TOUCH STONE
PAMPHLET#1

The Missing Billions

The UK Tax Gap

Through original and painstaking research, *The Missing Billions* reveals the truth behind the practices that are costing the public purse billions of pounds every year. *The Missing Billions* explains how, given the political will, much of this lost tax could be reclaimed to serve the public good through improving public services or reducing the tax bill of middle and low earners. With the UK's finances under their greatest strain for years, this is a timely study that will provoke widespread debate.

This pamphlet was researched and drafted for the TUC
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TUC

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TOUCHSTONE

The Missing Billions

The UK Tax Gap

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Foreword

by Brendan Barber, TUC General Secretary

Few issues can be more important to a modern democracy than the integrity of its tax system. The Budget is a highlight of the political year because it is the point at which Parliament allows government to continue. Without money, there could be no state and no society.

It is deeply troubling, therefore, to discover that the tax system is being increasingly undermined by the practice of tax avoidance. The sheer extent of money lost to these practices must add to the growing sense that a small group of wealthy individuals and organisations are operating beyond the normal rules of society that the rest of us believe to be fundamental to a fair and civilised life.

Tax avoidance is also having an impact on current Government policy. Gordon Brown, quite rightly, dedicated himself to keeping public borrowing to sustainable levels. As he edges dangerously close to being beyond that level, he is straining every administrative muscle to limit the growth in public spending. But this struggle is cast in a totally new light when one becomes aware that such large amounts are lost in tax every year to avoidance activities. In short, tax avoidance is now having a very direct impact on the resources spent on public services in the UK.

But we must be clear this is not just about public services. This is also about tax fairness. Not only is it the wealthiest who benefit most from exploitation of reliefs and loopholes in the tax system but the lost cash means there is less freedom for a Chancellor to create a fairer system for those who earn less. It is particularly striking that half of the amount lost to avoidance would be enough to raise the point at which the higher rate of tax starts by £10,000 of salary. Indeed, it may be middle-income earners who have a right to feel most aggrieved. You do not have to agree with our support for more resources for public services to agree that the tax system is unfair and needs reform.

This is of course only one symptom of a wider problem of growing inequality. Tax avoidance by the wealthy has become a huge problem because incomes for those at the top have grown more than for those in the middle.

This is the first TUC Touchstone pamphlet. Touchstones are designed to stimulate debate not just within unions but throughout society. Unions are pragmatic practical organisations who do not always do enough to intervene in the nation's intellectual life. Thanks to Richard Murphy, this pamphlet should get this process off to a cracking start by starting a serious national debate about the integrity of the tax system and what it means for public spending and fairness in Britain.

The result of the calculations set out in this report reveal that the amount of tax lost to avoidance and planning is a number bigger than most might ever imagine. £25 billion annually is lost from tax avoidance.

Executive summary

This report achieves what many have claimed impossible: it calculates the tax lost to the UK Government from tax avoidance and from tax planning by the very wealthy. Tax avoidance is the process of getting round taxation law without actually breaking it. Tax planning is the use of the opportunities Parliament has provided to citizens to reduce their tax rate.

The result of the calculations set out in this report reveal that the amount of tax lost to avoidance and planning is a number bigger than most might ever imagine. It is estimated here that £25 billion annually is lost from tax avoidance. This is made up of £13 billion p.a. from tax avoidance by individuals and £12 billion p.a. from the 700 largest corporations.

Estimating these figures involved an original detailed analysis of several sets of Government data and further analysis of 344 sets of accounts published by the UK's fifty largest companies covering a seven-year period.

It is estimated that an additional £8 billion p.a. is lost to public funds from tax planning by the wealthiest members of the UK community, i.e. those earning over £100,000 p.a.

The result of this is that the UK tax system is not nearly as progressive as Parliament intended and as social justice requires. In addition, public funds are more scarce than they may otherwise be and certainly more scarce than Parliament would have intended when agreeing tax rates. It is notable that the Government is currently seeking to rein in the annual growth in public spending by 30 billion pounds through an "efficiency programme". Given this figure is not far in excess of the current income lost to tax avoidance and is actually less than that lost to avoidance and planning combined, this report raises serious questions about the price now being paid by public services as a result of this activity.

In the case of individuals, tax avoidance usually takes the following forms:

- shifting income from the person who should really pay tax to someone else;
- moving transactions out of the UK
- changing the nature of transactions, in particular so that income is subject to Capital Gains Tax rather than income tax
- abusing the law on limited companies.

Companies have more opportunity than individuals to avoid and plan for tax. This is, in particular, because they operate internationally, opening avenues for tax planning and avoidance between territories that no individual can exploit. This is why the rate of tax lost to corporate tax planning and avoidance is found to be greater as a proportion of tax actually paid than that for individuals. This report bases its findings on new and original research of the fifty largest companies in the UK and shows that:

- The fifty largest companies almost always pay 5% less tax on average than they declare in their accounts.
- The average tax rate paid by these companies fell by more than 0.5% a year over a seven-year period to 2006, even though the UK tax rate for these companies was constant throughout that time – as a result, the *de facto* corporation tax rate for UK companies in 2006 was 22.5% when the actual rate agreed by Parliament was 30%.
- This means that when the new higher corporation tax rate for smaller companies reaches 22% by 2011 (as announced in the 2007 Budget), small companies are likely to be paying a higher proportion of tax on their profits than the fifty largest companies on current trends.
- If this *de facto* tax rate was the official tax rate it would place the UK 16th in a table of corporation tax rates for the EU 25 with France the highest and Malta the lowest – it would also mean that the UK had the lowest corporation tax rate of the Western European economies with the exception of Ireland.
- By the end of 2006, the cumulative tax savings recorded in the accounts of the fifty largest companies was £47 billion; this actually exceeded the total tax paid by *all* companies in 2006 by some £2 billion.

These figures strongly suggest that the regular complaints from the business community about the burden of tax they endure in the UK should be treated with a high degree of scepticism.

The facts relating to tax avoidance and tax planning make it clear that this deliberate behaviour is imposing a substantial cost on UK society, and on those taxpayers who seek to comply with the spirit and letter of UK tax law. Knowing this is not enough though. This report offers a series of practical solutions to address the problems identified.

Fundamentally, the current Government approach of plugging loopholes in tax legislation is inadequate. The Government must assert its right to collect and expend taxation revenues in pursuit of its democratic mandate. This has been lacking and it is now time for the Government to change the terms of this debate if it is to secure the full tax revenue that Parliament expects it to secure when tax rates and arrangements are agreed by MPs and Lords.

To this end, the following actions are suggested as a spur to public debate on how the Government and Parliament should react:

1. introduce a new law called a 'general anti-avoidance principle' that treats all tax avoidance as unacceptable and therefore open to challenge
2. stopping the current round of HM Revenue & Customs staff cuts so that adequate resources are available to tackle the issues this report raises
3. abolishing the domicile rule
4. abolishing unnecessary tax reliefs enjoyed primarily by the wealthiest individuals
5. making it much harder to abuse Capital Gains Tax by shifting the ownership of assets prior to their sale
6. applying income tax to all capital gains on assets held for less than a year
7. reforming the tax relief for charities to stop abuse, increase the income of charities and to cut their administrative burden
8. introducing 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
9. the introduction of 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
10. engage more actively internationally in tackling abuse promoted through tax havens
11. redesign the way small limited companies work to reduce the risk of tax abuse
12. increase cooperation on taxation internationally to ensure 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.

These proposals could at least halve the cost of tax avoidance and tax planning to the ordinary people of the UK. And as the report shows, the potential benefits of that are significant:

- Half of the total amount lost to tax avoidance could raise the level at which the higher rate tax rate is paid by £10,000, offering significant financial relief to those on middle incomes.
- Alternatively, the same amount would pay for a 20% increase in the state pension *or* could reduce the basic rate of income tax by 3p in the pound *or* could build an extra fifty hospitals.
- *As little as one quarter* of the total tax income lost to avoidance activities would be enough to provide five-and-a-half million public service staff, who are currently facing the prospect of a real terms pay cut, with a pay settlement equivalent to the rise in average earnings across the economy in 2007.

This pamphlet has three objectives:

- *to show that the Government is not collecting all the tax that is due to public funds*
- *to make clear that action can be taken if the appropriate political will is present*
- *to make the case for exercising that political will.*

What this pamphlet seeks to do

This pamphlet has three objectives.

The first is to show that the UK Government is not collecting all the tax that is due to public funds, and to provide an estimate of what amount of tax is being lost.

The second is to make clear that action can be taken to address the problem if the appropriate political will is present.

The third is to make the case for exercising that political will.

To do this the report looks at what tax evasion, avoidance and planning are. It then concentrates on the areas where there is greatest debate, which are those that relate to tax avoidance and tax planning. Since tax evasion is illegal there is a consistency of approach to it across the political divide which means that it is not addressed here.

Having defined tax avoidance and tax planning as its areas of concern the report then considers:

1. how these activities are undertaken
2. what these activities cost public funds
3. what can be done to tackle them
4. what the benefits of this action might be
5. why the arguments that nothing should be done about tax avoidance and planning are wrong.

Technical terms are avoided as far as possible or, where necessary, are defined in the text. However, a full glossary of tax terms is available at the end of the pamphlet to aid understanding.

In addition, a great deal of technical analysis has been undertaken to inform the figures of tax lost to avoidance that are quoted in this pamphlet. Much of this technical analysis is either of little interest to most readers of the pamphlet or will exceed their understanding of tax matters. For these reasons, relatively short and straightforward accounts of the analysis behind the figures for different types of tax avoidance are presented here. For those who are interested to see the detailed analysis, this can be found in a series of technical appendices at **www.tuc.org.uk/touchstonepamphlets**.

What are tax evasion, avoidance and planning?

Together tax evasion, avoidance and planning create what is called the 'tax gap'. This is the difference between the tax that might be expected to be paid given the tax system that is in operation and the tax that is actually collected.

To understand the tax gap the terms tax evasion, tax avoidance and tax planning must be defined. Another term, tax compliance, has also to be introduced because it suggests that a better option is available.

Tax evasion is an illegal activity undertaken to reduce a person or company's tax bill. It might be, for example, that the person or company:

a. fails to declare all or part of their income;

b. makes a claim to deduct an expense from their taxable income that they did not incur or which they were not entitled to deduct;

c. submits a tax return that appears to be legal but only because relevant facts are not disclosed to the tax authorities.

Tax compliance is at the other end of the spectrum from tax evasion. In straightforward terms tax compliance is seeking to comply with the law. When a person or company seeks to be tax compliant they do the following:

a. positively seek to comply with tax law in all the countries in which they operate

b. make full disclosure of all relevant information on all their tax claims

c. seek to pay the right amount of tax required by law (but no more) at the right time and in the right place

d. ensure that the tax submissions they make reflect the real transactions that they undertake. For example, tax avoidance can often involve setting up special companies, very often offshore. These companies might claim to own patents, copyrights or other valuable assets for which they can charge, but in reality the inventions, music, film rights or other products which those companies owned were not really developed by them and were not developed in the place where the income is received. If the tax payer was tax compliant they would not set up special companies for this purpose, and they would ensure that the income was taxed in the place where the asset that gives rise to it was created.

This activity attracts remarkably little attention, but on all available evidence most people and most companies do practice it, and by choice[1].

Tax planning is the way in which a person manages their tax affairs when they are tax compliant. It is the process of making those claims allowed for in law openly and transparently so that the right amount of tax as required by law, and no more, is paid in the right place at the right time and that these reflect the economic reality of the economic transactions they have undertaken. In most circumstances this activity is entirely acceptable. Indeed it would be odd for individuals or corporations to volunteer to pay more tax than Parliament intended. This report will, however, suggest one area where reconsideration of tax planning is necessary.

Tax avoidance is the grey area between tax compliance and tax evasion. In straightforward terms tax avoidance is trying to get round the law without breaking it. When tax avoiding, a company seeks to ensure that one of the following happens:

a. Less tax is paid than might be required by a reasonable interpretation of the law of a country.

b. Tax is paid on profits declared in a country which does not appear to be that in which they were earned.

c. Tax is paid later than the profits to which it relates were earned.

d. Tax is paid by a person who did not really generate the income that they declare. For example, income is quite often switched between members of a family to ensure it is declared by the person with the lowest tax rate even though the family member in question did not really earn the income in question.

Those who avoid tax rarely talk about tax compliance. They only wish to draw a distinction between tax evasion and tax avoidance. The former, as they are keen to say, is illegal. In that case they draw the conclusion that tax avoidance, since it is legal, is acceptable.

However, this position is unacceptable to many. As Denis Healey, Labour's Chancellor of the Exchequer in the 1970s, said: "The difference between tax avoidance and tax evasion is the thickness of a prison wall"[2]. His point was serious. Far from the difference between tax avoidance and tax evasion being easy to spot, he was making the point that it is often very difficult to tell on which side of the fine dividing line between tax evasion and tax avoidance a person is walking when undertaking what they claim is tax avoidance activity. Very often the only way of knowing is by being challenged, with the risk that illegality is proved. This makes clear how morally questionable is the pursuit of tax avoidance.

It is for this reason that Professor David Ulph, formerly of HM Revenue & Customs, has sought to distinguish tax avoidance from tax planning. To do so, he has said that tax planning happens when a taxpayer adjusts their real social, economic or organisational affairs to obtain the "best outcome" in response to the tax system. In contrast, tax avoidance happens when a taxpayer uses artificial or contrived methods of adjusting their social, economic or organisational affairs to reduce their tax liability in accordance with the law while not affecting the economic substance of the transactions[3].

This definition makes clear that tax avoidance is artificial. The purpose of tax avoidance is to obtain tax relief no matter what the circumstances of the transaction that gave rise to the tax. Tax planning, on the other hand, is obtaining tax relief for something you would be doing anyway, or which the Government wishes to encourage. This puts tax planning firmly within the domain of tax compliance.

The distinction is important. No one has an obligation to pay more tax than is required by law. On the other hand everyone should be expected to pay the tax that the law requires of them.

In short, both compliance and avoidance can claim to be legal, but only tax compliance can justify that claim with certainty. Tax avoidance relies on the existence of doubt for its validity.

The practices referred to in this report fall largely in the area of tax avoidance, and detail ways in which individuals and companies seek to minimise their tax bills by working around the law.

Because tax evasion is always unacceptable it is little addressed in this report. The issue is being actively addressed by HM Revenue & Customs with cross party political support.

Although tax planning is a form of compliance, it is addressed in this pamphlet for different reasons. An effective tax system is also an equitable tax system. That is because inequity encourages tax evasion and tax systems that suffer serious tax evasion cannot be considered effective. Equity in tax systems is normally measured in two ways.

The first is by considering the horizontal equity of the tax system which assesses whether those on similar income pay similar tax. The second measure is that of vertical equity, which means that those with higher income pay proportionately more tax. These equitable principles are considered paramount in a just tax system. When tax planning undermines these principles it too has to be the subject of consideration. This report suggests that is the case in the UK tax system. In particular, it identifies the fact that those earning over £100,000 are able to make a disproportionately greater and lucrative use of tax planning than those on lower incomes. In particular, those on these higher incomes who control their own businesses have more scope to plan their tax than those who pay tax primarily through PAYE.

How is tax avoided?

The ways in which tax is avoided differ slightly for companies and individuals. They do, however, have many techniques in common. They seek to secure reduced tax payments by:

1. changing the identity of the person undertaking a transaction
2. changing the location of a transaction
3. changing the nature of a transaction so that it appears to be something different from what it actually is
4. delaying recognition of a transaction
5. obscuring the information available on a transaction.

Examples of each, in turn, include the following:

1. putting a transaction that an individual might undertake into the name of their partner or children or alternatively into a company or trust, or in the case of a company choosing to create a separate subsidiary that enjoys a tax advantage in a group of companies
2. relocating a transaction to a tax haven
3. paying the income of a director of a company as a share dividend rather than as a salary so that National Insurance is not paid
4. using accounting rules to ensure that tax is delayed to a later set of accounts
5. undertaking a transaction in a location where accounting or taxation information is not exchanged with other tax authorities so that an enquiry cannot be made by another country wishing to obtain details of tax owed. Many tax havens have this characteristic.

What is clear is that companies and individuals can pursue these objectives in different ways. In addition, the data available to assess their success in doing so within the UK differs as to source and quality. As such, companies and individuals will be considered separately in the discussions that follow.

How do companies avoid tax?

Companies avoid tax by letting tax influence their decisions on:

1. where to incorporate their head office
2. where to incorporate their subsidiary companies
3. whether to use tax havens or not
4. what companies it will, or will not include in its group structure (which means which ones are added into the 'glossy' accounts, and which ones are not)
5. on what terms it will trade between group companies i.e. whether it will price intra-group transactions on genuine arms length terms, or not (see the glossary for the definition of 'arms length pricing')
6. where it will record its sales
7. where it will incur its costs
8. where it will locate its assets
9. where it will employ its staff
10. where it will borrow money
11. where it will locate its intellectual property
12. how it will structure its operations
13. whether it will seek to exploit special tax privileges.

All of these decisions relate to corporation tax. Opportunities to manage other taxes such as VAT and stamp duty also exist. These include:

1. where to locate transactions for VAT purposes to change the VAT rate charged on them. For example, many internet retailers are currently supplying goods from the Channel Islands to avoid UK VAT
2. whether to buy commercial property located in the UK through UK companies or through offshore subsidiaries: the latter avoid stamp duty
3. whether to pay staff as employees or contractors: by paying staff as contractors, employer's National Insurance obligations are avoided.

What do individuals do to avoid tax?

Individuals can seek to avoid a wide range of taxes, including:

1. income taxes
2. National Insurance Contributions
3. Value Added Tax (VAT)
4. Capital Gains Taxes
5. inheritance taxes

6. duties and other charges such as those on imports
7. environmental taxes
8. taxes from countries other than their own.

Given this wide range of taxes, and because the actions an individual takes to avoid one tax often have an impact on the amount of another tax they pay, this area is especially complex and the variety of mechanisms used are enormous. The following generalisations are possible, however:

1. Those who have to live off their incomes don't avoid taxes to any significant degree. There are three good reasons:
   - They don't have sufficiently large tax bills to justify avoiding them.
   - They cannot afford to pay the costs associated with tax avoidance, usually charged by lawyers or accountants.
   - Tax avoidance usually requires the person undertaking it to have income in excess of their current needs: by definition this excludes most people from the activity.
2. These reasons also mean that the wealthiest are able to avoid taxes but they also have two further advantages.
   - The wealthiest members of society are the most mobile. This assists tax avoidance which might require people to move internationally to achieve their aims.
   - Capital is transient in its location, and easy to relocate. People find it much harder to move. Capital is owned by the wealthiest members of society. They can therefore tax avoid more easily.
3. The self-employed have more opportunities for tax avoidance than those who are employed.
   - The income of employed people is subject to tax at source i.e. before the tax payer receives payment under the UK's PAYE system. This means that the scope for tax avoidance is considerably reduced for those who are in employment and any avoidance is undertaken with regard to their investment income.
   - In contrast, self-employed people or those who run their own companies pay tax on their profits. This provides them with a great many opportunities to tax avoid in the process of calculating both their income and what expenses might be offset against it. As a result, they can tax avoid on the whole of their income, whether resulting from their own efforts or from investment sources. As such, at least some of the opportunities for avoidance already noted for companies may also be available to the self-employed, although since many of those opportunities have an international dimension and most self-employed people only work in the UK the scope for the legitimate use of those arrangements is smaller for the self-employed.

