	(QQ 34–48)	The Association of Chartered Certified Accountants (ACCA), The Confederation of British Industry (CBI), The Institute of Chartered Accountants in England and Wales (ICAEW) and The Institute of Chartered Accountants of Scotland (ICAS)
*	(QQ 49–65)	Deloitte, Ernst & Young, Mercer & Hole, PricewaterhouseCoopers (PwC)
*	(QQ 66–77)	Tax Research LLP, ActionAid, Christian Aid and Richard Brooks, Author & Journalist
*	(QQ 78–89)	Law Society of England & Wales (LSEW) & Berwin Leighton Paisner (BLP Law), Macfarlanes and Slaughter & May
**	(QQ 90–104)	Rt Hon Margaret Hodge MP
**	(QQ 105–115)	Organisation for Economic Co-operation and Development (OECD) and European Commission
*	(QQ 116–127)	Professor Sol Picciotto, Lancaster University, Professor Rita de la Feria, Durham Law School and Professor Judith Freedman, Oxford University Centre for Business Taxation
**	(QQ 128–155)	HM Revenue and Customs (HMRC) and HM Treasury

Alphabetical list of all witnesses

- * The Association of Chartered Certified Accountants (ACCA)
- * ActionAid
- The Association of Investment Companies (AIC)
- Association of Revenue and Customs (ARC)
- Professor Alan J. Auerbach, University of California, Berkeley

- ** Professor Steve Bond
British American Business and the British-American Business Council (BABC)
British Bankers' Association (BBA)
BDO LLP
- ** Berwin Leighton Paisner (BLP Law)
- * British Petroleum (BP)
The British Venture Capital and Private Equity Association (BVCA)
- * Richard Brooks
- ** The Confederation of British Industry (CBI)
Chartered Institute of Taxation (CIOT)
- * Christian Aid
City of London Corporation
Paul Connolly, FCCA, United Practices Accountancy
- ** Professor Rita de la Feria
- * Deloitte
EEF, the manufacturers' organisation
- * Ernst & Young
- ** European Commission
- * Professor Judith Freedman
- ** Malcolm Gammie CBE QC
- * GlaxoSmithKline (GSK)
Dr Jost H. Heckemeyer, University of Mannheim
- ** Rt Hon Margaret Hodge MP
The Infrastructure Forum Taxation Working Group (TIF)
- * The Institute of Chartered Accountants in England and Wales (ICAEW)
- * The Institute of Chartered Accountants of Scotland (ICAS)
- * International Centre for Tax and Development (Professor Sol Picciotto)
International Chamber of Commerce (ICC UK)
Institute for Fiscal Studies (IFS)
Alastair Irvine CTA FRSA
KPMG LLP
London Chamber of Commerce and Industry (LCCI)
Legal & General Group
- * Law Society of England & Wales (LSEW)
- ** Macfarlanes
- ** Mercer & Hole

Moore Stephens LLP

Norton Rose LLP

** Organisation for Economic Co-operation and Development (OECD)

Prof. Dr. Jeffrey Owens, Institute for Austrian and International Tax Law, (WU) Vienna University of Economics and Business

Cyril Padabed, Maastricht University

* Professor Sol Picciotto, Lancaster University

* PricewaterhouseCoopers (PwC)

Recruitment and Employment Confederation (REC)

* Reed Elsevier Group

** Slaughter & May

* Tax Research LLP

The Tax Justice Network and the Trades Union Congress (TUC)

Anne Tschentscher, Maastricht University

Dr John Vella

APPENDIX 3: CALL FOR EVIDENCE

The Economic Affairs Committee has decided to conduct an inquiry into corporate taxation. The Committee would welcome written evidence on any or all of the issues set out below, or on any other relevant aspects, by 30 April.

