

The logo for Touchstone Extras, featuring a large, light grey circle on the left side. The text 'TOUCHSTONE' is stacked in two lines in a bold, sans-serif font, with 'EXTRAS' in a smaller font below it.

**TOUCH
STONE**
EXTRAS

Stemming the Flood?

*Assessing the UK Government's policy
on tax avoidance since Budget 2008*

TUC 

The TUC logo consists of the letters 'TUC' in a bold, sans-serif font, followed by a graphic element of a grid of squares that tapers to the right.

Contents

<i>Executive summary</i>	<i>4</i>
<hr/>	
<i>1 Background</i>	<i>5</i>
<hr/>	
<i>2 The changes the Government has proposed</i>	<i>6</i>
<hr/>	
<i>3 Budget 2008 measures</i>	<i>8</i>
<hr/>	
<i>4 PBR 2008 measures</i>	<i>10</i>
<hr/>	
<i>5 Budget 2009 measures</i>	<i>11</i>
<hr/>	
<i>6 Non-Budget measures</i>	<i>14</i>
<hr/>	
<i>7 Setbacks and new problems</i>	<i>17</i>
<hr/>	
<i>8 Assessing progress</i>	<i>19</i>
<hr/>	
<i>9 Proposals for reform</i>	<i>20</i>
<hr/>	
<i>References</i>	<i>22</i>

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Stemming the Flood?

The TUC Touchstone pamphlet *The Missing Billions* calculated that £25bn is lost to the Treasury each year through tax avoidance activities. The pamphlet played a key role in placing tax issues back on the political agenda. As a result, the Government has taken unprecedented action to close the 'tax gap'. *Stemming the Flood?* explains what measures have (and haven't) been taken and assesses the Government's success. It shows that while tax avoidance is now at the heart of Government thinking in a way that was unimaginable just a few months ago, there is still much more to do.

Touchstone Extra

These new online pamphlets are designed to complement the TUC's influential Touchstone Pamphlets by looking in more detail at specific areas of policy debate raised in the series. Touchstone Extra publications are not statements of TUC policy but instead are designed, like the wider Touchstone Pamphlets series, to inform and stimulate debate. The full series can be downloaded at www.tuc.org.uk/touchstonepamphlets

Executive summary

The TUC published its report entitled *The Missing Billions* that catalogued the £25bn per annum loss to the UK Exchequer as a result of tax avoidance in February 2008. Since then the economic environment has changed beyond recognition and the UK Government has had three opportunities to announce significant tax reforms.

This paper does four things.

- It assesses the reforms the UK Government has proposed in that period to tackle tax avoidance. It estimates that measures undertaken by the Government since Budget 2008 have saved the taxpayer £1bn.
- It notes some setbacks in achieving that goal that have occurred during the same period.
- It sets out a revised programme for tax reform, based on that in *The Missing Billions* but taking intervening events into account.
- It makes clear that a policy of cutting staff at HM Revenue & Customs (HMRC) is counter-productive when there is a shortage of skilled people available to that agency to tackle tax avoidance, and every one of their staff who does so collects many times their employment costs in tax from those seeking to avoid paying their obligations to society.

As was the case when *The Missing Billions* was published, the case for reform is pressing. When the alternative is now seen to be cuts in public services and resulting hardship and unemployment for millions in the UK the case has moved on from being an economic one to being a matter of social and moral necessity.

The report will be published and distributed widely to opinion formers and policy makers. The TUC will discuss the findings with the Treasury and urge action to address the still significant problem of tax avoidance.

1 *Background*

The TUC published its report on tax avoidance in the UK entitled *The Missing Billions*¹ in February 2008. That report suggested that the UK was losing at least £25bn a year as a result of tax avoidance activity, £13bn of this resulting from the actions of individuals and £12bn arising from tax avoidance activity by companies.

The report was well received, and has been widely quoted, but in the relatively short period since it was published two significant events have occurred that suggest it is now time to look again at the issue of UK tax avoidance. The first issue has, of course, been the onset of recession. This has radically transformed the Government's need for taxation revenue. The second series of events have been the Government's attempts to tackle tax avoidance, which have increased in range and scope over this period.