4. Those with international links often have greatest opportunity to plan their tax affairs.

   - If a person is resident in more than one country it provides them with an opportunity to choose under which country's rules they will be taxed.
   - If a person has family in more than one country it might provide opportunity to divert income to lower tax territories.
   - As soon as more than one country is involved in any tax situation it becomes harder to obtain information to determine whether abuse is taking place or not.
   - Those who are employed in more than one country can split their income to ensure that part at least is subject to lower rates of tax. This is commonplace amongst internationally mobile people such as many business executives.
   - The opportunity to flee is the ultimate way to avoid tax, especially as countries rarely cooperate effectively in collecting tax debts due to each other.

The cost of tax avoidance

Estimating the cost of tax avoidance is by definition difficult: it is always hard to put a number on what is not there. This means a number of techniques and estimates have to be used to assess tax not collected.

What is the tax loss from individuals?

This figure has to be split into two parts. The first is the cost of tax planning.

As has already been noted, tax planning is the process of claiming allowances and reliefs that the Government intended tax payers should claim; for example, to encourage investment. This is in general tax compliant behaviour. It is also, in general, activity which should be encouraged. The exception is if it does mean that the principles of horizontal or vertical equity are breached.

A second reason for considering this issue is that since tax avoidance is, in many cases, the claiming of allowances and reliefs in circumstances that the Government had not envisaged, the dividing line between tax planning and tax avoidance may need to be revisited to ensure that it is appropriately drawn in an equitable tax system. As a result, a cost of tax planning has to be calculated.

The second figure to be considered is that for the loss arising from tax avoidance; this is harder to calculate. This is because even though tax avoidance is anti-social, and is frequently subject to attack from HMRC, it is a legal activity. This means that a tax return that includes a successful tax avoidance activity i.e. one which is not legally challenged, is accepted as correctly stating a person's or company's income. As such the tax lost is not recorded, and nor is the income that was removed from tax as a result. Tangential measures have, therefore to be used to measure the effect of tax avoidance. These will be used in the first instance to consider tax paid by individuals. Companies will be considered after that.

*Tax planning by individuals**

Tax planning is normally an acceptable activity. It is the process of claiming the allowances provided by Parliament for a person to claim if they meet the necessary qualification requirement. For example, an age allowance for income tax is due to a person if they are above a specified age and have income of less than a set amount. Claiming that allowance is consistent with the principles of tax compliance.

* This is a summary of a more detailed technical analysis which can be found in Technical Appendix 1 at **www.tuc.org.uk/touchstonepamphlets**.

This is also true for expense claims and reliefs that are provided for in tax law and which are deliberately made available to encourage certain sorts of behaviour. The most obvious (and most common) example is claiming tax relief on making a payment into a pension plan. Such payments can be, within set limits, used as a relief to reduce a person's taxable income so that they only pay tax on their income after the offset of the pension payment. The Government provides this relief to encourage saving. Of course there can be debate about whether these reliefs are appropriate. For example, some question whether tax relief on pensions should be limited to the basic rate of income tax. But these debates are outside the scope of this pamphlet.

Tax planning can, however, create a problem when the allowances and reliefs which have been provided for in law are used by individuals purely to lighten their tax burden rather than undertake the behaviour that Parliament sought to encourage. Such activity also tends to reduce the vertical equity of the tax system, meaning that the underlying principle that those with higher income should pay more tax as a proportion of that income is undermined. In these circumstances, the value of the reliefs and allowances claimed means that their percentage tax rate is either the same or less than those on lower incomes.

The research undertaken for this pamphlet assesses whether tax planning results in this outcome in the UK and finds that it does. It finds that those who earn less than £30,000 a year on average reduce their income by no more than 4% (£1,200) by claiming reliefs and allowances, and that in most cases this relates to pension payments. Those earning £100,000 a year claim on average a 10% deduction (£10,000) and those earning £1 million a year claim almost a 30% deduction for expenses and allowances, many in this case relating to interest relief for buy-to-let properties and other business activities. Once income exceeds £100,000 a year pensions cease to be the major part of a person's claim for reliefs; in their place, other elements, largely related to savings and investment take over.

The result is twofold. First of all, effective tax rates are almost constant on incomes from just over £50,000, which is almost certainly not the will of Parliament. Second, most of the benefit of tax incentives for saving and investment goes to those whom the Government does not need to induce to save: the wealthy. This group save as a matter of course because they, of all people, are likely to have the excess of income over their current spending needs that allows them to do so. In addition, those who receive high salaries have less scope for tax planning than business owners and the self-employed. For example, high court judges cannot set up a company to sell their services to the justice system and transfer some of their income to a non-working spouse.

In absolute terms the value of reliefs granted to the best off in society (those earning over £100,000 being considered in this category) amount to about £8.4 billion on the basis of calculations in Technical Appendix 1. This has the result of removing vertical equity from the tax system and increasing the gap between the richest and poorest in our society. As such, it is suggested that these reliefs be revised for this group in society.

What is the cost of individual tax avoidance?

This figure is best estimated by considering the main techniques that individuals use to avoid tax. These are as follows.

1. Income is reallocated to a person or entity that has a lower tax rate than the individual whose activity really generates the income. The people or entities to whom the income is diverted might be:

    a. other members of a person's family e.g. a spouse or child
    b. a trust for the benefit of a person's family
    c. a company owned by the individual but taxed at lower rates than those they might enjoy personally
    d. an offshore company or trust (this mainly applies to those not domiciled in the UK – more explanation of domicile is available in the Glossary).

2. Changing the location of a transaction. This is much easier for those not domiciled in the UK than for those who are so domiciled. In both cases, however, the opportunity exists to relocate a transaction out of the UK, if a commercial justification for doing so can be created.

3. Changing the nature of a transaction so that it appears to be something different from what it actually is. This is commonplace, the most popular tactics being to:

    a. convert income into capital gains, which are almost always taxed at lower rates
    b. convert earned income into unearned income such as dividends to avoid National Insurance charges that only apply to earned income
    c. income is paid by way of benefits in kind that are taxed at less than their full value
    d. split income in small businesses so that VAT registration does not have to take place.

4. Delaying recognition of a transaction. This is done in all sorts of ways. For example:

    a. Businesses seek to delay billing at their year end dates.
    b. Bonuses due for one year are paid in the next tax year, especially when they are paid in a form that allows at least part to be free from PAYE, so deferring the tax payment.

5. Obscuring the information available on a transaction. These arrangements are often the most abusive and suggest a transaction is of a form for which a tax relief is due when in fact the transaction is designed to achieve a quite different goal. A recent example is the practice promoted by a firm of tax advisers as a result of which it is believed that wealthy individuals bought shares in companies quoted on the Jersey Stock Exchange. After the shares had been purchased the price of the shares was inflated enormously by a few people undertaking transactions at a price substantially higher than the price at which most people had acquired their shares. Having had this higher price established as a benchmark for valuation purposes the people undertaking tax avoidance then donated their shares in these companies to charities which had no choice but to accept them. Such donations of shares are subject to gift aid relief for income tax purposes meaning that for every £1 of value donated the higher rate tax payer receives

approximately 23p as a tax refund. If the price originally paid was £1 but the value at the time of the donation was £1,000 then the loss of the £1 paid for the shares is irrelevant compared to the £23 tax refund received on each share gifted. The fact that the charity received shares which were virtually worthless in reality appeared not to worry the promoters of the scheme.

Schemes of this sort are attacked, frequently, by HM Revenue & Customs.

The costs of any of these arrangements is hard to estimate, and HM Revenue & Customs can only ever guess at the amounts lost to public funds as the necessary data inevitably remains unrecorded. Some clues are, however, available. These, with the resulting estimates made, are as follows.

Income shifting *

Income shifting happens in two ways. Either income is shifted from the person who really generates it to someone else (that might be, for example, a member of their family or a company they own) who will pay a lower rate of tax on it than they would if they declared it on their tax return. Alternatively, income is shifted to try to change employment income into investment income. This is of benefit, as the UK tax system stands at present, because income earned from an employment is subject to National Insurance, which is in some cases almost as much as the income tax charged, but income from investments escapes all National Insurance charges.

In Technical Appendix 2, detailed calculation is made of the impact of these two exercises using data published by HM Revenue & Customs. This calculates that £3.6 billion of income is shifted and maybe £1.3 billion of tax is lost as a result. Astonishingly, that data, based on tax return information, suggests that half of all investment income is earned by those in the lower half of the income distribution. Each would have, on average, investment income of about £1,400. The top half of the income distribution would earn a little over £8,600 each on average. Some though, would earn considerably more. The wealth allocation to the two groups would, though, in total be remarkably alike.

However, this clearly makes no sense. As data on marketable wealth distribution (i.e. total wealth less the value of domestic properties) shows, wealth in the UK is not distributed in the way the income tax return data implies. The latest data available from HM Revenue & Customs[4] shows that the top 1% of wealth holders own 21% of all marketable assets, the top 10% have 53% of marketable assets and the top 50% have 93%. The bottom half of the profile therefore have 7% between them. There must be an explanation for the wealth distribution and income distributions shown on tax returns being so markedly out of line. The only reasonable explanation for this anomaly is that there is significant income shifting. Non working spouses and, maybe, children must be the recipients of this apparent largesse.

As a result, and as the analysis shows, the apparent wealth of those with very low incomes is significantly overstated by tax return declarations and for those on higher incomes apparent wealth reflected in tax returns is understated. At the very highest levels of income meaningful data cannot be extrapolated.

* Go to Technical Appendix 2 at **www.tuc.org.uk/touchstonepamphlets**.

Calculating a precise sum involved is bound to involve approximation but by simply assuming that wealth is only reallocated to those with income levels up to £10,000 (at which point 22% tax is almost always going to be paid, reducing the attraction of shifting for many) then the likely result is, assuming those shifting all pay at 40%, that £3.6 billion of income is shifted and maybe £1.3 billion of tax is lost as a result of this one component of income shifting.

The figure might well be higher in practice for three reasons.

1. The shifting of income from property is not included in these figures but is likely to be actively undertaken and would explain the apparent high rates of property income amongst those on low incomes suggested by HMRC tax return data. Over £1.2 billion of property income is declared by those in the income bands where income shifting appears to be a significant factor in income declared: the tax lost might be over £400 million as a result.

2. It is known from Treasury data published in the pre-Budget Report for 2007 that at least £250 million a year has been lost from income shifting between spouses within privately owned limited companies[5].

3. It is now possible to purchase pensions for non-earning spouses and even children. The effect cannot be quantified.

The result is that total income shifting is likely to exceed £2 billion per annum before the impact of shifting income to trusts and companies is taken into account.

The total impact of shifting income from self-employed persons into companies has been estimated to be up to £1.2 billion per annum[6].

In total, based on this analysis, income tax lost through tax avoidance from income shifting is likely to be not less than £3.2 billion per annum.

Changing the location of a transaction

The principle tax lost by legitimate tax avoidance due to the relocation of transactions outside the UK is associated with exploitation of the domicile rule. The most reliable estimate of total tax lost as a result of the exploitation of this rule by people resident in the UK is £4.3 million per annum[7]. The workings are noted in Technical Appendix 3*.

The Government expects to recover about £500 million a year of this sum using rules announced in the 2007 pre-Budget Report[8]. The loss will remain at £3.8 billion per annum as a result.

Changing the nature of a transaction

There has always been a strong incentive to recategorise income as a capital gain within the UK tax system. There are several reasons:

1. After reliefs and allowances the effective tax rates have always tended to be lower than for income.

2. An additional personal allowance (£9,200 a person in 2007/08 – a figure in itself much higher than the allowance available for income tax which is £5,225 in the same year) is available for offset against capital gains, meaning that the amount of income that can be received tax-free is increased almost three fold if some can be categorised as gains.

* Go to Technical Appendix 3 at **www.tuc.org.uk/touchstonepamphlets**.

3. Capital assets can be gifted tax-free between spouses with no questions asked, so making them easy to shift to a partner with a lower tax rate, so reducing overall tax liabilities still further.

There has also been an additional motive for income shifting in the last decade: Capital Gains Tax liabilities have been settled at a person's marginal income tax rate since 1997. In other words, the value of a person's gains after all allowances has been added onto their income subject to income tax to then determine the tax rate payable. In cases where one partner to a marriage has been liable to income tax at 40% and the other has had little or no income tax liability, the incentive to shift the gain (tax-free) from one spouse to the other to make use of the lower taxed partner's reduced liability has been significant, and appears not to have been subject to challenge from HM Revenue & Customs.

As is the case with much data on the tax system, reliable and comprehensive data with regard to Capital Gains Tax appears not to have been published since 2004/05. This is, in itself a worrying trend. Analysis will, as a result, have to be based upon data for that year.

In 2004/05 total chargeable capital gains declared by individuals in the UK amounted to £8,733 million[9]. In addition, trusts declared gains of £1,044 million. Companies do not pay Capital Gains Tax, their gains being subject to corporation tax as part of their profits.

These gains arose on asset sales totalling £44.4 billion with the gains before indexation allowances and taper reliefs amounting to £23.2 billion[10]. The split of the assets disposed of was as follows*:

Type of asset	Gross proceeds £'mil	Proportion
Quoted shares on London Stock Exchange	5,805	13.1%
Other shares	13,631	30.7%
Other financial assets	5,325	12.0%
Agricultural land	1,808	4.1%
Commercial property	2,584	5.8%
Residential property	10,120	22.8%
Other land	954	2.2%
Other assets	4,135	9.3%
	44,362	**100.0%**

The length of ownership of assets is as important though. 19% of all financial assets sold and subject to capital gains had been owned for a year or less at the time of disposal. 16% of all non-financial assets had been owned for a year or less at the time of disposal[11]. Total disposal consideration of both groups amounted to £7.8 billion, or over 17% of all reported gains.

Gains are meant to arise on investments. By definition these are usually meant to be long-term holdings. Those arising on short-term trades are likely not to have arisen on investments at all: these are traded assets and the profit should in that case be subject to income tax. Over £1 billion of chargeable gain was declared on these disposals, a percentage rate of 13%. This is a relatively low proportion of profit compared to disposals as a whole, where the average is 52%. Gains of this duration do not attract taper relief,

* Rounding has taken place on all tables in this pamphlet; as a result totals may vary slightly.

meaning that one of the big advantages of this tax was not secured. However, the offset of the additional personal allowance for Capital Gains Tax almost certainly was secured. It is likely that up to £200 million of tax revenue was lost from income tax as a result of this shift and given that many more such gains will never be reported, having been kept below the Capital Gains Tax personal allowance limit, the loss is likely to be much higher in reality. An estimate of £500 million of tax loss is used here. Given that the reported volume of share sales on the London Stock Exchange by UK-based individuals in the table noted above appears exceptionally low in proportion to their estimated volume of holding this appears, if anything, a significant underestimate.

In addition, another trait is apparent in the data. When looking at the taxable income of those making capital gains a strange pattern emerges[12]:

Income bracket	Reported gains	Proportion of gains
£	£'mil	
0	1,138	13.0%
2,020	2,227	25.5%
31,400	775	8.9%
50,000	1,108	12.7%
100,000	3,487	39.9%
	8,733	**100.0%**

Extraordinarily 28% of all gains in the UK are made by those with insufficient income to pay income tax, or who only pay tax at 10% (which was the income bracket of table income to £2,020 in the year in question). In contrast the 25 million or so basic rate tax payers[13] made just 8.9% of all capital gains.

The total Capital Gains Tax paid in 2004/05 on the net declared gains of £9,777 million (including trusts) was £2,283 million[14]. This is an effective rate of 23.4%. 174,000 individuals and 15,000 trusts made disposals in the year[15]. The allowance in the year was £8,200 for an individual and half that for a trust, giving total allowances of about £1,484 million. This would leave chargeable gains at £8,293 million. If it is assumed, as seems very likely, that all the gains reported by those on the 10% or 0% income tax rates were in fact reallocated to them from those who should have paid at 40%, and having allowed for individuals alone £7,306 million of gain should have been taxed on individuals. Of these 28.8% were taxed at well below the expected rate, and maybe at no more than 10%. If this proportion had been subject to an additional 30% tax, as seems likely to have been due, then the additional tax yield would have been £630 million. Almost certainly this sum has been avoided.

The other significant way in which a transaction's nature is changed is to recategorise it as investment income rather than as earnings from employment. The motive for this is simple: investment income is not subject to National Insurance charges and earnings from employment are. For those in employment this recategorisation is almost impossible but for those who own their own businesses the process is relatively simple. All they need do is not pay themselves a salary out of the companies they own in exchange for the labour that they supply to it. The company is then recorded as making a higher profit as a consequence and the dividends that they can then pay themselves as shareholders out of that profit are considered investment income and not earnings from employment. The result is that National Insurance charges are avoided.

Estimating the cost of this behaviour is hard, and one measure for that income shifted has already been included in the section on that theme, above. An alternative approach has to be used to estimate the total sum involved and the total National Insurance Contributions that might be lost as a result of this activity. This has to be undertaken on the basis of looking at dividend yields received by UK based shareholders.

Total dividend income received by UK taxpayers on 2004/05, the last year for which such data is available, was £32.6 billion[16]. The total quoted investments from which these could have been earned were worth £284 billion, as noted above (£208 billion of shares and £76 billion through unit and investment trusts). The implicit rate of return is 11.5%. However, the dividend yield from UK quoted companies is much lower than that, at 3.6%[17]. At best the return from dividends in the year should not be higher than just over 5%[18], and that assumes a portfolio chosen solely with dividend payment in mind. A median might be taken for the purposes of this review at, say 4.3%.

In that case the additional declared dividends arise because of returns on unquoted shares. The Revenue's data makes it clear that the dividend figure is for UK source income, and the tax return allows for this analysis to be undertaken.

If that is the case then dividends from private companies in the UK amount to about £20.4 billion per annum. Some of these will be genuine dividends i.e. they will be paid to people who have no involvement with the entity that pays them, bar owning shares. However, it is thought that there are at least 200,000[19] (and maybe many more) companies now registered in the UK that are owned and managed by the one person who also generates all the income of the company who then substantially rewards themselves by way of payment of a dividend to avoid the payment of National Insurance Contributions that would arise. Assuming each of these persons has above average income, because if they do not there is little or no incentive to incorporate a company (it being easier to be self employed), the likely distribution from each company might be as high as £50,000 a year, or £10 billion, a sum within the plausible range. If this whole sum had been subject to the employer's and employee's National Insurance Contributions avoided in each company, the figure lost probably exceeds £9,000 per annum, or a total of £1.8 billion.

Deferring income

Most accountants are aware that self-employed people, in particular, seek to defer recognising their income to save tax. Indeed, in 2005 a change in UK accounting rules that applied mainly to accountants and lawyers forced those two groups, in particular, to recognise income they had been accustomed to delay with an estimated yield to the Treasury in the first year of the arrangement of £140 million, expected to rise to over £380 million after 3 years[20].

Unfortunately there is almost no further data to suggest the cost of this practice to the Treasury. An estimate cannot, therefore, be made.

Obscuring the nature of transactions

This area has been the focus of much government activity, with a particular emphasis from 2004. Unfortunately no estimate of expected tax revenues was made when substantial anti-avoidance rules for tax were introduced for income and corporation taxes in the 2004 budget. However, when these rules were extended in 2005 the estimated additional revenue was approximately £850 million a year[21]. In 2006 the benefit was expected to be about £200 million[22]. The Pre-Budget report for 2004 announced measures estimated to be worth £1 billion a year[23]. And the 2007 pre-Budget Report announced further measures expected to collect £500 million a year[24].