The inquiry will seek to answer questions such as:

1. Is there a good rationale for the existing system of taxing corporate profits? What proportion of total tax receipts should come from corporation tax? Who bears the burden of corporation tax?
2. How vulnerable are UK corporation tax revenues to a recession, or tax avoidance activity? To what extent has corporation tax become a voluntary tax?
3. How does corporation tax affect decisions by firms to incorporate, where to locate, how much to invest, how to finance activities and where to record profits?
4. Is there a need to reform the UK base for corporation tax? If so, how? For example, should the preferential tax treatment of debt over equity be removed? Should reforms encourage more capital investment, particularly in UK infrastructure?
5. Is the taxation of companies too narrowly focused on a complex definition of profits? Could a tax based on a broader measure of economic activity less susceptible to manipulation help to ensure that the burden is spread more fairly across the corporate sector? What would be the consequences of shifting the corporate tax base from profit to sales/turnover?
6. Should the taxation of SMEs be reformed? Are schemes such as the Enterprise Investment Scheme successful in leveraging additional investment in the UK and do they represent good value for money?
7. Is there a need to reform the basis of the international allocation of multinational profits between countries? If so, should this be based on the existing conventions, as recently suggested by the OECD, or is there a need for more fundamental reform? What other feasible alternatives are there, consistent with international law?
8. What scope is there for the UK Government to act alone in addressing concerns about the taxation of international business?
9. Is there a meaningful distinction between “harmful” and “fair” tax competition? Where will future competition lead the UK corporation tax?
10. Is there a problem in the UK that foreign companies are able to gain a competitive advantage through greater tax avoidance opportunities?
11. How successful is the HMRC in dealing with large international business?
12. Has the use of aggressive tax avoidance schemes increased or decreased over the last decade? Why? How successful has the DOTAS scheme been? Should promoters of tax avoidance scheme be named and shamed?
13. Is there a need for greater transparency by multinational companies in declaring taxes paid in different countries?

APPENDIX 4: GLOSSARY

ACCA The Association of Chartered Certified Accountants
AIC The Association of Investment Companies
ARC Association of Revenue and Customs
BABC British-American Business Council
BBA British Bankers' Association
BP British Petroleum
BLP Law Berwin Leighton Paisner
BVCA The British Venture Capital and Private Equity Association
CBI The Confederation of British Industry
CIOT Chartered Institute of Taxation
GSK GlaxoSmithKline
HMRC HM Revenue and Customs
TIF The Infrastructure Forum Taxation Working Group
ICAEW The Institute of Chartered Accountants in England & Wales
ICAS The Institute of Chartered Accountants of Scotland
ICC UK International Chamber of Commerce
IFS Institute for Fiscal Studies
LCCI London Chamber of Commerce and Industry
LSEW Law Society of England and Wales
OECD Organisation for Economic Co-operation and Development
PwC PricewaterhouseCoopers
REC Recruitment and Employment Confederation
TUC Trades Union Congress

APPENDIX 5: TAX TREATMENT OF DEBT AND EQUITY

1. Corporation tax is generally acknowledged to distort business decisions. The Institute for Fiscal Studies listed several areas of concern which apply even in a domestic context, including choice of legal form for, the incentive to use debt finance, the level of investment, the type of investment and the level of risk.¹⁵⁹ Some of these are inherent in any tax levied on corporate profit. The differential treatment of debt and equity under UK corporation tax has often been debated.

2. The traditional view was expressed by Pascal Saint-Amans, Director of the OECD's Centre for Tax Policy and Administration, that since interest is a cost of doing business it should receive tax relief. Asked whether there is a clear distinction between debt and equity, Mr Saint-Amans said: "I believe so. Debt is something that you owe to a third party while equity is something that you own, so that explains why the tax treatment is different in almost all countries."¹⁶⁰

3. Mr Chris Sanger, Global Head of Tax Policy at Ernst & Young took a similar view about the difference between debt and equity at the extremes, but with the qualification that this refers to the case where those "that provide debt and receive interest will find themselves paying tax on that interest".¹⁶¹ This is an important qualification. Profits earned by companies should be taxed at least once. If profits are paid in interest to lenders who do not pay tax on the interest received, no tax is paid on those profits. This is the case in the UK if the lender is tax exempt, for example a pension fund. From a domestic perspective, it is also the case when the interest is paid to a lender resident abroad who is not liable to UK tax. Avoidance opportunities are created if the lender is part of the same multinational group, located in a low-tax jurisdiction. The OECD "BEPS" report highlights the tax treatment of related party debt-financing as a particular problem in the international sphere.¹⁶²

4. Other witnesses pointed out that debt and equity had different characteristics. For example, Mr Richard Collier of PwC said that "there is a clear commercial distinction between debt and equity and ... there are wholly different rights, obligations and risks". He added however:

"But it is a fact that different instruments sometimes do the same thing ... there is a lot of complexity around the borderline between debt and equity ... we have not got just one distinction, but many between debt and equity in the tax code, for different purposes. Also ... the debt/equity borderline is being tested by the evolution of financial instruments."¹⁶³

The use of hybrid instruments containing a combination of traditional features of debt and equity instruments was also acknowledged by Mr Sanger: "The

¹⁵⁹ Institute for Fiscal Studies, paragraph 7.