This paper focuses on what the Government has, and has not done, since February 2008. It analyses the approaches it has adopted and appraises their chance of success; it highlights those changes which increase the likelihood of successful tax avoidance (of which there have been several), offers praise where it is due (as on occasion it is) and it makes the case for continuing change and vigilance in this area.

2 The changes the Government has proposed

The Government has had three opportunities to change legislation on tax avoidance since *The Missing Billions* was published. These arose in the budgets of 2008² and 2009³ in the Pre-Budget Report (PBR) of 2008⁴. Each included significant anti-tax avoidance measures, but many were of a routine nature, blocking identified loopholes. This report will not discuss those detailed and reactive initiatives; its focus is upon those changes that represent policy initiatives.

The policy initiatives that the Government has proposed can be summarised in the following table which is based on data published by The Treasury as part of the Budgets and PBRs:

Announcement	Description of initiative	Estimated second year impact £m ⁵
Budget 2008	Disguised interest	120
	Controlled foreign companies	150
	Double tax treaties	40
	Other routine measures	280
PBR 2008	Change of accounting practice regulations	15
	Enhanced tax avoidance disclosure rules	15
Budget 2009	Foreign exchange abuse: targeted anti-avoidance rule	20
	Corporate intangible assets regime abuse	130
	Double tax relief abuse	100
	Publishing the names of serious tax defaulters	20
	Accountability of senior accounting officers	40
	Debt management review	5
	Others	55
Total		990

This suggests that approximately £1bn of tax avoidance has been tackled in little more than 18 months, which represents a small but useful encroachment on the tax losses arising from this activity .

This however is not the whole story. First of all, not all of the measures announced have been enacted in the form anticipated when announced, as will be noted below. Second, some proposals have arisen outside the formal budget and PBR structures. In particular, the G20 in London in April 2009 gave rise to a significant initiative to tackle tax haven abuse, worthy of consideration here, and subsequent to the Budget in 2009 a draft Banking Code of Conduct has been proposed, which it is suggested will have significant taxation effects. Again this will need consideration. Finally, this is not a story of consistent progress. Some anti-avoidance measures have been abandoned with somewhat less fanfare than those introduced. The reasons for, and consequences of, these changes, have also to be considered.

Before dealing with these additional issues it is, however, appropriate to review the mainstream measures announced in the Budget initiatives and consider what impact these might have.

3 Budget 2008 measures

Disguised interest

This measure tackled tax avoidance using sophisticated financial products. Two particular arrangements were targeted. The first involved the abuse of leases and the second the creation of interest which did not have to be declared on tax returns.

Both were technical abuses revealing the creativity of the accounting and legal professions when seeking to undermine the taxation system. The changes are a credit to the tax disclosure regime introduced in 2004 which was designed to provide early information to HMRC about the detail of tax avoidance schemes so allowing those schemes to be risk assessed. Where appropriate this then allowed loophole closing anti-avoidance legislation to be passed earlier than might otherwise have been the case. The 2008 changes did not, however, represent significant changes in policy with the exception that principles-based legislation was introduced to tackle these abuses, which is something that the TUC supports for two reasons. First it provides enhanced flexibility to tax officials when seeking to challenge abuse and the ways in which it develops without requiring new legislation to tackle each and every such development. Secondly it paves the way for a general anti-avoidance principle (GAntiP) which would enshrine in tax law the principle that transactions undertaken solely or mainly to secure a tax advantage should not result in tax relief being given.

Controlled foreign companies (CFC) legislation

CFCs are companies that are incorporated outside the United Kingdom that are under the control of a UK parent company. A number of highly publicised tax abuses sought to circumvent these rules by using limited liability partnerships established in tax havens (or secrecy jurisdictions, as we prefer to call them). These arrangements were also, often, associated with the use of trusts, and many of the arrangements were highly abusive and artificial. As a result the Government introduced legislation to bring these arrangements within the scope of the UK's controlled foreign company legislation, which allows HMRC to treat these arrangements as taxable in the UK even though they do not appear to be undertaken by entities resident here.

This move is part of a continuing policy initiative that the Government is pursuing on the taxation of profits arising overseas. In broad terms the Government has changed its tack on this issue since 2008: until recently UK corporate tax policy required that all profits of a UK parent company would, at least in theory, eventually be taxed in the UK, even if earned overseas, albeit that credit was given for tax paid in the country where the profits rose. The new policy is that if the profits are earned in a country with an acceptable taxation regime and in a subsidiary that is pursuing a genuine trade then the profits in question should only be taxed in the country in which they arise, and not on their subsequent transfer to the UK.