The point is simple. There is ongoing abuse of taxation rules. Based on the level of abuse which is tackled each year, and assuming it takes several years before known activity is tackled by legislation, it is reasonable to assume that several billion of tax avoidance is happening each year that has yet to be tackled. For the sake of valuation this will be modestly assumed to be £3 billion a year.

Summary

This review of tax planning and tax avoidance by individuals has given rise to a range of estimates of the extent of such activities. It has been assessed that tax planning by those earning over £100,000 costs public funds £8.4 billion. The findings from analysis of tax avoidance by individuals can be summarised as follows:

Activity	Sum lost
Income shifting	£3.2 bn
Changing the location of transactions	£3.8 bn
Income shifting to capital gains	£0.5 bn
Capital gains shifting to lower rate tax payers	£0.6 bn
Tax planning – avoidance of National Insurance on dividends	£1.8 bn
Other tax planning	£3.0 bn
Total (excluding companies)	**£12.9 bn**

What is the tax loss from companies? *

A number of definitions of tax unpaid by companies is available[25]. For the purposes of this report the most important is the 'expectation gap', which is the difference between the rate of tax set by the government of the country in which the company operates and the actual rate of tax they pay. This gap is a measure of the difference between the contribution society expects business to make by way of tax paid, and what is actually paid. It so happens that throughout the whole period surveyed the UK corporation tax rate for the companies reviewed was 30%.

This comparison of the headline rate of tax with tax actually paid might seem a crude measure but in fact numerous academic studies have found that the headline rate appears to be a major influence on business decision making and that the effective rate is also of significance[26]. If, therefore, business takes account of this difference in making their decisions it is entirely appropriate to do so for other purposes.

In preparing this report, accounting data of the fifty largest companies in the FTSE 100 in July 2007 was reviewed in depth[27]. That review involved collecting extensive information on their financial reporting for each of their financial years ending in 2000 to 2006 inclusive (or a shorter period if they were formed after 2000 with no obvious predecessor, as was true in several cases). This involved three hundred and forty four sets of accounts in all spread over a seven-year period.

* This is a summary of a more detailed technical analysis which can be found in Technical Appendix 4 at **www.tuc.org.uk/touchstonepamphlets**.

For the companies included in the survey the conventional profit and loss ratios of tax paid are as follows (with the companies surveyed being listed in the order of their market worth)*:

Table 1 Declared tax rate – percentage		2000 %	2001 %	2002 %	2003 %	2004 %	2005 %	2006 %	Avge. %
1	Royal Dutch Shell plc	46.9	43.7	44.3	43.2	46.7	40.4	41.0	43.7
2	BP plc	29.4	38.3	38.5	34.6	34.2	29.7	35.6	34.3
3	HSBC Holdings plc	22.9	19.7	26.3	24.3	25.6	24.3	23.6	23.8
4	Vodafone Group plc	50.8	-15.9	-15.8	-47.6	-62.5	-44.3	-12.2	-21.1
5	GlaxoSmithKline plc	28.2	29.4	26.5	27.5	27.8	28.5	29.5	28.2
6	Royal Bank of Scotland Group plc	34.3	36.0	32.7	31.0	31.2	30.0	29.3	32.0
7	Barclays plc	27.0	28.0	29.8	28.0	28.0	33.6	27.2	28.8
8	Anglo American plc	26.1	24.7	33.3	27.5	27.6	24.5	27.6	27.3
9	AstraZeneca plc	33.8	27.0	29.2	27.2	24.7	29.1	29.0	28.6
10	Rio Tinto plc	32.6	36.2	54.0	27.1	23.4	24.8	23.2	31.6
11	HBOS plc	0.0	29.1	28.7	29.0	28.5	32.2	31.1	29.7
12	British American Tobacco plc	44.9	42.9	38.7	49.7	35.1	26.7	25.9	37.7
13	BHP Billiton plc	0.0	39.3	36.3	33.6	23.1	24.2	22.6	29.9
14	Tesco plc	27.8	27.3	30.9	30.5	31.1	30.2	29.0	29.6
15	Lloyds TSB Group plc	28.6	27.4	29.3	23.6	28.7	33.1	31.6	28.9
16	Xstrata plc	0.0	0.0	16.8	13.1	12.9	22.1	39.9	21.0
17	BG Group plc	31.9	31.8	47.1	38.9	39.6	37.5	44.5	38.8
18	Diageo plc	27.6	24.2	27.1	74.5	24.7	21.0	8.4	29.6
19	BT Group plc	30.5	-63.2	30.3	14.5	27.7	22.3	24.1	12.3
20	Standard Chartered plc	26.2	32.9	30.7	32.1	29.5	26.5	25.9	29.1
21	Unilever PLC	51.5	42.7	38.7	33.6	27.5	26.3	23.7	34.9
22	Reckitt Benckiser PLC	29.5	28.3	25.1	25.9	23.9	23.6	22.9	25.6
23	Aviva plc	-18.1	82.5	-73.0	26.4	23.9	24.9	19.8	12.3
24	National Grid plc	0.0	0.0	-29.9	36.7	19.2	21.3	31.6	15.8
25	SABMIller plc	24.3	28.8	34.3	45.3	41.6	38.7	31.8	35.0
26	Prudential plc	30.0	5.5	9.1	41.1	35.7	24.1	28.4	24.8
27	Imperial Tobacco Group plc	28.2	28.1	33.1	35.4	34.6	33.2	26.5	31.3

* Every effort has been made to avoid errors during the complex process of estimating tax rates from company accounts; any error that may exist is entirely unintentional

Declared tax rate – percentage	2000 %	2001 %	2002 %	2003 %	2004 %	2005 %	2006 %	Avge. %
28 BAE Systems plc	103.9	282.9	-11.4	96.6	-100.9	16.2	24.8	58.9
29 Cadbury Schweppes plc	29.6	29.6	30.7	30.7	29.4	16.6	15.6	26.0
30 Centrica plc	24.9	33.1	34.8	34.2	17.9	24.5	-158.8	1.5
31 Scottish & Southern Energy plc	21.5	21.9	26.4	27.6	26.3	39.8	29.2	27.5
32 Man Group plc	-45.8	21.9	21.2	21.0	22.0	22.4	18.0	11.5
33 British Sky Broadcasting Group plc	-3.3	-4.7	-8.3	-48.9	32.9	32.6	31.0	4.5
34 Marks & Spencer Group plc	37.9	98.1	54.3	29.1	29.3	21.2	30.2	42.9
35 J Sainsbury Plc	31.8	38.7	35.0	30.9	33.8	-333.3	44.2	-17.0
36 Rolls-Royce Group plc	50.0	44.8	49.5	35.6	33.0	27.3	28.5	38.4
37 Legal & General Group plc	36.3	-28.2	-69.8	13.9	28.2	36.3	15.4	4.6
38 WPP Group plc	30.0	30.7	50.3	34.9	30.7	32.8	29.2	34.1
39 Old Mutual plc	18.0	343.2	52.7	54.4	32.8	30.1	36.2	81.1
40 Land Securities Group plc	23.1	25.9	27.5	28.1	22.7	-77.0	29.0	11.3
41 Wm Morrison Supermarkets plc	36.7	34.5	36.1	34.1	38.2	30.8	20.0	32.9
42 Reed Elsevier PLC	82.8	53.8	37.0	35.3	45.7	33.8	13.3	43.1
43 Wolseley plc	35.9	36.4	29.8	30.0	29.0	28.8	30.2	31.4
44 Reuters Group plc	19.0	67.7	-4.7	44.9	16.7	13.0	6.2	23.3
45 Hanson plc	22.8	-1.2	31.5	-31.3	9.2	6.7	17.0	7.8
46 Imperial Chemical Industries plc	-134.5	27.3	35.0	48.2	32.3	16.0	17.2	5.9
47 British Land Company plc	17.6	11.9	6.9	19.2	7.8	-169.3	21.4	-12.0
48 Associated British Foods plc	44.9	29.7	22.6	28.0	29.6	29.0	26.5	30.0
49 Compass Group plc	25.1	36.2	36.1	39.9	41.1	78.4	18.4	39.3
50 Shire plc	4.7	56.1	-11.7	-21.8	123.3	-27.7	67.0	27.1
Total	1,207.9	1,964.9	1,163.8	1,421.3	1,305.2	617.6	1,131.3	1,258.8
Number in population	46	48	50	50	50	50	50	–
Average	**26.3**	**40.9**	**23.3**	**28.4**	**26.1**	**12.4**	**22.6**	**25.2**

Negative rates usually indicate the existence of a loss, not a tax refund.

What is readily apparent is that there is significant volatility both within companies over time and between companies on the declared rates of tax. This is because this ratio is a poor indication of the tax actually due by companies because the tax and accounting treatment of the many transactions companies undertake are not the same. For example, as noted in Technical Appendix 4, the tax and accounting treatments of the purchase of equipment by a company for use in its business are very different.

As a result of these differences two important changes have to be made to the data published by companies to ensure that a more appropriate view of the tax they both pay and its relationship to the profits they earn is correctly stated.

The first such change is needed because some of the tax charged in the profit and loss account of all the companies in this survey will almost certainly never be paid. This is because that tax charge is usually made up of two components. The first is the current tax charge and the second the deferred tax charge. It is only the current tax charge that is likely to be paid by the company in the near future, which for these purposes usually means within twelve months of the end of the period for which the accounts have been prepared. Deferred tax might be defined as tax that might be payable at some time in the future as a consequence of transactions that have already occurred, but with there being no certainty as to when, if, or ever that tax might be paid. A more detailed description is included in Technical Appendix 4. The key issue to understand is that the deferred tax balances owed by the companies surveyed for this report have increased enormously over the period under review. This is shown by this table, which records the total deferred tax liabilities recorded as owing by these companies:

Table 2	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Deferred tax owing at year end	£m	£m	£m	£m	£m	£m	£m
Total	**8,772**	**12,086**	**29,504**	**32,933**	**34,603**	**34,433**	**46,699**
No. in population	42	46	50	50	50	50	50
Average	209	263	590	659	692	689	934

The evidence is clear: over seven years the deferred tax due by this group of companies has risen year on year from an average of £209 million each to an average of £934 million each. So substantial has been the growth that by 2006 the amount of deferred tax on the balance sheets of these companies, for which no payment date was known amounted to £47.7 billion, and as such exceeded by more than £2 billion the total corporation tax paid in the UK in the tax year 2006/07[28].

So significant is this trend that the first modification made to the tax figures companies declare is to only use the current element of the tax charge when considering what is likely to be paid. After all, tax is of no benefit to governments unless it is paid to them.

The second modification is to add back to the reported profits of the companies surveyed the charge included in their accounts for the write off of goodwill. Goodwill is the difference between the price paid when buying a company and the actual value of the assets that are acquired. This sum has to be written off over time under most accounting rules and substantial goodwill write-off charges are included in the profit and loss accounts of many of the companies in this survey but these charges are not tax allowable. As a result, to add this number back gives a better and more reliable indication of the taxable profit of the company than is available from using the unadjusted profit before tax in the accounts. The remaining figure can only be an approximation. However, there is currently no more satisfactory basis for assessing the tax gap than the data made available in companies' consolidated accounts as adjusted for this figure, and hence it is used here.

Very different figures for the Expectation Gap emerge if these two adjustments are made, as the following table shows, this time just showing average, but with the full version in Appendix 4:

Table 3	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Avge.**
Declared current tax rate to pre-goodwill profit – percentage	%	%	%	%	%	%	%	%
Ranked by average								
No. in population	46	47	50	50	50	50	50	–
Average	18.7	29.6	-19.2	26.7	23.8	14.4	21.9	16.1

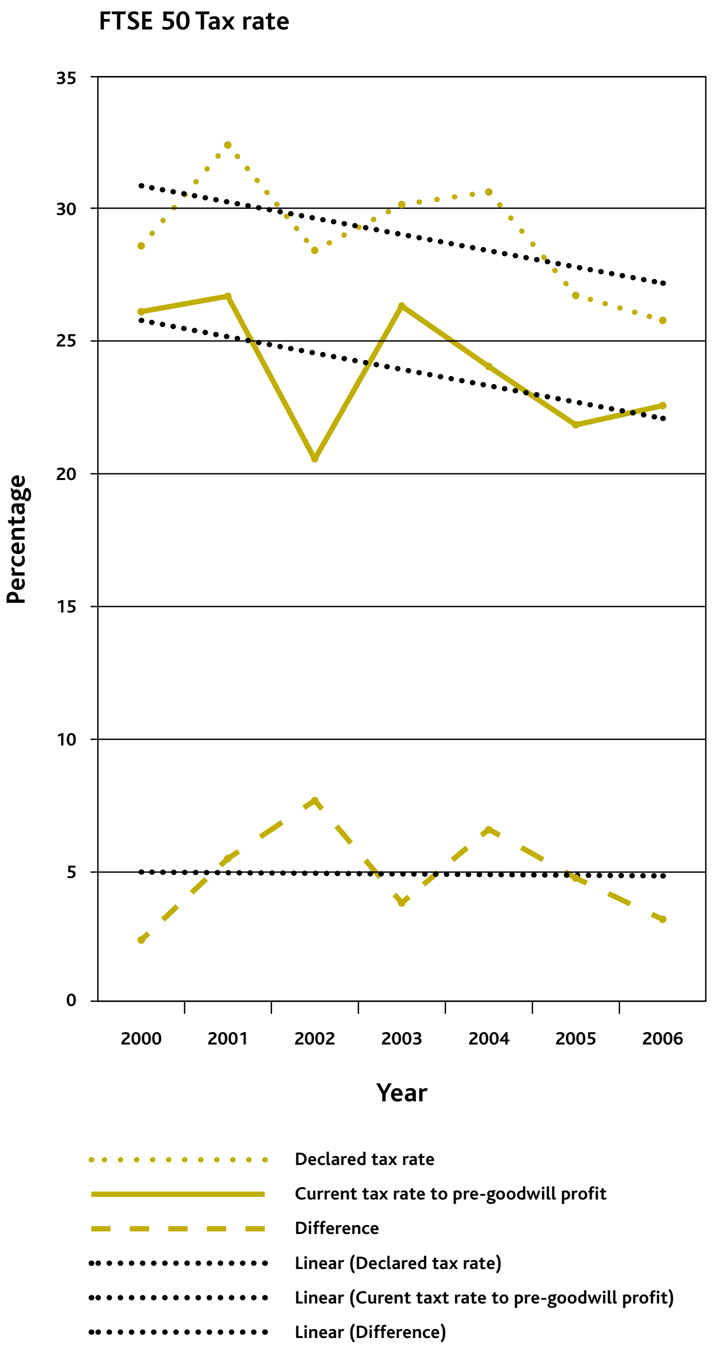
Unfortunately this table still produces some aberrational outcomes for analytical purposes and as such it is necessary to eliminate the statistically outlying data that distorts the underlying trend. The average ranking in the following table has, however, been kept constant for ease of comparison. The following table shows the resulting averages:

Table 4	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Avge.**
Declared current tax rate to pre-goodwill profit – percentage	%	%	%	%	%	%	%	%
Ranked by average – top and bottom 3 of sample eliminated								
Losses eliminated								
No. in population	40	41	44	44	44	44	44	–
Average	26.1	26.7	20.7	26.3	24.0	22.0	22.5	24.1

A clear trend is now seen. Effective tax rates are falling over the period. If these effective tax rates are compared with the tax rates as shown in the original table, similarly adjusted to exclude aberrations for the sake of consistency, then the following table results:

Table 5		**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Declared tax rate	%	28.5	32.3	28.4	30.2	30.6	26.9	25.8
Current tax rate to pre-goodwill profit	%	26.1	26.7	20.7	26.3	24.0	22.0	22.5
Difference	%	2.5	5.6	7.7	3.8	6.6	4.9	3.3

If expressed as a graph the following trends are clear:



This reveals that declared tax rates in the UK are on average a consistent 5% higher than current tax rates. Both have fallen over a seven-year period.

In 2000 the effective current tax rate was 26% and in 2006 it was 22.4%. Declared rates were, on a trend basis, 5% higher in both cases.

The average decrease in current tax rates a year was just over 0.5% per annum throughout the period. Throughout the period the UK tax rate was 30%.

As the detailed calculations in Technical Appendix 4 show, it would seem that just fifty companies have an expectation tax gap of almost £13 billion by 2006. It does, however, have to be recognised that the situation is a little more complicated than this. Some of this gap relates to the non-UK activities of these companies and none of them make it easy to work out how much of their profit is earned in the UK, or how much of their tax is really paid here. Of those that do give some indication on this issue the data is itself conflicted but based on a broad range of calculations this report estimates that approximately 44% of the profits of the companies surveyed should be subject to UK tax.

If that is the proportion of profit attributable to the UK within the sample, the UK tax gap for these companies is:

Table 6		**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Pre Goodwill profits of top 50 companies	£'m	74,665	74,996	71,546	97,459	122,506	152,665	172,919
% tax gap	%	3.9	3.3	9.3	3.7	6.0	8.0	7.5
Difference	£'m	2,947	2,447	6,649	3,583	7,292	12,234	12,939
Attributable to UK	44%	1,297	1,077	2,926	1,576	3,208	5,383	5,693

An expectation tax gap of £5.7 billion might arise from these companies alone in the UK, and that gap is increasing significantly over time. Extrapolating this data to the rest of the UK requires some further consideration. First of all, it is unlikely that the same opportunities for tax planning are available to small companies and as such extrapolation of the sample result across all companies is not appropriate. Extrapolation across all large companies is, however possible. These companies are approximately 700 in number for corporation tax purposes and have their affairs managed by the Large Business Service of HM Revenue & Customs, about whom the National Audit Office issued a report in July 2007 [29].

In 2006–07, HM Revenue & Customs raised £44.3 billion in corporation tax, of which £23.8 billion came from those businesses within the Large Business Service. In 2006 the companies in this survey declared UK current tax liabilities of £11.5 billion, or just under half the total tax managed by this unit. If the estimated loss is extrapolated across all of these 700 companies then the total corporation tax expectation gap might be some £11.8 billion. This is an increase from £9.2 billion, which was the estimate made the last time a similar exercise to that undertaken here was completed, relating to the period to 2004 [30].

As a proportion this may be the highest gap of all. Much may be due to legitimate tax planning, but by no means all is. Some, undoubtedly, is due to tax avoidance.

When this sum is added to the £12.9 billion of tax loss already calculated for individuals it suggests that the total UK tax gap due to tax avoidance can be estimated at £24.7 billion, and rising.

What the figures mean

This report suggests that there is £12.9 billion of personal tax avoidance and £11.8 billion of corporate tax avoidance in the UK, totalling £24.7 billion in all. In addition, there is £8.4 billion of personal tax planning by those earning over £100,000 p.a. These numbers are, however, meaningless to most people unless put in context because the number of people used to accounting in billions is limited. In addition just providing a basis for understanding the numbers is not enough; their social significance has to be considered as well.

The next sections of this report deal with these issues with the intention of offering an agenda for change that will promote the well-being of as many people as possible in the UK.

The role of taxation

To understand and interpret the significance of the number that has been calculated for the tax gap the purpose of taxation itself has to be understood. Taxes are used to:

1. provide public funds
2. redistribute income to reduce poverty and inequality – progressive forms of taxation [31] are one of the main means by which wealth is redistributed in any society
3. 'reprice' goods and services to ensure that all social and environmental costs of production and consumption are reflected in the market price
4. strengthen and protect channels of political representation [32]
5. provide a tool for the management of an economy, usually in combination with government borrowing[33].