¹⁶⁰ Q109.

¹⁶¹ Q52.

¹⁶² OECD, Addressing Base Erosion and Profit Shifting, Paris: OECD, February 2013.

¹⁶³ Q52.

challenge comes where you have items that are close to being equity or close to being debt.”¹⁶⁴

5. The relatively generous treatment of debt finance tends to promote the use of debt over equity, as noted by Professor Steve Bond of Oxford University.¹⁶⁵ As emphasised by the Mirrlees Review, of which Professor Bond was a member:

“It is unclear why we should want the design of the corporate income tax to encourage companies to have more fragile balance sheets than they would otherwise choose. As a result, more firms are likely to default in an economic downturn than would otherwise be the case. This imposes real costs, notably when firm-specific assets cannot be redeployed easily to other uses.”¹⁶⁶

6. But in its Corporate Tax Road Map in 2010, the Government has argued:

“The UK’s current interest rules, which do not significantly restrict relief for interest, are considered by businesses as a competitive advantage and it is the Government’s view that this advantage outweighs potential benefits from moving towards a more territorial system for interest.”¹⁶⁷

As noted in Chapter 3, the Government appears to see the UK’s relatively generous tax deductibility of interest payments as an important plank of British competitiveness in corporation tax. But, also as noted in Chapter 3, many other features also matter.

7. One option for change would be to eliminate or at least reduce the deductibility of interest payments. But that would raise other issues. There would be a problem of double taxation where the lender was taxed on the interest received, for example in the case of lending by banks, also subject to corporation tax and hence generally subject to tax on the interest received. The corporation tax treatment of banks would therefore have to be reconsidered. The UK would also be out of step with international practice.

8. The Mirrlees review instead advocated introducing an “allowance for corporate equity” (“ACE”) for equity finance. Broadly, this would equalise the treatment of debt and equity by giving a similar relief for equity finance, based on a notional return on equity invested. Professor Bond stated:

“The ACE allowance would provide tax relief for costs associated with using equity to finance investment: that is both retained profits and new equity issues. The basic idea is to level up the treatment of equity and debt sources. That obviously deals with the differential treatment of debt and equity.”¹⁶⁸

9. Professor Bond also identified a more general problem that corporation tax creates a disincentive to invest by raising the cost of capital: since companies have to pay tax out of their earnings, the required return on their investment is

¹⁶⁴ Q52.

¹⁶⁵ Q1.

¹⁶⁶ Mirrlees Review, *Taxing Corporate Income, Tax by Design*, Oxford: Oxford University Press, September 2011.

¹⁶⁷ H.M. Treasury, *Corporate Tax Reform: delivering a more competitive system*, April 2010.

¹⁶⁸ Q1.

raised by the tax. By allowing a “normal” return on investment to be tax-free, whether financed by debt or equity, Professor Bond argued that:

“A well designed ACE allowance could go much further and, at least in principle, eliminate the impact of the corporation tax on the cost of capital: that is, the required rate of return for all types of investment, regardless of the source of finance. As a welcome by-product, it could also introduce indexation against inflation without having to think too much about it.”¹⁶⁹

10. Versions of the ACE allowance have been introduced elsewhere, for example, in Belgium and Italy. Even if it brought other advantages, its introduction could be costly in terms of foregone tax revenue: according to Professor Bond this would amount to between one eighth and one quarter of corporation tax revenue,¹⁷⁰ comparable to the cost of reduction in the rate of corporation tax from 28% to 20%.

11. An intermediate reform which could in principle achieve revenue neutrality would be to restrict the relief for debt finance, while introducing partial relief for equity finance at the same rate. The revenue gain from the former would compensate for the revenue loss of the latter. This could again equalise the treatment of debt and equity, though its effect on the cost of capital would be much smaller.¹⁷¹

¹⁶⁹ Q1.

¹⁷⁰ Q2.

¹⁷¹ The consequences of such a reform have been analysed by Ruud De Mooij and Michael P. Devereux, “An applied analysis of ACE and CBIT reforms in the EU?” *International Tax and Public Finance*, 2011, 18, 93–120.