On the other hand, when the UK is not satisfied that these conditions apply, suggesting instead that profit has been artificially transferred out of the UK to a company that is not pursuing a real trade or to a company in a location with an unacceptable tax regime, then HMRC is seeking stronger powers to bring those profits that companies have sought to take out of the UK back within the UK tax net.

In broad terms this policy is appropriate: in a genuine multinational company that is genuinely trading in multiple countries there appears to be no good reason why profits should be subject to a second taxation charge because they must flow through the UK to reach what is, almost certainly, an international shareholding community. To do so only reduces the effectiveness of the UK as a holding company location, and there appears to be little economic incentive to do that.

That concession does, however, create two significant risks. Firstly, the change in government policy might result in a potentially significant loss of corporation tax income. This is because without adequate protections being put in place it would be all too easy for a multinational corporation to artificially attribute profits to low tax areas. Secondly it created the risk that the UK might be seen to be offering itself as a form of tax haven for some headquarters companies, leading to potential counter attack from other locations with the additional risk that this could undermine the cohesiveness of the international initiative to tackle tax abuse. So far this does not, however, appear to be the case.

As we note below, however, the biggest current concern is that the process of change is currently incomplete and that the implementation of it has not, as yet, been properly managed, meaning that significant tax avoidance opportunities have been created that did not exist before the change process began.

Double Taxation Treaty Abuse

This scheme, announced at the same time as that noted in the previous section, tackled overlapping areas of abuse. Double tax treaties are important: they are designed to prevent income being taxed twice in differing countries, and that is part of tax justice. It is obviously inappropriate that the same income be taxed at full rate in more than one location. It is equally obvious that those who abuse double tax treaties to secure double non-taxation should be prevented from doing so. The proposal made in the 2008 budget stopped the artificial diversion of income from a UK resident individual to a foreign partnership using complex structures that resulted in a claim that the income fell out of UK taxation. This move was an entirely appropriate anti-tax avoidance measure.

4 *PBR 2008 measures*

PBRs are not meant to be the place to announce major tax initiatives – but the reality has been that the distinction between PBRs and the Budget has been reduced to the point where tax policy is now as likely to be announced in November as March.

The 2008 PBR in fact only announced two costed changes to the law. The first was an amendment to the tax avoidance disclosure regime, introduced at Budget 2004. Although it was announced as an administrative change the intention was to make sure that more schemes were captured by the rules so that HMRC had more chance to respond to avoidance swiftly and in a targeted fashion.

This change was necessitated by the behaviour of some tax advisers who had extended their tax avoidance activities so far that they were by 2008 seeking to avoid the requirements of the anti-avoidance disclosure scheme rules. This announcement cracked down on these practitioners, famously described as “spivvy firms [who] specialised in promoting the kind of tax avoidance schemes others would not touch”⁶ by Dave Hartnett, now Permanent Secretary for HMRC at HM Treasury.

The second measure was another change in rules designed to challenge the ongoing losses on artificial arrangements within lease contracts.

5 *Budget 2009 measures*

As economic pressure on government financing increased so has the need for anti-avoidance measures increased, and this was reflected in the Budget for 2009. The Budget included a number of significant and bold policy initiatives to tackle tax avoidance issues, many of which were not anticipated by the tax profession.

A group of these initiatives represented a significant change in UK tax policy, in no small part because they appear to break down the principle that the Revenue will handle all taxpayer's affairs in confidence. These arrangements are as follows:

Publication of names of serious tax defaulters

The Government announced legislation that allowed HMRC to publish the names of companies and individual taxpayers who incur a penalty because they have deliberately understated over £25,000 of tax due. A similar policy was adopted several years earlier in the Republic of Ireland.

The reason for adopting this policy is that the vast majority of tax enquiries do not result in criminal prosecutions: they are settled by way of civil agreements even though the law has been broken. To date this has, however, meant that no publicity could be given to these cases since the person making the settlement had not been found guilty of an offence, even though they might have paid a significant tax penalty.