In this context the tax gap is more significant than a figure for tax not available for the public purse, important as that is. Tax not paid also has the following outcomes.

1. It increases the gap between rich and poor in society, and in arbitrary fashion.
2. The democratic process is undermined. That process is dependent upon treating all people as equal before the law. If tax is not collected then the credibility of that equal treatment is threatened. In addition, if the legal system created by the democratic process appears to unreasonably favour some in society without apparent justification then the credibility of that process is, once more, undermined. This is particularly so if those favoured are a minority, as are those

with significant wealth in the UK who appear to enjoy particular favour in its tax system – much of the tax planning and avoidance that takes place being for their benefit, including that by companies of whom they are the owners. The majority of people gain the impression, therefore, that they are sharing a disproportionate share of the burden of tax, which leads to disenchantment with the political process.

3. Economic management is harder when some, including major corporations, seek to avoid the consequence of that process.

Whilst the analysis of the impact of the tax gap that follows tends to focus upon the amount of tax lost, the above issues are as important in the creation of social justice.

*Putting the numbers in context**

More important than considering the number as wealth, however, is to consider it as a lost income stream to fund socially desirable activity in the UK.

- One half of the amount lost to tax planning alone by those earning over £100,000 could increase the child tax credit by enough to halve child poverty in the UK.
- Just under half of the total amount lost to tax avoidance would pay for a 20% increase in the state pension or could reduce the basic rate of income tax by 3p in the pound, or could build an extra 50 hospitals.
- One quarter of the total tax income lost to avoidance activities would be enough to provide five-and-a-half million public service staff, who are currently facing the prospect of a real terms pay cut, with a pay settlement equivalent to the rise in average earnings across the economy in 2007.
- Just over a quarter of the total amount lost to tax avoidance could be used to increase the education budget by 10% or to increase the health budget by 6%.
- Half of the total amount lost to tax avoidance could raise the level at which the higher rate tax is paid by £10,000.

* The calculations for these figures can be found in Technical Appendix 5 at **www.tuc.org.uk/touchstonepamphlets**.

How the tax gap can be tackled

Clearly losses to public funds of this magnitude cannot be ignored. Action has to be taken by Government to ensure the sustainability of public finances and to protect the integrity of our parliamentary democracy. The proposals for change below are offered as a spur to public debate on how the Government and Parliament should respond rather than as a fully developed programme designed to tackle the problems identified in this pamphlet.

Tax planning

As this report has shown, tax planning is widespread and mostly entirely legitimate, but the benefit arising from it to a very small group within society is very large indeed. In absolute value the reliefs likely to be granted to the best off in society (those earning over £100,000 being considered in this category) amount to about £8.4 billion on the basis of calculation used in this report. Approximately 570,000 people fall into this category at present in the UK[34], giving an average cost of tax relief to this group of £14,700. Clearly some benefit much more.

Raising taxes on this group is politically difficult: asking them to pay tax at the rates that they already believe applies to them is easier, especially as at present it seems likely that this group have overall tax rates that might fall as the level of income rises. This objective can be achieved by introducing a 'minimum income tax rate' for those earning above £100,000.

This minimum tax rate might, for example, suggest that the overall rate of tax paid by a person earning £100,000 should be 32% (as opposed to about 30.8% on average at present[35]) rising to 37% at 150,000 and 40% at £200,000 and above. This would be easy to calculate and collect through the tax return process. Calculations based on HM Revenue & Customs data suggest that such a charge might raise an additional £5.7 billion in tax a year. Some small loss might arise from a limited number of people leaving the UK, as many threaten to do when it is recommended that tax rates for the wealthy should rise. As such, it is prudent to assume that £5 billion of additional tax revenue might be raised in this way.

If this extra revenue were used to reduce income tax for the rest of society this would allow the basic rate of tax to be cut by 1p and to allow the income tax threshold at which tax starts to be charged to rise by £400 a year, helping take a significant number of people out of tax altogether[36].

Tackling tax avoidance

Tax avoidance is the area that has been subject to the most obvious attention of HM Revenue & Customs over recent years. It has been estimated that more than 40% of all tax legislation targeted tax avoidance in the years 2004 to 2006[37].

Starting in 2004, HM Revenue & Customs effectively outlawed all schemes that allowed employees to be paid without National Insurance being due, in the process stopping a long history of abusive payments using ever increasingly exotic media including fine wines, carpets and platinum sponge. This has been very successful: the use of such schemes has almost entirely ceased.

Other forms of tax avoidance have been tackled by requiring that all tax planning schemes targeted at larger clients be disclosed to HM Revenue & Customs within days of their being marketed or being used. These disclosure arrangements now apply to income tax, corporation tax, Capital Gains Tax, National Insurance, stamp duty and VAT. The number of schemes disclosed has fallen heavily since the arrangements were introduced but this is because it is now widely believed that the largest accounting firms have left this market, partly also because of covenants they have given concerning their behaviour to US authorities as a condition of retaining their licence to operate in that country.

There can be no doubt that over the last four years HM Revenue & Customs have had considerable success in sidelining but not eliminating this activity.

Changing the language of tax

The difficulty with these initiatives by HM Revenue & Customs is that they have been to date a response to tax avoidance, but have not as yet sought to change the terms of the confrontation between those who wish to avoid tax and the taxation authorities. What this means is that the Revenue have in effect joined in a game of cat and mouse. The avoiders seek to find holes in taxation legislation that they can exploit and in response the Revenue have sought to plug those rules with ever more complex legislation that does in turn generate opportunity for ever more obscure abuse as a result.

This responsive behaviour may have been appropriate to date but it is also indicative of a philosophical dilemma that afflicts many who look at this issue. An appropriate response to tax abuse must be more comprehensive than a policy of plugging loopholes in tax legislation. It must include an assertion of a government's right to collect and expend taxation revenues in pursuit of the democratic mandate of the government of the day. This has been lacking and it is now time for the Government to change the terms of this debate if it is to win.

One particular change is essential if this is to happen. Politicians have a habit of describing tax due as being the "taxpayer's money". In a context where this is taken to mean that a government has a duty to secure the best value for money for its citizens, this language may be acceptable. But, the term also has the unfortunate consequence of implying that taxes still belong, by right, to the person paying them. As such they encourage the view that a person not paying a tax is simply keeping money that is rightfully their own.

This can be contrasted with benefit fraud where it is seen that the recipient (who is pursuing an activity fundamentally similar to tax evasion) is undertaking a much more serious crime because they are taking someone else's money i.e. the Government's. That is not true. In both cases the money secured for private benefit is the Government's because tax that is due by law to a government is not the property of the taxpayer at all; it is a debt owing to the State. The taxpayer only has legal entitlement to their money after tax income. Language has to change in this respect if the message that tax avoidance is an abuse of society as a whole is to be created[38].

One further change is necessary to complete the change required in the language of government. Put simply, appropriate tax has to be promoted as a 'good' rather than as a 'bad'. A government agency, National Savings and Investments, promotes tax-free savings using this language:

> "You have worked hard for your money . . . make it work harder for you. With no income tax to pay on the investments shown below, you get to keep all your returns"[39].

This is, of course, indication of the trait noted above, where it is suggested that a taxpayer has the right to keep all their income. But there is a more subtle message implicit in this use of language, which is that appropriate tax is both a bad thing, and avoiding it is a socially appropriate act. If the Government is to change the culture surrounding the payment of tax in the UK then this approach has to change and Government has instead to refer to taxes as part of "public funds", "community resources" or even a "common", or "shared", wealth. Ownership is retained, but it is also shared.

Stop HM Revenue & Customs staff cuts

Changing the language of tax will not, by itself increase the tax yield as a result of reduced tax avoidance. There can be no doubt that the most effective weapons with which to tackle this are efficient and effective tax staff in HMRC. It is only by policing the tax system that an environment can be created where taxpayers think tax avoidance will not pay.

Current action by the Government appears entirely counter-intuitive in this respect. Between 2005 and 2010 three hundred tax offices will close and by 2011 a total of 25,000 staff reductions will have been made. The staff reductions equate to 25 per cent of HMRC numbers[40].

This policy is counter-productive. Whatever the merits of constraining growth in the civil service, to reduce the staff of the department that has greatest capacity to fund that service, whilst enforcing an important element of the law, is always bound to produce dubious financial benefits.

In 2006-07 HM Revenue & Customs cost £4,389 million to run if the costs of child benefits and children's trust funds paid are excluded from its accounts[41]. Of this total, £2,841 million related to staff costs including pensions and employer's National Insurance payments. Total staff numbers in the year averaged 91,373 meaning each staff member cost £31,092. If their overhead cost was added then each cost £48,033. But the average yield in tax for each person employed was £4,636,588[42]. That means each member of staff recovered 96.5 times their full cost of employment.

Of course, this is a simple statistic and relates to a complex organisation. If HM Revenue & Customs had many fewer staff the tax paid might still be substantial given that, as HM Revenue & Customs have themselves noted [43], maybe 50% of all people choose to be tax compliant and 40% might be capable of persuasion to be so. Many of the staff are, therefore, targeted at those who are capable of persuasion of being tax compliant, and at those who choose not to be. These are smaller in number, but the total tax loss calculated in this report suggests that those involved in this activity may be very significant in number given the total scale of the losses noted.

If this is the case then it would seem that the marginal situation where the cost of employing tax compliance staff exceeds any benefit derived either by the Government or society as a whole by doing so has not been reached. Indeed, the opposite seems true. Increasing staff at this time seems likely to provide a positive yield in terms of taxation, and so provide a bonus for society as a whole as it will be appreciated by the majority that the rule of law is being upheld and that the democratic accountability of the taxation system is being enhanced as a result. The Government must be aware of these concerns, which have been widely reported in the press [44]. They must also know that many in the tax profession share common ground with the unions representing HMRC staff in believing that the outcome of the job cuts is bound to be a loss of efficiency by HM Revenue & Customs [45], and so an increased tax gap. For example, the journal Taxation has recently launched a campaign to prevent planned job losses at HMRC.

Making life hard for the tax avoider

If these initiatives were to be followed they would, by themselves, make life a lot harder for the tax avoider. That is because tax avoiders do not wish to be seen to break the law: many of those who tax avoid would suffer considerable personal reputational risk if they were found to be tax evading, which is what failed tax avoidance is. This is why they are so anxious to promote the idea of tax avoidance instead, which takes care to work round the law, or quite literally avoid it. There is little reputational risk in this at present, not least because of the privacy rightly afforded to taxpayers in the management of their affairs by HMRC.

This, though, suggests that the next stage of the attack on tax avoidance is not to continue seeking to close loopholes; it is to remove the incentive to avoid in the first place. To achieve this it has to be appreciated that the tax avoiders' tricks are relatively limited in number, as has been shown already.

In summary, they aim to divert income from one person to another (which can be a company) or they seek to recategorise income so that it can be taxed at a lower rate than that it would normally attract.

The withdrawal of allowances for those earning over £100,000 noted above, with regard to tax planning, is one way of removing the incentive to tax avoid. This arrangement would simply negate the benefit of tax avoidance for this part of the tax paying community and would be an important initiative, but there are a range of other ways in which whole mechanisms that provide opportunity for the exploitation of differing tax rates could be removed to reduce tax avoidance, and (with careful planning) ensure that society benefits at the same time. A range of such options are considered below.

Abolish the domicile rule

First, the domicile rule that has been calculated to cost £4.3 billion in lost taxation revenues before the planned changes in the pre-Budget Report of 2007 could be abolished in its entirety[46]. The limited reform that has been proposed in the Pre-Budget Report 2007 falls far short of this ideal, instead proposing that the rule can be retained and be available to anyone who wishes to pay £30,000 a year to utilise it, assuming they also meet the other qualification criteria.

This new proposal fails to meet either of the most basic tests of horizontal or vertical equity within the UK tax system. As such on the grounds of equity alone the domicile rule, and the proposed modification to it, should be abolished as both give the signal that there are two parallel tax systems in the UK, with one now being available exclusively to the wealthy so they can avoid tax. This cultural flaw in the tax system has to be abolished, and the resulting revenue raised could be used to halve child poverty in the UK through the tax credit system, for which it is sufficient.

Abolish savings tax loopholes

All tax reliefs on savings will tend to benefit the better off as the poor will not have the spare cash to save. But at least tax relief on savings vehicles such as ISAs are strictly limited and are therefore less significant to the relatively small number of the wealthy with whom this pamphlet is concerned.

Reliefs that could be abolished include those for investment in Venture Capital Trusts[47] and Enterprise Incentive Schemes[48]. These provide tax relief to those investing in smaller businesses but there is significant evidence now available that since the creation of such schemes, or their predecessors in the early 1980s, they have not been a source of significant funds for innovative, entrepreneurial activity. Much of that activity is too small to attract funding from these arrangements. They are instead used for complex tax planning whilst providing funds to companies that would be quite able to secure investment without tax relief being available.

These tax reliefs, which are the almost exclusive preserve of the very wealthy, should therefore be abolished and the tax saved should instead be used more creatively. The saving would be £235 million a year[49]. The most obvious use of that resource would be to provide grant funding to small businesses that could prove an economic need for state support during their development stage or for the improvement of training in smaller businesses where state support is currently too limited. Both are likely to have significantly greater impact on the development of an enterprise culture supplying high quality goods and services in the UK than does the existing tax relief scheme.

Tackle the shifting of capital gains

Many Capital Gains Tax liabilities are avoided by transferring the ownership of an asset to a spouse immediately prior to sale. This means that two personal allowances for Capital Gains Tax are then available for offset against the gain and, as the evidence in this report suggests, part of the gain might then also be charged at lower rates of tax (although this might not be relevant in future if capital gains are subject to a flat rate charge as proposed in the Pre-Budget Report 2007).

This abuse could be tackled in one of two ways:

1. All gains on assets held for less than one year should be subject to income tax, so preventing use of the second Capital Gains Tax allowance on transfers made for this purpose. Or:

2. The gain on the sale of any asset transferred between spouses less than one year before sale should be taxed as if the asset remained the property of the person who made the gift to the spouse.

Up to £600 million of tax might be raised as a result of this change: enough to pay for two to three new hospitals a year[50].

'Capital gains' on all assets held for less than one year should be subject to income tax.

Maybe £500 million of tax a year is lost because gains on assets held for short periods are subject to lower rates of tax than they would be if treated as being a trade in assets under income tax rules.

This abuse should be tackled by ensuring that the gain arising on all asset disposals, where the asset sold had been owned for a year, are charged to tax at income tax rates and offset only against income tax allowances, although otherwise being considered capital gains.

This rule change would pay for the complete rebuilding or total refurbishment of almost 200 primary schools a year[51].

Reform the tax relief for charities

The next tax relief change appears controversial, but has the capacity to release significant resources for social benefit in the UK. This would be the result of abolishing the tax relief on gifts made to charity in the UK. The current tax scheme for such gifts is absurdly complex, imposing a considerable administration burden on charities that could use the resources expended in managing tax reclaims much more effectively in pursuit of the good causes for which they have been created.

It must however be noted that charities do benefit from the existing rules that provide tax relief for gifts made to them. They recover income tax at the basic rate on all gifts for which they can secure documentation made from identifiable people who have confirmed they pay tax in the UK. It is this documentary burden that is onerous.

The arrangement is also discriminatory: some forms of charitable giving, such as street collections, are less tax efficient than others but all result from giving with charitable intent. It is strange that some forms of giving are favoured more than others.

The solution is simple. It should be assumed that all gifts to charities are made out of taxed income. This is, after all, highly likely to be true. The charity should then be allowed to make claim to the Government for a sum equivalent to the tax that would have been paid at basic rate. This would be a sum in excess of that charities can claim under the Gift Aid rules since not all that income is subject to tax relief at present.

The result would be an increase in the income of UK charities and a massive saving in their administrative costs. Both would, surely, be welcome. The cost of the additional relief would be covered by the withdrawal of the current wholly anomalous situation where UK individuals paying tax at higher rate can actually enjoy a personal tax refund of the difference between the higher rate of income tax and the basic rate on the value of all gifts they make to charities: a tax relief from which the charities themselves get no benefit at all. By abolishing this relief another opportunity for tax avoiders, which has been subject to spectacular recent abuse [52] (as detailed in the example related to the manipulation of shares on the Jersey Stock Exchange quoted above), could be eliminated. Recent research by HM Revenue & Customs [53] has shown no apparent influence of this tax relief on the decision of higher rate tax payers to donate to charity, or not, and as such it is unlikely that the value of gifts they make will be affected to any significant degree.

Charge investment income at an appropriate rate of tax

There is a further tax avoidance activity which is exploited almost entirely by those with wealth. Whilst income earned as a result of the expenditure of effort by an individual is almost invariably subject to National Insurance charges, income earned passively as a result of a return on investments is not subject to such charges.

Rates of National Insurance vary. For those earning less than £87 a week [54] there are no such charges. Between that sum and earnings of £670 a week (equivalent to total earnings of £34,840 a year) National Insurance is charged at 11% on the employee. Above this earnings limit, National Insurance is charged at 1% on all sums earned from employment, making this, by definition, a regressive and therefore inequitable tax. In all cases when an employee has to make a contribution their employer has to as well, at present at the rate of 12.3% on the wage paid.

This means that the combined marginal rate of charge for this effective tax is in the case of the majority of employees in the UK some 23.3%, which is higher than the marginal rate of income tax for most people in the UK. It is extraordinary that there is no equivalent charge on investment income, and that there has not been so since the abolition of the investment income surcharge in 1984 [55].

It is this anomaly that has created the incentive for earned income to be translated into unearned income and that has in turn given rise to the boom in the number of small limited companies in the UK where earned income is distributed to the members by way of dividends, and by no means always to the person who generated that value by the expenditure of their effort. The relief has also meant that investment income is always assumed to have higher status to that from employment, a logic that inverts all natural justice. The existence of such companies has in turn facilitated the increase in income shifting within the UK economy as shares can be reallocated within a company to achieve this with relative ease.

There is little stronger incentive to tax avoidance than the opportunity that this anomaly produces and it should be closed. The way to do so is clear. An investment income surcharge should be introduced on all investment income received by a UK resident person. This surcharge could reasonably be charged as a 10% additional income tax on all investment income they receive on a sum in excess of the lowest level at which National Insurance is charged. Complete exemption from this charge could be available for all people over the age of 60 and for those registered disabled and in receipt of associated benefits. To be clear, this 10% surcharge would only apply to interest or the income arising from an investment. On current rates this means that an individual would need to have invested approximately £100,000 before paying any surcharge on earnings from that investment, and then only on income arising from assets held over this limit.

Total tax on investment income received by those who are currently higher rate taxpayers in the UK is expected to amount to £11.3 billion in 2007/08[56]. On average they paid £3,091 of tax on this each[57]. In consequence it is likely that their total investment income amounted to about £28.4 billion. Assuming that 60% of this total investment income attributable to this group would be subject to this new tax then additional revenue of about £1.7 billion a year would be generated and a massive incentive for tax avoidance would have been removed from the UK economy.

£1.7 billion a year could, over the next six years, pay most of the cost of the London Olympics without recourse to other funding[58].

In addition, significant improvement in the horizontal equity of the tax system would have been created because the likelihood that people earning similar sums would pay similar tax would increase significantly as a removal of this bias towards one form of income over another. The vertical equity of the system would also be improved as the chance that tax might be progressive throughout the income range would be substantially increased. On the grounds of social justice this change is, therefore, wholly justified. As a result there is no reason to presume that there will be significant loss to the economy as a result of this change. Indeed the reverse might be the case because the perverse disincentive to work currently inherent in the tax system will have been removed.

A general anti-avoidance principle

The above measures tackle some of the more obvious opportunities for tax avoidance. More complex tax avoidance must be tackled by the creation of what is called a general anti-avoidance principle, or GANTIP[59], in taxation law. A GANTIP is a simple statement of principle: it says that if any step is added into an otherwise commercial arrangement for the sole or main purpose of securing a reduction in a tax liability then that step will be ignored for tax purposes by HM Revenue & Customs. In effect, this makes clear that HM Revenue & Customs would have the power to over-rule any tax avoidance scheme designed to exploit loopholes and allowances.

This is not as innovative as it sounds, The House of Lords effectively created such an arrangement in the 1980s when ruling in two cases called Furness V Dawson[60] and Ramsey[61]. For more than a decade the tax profession believed as a result that if such steps were taken they could be knocked down by HMRC. However, statute law never confirmed this and as result the ruling of the House of Lords was eventually challenged and in 1996 in a further House of Lords ruling, called the Westmoreland case[62], the principles in the two earlier decisions were overturned, and artificial tax planning was effectively allowed again in UK law[63]. The result was a flood of tax planning from which, more than a decade later, full recovery has not been made. A GANTIP would make clear that this was unacceptable and would put massive pressure on tax avoiders to reform their ways, and would create penalties for them if they did not.

Tackling tax haven abuse

Some further specific issues of concern need to be addressed. One is tax havens. There are at present about seventy recognised tax havens in the world[64] of which the UK is one because of its domicile rules, amongst other things. Of most immediate concern though are those states that make a substantial part of their income from providing tax haven services to people not physically resident in their country. These tend to be small states, are quite often islands and about half have the common distinguishing characteristic that they are either British Crown Dependencies, such as Jersey, Guernsey and the Isle of Man or are Crown Protectorates, such as the Cayman Islands, British Virgin Islands, Turks & Caicos Islands, Bermuda and St Kitts, to name just a few.

What these locations have in common is the protection of the British State and the continuing provision of abusive tax practices, despite many initiatives to limit their impact over the last decade[65]. So, and for example, it is normal in these locations for little or no tax to be charged on transactions recorded there so long as they actually take place elsewhere, or can be deemed to have been so.

In addition, the companies and trusts formed to record these transactions will invariably be cloaked in a shroud of secrecy which might at best allow the nominee directors who supposedly run and own these companies to be identified, even though in practice others will almost always actually undertake these tasks. At worst no such information or any accounting data is available to any enquirer at all. Behind this shroud of secrecy almost any form of abuse can take place.

Whilst very limited opportunities to crack these arrangements have been offered by the tax havens in recent years, for which the tax havens have sought much publicity, these arrangements are of little value because no information need be supplied to an enquiring country unless that enquirer can specify precisely what information is needed, why it is needed, who has it, and what it will be used for. Of course, almost by definition this information is not known by the enquiring state precisely because of the secrecy which surrounds these locations and all with the full support of the UK Government.

Tax haven activity would not end if the UK Government changed its attitude to these Crown Dependencies and Protectorates, but if the UK Government simply required that these locations, all of which are wholly dependent upon the UK for their legitimacy, used the same standards of disclosure and accountability as the UK itself then much of their attraction as places in which considerable volumes of corporate profit are hidden and enormous personal tax abuse and corruption take place would disappear. This would be a step in the right direction.

As it is they contribute to substantial loss of tax revenues. As *The Guardian* newspaper[66] showed in November 2007, 47p[67] out of each £1 spent on bananas in a UK supermarket ends up in a tax haven so that the profits of the companies shipping these popular fruit can be hidden from tax.

And as the Tax Justice Network has shown, maybe $11.5 trillion of assets are held by the wealthiest people in the world in tax havens[68], at a potential tax cost to the combined governments of the world of approximately $255 billion a year. This sum is more than 2.5 times total world wide aid flows in 2007[69].

There is a domestic effect as well. The UK's tax amnesty for those holding bank accounts with the offshore branches of a limited range of UK high street banks in the main Crown Dependencies (principally Jersey, Guernsey and the Isle of Man) led to more than 60,000 people admitting that they had undeclared income in these places and it is expected that at least £500 million of tax will be recovered as a result[70]. It is also anticipated that much more will be discovered when those who did not make a voluntary declaration are pursued, as HMRC have said is their intention.

The evidence in that case is clear: tax havens are harmful to the operation of the tax systems of the UK and other counties with large populations, and this is before the corrupting effect they have on commercial life, accountability and the development process is considered. The latter is especially important; far too much aid cash is sent back to the developed counties of the world for investment by corrupt developing country government officials who hide their tracks through the world's tax havens.

For all these reasons the UK needs to change its policy on tax havens. It is time for the UK to demand that these places change the ways in which they manage their economies. The saving to the UK by way of tax recovered would almost certainly be sufficient to provide resources to assist these places to refocus their economies on more acceptable economic activity, and in the long term the problem that these places represent by undermining the rule of law and the democratic right of elected governments to collect the taxes due to them will also be curtailed as a result, which would be an enormous gain for society throughout the world.

Redesign limited companies

There is a major flaw in the favourite incorporated trading medium used by small businesses in the UK. This is the limited company, and it is simply not fit for purpose in the 21st century.

The limited company is a Victorian creation, and like so much of the current financial architecture of the world a curiously British invention. However, implicit in its now anachronistic structure are the assumptions that:

1. The owners of this company are distinct from those who manage it.
2. Those who manage the company do so in the sole interest of the shareholders.
3. The directors may be distinct from the employees of the company who actually work for it (a circumstance perhaps normal in Victorian England, but far from so now).
4. The creditors of the company can rely upon the existence of a substantial share capital subscribed by the members to protect them from loss.

None of these assumptions now hold true. The subscribed capital of the more than 2.3 million limited companies now incorporated in the UK is often little more than £2 and those shares will usually be owned by the sole director who also undertakes much of the work of the company but shares ownership of the entity with one or more members of his or her family.

The fiction that these companies provide the owners with limited liability is also untrue. Too often if they require loan capital that money has to be guaranteed by the owners of the share capital, and they are in most cases the only people apart from the tax authorities that lose in the event that the company fails. Put simply then, the limited company is now an out of date trading entity which fails to deliver the advantages it was designed to supply.

Limited companies do now, however, supply one advantage to tax avoiders which it was never intended that they deliver. Because ownership of a company can be split so that, for example, several members of a family can own shares in a company for which only one of them works, all of them can enjoy part of the income that one person generates. This can be achieved by not paying that person a salary in exchange for the work they undertake for the company. That inflates the profits of the company out of which dividends can then be paid to the owners of shares in it, even if they expended no effort at all to earn that income. If they enjoy a tax rate lower than that which would have been paid if a salary had been paid to the person whose efforts actually generated the profits of the company tax will have been saved and no National Insurance will have been paid either, as noted above.

This has been an enormous incentive behind the boom in the number of limited companies in the UK, the other being that many companies offering contract work to individuals will not engage them unless they provide their services through a limited company; thus protecting the 'employer' from a claim of negligence when tax is not deducted at source.

It is now ludicrous that an entity created to provide opportunity for individuals to pool their capital and share risk in enterprises they did not manage for the benefit of the economy as whole is now being used, in the main, by individuals who contribute almost no capital to their companies with the main aim of lowering their tax liabilities. It is time that this anomaly was removed.

This possibility exists[71]. There is already an alternative limited liability trading entity available in the UK. It is called the Limited Liability Partnership (LLP). It is a legal entity. It protects its members from liability if they are not at fault for the loss. Importantly it protects the members from each other. It can also own property in its own right, which is essential.

As important, it charges the members to tax on all the profits of the business as if they were self employed. There is no tax on the LLP at all. This immediately cuts out a whole raft of tax planning opportunities, and also massively reduces the administrative burdens on the business. The problem of the income of the business being converted into an investment return is eliminated. The income of an LLP is all subject to National Insurance, albeit at the slightly lower self-employed rates for which lower benefits are paid in return. And, because this is a modern entity it is easy to change the way in which profits are allocated to the members so that each can be allocated the appropriate economic reward for the effort they have expended in a year without any legal complications arising.

It is now time for the Government to encourage by legislation the use of LLPs rather than limited companies by the small business community. This could be done by implementing the following:

1. A change in company law to allow the re-registration of small limited companies as LLPs.
2. The introduction of new capital requirements for the incorporation of limited companies undertaking trades, and over time forced re-registration of those that do not meet that standard as LLPs. This might be done by stipulating that a limited company could not be used unless at least £25,000 of capital was subscribed to it. Those that did not do so would become LLPs by default.
3. Create new, economically justifiable and verifiable standards for splitting income in LLPs for tax so that the risk of legal challenge to such arrangements will be substantially reduced in future, so providing taxation certainty for smaller businesses.

If this were done then:

a. The administrative burdens for many small businesses would be reduced.
b. The certainty of the arrangements under which they can operate would be increased.
c. The rewards that they rightly seek to pay to those who contribute to the management of these companies from within domestic relationships will be rewarded, but within appropriate constraints.
d. The attraction of freelance status in tax terms would be retained.
e. The current injustice that sees income from labour more heavily taxed in the UK than income from capital would be eliminated in large part.
f. The incentives for tax planning would be reduced, so simplifying tax administration.
g. The opportunity for tax abuse would be reduced.

The challenge in creating such a system is significant because it requires co-operation across government departments, but is far from insurmountable. It is part of the challenge of creating an enterprise culture that meets the needs of the UK in the 21st century.

Tax co-operation

Internationally there are two final issues to note.

The first is that the UK has been a persistent opponent of many of the tax initiatives of the European Commission and other bodies that seek to encourage tax cooperation as a means of tackling tax abuse. There appear to be two reasons for this.

The first, without doubt, is its commitment to maintaining the UK as a tax haven. For example, the UK has persistently refused to agree to allow the deduction of tax from interest payments within the EU which would massively limit the effectiveness of tax havens. This measure would considerably reduce cross-border tax evasion and avoidance because tax at a basic rate (probably 20% in the case of the UK) would have already been deducted from that income before it reached the tax haven. The motive for refusing this is that it would, in the opinion of the UK, undermine the City of London.

The second reason is that the UK persists in arguing that it must have fiscal independence from Europe. By this it means it wishes to retain the right of control over both its tax base (how taxable income is defined) and its tax rates, even though in the case of one major tax, VAT, the tax base is already set at a European level. The argument may have political appeal, but the reality is that by promoting this flexibility, international corporations can secure tax advantages for themselves by ensuring that governments compete with each other on both tax rates and the tax base. The result has been the long-term decline in effective tax rates noted in this report, which can only be tackled by the major populous states of the world working together.

One way in which the UK could now evidence this willingness to tackle the harmful effects of tax competition would be to commit to the creation of what is called the Common Consolidated Corporate Tax Base (CCCTB) for Europe[72]. This is an exercise being pursued by the European Commission with the support of a significant majority of countries within the EU, the exceptions being the tax haven states such as the UK, Ireland, Malta, Cyprus and some (but not all) Eastern European states. The CCCTB would make arms length pricing irrelevant in Europe. A unitary basis of allocation of taxable profits to countries would be used, meaning that tax would be paid where the economic activity that gave rise to it occurred. This would substantially reduce the misallocation of profit to tax havens.

There is a second way in which this could be achieved. If all multinational corporations were required to report the economic transactions they undertook on a country-by-country basis then enormous benefits would follow. These would include: disclosure of where their sales were made to both third parties and other companies within their group; how their purchases were split likewise; what their labour costs were and how many people they employed; what their profits were and how much tax they paid; plus some limited balance sheet information.

First of all the composition of the labour force of the company, which is the single asset most likely to generate profit would be known, and measures could be created to check how it was rewarded, with geographical comparison being possible.

Second, it would be possible to check whether the locations where profit was declared and tax was paid were consistent with the places where sales were made and staff and assets were located. If there was an obvious mismatch then an investigation could be undertaken. So, for example, if a company declared significant profits in the Cayman Islands but all its sales and purchase in that location were made on an intra-group basis and there were no staff or assets there then it would be highly likely that a transfer pricing scam was taking place. It would then be easy for the countries losing tax revenue as a result to challenge what was happening. Securing the data to do this is at present very difficult.

This basis of taxation has been proposed for inclusion by civil society groups such as Publish What You Pay[73] and the Tax Justice Network[74]. The move has now been supported by the European Parliament[75] who has asked that such a standard be created, at least for the extractive industries.

The UK's accounting bodies have consistently opposed this move, with the apparent support of the Department for Business, Enterprise and Regulatory Reform. So has the International Accounting Standards Board[76], who set the rules for multinational company reporting. If this system of accounting were required the probability of ensuring large corporations pay the tax expected of them would increase considerably, and the corporate tax Expectation Gap might be substantially reduced. That is why the reform is needed, and it is why the UK should support it. It is essential if the UK corporate tax gap is to be closed.

At the same time this disclosure would massively increase corporate accountability and make it possible to hold these companies to account as corporate citizens of the places where they are located in ways not possible at present, when they do not even have to admit that they have an operation in a country. This would, for example, have considerable benefits for all employees of all such companies.

Summary on tax avoidance

The measures recommended in this section would make a significant contribution to cutting tax avoidance in the UK. It is clearly impossible to tell with any accuracy by what degree tax avoidance might be reduced, but such is the scope of the proposed measures that it is reasonable to think that a halving of tax avoidance might be possible. This would save maybe £12 billion in the UK in a year: enough to build 50 hospitals a year. Put another way, the basic rate of income tax could be cut by 3p in the pound[77] if this saving were available or the point at which higher rate tax need be paid could be increased by in excess of £10,000[78], making the progressive nature of the tax system when this happens easier to manage for many on middle incomes. Some combination of all three would also be possible, of course.

This might, however, be an underestimate because the removal of so many opportunities for tax avoidance will issue the clear signal that this activity is socially unacceptable.

Conclusion – responding to the critics

There will be those who will argue that whatever tax might be raised the actions outlined in this report should not be taken.

It is extremely hard for anyone to argue in favour of criminal behaviour, such as tax evasion, but the measures dealt with here relate to legal, but ethically unacceptable activities and debate is, therefore, inevitable. The arguments those opposing the proposed measures might present include the following:

1. ***The withdrawal of tax incentives for some forms of saving and incentive might harm enterprise.***
   This argument does assume that these activities cannot survive without state subsidy. This paper accepts the need for state subsidy within the economy, but thinks it has to be targeted and appraised on a case-by-case basis rather than by a blanket system of tax reliefs. The recommendation is therefore that the specified tax reliefs for savings and investment be withdrawn but that they be replaced with targeted measures. Such measures might include support for specific industries, or businesses of certain sizes or for training for specific skill needs of which there is proven need within the UK. The result would be a more targeted use of state spending (which is what tax reliefs also are) to achieve specific economic goals.

2. ***People will leave the UK and economic activity will suffer as a result.***
   This argument has been used time and again with regard to reform of the domicile rule, despite no-one ever producing any evidence to prove that it is true.

   Of course some people might leave if such a change were introduced. But latest data suggests 400,000 people leave the UK each year, more than 200,000 of them being long-term residents[79]. The question has to be, in that context, whether or not any additional emigration would have any real economic consequence.

   The answer is almost certainly not when the specific context of the domicile rule and other tax arrangements affecting the wealthiest in society are considered. The reason is simply stated. Those who are in the UK to exploit its domicile rule do so by leaving their economic assets outside the UK. If those assets were located in the UK then the income from them would be taxed in this country. It follows that they are not located here and the consequence of their owners leaving the country will be minimal as a result.

3. ***The City will be harmed.***
   This argument suggests that without being a tax haven the City of London could not be as successful as it is. But nothing in this report actually changes the key characteristics which make London successful, which are a high degree of expertise, acceptable regulation, its situation in a favourable time zone, acceptable tax rates and the absence of tax withholding from interest and the payment of dividends to shareholders in companies.

   For example, having companies pay appropriate tax on their profits will not affect their capacity to pay dividends. As the analysis for this report shows, as companies have increased their profits and lowered their effective tax rates they have in fact retained the difference and not paid it to their shareholders (see Technical Appendix 4*). Dividends appear almost unaffected by either profitability or tax paid. In that case the recommendation made that companies and others pay the tax expected of them is to simply uphold the status of credible accounting and reporting systems, something the UK should be doing if effective markets are to flourish, as the City requires.

4. ***Tax is a disincentive to economic activity.***
   There is no doubt that this can be true if tax rates are very high. But so far no one has shown that the UK has tax rates anywhere near those rates. At present UK tax rates are about mid-range in the OECD and would be lower if the avoidance measures outlined in this pamphlet are taken into account.

   This report does not recommend raising tax rates. What it does do is recommend that those tax rates are applied fairly and consistently so that taxpayers are, as far as possible, equally treated. In addition, it suggests that, in the case of the highest personal tax rate, reliefs and allowances are withdrawn until this rate is paid. This is necessary to achieve vertical equity in a tax system which does not otherwise have it. The proposed additional charge on investment income is intended to achieve the same result with regard to horizontal equity.

   There is no evidence that this will be a disincentive to those living and working in the UK. Indeed the opposite is likely to be true. The creation of a level playing field is a pre-requisite for vibrant economic activity and the proposals in this paper are seeking to create that level playing field.

5. ***Tax changes will increase administrative burdens.***
   This is certainly not true of the proposals made in this paper. Most, particularly as they relate to individuals, will make the administration of their tax affairs considerably easier, and wil reduce the paperwork they have to complete to ensure that their income is correctly stated.

* Go to **www.tuc.org.uk/touchstonepamphlets**.

6. *Offshore arrangements have to stay as they provide the capital the UK needs.*

This argument is subtle. The UK runs an almost perpetual trade deficit, matched by an almost constant borrowing requirement by the Government. Both mean that the attractiveness of the City to global finance has to be maintained to ensure that funds flow into the UK to meet the need of financing these deficits. There can be little doubt that this situation has influenced the attitude of the UK Government towards tax haven activity. The Crown Dependencies of Jersey, Guernsey and the Isle of Man are all, in effect, satellites of the City of London for achieving this objective, much as Cayman and Bermuda fulfil the same role for the USA.

This is obviously a serious issue: it is a matter of concern that our country is dependent for its financial stability upon the existence of tax havens where tax evasion is commonplace and the control of money laundering is weak[80].

This report does not tackle the macro-economic issue of funding of the national debt. But it does not accept that steps to encourage tax avoidance and, worse still, tax evasion should be a necessary component in ensuring the financial viability of the UK. If that is indeed the case, more substantial reform is needed to remedy the problems.

7. *The private sector makes money, the public sector spends it: charging more tax cuts profits and so in turn harms the public sector.*

This argument is not accepted. It is premised on a false perception of the role of the private and public sectors and does not reflect the reality which is that the private and public sectors work in tandem to create wealth, each being unable to do so without the other in a democratic society.

The debate about where the dividing line between the two is one on which disagreement occurs, but to argue that one creates value and the other expends it is wrong unless it is also assumed that education is of no worth, nor is health, nor is a transport infrastructure, let alone a legal system that both maintains law and order and the system of property rights on which the market economy is based. This argument is, therefore, rejected.

It is also rejected for one further reason. There is no reason why the recommendations in this report should lead to more tax being paid as a whole. Of course, they could if existing tax rates were maintained but if the sums now lost to tax avoidance were used by a government to cut the tax rates used for all tax payers the result would not be a bigger tax take but improved equity in the way that tax is paid. That is something quite different. This option would therefore increase the choices available to Government when managing the economy.