The change in the law has the deliberate intention of creating reputational risk for those who have broken tax law but have not been prosecuted as a result. This is expected to have a significant deterrent effect: for at least some who commit tax offences and subsequently settle their liabilities by way of civil agreement the avoidance of publicity has been an issue of considerable concern. The chance of anonymity has now been removed from those committing such offences.

This move is to be welcomed, although it has been subject to significant criticism within the tax profession who say it might catch those who make innocent errors. Innocent error of such scale is, however, usually indicative of a degree of inappropriate carelessness with regard to the application of the law. There is no room for such mistake in other areas, such as the benefit system. In that case the deterrent effect of this measure is appropriate, justified and overdue. The amount of tax evasion (for that is what this issue addresses) that will be prevented as a result is very hard to assess, although as noted above HMRC have provided what seems to be a cautious estimate of £20m a year. What the measure does, however, do is increase the risk profile of aggressive tax avoiders who risk committing tax evasion, and that is a significant move in the right direction.

New reporting requirements for tax defaulters

At the same time a further measure was introduced. HMRC are aware that a small minority of tax defaulters put significant tax revenues at risk. As a result a new measure has been introduced that means that those who have incurred a penalty for the deliberate understatement of tax of at least £5,000 will now be required to provide more information on their tax affairs for up to five years after an investigation has been resolved to ensure they have proper systems in place that allow them to make a correct tax return. This will assist HMRC in monitoring their compliance with the requirements of the law during this period.

This had not been possible until Budget 2009. Once a person or company has, to date, settled a tax enquiry and agreed a tax settlement their future affairs could only be investigated by opening another new and separate enquiry, with all the costs associated with that process. The new powers effectively provide the equivalent of a probationary period for those who have been shown to have scant regard for the requirement that they keep proper books and records that are the basis for any tax return.

These orders are likely to be widely used, but will be of little concern to the vast majority of taxpayers, self employed people and companies. They will have a significant deterrent effect on that minority of taxpayers who show scant regard for the law. There is, however one important proviso to note: HMRC must have sufficient staff available for them to undertake the work that this procedure will require. It is not clear that this will be the case as a consequence of the current round of job cuts HMRC are undertaking.

Accountability of senior accounting officers

The measure that proved most controversial of all in this Budget was the announcement that henceforth senior accounting officers of major companies would have to certify personally that adequate systems to prepare accurate tax computations are in place in their organisations. In the event of penalty being due these would be a personal liability of that senior accounting officer.

Given that the maximum penalty due is modest and the companies that this provision relates to are those with sales of more than £200m a year⁷, meaning that the senior accounting officer in question is likely to enjoy a considerable income, the furore this proposal created could not just be about the personal liability issue. The reality was, as Deloitte discovered when undertaking a survey on this issue, that half of all companies were not sure they could comply with this most basic requirement that is already implicit in company law⁸. This is an extraordinary finding, and shows the timeliness of this issue as well as revealing the cause of its unpopularity.

Offshore disclosure

Announced in the Budget but with details published in August 2009, another significant new initiative was the launch of a second 'disclosure opportunity' for offshore bank account holders. This will run until March 2010. This new 'disclosure opportunity' has been given real bite by HMRC having served notices on more than 300 banks operating in the UK requiring that they disclose details of all accounts they maintain on behalf of UK resident customers.

The first disclosure opportunity, for the offshore customers of Lloyds TSB (as then was), Barclays, Royal Bank of Scotland, HSBC and HBOS (again as then was) in 2007 was a success. Some 42,000 people voluntarily disclosed tax evasion using offshore accounts and more than £400m of tax was paid⁹. HMRC were, however, aware that many offshore bank accounts were held with smaller or lesser known institutions and that this issue had not been

addressed by the first disclosure programme, which like the current scheme offered those coming forward a chance to pay their tax and the interest due on its late settlement together with a modest penalty of just 10 per cent of the tax due, assuming no other criminality was disclosed.

Four benefits result from this process. First tax is collected. Second taxpayers are brought back within the tax net. Third the hold of offshore banks on the affairs of some taxpayers is broken, and fourth, information about the banks in question and those who might have introduced their customers to them can be collected, giving a chance to crack down on the tax advisers who promote such arrangements. As a result whilst such schemes have about them the appearance of an 'amnesty', meaning some avoid penalties otherwise due, they are undoubtedly effective in terms of revenue raised at low cost now and in the future. So long as it is understood that this is the last such offer this arrangement is, therefore, to be welcomed.