8. *Tackling tax avoidance creates uncertainty for business.*

This has often been argued, especially when it is suggested that a general anti-avoidance principle should be introduced.

In practice the evidence runs contrary to the argument. For example, in December 2004 the Paymaster General announced that henceforth any tax avoidance scheme designed to ensure that payment of a salary to an employee might take place without National Insurance being charged would be abolished with effect from December 2004, even if not known of at that time. This had the effect of creating a targeted anti-avoidance principle (which is a reduced version of a general anti-avoidance principle dealing with abuse in just one area). The result was immediate and effective. These schemes ceased to be used. Business had greater certainty as a result. It knew it need not consider these issues any more, and did not do so.

This would be true of all the steps suggested in this report, the result of which would be enhanced certainty for business enabling them to focus on what they should do best, which is to make a positive contribution to the UK economy.

It is in fact very hard to find any justification for the continuation of tax planning with benefit for those best off in society, or for tax avoidance, unless those making the case do so out of self-interest. When horizontal and vertical equity within a tax system clearly results in an optimal outcome for society, self interest cannot validate practices that promote injustice. That is why measures to tackle tax avoidance and tax planning which benefits the best off in society must be taken now. When resources are limited there are better uses for the cash lost to these activities, and it is to those better purposes that the cash must be allocated.

Glossary

A more detailed glossary including terms used in the technical appendices can be found at **www.tuc.org.uk/touchstonepamphlets**.

Aggressive tax avoidance	The use of complex schemes of uncertain legality to exploit taxation loopholes.
Arms length pricing	See transfer pricing
Capital Gains Tax	A tax on the profits from the sale of capital assets such as stocks and shares, land and buildings, businesses and valuable assets such as works of art.
Company or corporation	An entity treated as a separate legal person from those who set it up, established under the rules of the country in which it is registered.
Corporation tax	A tax on the profits made by limited liability companies and other similar entities in some countries, but otherwise usually being similar in application to income tax.
Deferred tax	A fictional tax which only exists in company accounts and is never paid. Deferred tax does not, as such, exist. But the rules of accountancy generally require that income be matched with expenses. If an expense is recognised for tax purposes more quickly than it is for accounting purposes (which is common with much plant and equipment) this means that the tax cost for the years when this happens are understated. Conversely, when all the tax allowances have been used on the assets there might still be accounting charges to make and the tax cost would then be overstated. To balance this equation a notional tax charge called deferred tax is charged to the profit and loss account in the earlier years and put on the company's balance sheet as a liability. The liability is released as a credit to profit and loss account in the later years and supposedly over the life of the asset all should balance out.
Domicile	The country identified as a person's natural home, even if that person has not been resident there for extensive periods of time. This concept, which is almost uniquely British and unknown in the tax law of other countries bar Ireland, says that a person acquires their father's domicile on birth if their parent's were married and their mother's if not. This means a person born in the UK can have a natural home in another country even if they have never lived there so long as they, or their parents before they reached the age of 18 took no steps to prove that they intended to live in the UK forever and that they had severed all contact with their previous natural home. Because the UK does not wish its citizens to lose their UK domicile, which does, for example, theoretically mean that their estates remain subject to Inheritance Tax even if they left the UK for some time before dying, the Government also makes it quite hard for a person to acquire UK domicile. Harder, in fact, than becoming a citizen in most cases, a concept to which it has no relationship.

Effective tax rate	The percentage of tax actually paid in relation to the total income of the person paying the tax.
General anti-avoidance principle (GANTIP)	A law that seeks to prevent a tax payer from obtaining the taxation benefit arising from any transaction if they undertook it solely or mainly to obtain a tax benefit. If they did, they lose that benefit.
General anti-avoidance rule (GARR)	A general anti-avoidance rule seeks to tackle those who try to break the rules of taxation through the use of further rules. Rather than considering intention like a GANTIP (see above), it lays downs ways of interpreting a series of events to determine whether the benefit of tax legislation can be given to the tax payer. Because rules are invariably open to interpretation a general anti-avoidance rule runs the risk of increasing the opportunity for abuse.
Horizontal equity	One of the two measures of the inherent justice within a tax system. Horizontal equity requires that those with similar income pay similar tax. The second measure is that of vertical equity (see below). These equitable principles are considered paramount in a just tax system.
Income tax	A tax charged upon the income of individuals. It can also be extended to companies, but is not in the UK. The tax is usually charged upon both earned income from employment and self employment and unearned income e.g. from investments and property.
Inheritance tax	A form of gift tax charged upon the estates of people upon their death.
Limited Liability Partnership (LLP)	A legally recognised partnership that provides its members with limited liability.
Loophole	A technicality that allows a person or business to avoid the scope of a law without directly violating that law.
National Insurance Contributions	See social security contributions. Often called NIC.
Offshore	Offshore relates to any jurisdiction (regardless of whether they are islands) which provides tax and regulatory privileges or advantages, generally to companies, trusts and bank account holders on condition that they do not conduct active business affairs within that jurisdiction. The term "offshore" is very broad and normally includes "onshore" tax havens such as Andorra, Lichtenstein, etc. The IMF considers the UK to be a tax haven.
Partnerships	Any arrangement where two or more people agree to work together and share the resulting profits or losses.
Payroll taxes	See social security contributions.
Private company	A company not quoted on a stock exchange. Shares cannot usually be sold without the consent of the company or its owners; in many countries little or no information need be disclosed on the activities of such companies even though their members enjoy the benefit of limited liability.
Progressive taxes	A tax system in which as income rises the amount of tax paid increases in proportion to the income as well as in absolute amount i.e. the percentage tax rate increases as the income rises. Also referred to as Graduation.
Public company	A company whose shares are quoted on a recognised stock exchange and are available to be bought and sold by anyone who wishes without consent being required from the company itself. Generally required to be more transparent than private companies.
Quoted company	See public company.

Regressive taxes	A tax system in which as a person's income from all sources increases the amount of tax they pay reduces in proportion to their income even if it increases in absolute amount i.e. their percentage tax rate falls as their income goes up.
Residence	For an individual, the person's settled or usual home; for simplicity a presumption may be applied based on a rule-of-thumb, such as presence within the country for six months or 183 days in any tax year. It may be possible to be resident in more than one country at one time (though double tax treaties aim to prevent this). Some individuals may also try to avoid being resident anywhere. For companies, residence is usually based on the place of incorporation but can also be where the central management and control of the company is located, if they are different. Tax haven companies formed for non resident owners are usually defined not to be resident in their country of incorporation.
Social security contributions	Payments made towards a fund maintained by Government usually used to pay pension and unemployment benefits. Health benefits are sometimes covered as well. Social security contributions are generally considered to be taxes.
Stamp duty	A tax on the value of contracts. Usually charged on contractual dealings on shares and other stocks and securities and on dealings in land and property.
Subsidiary company	A company 50% or more owned by another company which is its parent company.
Tax avoidance	The term given to the practice of seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud). The term is sometimes used to describe the practice of claiming allowances and reliefs clearly provided for in national tax law. It is, however, now generally agreed that this is not tax avoidance. If the law provides that no tax is due on a transaction then no tax can have been avoided by undertaking it. As such this practice is now generally seen as tax planning. So what the term tax avoidance now usually refers to is the practice of seeking to not pay tax contrary to the spirit of the law.
Tax base	The range of transactions that a country chooses to tax. A broad base includes a wide range of transactions. A narrow base includes relatively few transactions.
Tax competition	This is the pressure on governments to reduce taxes usually to attract investment, either by way of reduction in declared tax rates, or through the granting of special allowances and reliefs such as tax holidays or the use of export processing zones. Applies mainly to mobile activities or business, but the competition to attract investment may result in an overall decline of corporation tax rates and in the amounts of corporation tax paid, often resulting in an increased burden on individuals.
Tax compliance	A term that is acquiring a new use. It can mean payment of tax due without engaging in tax avoidance or evasion. It is also now being used in contrast to the terms tax avoidance and tax evasion. Tax compliance in this context is used as a test of a person's intention before they undertake a transaction. It asks whether the person is seeking to comply with the spirit of the legislation concerning the transaction into which they are entering. If they are, then it should be presumed their intent was to be legal. If they are seeking to comply with the letter but not the spirit of the law (and it is usually possible to determine this from the form the transaction takes) then it should be presumed their intent was to break that law, the onus of proof otherwise falling upon them. This test is then used in connection with a general anti avoidance principle to determine whether that principle should be applied to a transaction, or not. A person who has used an appropriate motive is "tax compliant".

Tax evasion	The illegal non-payment or under-payment of taxes, usually by making a false declaration or no declaration to tax authorities; it entails criminal or civil legal penalties.
Tax haven	Any country or territory whose laws may be used to avoid or evade taxes which may be due in another country under that country's laws. The Organisation for Economic Cooperation and Development defines tax havens as jurisdictions where: 1. Non-residents undertaking activities pay little or no tax. 2. There is no effective exchange of taxation information with other countries. 3. A lack of transparency is legally guaranteed to the organisations based there. 4. There is no requirement that local corporations owned by non-residents carry out any substantial domestic (local) activity. Indeed, such corporations may be prohibited from doing business in the jurisdiction in which they are incorporated. Not all of these criteria need to apply for a territory to be a haven, but a majority must.
Tax non-compliant	A person who is not seeking to be tax compliant.
Tax planning	A term used in two ways. It can be used as another term for tax compliance. When, however, tax legislation allows more than one possible treatment of a proposed transaction the term might legitimately be used for comparing various means of complying with taxation law.
Transfer-pricing	A transfer pricing arrangement occurs whenever two or more businesses (whether corporations or not) which are owned or controlled directly or indirectly by the same people trade with each other. The term transfer pricing is used because if the entities are owned in common they might not fix prices at a market rate (or what is called an arms-length price) but might instead fix them at a rate which achieves another purpose, such as tax saving. If a transfer price can be shown to be the same as the market price then it is always acceptable for tax. What are not acceptable for tax purposes are transfer prices which increase the cost or reduce the sales value in states which charge higher tax rates and increase the sales value or reduce the costs in states with lower tax rates. The difficulty for many corporations at a time when over 50% of world trade is within rather than between corporations is that there is no market price for many of the goods or services that they trade across national boundaries because they are never sold to third parties in the state in which they are transferred across national boundaries within the corporation. This gives rise to complex models in which attempts are made to allocate value to various stages within the supply chain within a company, which process is open to potential abuse. For this reason it is argued that such firms should be taxed on a unitary basis.
Transnational corporations (TNCs)	A corporation with subsidiaries or divisions in two or more nations. Also known as multinational corporation (MNC).
Trusts	A trust is formed whenever a person (the settlor) gives legal ownership of an asset (the trust property) to another person (the trustee) on condition that they apply the income and gains arising from that asset for the benefit of a third person (the beneficiary). Trusts can be established verbally but typically take written form. Trustees are frequently professional people or firms charging fees. Trusts are usually of one of three types: • discretionary trust • charitable trust • interest in possession trust.
Trustees	The people who hold the legal title to assets held in a trust and administer it.

Trust beneficiary

Anyone who may obtain a benefit from a trust. A person who has the right to a benefit has an 'interest in possession'; a discretionary beneficiary can get income or benefits only when and if the trustees decide to pay it to them.

Trust settlor

The person who establishes a trust by gifting assets to it.

Unitary basis

Treating the income of related entities within a single firm or corporate group on a combined or consolidated basis, and applying a formula to apportion it for taxation by the different countries or territories from which it derives. Each may apply the rate of tax it wishes. It has been used in federal countries such as the USA, applying an allocation formula based on a ratio of sales, employment costs and assets employed within each state. It has been opposed by tax authorities (and TNCs) because they consider that it would be too difficult to reach international agreement especially on the formula. However, taxation of highly integrated TNCs may in practice entail a formula-based allocation of profits, due to the difficulty of finding appropriate arm's length transfer prices.

Value Added Tax

Known as VAT. A value added tax is charged by businesses on their sales and the supply of services. It allows those same businesses to claim credit from the Government for any tax they are charged by other businesses incurred by them in the course of their trade. The burden of VAT therefore falls almost entirely on the ultimate consumers. VAT is a regressive tax since lower income households always spend a higher proportion of their income on consumption and therefore invariably spend a greater proportion of their income on this tax than do the better off. Because of the role of VAT in the economy, income and other taxes have to be progressive to ensure that the tax system as a whole is equitable.

Vertical equity

One of the two measures of the inherent justice within a tax system. Vertical equity requires that those with higher income pay proportionately more tax. The second measure is that of horizontal equity (see above). These equitable principles are considered paramount in a just tax system. When tax planning interacts with them it too has to be the subject of consideration.

Wealth tax

A tax on a person's declared wealth, typically imposed annually at a very low rate. Once commonplace in Europe these are now little used since they are thought to encourage people to hide assets offshore.

Withholding tax

Tax deducted from a payment made to a person outside the country. Generally applied to investment income, such as interest, dividends, royalties and licence fees.

Notes

1 Dave Hartnett, Director General of HM Revenue & Customs, suggested in June 2006 that research undertaken in Canada showed that 50% of taxpayers would be compliant irrespective of the circumstances, and 10% would be non-compliant. The remaining 40% were capable of being influenced into compliance. **www.kpmg.co.uk/pubs/beforepdf.cfm?PubID=1744** accessed 20.4.07

2 Quoted at **http://en.wikipedia.org/wiki/Tax_evasion** accessed 24-1-07. The original date of this comment has never been determined.

3 Based on quotes in **www.kpmg.co.uk/pubs/Tax_and_CSR_Final.pdf** accessed 12-10-07

4 Source: **www.hmrc.gov.uk/stats/personal_wealth/table13_5.pdf** accessed 1-11-07

5 **www.hm-treasury.gov.uk/media/F/9/pbr_csr07_annexb_305.pdf** page 164, accessed 1-11-07

6 **www.taxresearch.org.uk/Documents/TRLLPSmallBusinessTax8-08.pdf** page 14 accessed 1-11-07

7 **www.taxresearch.org.uk/Blog/2007/09/09/the-domicile-rule-costs-£43-billion/** accessed 1-11-07

8 **www.hm-treasury.gov.uk/media/F/9/pbr_csr07_annexb_305.pdf** page 164 accessed 1-11-07

9 **www.hmrc.gov.uk/stats/capital_gains/table14-1.xls** accessed 2-11-07

10 **www.hmrc.gov.uk/stats/capital_gains/table14-4.xls** accessed 2-11-07

11 **www.hmrc.gov.uk/stats/capital_gains/table14-5.xls** accessed 2-11-07

12 **www.hmrc.gov.uk/stats/capital_gains/table14-5.xls** accessed 2-11-07

13 **www.hmrc.gov.uk/stats/income_distribution/table3-5.xls** accessed 2-11-07

14 **www.hmrc.gov.uk/stats/tax_receipts/table1-2.pdf** accessed 2-11-07

15 **www.hmrc.gov.uk/stats/capital_gains/table14-1.xls** accessed 2-11-07

16 **www.hmrc.gov.uk/stats/income_distribution/table3-7.xls** accessed 5-11-07

17 **www.iht.com/articles/2007/02/15/bloomberg/bxatm.php** accessed 2-11-07

18 **www.ftse.com/japanese/Indices/UK_Indices/Downloads/ukdividend_factsheet.pdf** accessed 2-11-07

19 This figure was discussed with the Professional Contractors Group on 2-11-07 who thought it a likely understatement. **www.pcg.org.uk/cms/index.php?option=com_contact&task=view&contact_id=2&Itemid=359**

20 **www.hm-treasury.gov.uk/media/0/7/bud06_cha_134.pdf** page 210 accessed 2-11-07.

21 **www.hm-treasury.gov.uk/media/A/5/bud05_chapA_146.pdf** page 186 accessed 2-11-07

22 **www.hm-treasury.gov.uk/media/0/7/bud06_cha_134.pdf** accessed 2-11-07

23 **www.hm-treasury.gov.uk/media/D/6/pbr04_chapB_320.pdf** accessed 2-11-07.

24 **www.hm-treasury.gov.uk/media/D/6/pbr04_chapB_320.pdf** accessed 2-11-07.

25 For a discussion of 20 possible Gaps see **www.taxjustice.net/cms/upload/pdf/Mind_the_Tax_Gap_-_final_-_15_Jan_2006.pdf** accessed 5-11-07

26 For example, see *Do Countries Compete over Corporate Tax Rates?*, Michael P. Devereux, Ben Lockwood, Michela Redoano, 2005 **www.sbs.ox.ac.uk/NR/rdonlyres/ACE5A5B5-1508-4F65-8F11-136CDB5C84C7/0/DevereuxLockwoodRedoano.pdf** accessed 5-11-07

27 There was one exception: Standard Life should have appeared at 49 in the list but had been a quoted company for less than a year at the time the data was collected. Prior to 2006 it has a completely non-comparable reporting basis to all other companies in the survey as it was a mutual company. As a result it was excluded from the survey and the 51st company, Shire plc was substituted in its place.

28 **www.hmrc.gov.uk/stats/tax_receipts/table1-2.pdf** accessed 9-11-07

29 **www.nao.org.uk/publications/nao_reports/06-07/0607614.pdf** accessed 12-11-07

30 **www.taxjustice.net/cms/upload/pdf/Mind_the_Tax_Gap_-_final_-_15_Jan_2006.pdf** accessed 12-11-07

31 A tax system where as income rises the amount of tax paid increases in proportion to income as well as in absolute amount i.e. the percentage tax rate increases as the income rises.

32 Analysis based on Cobham, A. 2007 *The tax consensus has failed* presented to TJN conference, Nairobi, Kenya, January 2007

33 See **http://en.wikipedia.org/wiki/Fiscal_policy** accessed 29-1-07 for a discussion of fiscal policy.

34 **www.hmrc.gov.uk/stats/income_tax/table2-5.xls** accessed 16-11-07

35 ibid

36 **www.hmrc.gov.uk/stats/tax_expenditures/table1-6.pd**f

37 **www.taxresearch.org.uk/Blog/2006/12/06/41-of-all-uk-tax-legislation-tackles-tax-avoidance/** accessed 16-11-07

38 For further exploration of these ideas see *The Myth of Ownership: Taxes and Justice*, Liam Murphy and Thomas Nagel, Oxford University Press 2004

39 **www.nsandi.com/savingneeds/taxfreeinvestments.jsp** accessed 14-11-07

40 **www.hmrc.gov.uk/lbo/minutes-061207.htm** accessed 14-11-07

41 **www.hmrc.gov.uk/about/hmrc-06-07-acc.pdf** accessed 14-1--07

42 Based on **www.hmrc.gov.uk/stats/tax_receipts/table1-2.pdf** accessed 14-11-07

43 See footnote 1

44 See, for example, **www.accountancyage.com/accountancyage/news/2168825/hmrc-senior-staff-concerned** accessed 14-11-07

45 See, for example, **www.vnunet.com/accountancyage/analysis/2189133/taxman-efficiency-drive-slammed** accessed 14-11-07

46 **www.taxresearch.org.uk/Blog/2007/09/09/the-domicile-rule-costs-£43-billion/** accessed 19-11-07

47 **www.hmrc.gov.uk/guidance/vct.htm** accessed 19-11-07

48 **www.eisa.org.uk/render.aspx?siteID=1&navIDs=21,97** accessed 19-11-07

49 **www.hmrc.gov.uk/stats/tax_expenditures/table1-5.pdf** accessed 19-11-07

50 There is no fixed price for a hospital, but a review of the average price of current PFI funded hospitals suggests an average cost of £200 million a hospital is often quoted. See, for example, **www.guardian.co.uk/society/2007/feb/27/hospitals.health** accessed 7-12-07

51 Based on **www.hm-treasury.gov.uk/media/3/9/pbr_csr07_annexd1_189.pdf** accessed 16-11-07

52 A further example can be found at **www.taxresearch.org.uk/Blog/2006/12/28/vantis-anothr-name-for-the-hall-of-shame/** accessed 19-11-07

53 **www.taxresearch.org.uk/Blog/2007/05/21/charitable-giving-£210-million-of-tax-releif-for-the-best-off-in-society/** accessed 19-11-07

54 **www.hmrc.gov.uk/rates/nic.htm** accessed 19-11-07

55 **www.hmrc.gov.uk/manuals/apmanual/AP3024.htm** accessed 19-11-07

56 **www.hmrc.gov.uk/stats/income_tax/table2-6.pdf** accessed 19-11-07

57 Based on data in **www.hmrc.gov.uk/stats/income_tax/table2-1.pdf** accessed 19-11-07

58 **http://news.bbc.co.uk/1/hi/uk_politics/6391075.stm** accessed 16-11-07

59 See **http://denning.law.ox.ac.uk/tax/BTR_version_inaugural_lecture.pdf** accessed 19-11-07

60 **http://en.wikipedia.org/wiki/Furniss_v._Dawson** accessed 19-11-07

61 **http://en.wikipedia.org/wiki/The_Ramsay_Principle** accessed 19-11-07

62 **www.publications.parliament.uk/pa/ld200001/ldjudgmt/jd010208/macniv-3.htm** accessed 19-11-07

63 Discussion about creating a GAAR took place in 1998 at government level but was not pursued.

64 See **www.innovativefinance-oslo.no/pop.cfm?FuseAction=Doc&pAction=View&pDocumentId=11607** page 128 accessed 19-11-07

65 See, for example **www.oecd.org/dataoecd/33/0/1904176.pdf** from the OECD and **http://ec.europa.eu/taxation_customs/resources/documents/COC_EN.pdf** from the EU, both accessed 19-11-07

66 **www.guardian.co.uk/business/2007/nov/06/12** accessed 19-11-07

67 **www.taxresearch.org.uk/Blog/2007/11/06/tax-is-going-bananas/** accessed 19-11-07

68 **www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf** accessed 19-11-07

69 Based on data on page 21 of **www.dfid.gov.uk/pubs/files/sid2007/sid07-full-version.pdf** accessed 19-11-07

70 **www.ft.com/cms/s/0/2dae16da-9641-11dc-b7ec-0000779fd2ac.html** accessed 19-11-07

71 For a detailed description see **www.taxresearch.org.uk/Documents/TRLLPSmallBusinessTax8-08.pdf** accessed 19-11-07

72 See **http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm** accessed 21-11-07

73 **www.publishwhatyoupay.org/english/** accessed 21-11-07

74 **www.taxjustice.net/cms/front_content.php?idcat=2** accessed 21-11-07

75 **www.publishwhatyoupay.org/english/pr/pwyp_141109.doc** accessed 21-11-07

76 **www.iasb.co.uk/** accessed 21-11-07

77 **www.hmrc.gov.uk/stats/tax_expenditures/table1-6.pdf** accessed 21-11-07

78 Based on **www.hmrc.gov.uk/stats/tax_expenditures/table1-6.pdf**

79 **www.telegraph.co.uk/news/main.jhtml?xml=/news/2007/11/15/nemi115.xml** accessed 21-11-07

80 See **www.nao.org.uk/publications/nao_reports/07-08/07084.pdf** accessed 7-12-07 for a description of these failures.

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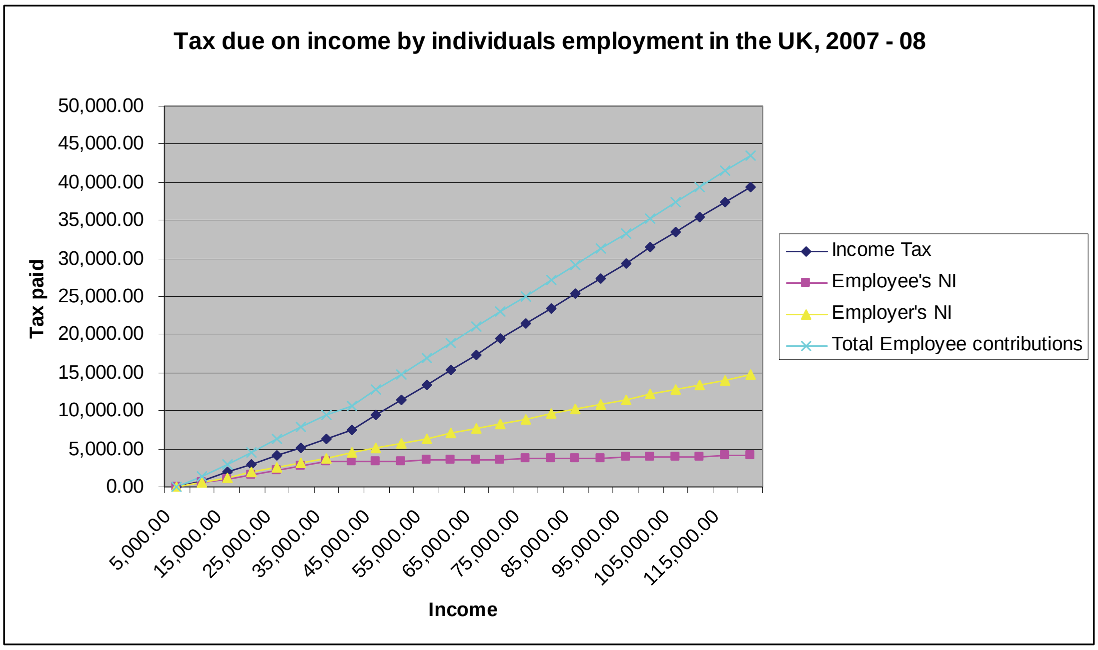
Technical Appendix 1

Tax planning by individuals

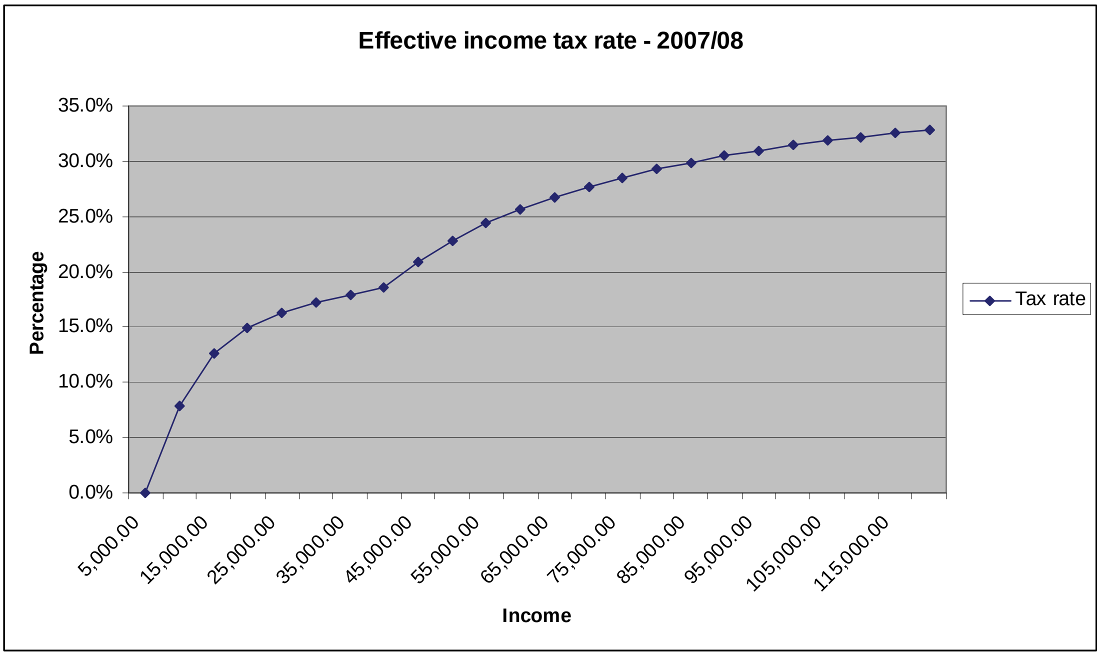
Tax planning is an acceptable activity unless it harms the overall equity of the tax system. This would be the case if an excessive part of the cost of tax reliefs intended to influence behaviour went to those who have little need for the incentives provided and the result was a loss of vertical equity within the tax system as a whole. This needs to be calculated.

The tax that is due, in theory, on employment income in the UK in the tax year 2007/08 is shown by the following graph:

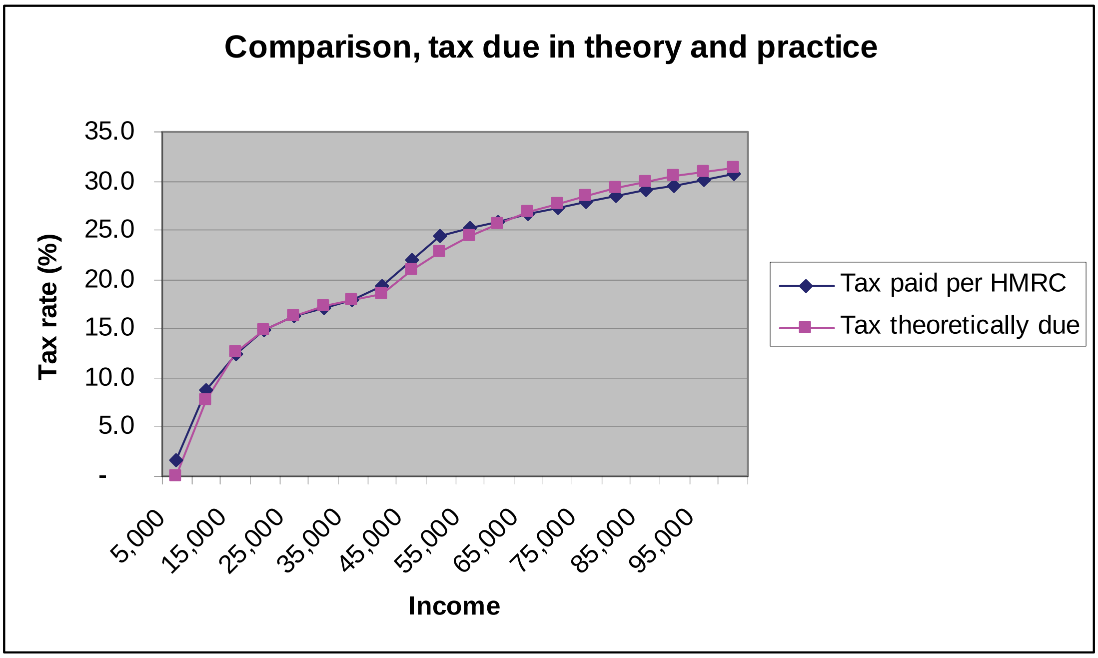


The pattern is clear: income tax appears to be progressive even if employee's national insurance contributions are not. This is what the tax system intends. This is what vertical equity should look like.

The percentage rate of overall income tax due, as reflected in the above graph is shown here:



When this is compared with the data published by HMRC on income tax expected to be paid in 2007-08[1] what is stunning is that there is, apparently almost no divergence:



There is a second, remarkable coincidence. If data from HMRC on average weekly wages by decile[2] is compared with similar information from the Annual Survey of

[1] http://www.hmrc.gov.uk/stats/income_tax/table2-5.xls accessed 18-10-07
[2] http://www.hmrc.gov.uk/stats/income_tax/table2-7.xls accessed 18-10-07

Hours and Earnings (ASHE) for 2005-06[3] (the last year available) the data is remarkably similar:

	bottom decile	lower quartile	median	upper quartile	top decile
Weekly:	£	£	£	£	£
ASHE	244.1	316.3	447.1	632.9	886.1
HMRC	240.5	312.3	440.9	626.1	869.7
Difference	3.6	4	6.2	6.8	16.4
Annualised:					
ASHE	12,693	16,448	23,249	32,911	46,077
HMRC	12,506	16,240	22,927	32,557	45,224
Difference	187	208	322	354	853

£853 difference a year from each top decile household does not suggest that a substantial amount of tax planning is taking place.

What this coincidence does suggest, however, is two things. The first is that this data reflects incomes after tax has been avoided. The second is that since top decile earnings start at £45,000, which is a good but by no means exceptional salary for an employee in the UK, there are a substantial number of people earning more who might well be avoiding significant amounts of tax. That is not shown by this published data because it lacks sufficient detail on the behaviour of those earning over £50,000 a year.

Three million six hundred and seventy thousand people pay tax at higher rates in the UK[4]. This means they have taxable income in 2007/08 of in excess of £34,600 meaning that their actual earnings when personal allowances are taken into account would need to exceed approximately £40,000. This group represent 11.6% of all taxpayers but they pay 55% of all income tax[5].

This information still provides no indication of the extent of tax planning undertaken across the income brackets found in the UK. To explore this, data from 2004/05 has to be used. This is because it is the most recent available for this purpose: publication of the information in question appears to have ceased when the Inland Revenue merged with HM Customs & Excise when HM Revenue & Customs was formed. The analysis that follows is all based on data published by HM Revenue & Customs on personal incomes for that year[6] and most particularly uses tables 3.4, 3.5 and 3.8. These produce the following information, the figure used for each tax bracket being the lower value for the range:

[3] http://www.statistics.gov.uk/pdfdir/ashe1006.pdf accessed 18-10-07
[4] http://www.hmrc.gov.uk/stats/income_tax/table2-1.xls accessed 29-10-07
[5] Derived from http://www.hmrc.gov.uk/stats/income_tax/table2-6.xls accessed 29-10-07
[6] http://www.hmrc.gov.uk/stats/income_distribution/menu.htm accessed 29-10-07

Income Bracket £	Tax paid (Total) £mil	Value of reliefs (pre tax) £mil	Marginal Tax rate	Cost of relief £mil
4,745	84	40	10%	4
6,000	2,575	475	10%	48
10,000	7,869	1,305	22%	287
15,000	11,215	2,060	22%	453
20,000	22,536	4,570	22%	1005
30,000	27,194	5,910	22%	1300
50,000	12,100	2,110	40%	844
70,000	9,480	1,530	40%	612
100,000	12,600	2,030	40%	812
200,000	8,790	1,380	40%	552
500,000	3,910	621	40%	248
1,000,000	4,610	754	40%	302
	122,963	22,785		6,467

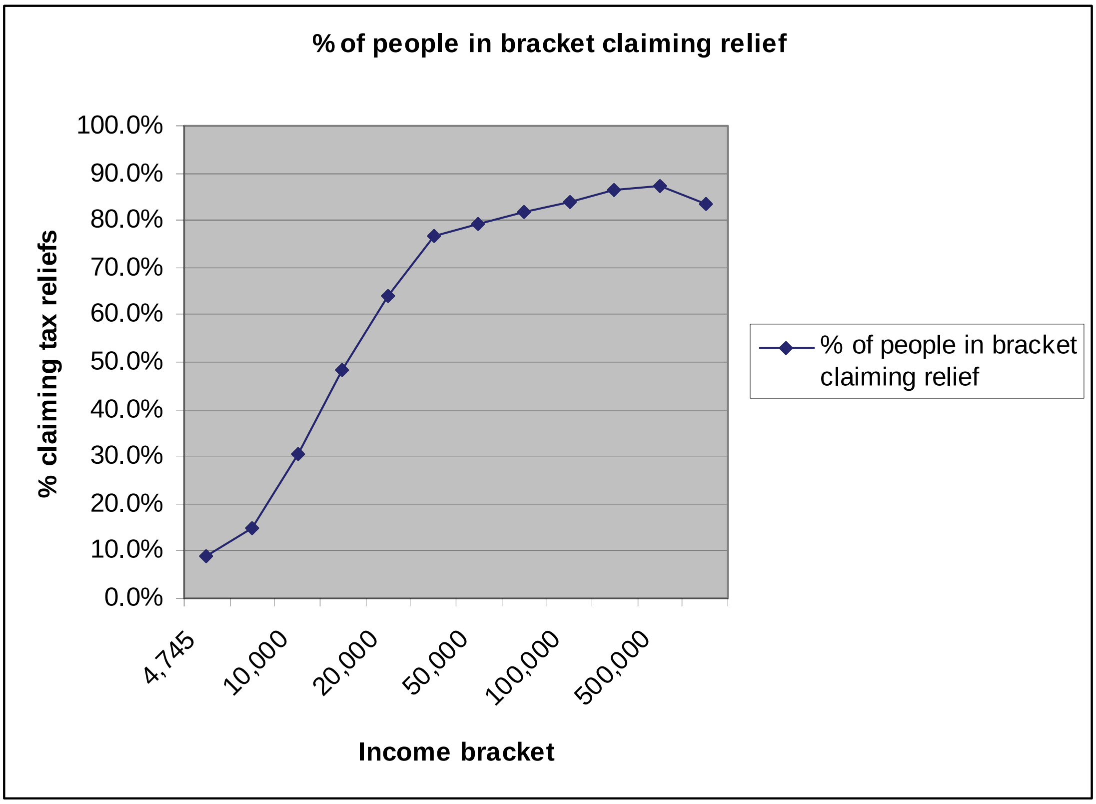
It is stressed that the reliefs in question are of a limited range and a broader range of reliefs are considered below. Even so, this table already shows some key information. For example, those earning over £70,000 in the year in question paid 32% of all income tax but enjoyed the benefit of 39.1% of all tax reliefs.