In addition to these arrangements targeting particular issues, and with the new, and added risk of disclosure of names of offenders being attached, there were other important initiatives in the Budget for 2009:

1. Further abuses of double tax reliefs using entirely artificially manufactured tax arrangements were outlawed.
2. Abuse of rules on providing tax relief for purchased goodwill were outlawed.
3. Abuse of North Sea Oil tax relief schemes was stopped.

Each of these was, however, a reactive measure designed to close a specific loophole and is not considered further here.

6 *Non-Budget measures*

Two major non-Budget measures need noting.

Tax havens

The first has been the G20 orchestrated action against tax havens. In its communiqué issued on 2 April the G20 said¹⁰:

We agree ... to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over.

The supporting statement on strengthening the financial system said¹¹ (in edited form):

It is essential to protect public finances and international standards against the risks posed by non-cooperative jurisdictions.

We call on countries to adopt the international standard for information exchange. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of information.

We stand ready to take agreed action against those jurisdictions which do not meet international standards in relation to tax transparency. To this end we have agreed to develop a toolbox of effective counter measures for countries to consider.

We are also committed to strengthened adherence to international prudential regulatory and supervisory standards.

Some doubted whether this meant the beginning of the end of tax havens, as Gordon Brown claimed for the G20 process¹². However, the Prime Minister went on to strengthen the G20 message in a series of letters to the governments of the UK's Crown Dependencies and Overseas Territories issued at the time of the G20 meeting and in the week afterwards¹³. The letters made it clear that the Crown Dependencies and British Overseas territories were required to reform or face sanction.

Some territories are already seeing the practical implications of this new policy. The Cayman Islands has been subject to a UK demand that it impose new taxes as a condition of allowing it to take a loan to stave off a financial crisis, and the Turks and Caicos islands have been made subject to direct UK rule because of a local corruption scandal.

The impact of the policy appeared to move closer to home in October 2009 although the full details have yet to become clear. First, news from the Isle of Man appears to suggest that the UK is seeking to claw back between £50m and £100m of the estimated £230m subsidy the UK has been giving that island. This represents a sum of between 9 per cent and 18 per cent of the island's total income – and still a big saving for the UK. It would, however induce

a budget crisis in the Isle of Man, which crisis will only be exacerbated by the news that the UK is no longer willing to argue in Europe that its Crown Dependencies (Guernsey, Jersey and the Isle of Man) comply with the requirements of the EU Code of Conduct for Business Taxation. This means that each island will have to reform its tax system – almost certainly meaning the end of the zero per cent tax rates that have been critical to their status as a centre for banking services and transactions, so undermining the future of their financial services sector but at the same time offering real prospect of reduced losses to the UK from tax avoidance and evasion.

As a result, some tax havens have already begun the reform process. Most of the major British territories have now met the OECD standard of 12 Tax Information Exchange Agreements. Critics however point out this number is small when there are more than 200 jurisdictions in the world and the standard of proof required to make an information exchange request is so high that HMRC must in effect know the answer to most of the questions it might seek assistance on from a foreign tax authority before making enquiry of them.

In addition, many of the fundamental concerns of tax haven critics have not been addressed: banking secrecy remains in many places, multinational corporations can continue to trade in these places without having to file accounts and recent media reports suggest that whilst these places may have all the right regulations in place they also do their utmost to ensure that their customers can avoid them. There is real doubt as a result as to whether the changes implemented so far have been sufficient to change the culture of offshore finance.

This concern was reflected in the report of the Treasury's independent review of offshore financial centres which was published in October 2009¹⁴. It said:

Meeting international standards on tax transparency, financial sector regulation and financial crime is an absolute must if the jurisdictions wish to continue to hold themselves out as internationally active financial centres, but international pressure must also be maintained on competitor jurisdictions to raise their standards.

A number of the jurisdictions I have reviewed have a good story to tell, but there is no room for complacency. Others have more to do, particularly on regulation and tackling financial crime.

Some will need technical assistance to help with the fight against financial crime, but the local governments must first demonstrate that they are committed to taking the action necessary to secure the benefits of this assistance in the long-term. There can be no second chances.

Given the growing momentum behind significant international and domestic efforts to constrain tax avoidance and evasion, it is vital that the local populations of tax havens, many of whom have worked in the financial services sector as it has been the only source of employment available to them, should not suffer. It is very important that these locations should be given financial and other support to protect jobs and livelihoods.

In particular, it is vital that any changes to subsidies or flows of funds from the UK Government to the Crown Dependencies and British Overseas Territories that may be reduced as a result of new regulations (such as the Common Purse Agreement with the Isle of Man) must be replaced with new funds negotiated on a different basis, with an emphasis upon the need to develop new economic activity in these locations. In addition, transition funds should be made available by the international community and national governments to prevent any redundancies or hardship during the period in which territories are restructuring their economic activity. Most importantly, any transition must be agreed and shaped through

a process of dialogue between national governments, multilateral agencies, territory governments, businesses and unions.

The TUC hopes to publish a comprehensive report on tax havens in the New Year. This will look in detail at the recent advances made by the Crown Dependencies in terms of improvements to their transparency and will provide a thorough account of the nature of the support that needs to be given to the islands in the wake of the concerted international efforts to limit tax evasion and avoidance. In particular, the report will urge the Government to press the European Union to make transition funds available to all European offshore centres. Given that the EU has been a particularly strong source of action against offshore activities – through the Code of Conduct on Business Taxation and the Savings Tax Directive – such a move would seem fully justified.

The tax code of conduct for banks

The second change has been the announcement of a Code of Practice on Taxation for Banks¹⁵, the draft version of which was published in June 2009. The Code is unusual in its approach. As it says:

The Government believes that for the tax system to be effective it must be seen to operate fairly and everyone should pay their fair share of tax. Tax avoidance undermines the ability of the tax system to deliver the Government's objectives and creates other unwelcome distortions.

Tax avoidance takes many forms. It can, for example, involve exploiting loopholes in legislation, artificially creating the conditions for tax relief, or using different parts of the tax code together to get a result which was never intended by the legislation.

And, as was also noted:

Given their access to capital, as well as their range of contacts, banks are uniquely placed to enter into transactions designed to avoid tax, offer transactions of this sort to their customers, or provide the very large amounts of funding and other financial instruments these transactions can require. The Code ... seeks to change behaviours and attitudes towards tax avoidance in the banking sector.

To tackle this issue the Code says that:

The Government expects that banking groups, their subsidiaries, and their branches operating in the UK, will comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament. This means that banks should: adopt adequate governance to control the types of transactions they enter into; not undertake tax planning that aims to achieve a tax result that is contrary to the intentions of Parliament; comply fully with all their tax obligations; and maintain a transparent relationship with HMRC.

There is as yet no clear indication that UK banks will voluntarily comply with this Code. When the consultation process on the Code was concluded there was clear indication that many of the professional bodies representing banks and tax advisers objected to the voluntary nature of the Code and to what they saw as the implied requirement that, as they saw it, banks should pay tax on a non-statutory basis. Some have argued this is 'unconstitutional'¹⁶. These issues will be addressed later in this report when recommendations are made.

7 *Setbacks and new problems*

The impression given so far in this report is that there has been progress on all fronts with regard to tackling tax avoidance and evasion. This is not true. Some previously proposed policies failed during this period. Other initiatives have not worked as planned. And new problems have developed.

Income shifting

The major policy setback was the failure to tackle income shifting in private limited companies. As the TUC showed in *The Missing Billions*, income shifting is a major tax avoidance problem where couples in married relationships and civil partnerships shift income between them to maximise use of tax allowances and lower tax rates. It has an impact on receipts of income tax, national insurance, capital gains tax and inheritance tax.

In 2007 an initiative was announced to stop related couples owning private limited companies in which only one partner really worked, but where the benefit of the efforts of that one person was then split between them for tax purposes, with the split returns usually being paid to them as dividends and not in the form of a salary. This firstly undermines national insurance receipts and secondly diverts what is by then investment income to a person who has no real entitlement to receive it. When announced the anti-avoidance initiative was meant to raise at least £260m in tax year 2009/10¹⁷.

However in the PBR for 2008 it was announced that:

The Government firmly believes it is unfair to allow a minority of individuals to benefit financially from shifting part of their income to someone else who is subject to a lower rate of tax – known as income shifting. The Government has consulted on this issue, but given the current economic challenges is deferring action on income shifting and will not bring forward legislation at Finance Bill 2009. The Government will instead keep this issue under review.

The reality is that the issue has been abandoned for the time being. The result is that a favourite trick of High Street accountants remains available for maybe hundreds of thousands of people to abuse each year at cost to the tax payer much in excess of the estimated saving HMRC hoped to achieve. In *The Missing Billions* it was estimated that this type of arrangement cost HMRC not less than £1.2bn per annum whilst other forms of income shifting might cost up to £2bn per annum. At present all such arrangements appear immune from serious HMRC attack.

Redomiciling

The process of reforming the basis of taxation for foreign income of UK-based companies has not been without problems.

The first problem has been the mismanagement of the process so that the rules that exempt foreign source income from tax in the UK have come into effect but the necessary changes to the controlled foreign company rules needed to prevent their abuse are still not complete. This means that a significant opportunity for abuse has been created which it may be hard to close. This appears to have been a major management error and means that successful delivery of this policy change on a revenue neutral basis, as planned, may not happen.

Second, this policy has been subject to attack with a number of the largest companies in the UK claiming that they have moved their place of tax residence out of the UK to avoid the impact of the planned controlled foreign company rules. In most, but not all cases, they have created new parent companies incorporated in Jersey (which has a zero per cent corporation tax rate) but claim to have tax residence in Ireland (which has a 12.5 per cent corporation tax rate but no controlled foreign company rules basically meaning that no foreign source income need be taxed there).

This process has revealed a substantial flaw in UK corporation tax law, which is that only companies and their branches resident in the UK are liable to UK corporation tax. This is a problem because a company is only resident in the UK if either it is incorporated here or it has its central management and control in the UK. The second test is almost always satisfied by determining where its board meetings are held.

Forming companies in Jersey gets round the first problem. The companies which have emigrated think they have got round the second issue by renting offices in Dublin and buying their board of directors a few return tickets to Ireland each year but otherwise carrying on trade as normal, as before, in the UK. This may, however, be an artificial device, as some in the press have suggested¹⁸. As such this is an issue that now needs to be addressed as part of the anti-avoidance agenda.

Personal tax exodus

The prospect of 50 per cent personal tax rates has led to suggestions that there will be an exodus of people from the UK, whether they be bankers or other highly paid people. Leaving aside the accuracy or factual basis for these claims and also leaving aside a cost-benefit analysis, there is a significant tax issue to address, which is the ease with which a person can become non-resident in the UK and yet retain significant economic ties with this country. As the so-called 'Monaco Boys' have proven, it has been possible to become non-resident in the UK and yet commute in from the south of France and be in the UK for up to three nights a week.

A number of recent court cases have left considerable uncertainty about when a person is, or is not, resident in the UK. At present the situation is open to significant exploitation. This is, again, a matter to which we return below when making recommendations for the next steps to be taken in the anti-avoidance programme.

8 *Assessing progress*

In the context of a tax avoidance driven tax gap of at least £25bn a year progress in the last 18 months has been useful, but modest. When the noted setbacks are taken into account the overall achievement is likely to be limited.

That is worrying. Tax avoidance is now an issue at the core of the political debate, and it will remain so, whoever might be in power after the next general election. The key political issue is that the recession is creating a need for additional government revenue, since it is primarily a shortage of revenue and not an excess of spending that has created the current level of government deficit.

The reality is that tax is paid by consent in the United Kingdom. This may not appear to be the case for those in employment with limited investment income, but for those who are self employed or who run companies the relatively high rate of compliance with tax law is the consequence of voluntary disclosure to HMRC since the resources it has available to pursue those not willing to pay are very limited. This rate of voluntary compliance is dependent upon widespread acceptance of the tax system being, despite all complaints made, broadly equitable.

When additional revenue is being demanded the obligation upon political parties of all hues to close loopholes exploited by those avoiding tax will be high since the existence of persistent tax avoidance, especially when undertaken by major corporations and those with significant earnings, will undermine the widespread perception of tax justice that exists at present. It is, therefore, an issue of considerable significance to the future well-being of the UK that tax avoidance be tackled. The remainder of this paper does, therefore, outline the TUC's proposals for tackling this issue. Many of these proposals have been made previously in *The Missing Billions*. Others take into account the new issues noted in this paper.

9 *Proposals for reform*

To tackle the problem of tax avoidance, the following actions are suggested:

1. There should be a minimum rate of tax to be paid on the income of those earning more than £100,000 a year to ensure that they do not unduly benefit from tax reliefs and allowances that society cannot afford to provide to them.

Since this policy was first proposed in *The Missing Billions* the Government has made small and welcome steps in this direction by reducing the rate of tax relief for some pension contributions paid by those with earnings of more than £150,000 a year and by restricting the right to a personal allowance for those earning more than £100,00 a year but there is a long way to go if all opportunities for abuse are to be eliminated and if the tax system is to be simplified, as many think desirable.

2. The current round of HMRC staff cuts should be stopped so that adequate resources are available to tackle the issues this report raises.

3. The UK's domicile rule should be abolished as a first step towards simplifying the UK's overly complex rules on personal tax residence.

4. A new statutory basis should be created for determining when a person is tax resident in the UK, as is currently being considered by the Treasury. This must be based on more than a simple count of the number of days they spend in the UK each year but must also be simple enough to operate so that most ordinary people can determine their residence status on the basis of a simple on line set of questions and answers. Any such rule must also include significant anti-avoidance rules so that those leaving the UK to live in a location with low or no taxes and no history of tax cooperation with the UK should face considerably higher obstacles before being considered non-resident than do those leaving for locations such as other EU countries.

5. There should be reform of the rules on company residence so that the artificial relocation of a company's place of management and control in an effort to escape the UK tax net becomes considerably harder to achieve.

6. Introduce robust new controlled foreign company rules that, in particular, tackle abuse arising from companies transferring the ownership of intellectual property into tax havens.

7. Introduce a new law called a 'general anti-avoidance principle', or GAntiP, that treats all tax avoidance as unacceptable and therefore open to challenge. The Government continues to move slowly in this direction, with a move towards what is called 'principles-based legislation' in some areas and an increasing number of 'targeted anti-avoidance rules' that seek to achieve the same objective as a GAntiP in limited areas. It must now have the courage to make this approach universal.

8. Tackle income shifting in three ways:
 - a. Radically reform the way in which small companies are taxed to both simplify current arrangements and prevent abuse – this would require the income of such companies to be treated as belonging to their shareholders unless those shareholders are not resident in the UK, so preventing tax deferral by use of corporate structures.
 - b. Introduce an additional tax charge on investment income above a set limit so that it is taxed at rates similar to those applied to earned income when national insurance is taken into account to reduce the incentive to shift income between partners in a relationship and to create fairness between those living on earned and unearned income, which does not exist at present.
 - c. Make it much harder to abuse Capital Gains Tax by shifting the ownership of assets prior to their sale.
9. Charge all capital gains on assets held for less than a year to income tax and increase the rate of tax on remaining gains considerably to reduce the incentive to shift income so that it is treated as if a gain.
10. Reform the tax relief for charities to stop abuse, increase the income of charities and to cut their administrative burden.
11. Demand that all tax havens in the world enter into Tax Information Exchange Agreements with the UK.
12. Promote the use of new mechanisms for automatic information exchange between all tax jurisdictions (except those where human rights abuses are commonplace) so that information is provided by one jurisdiction to another jurisdiction if a tax resident person of the second jurisdiction has an interest in a financial structure (whether that is a bank account, company, partnership, trust or foundation) in the first jurisdiction. Information exchange of this sort would provide the 'smoking gun' needed to prevent significant amounts of offshore tax abuse because it would ensure HMRC would have sufficient information to investigate any person with an offshore account.
13. Increase cooperation on taxation and accounting internationally to ensure that companies are held to account for where and how they operate and are required to act as good corporate citizens, including in the payment of their dues to society as a whole and in each location in which they operate.
14. Make the Bank Code of Conduct legally enforceable.
15. Introduce a code of conduct for all taxpayers, tax advisers and the Government itself, with increased penalties for non-compliance¹⁹.
16. Apply the 'name and shame' provisions now being used to target tax evaders and large companies to the bankers, lawyers and accountants who might have assisted those so named.

It is not possible at this juncture to quantify precisely the benefit that would result from this programme of tax reform. It is reasonable to expect the benefit to considerably exceed £10bn per annum.

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