The data set can be extended to reflect the number of people involved:

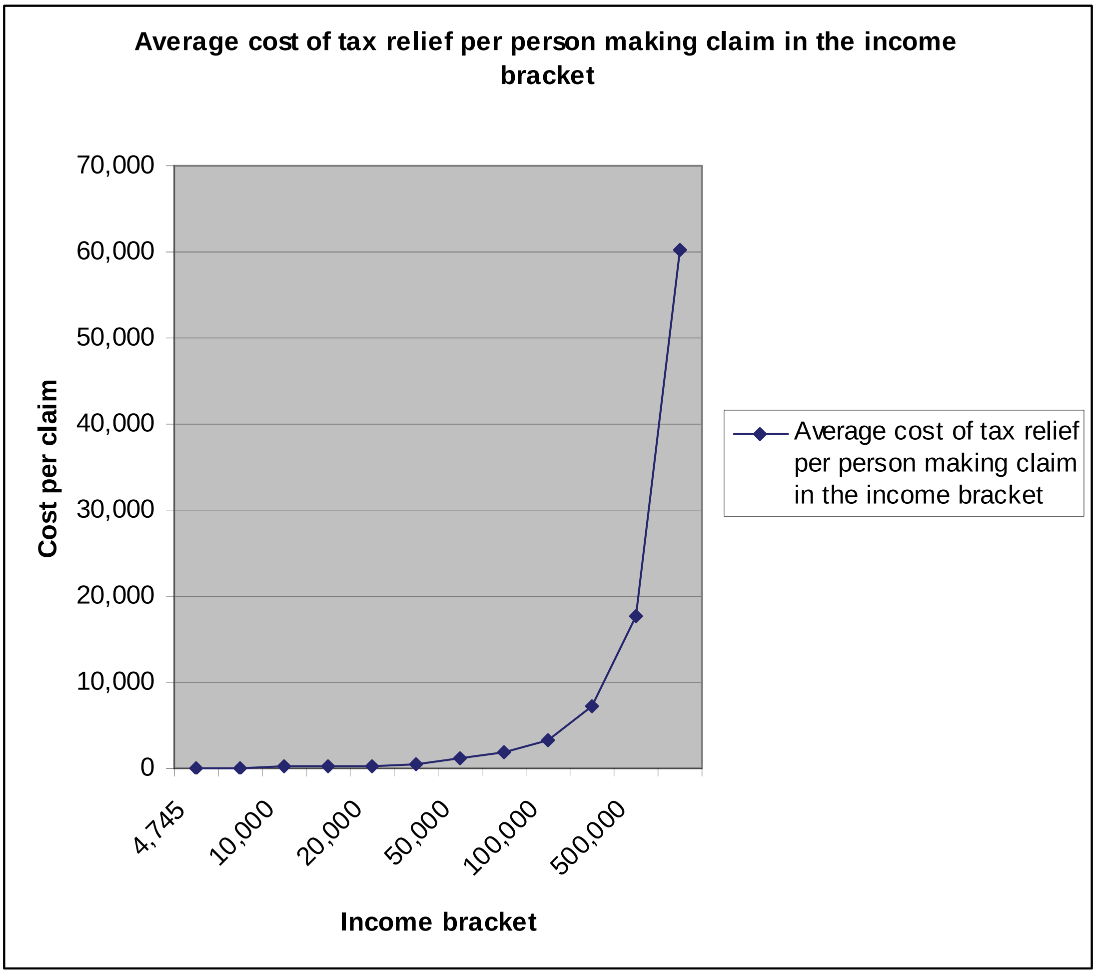
Income Bracket £	People making claim 000	Cost per person £	Number in bracket	% of people claiming
4,745	128	31	1,432	8.9%
6,000	887	54	5,991	14.8%
10,000	1,910	150	6,302	30.3%
15,000	2,360	192	4,869	48.5%
20,000	3,810	264	5,939	64.2%
30,000	3,120	417	4,058	76.9%
50,000	677	1,247	856	79.1%
70,000	335	1,827	409	81.9%
100,000	251	3,235	299	83.9%
200,000	76	7,263	88	86.4%
500,000	14	17,743	16	87.5%
1,000,000	5	60,320	6	83.3%
	13,573		30,265	

Now it is clear that just 2.7% of people are in the brackets starting at £70,000 and above, but between them enjoy 39% of all tax reliefs when expressed in terms of tax saved. Those reliefs are worth more than £60,000 of tax saving, on average, for those earning over £1 million a year.

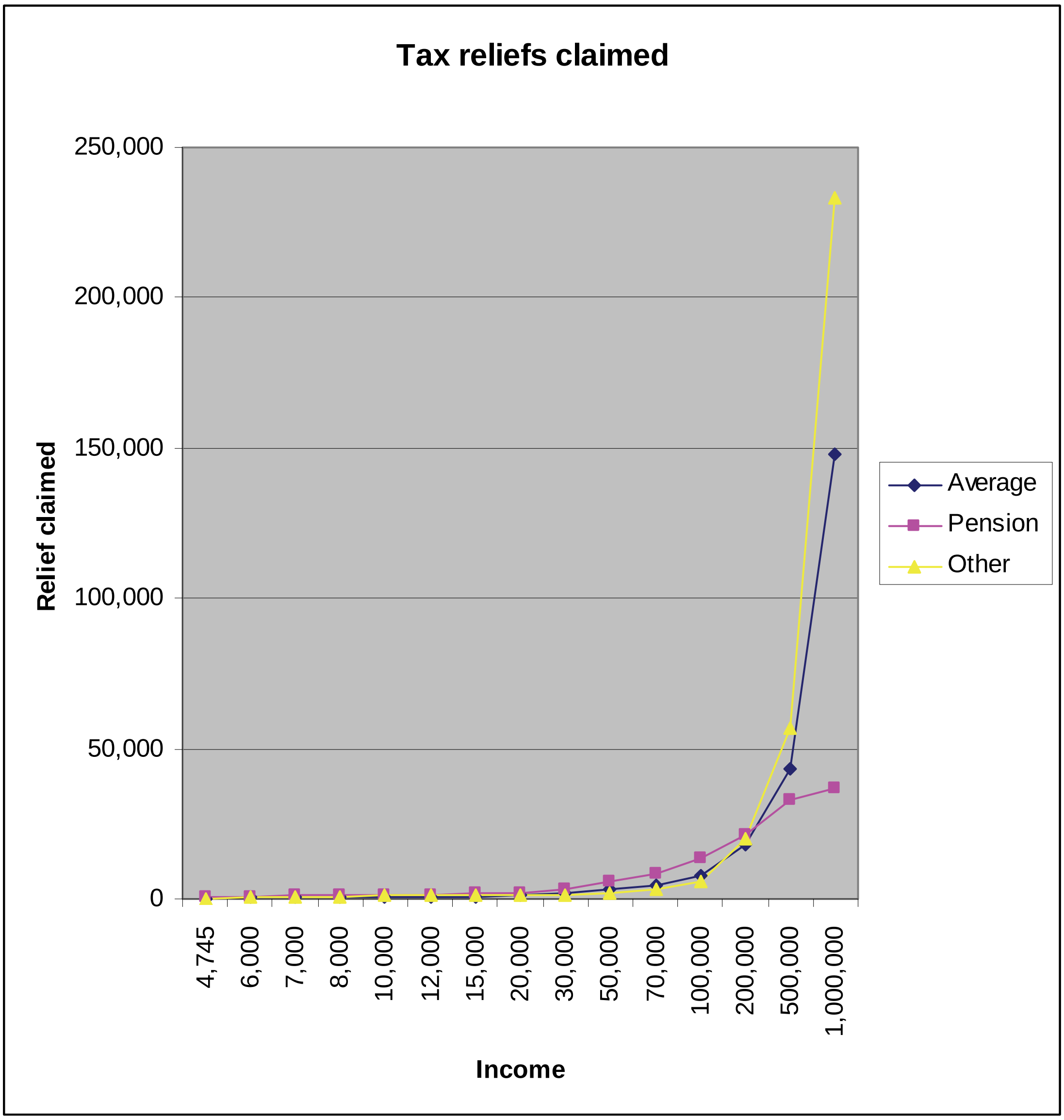
As is also clear, the percentage claiming reliefs rises with income. As the table makes clear, just 8.9% of those earning about £5,000 per annum make a claim for any sort of tax relief, and benefit by just £31 each, on average. The increase in the proportion claiming relief is dramatic:



The increase in the value of their claims made is more dramatic still:

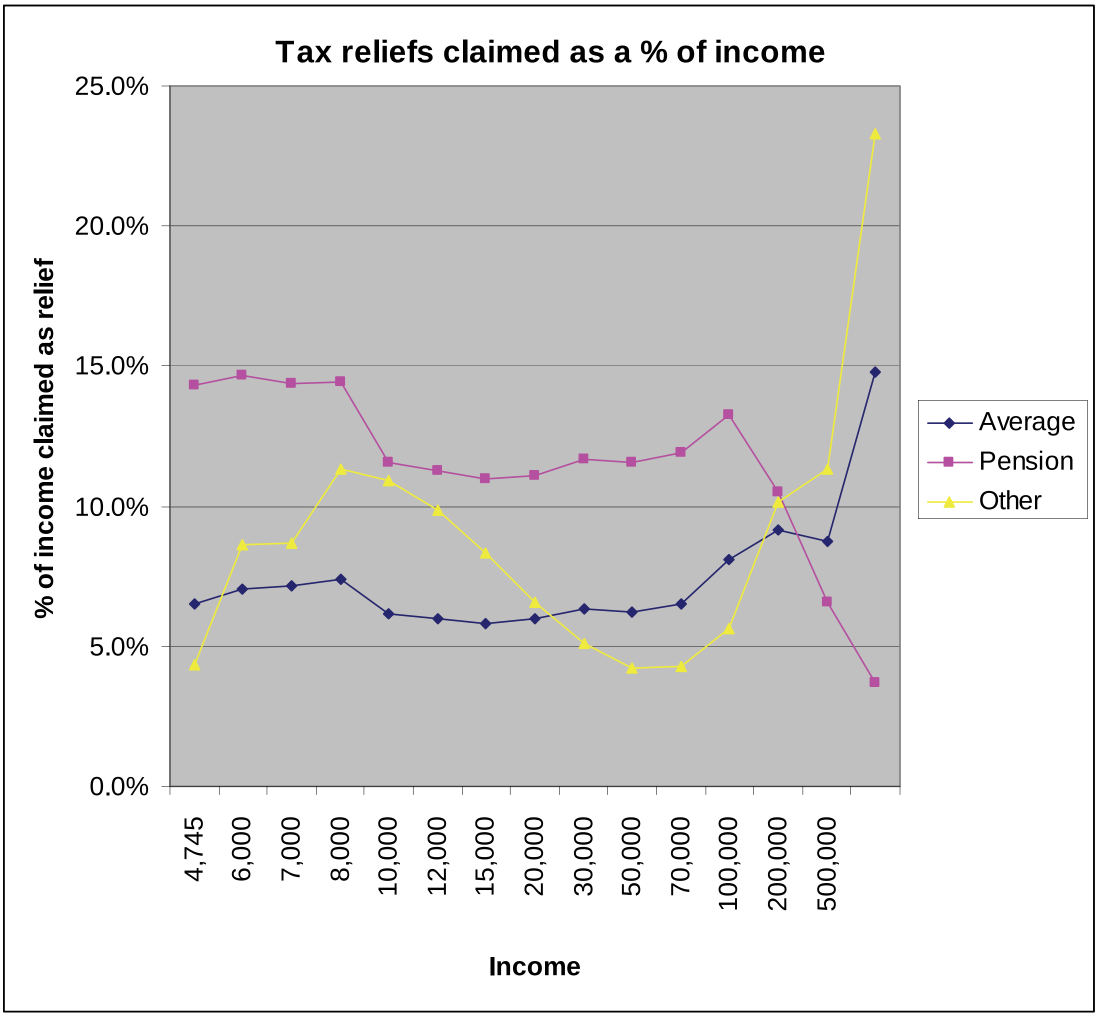


If the claims are expressed according to the value deducted from income, and by type of claim, the same dramatic increase is seen:



What is stunning in this case is that tax relief claimed on pensions ceases to be as significant at the highest levels of income and "other claims" predominate. These are much less significant for all other groups and suggest that many tax reliefs are really only of much significance to this very small group in society.

Perhaps more tellingly, each type of claim expressed as a percentage of taxable income is as follows:



The relative importance of claims for pension relief falls as income rises. In contrast, except for those on very low incomes claiming what are, almost certainly, fixed deductions allowed for certain occupations it is apparent that the value of "other reliefs" is almost insignificant until income exceeds £70,000.

It should be stressed though that these other claims are not for basic allowances, they are described as being for "All other interest, charges and deductions". The overall value of all identified claims of this sort (i.e. the amount by which income is reduced as a result of the claim made) is as follows for the most recent year available[7] (2006/07):

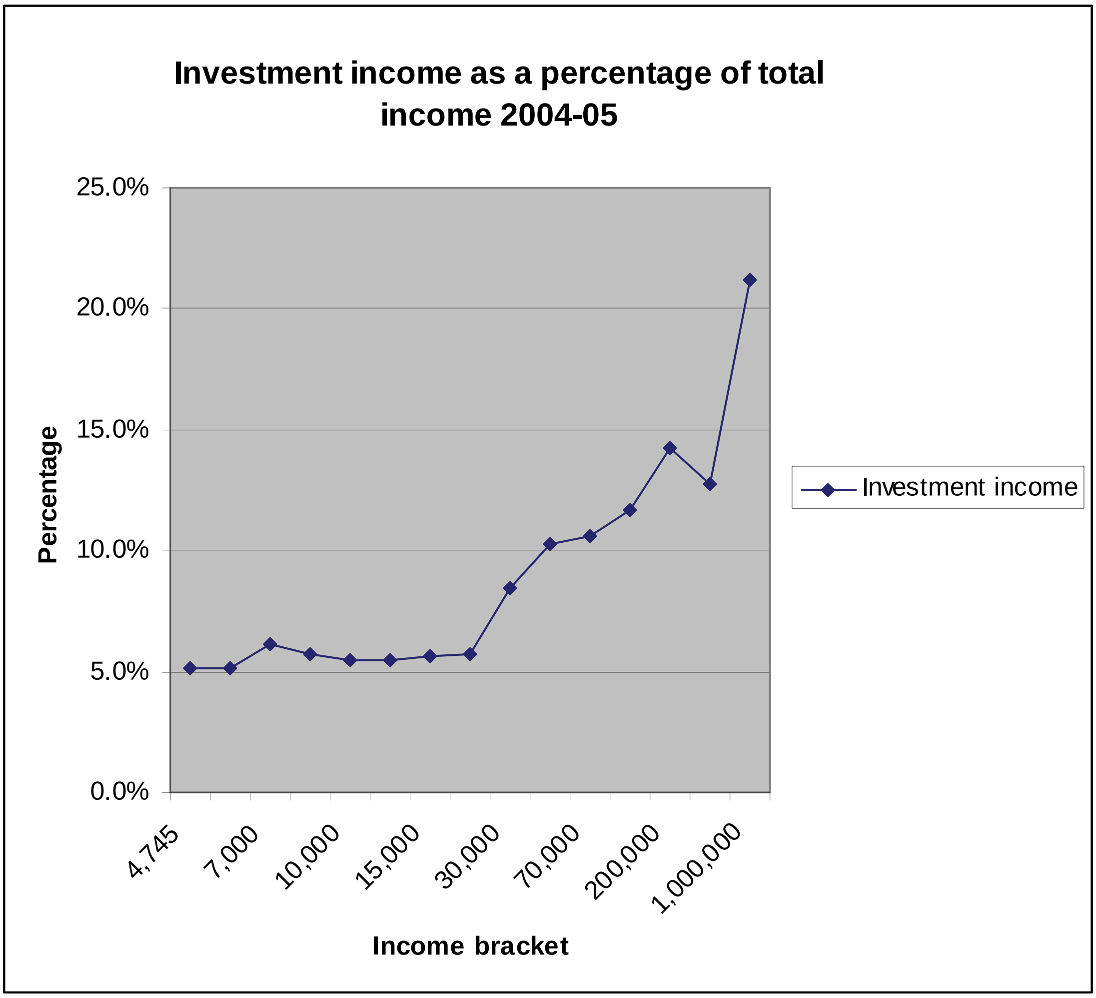
[7] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.xls for 2006-07

	Estimated cost for 2006-07 £ mil
Relief for:	
Approved pension schemes	16,300
Share Incentive Plan	280
Approved savings-related share schemes	140
Enterprise Management Incentives	120
Approved Company Share Option Plans	190
Personal Equity Plans	475
Individual Savings Accounts	1,625
Venture Capital Trusts	75
Enterprise Investment Scheme	140
Professional subscriptions	80
Rent-a-room	100
Seafarers' Earnings Deduction	100
Exemption of:	
First £30,000 of payments on termination of employment	800
Interest on National Savings Certificates including index-linked certificates	150
Premium Bond prizes	200
Income of charities	1,200
Foreign service allowance paid to Crown servants abroad	95
Life assurance premiums (for contracts made prior to 14 March 1984)	50
Small budget film tax relief	240
Large budget film tax relief	240

The total of such reliefs amounts to £22,600 million, a figure sufficiently similar in amount to that shown for the 2004/05 tax year above to assume that there is substantial overlap in the data.

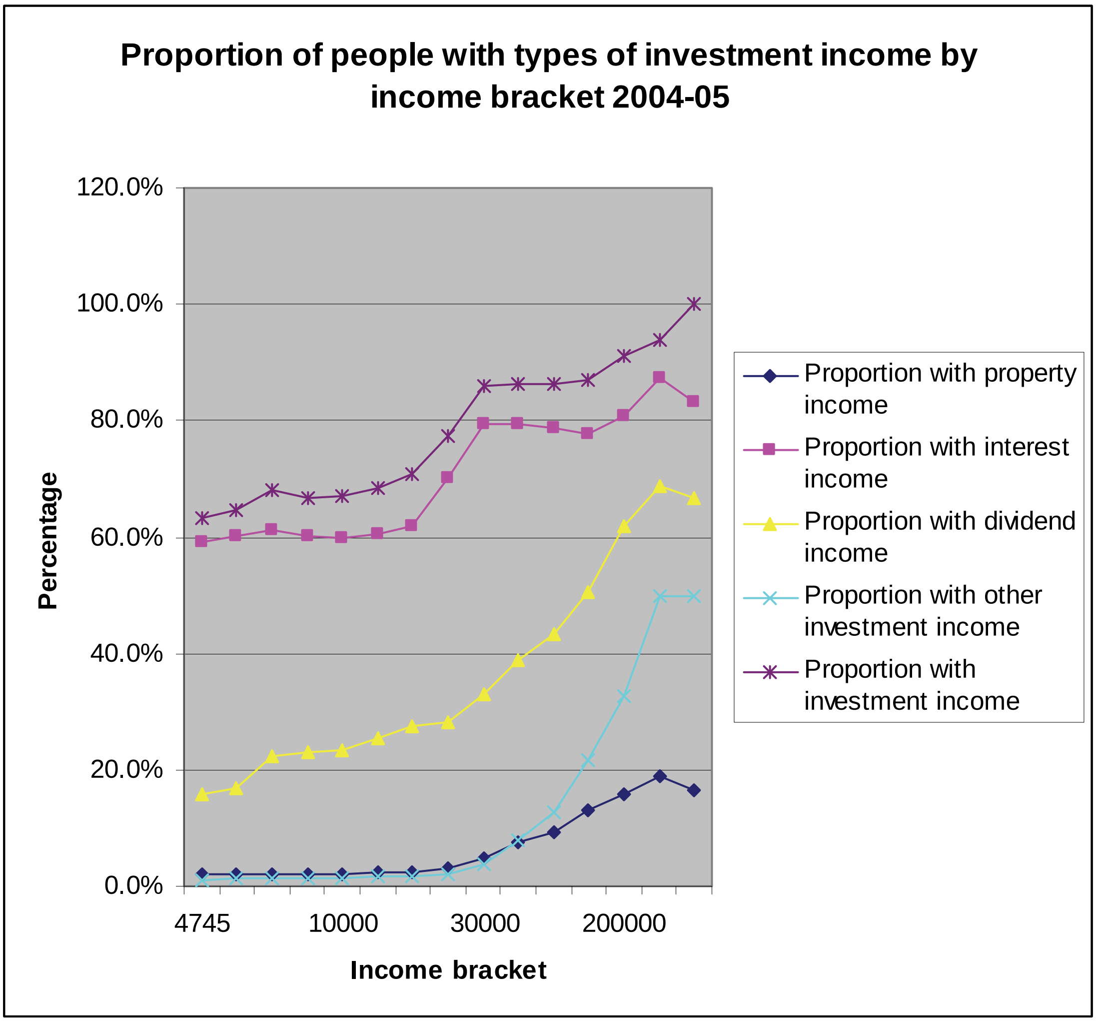
What is apparent is that pension allowances dominate the reliefs given, and that many (but not all) of the rest relate quite strongly to investment income. As this graph shows, investment income is of by far the greatest significance to the wealthiest in society[8]:

[8] Source http://www.hmrc.gov.uk/stats/income_distribution/table3-5.xls accessed 30-10-07



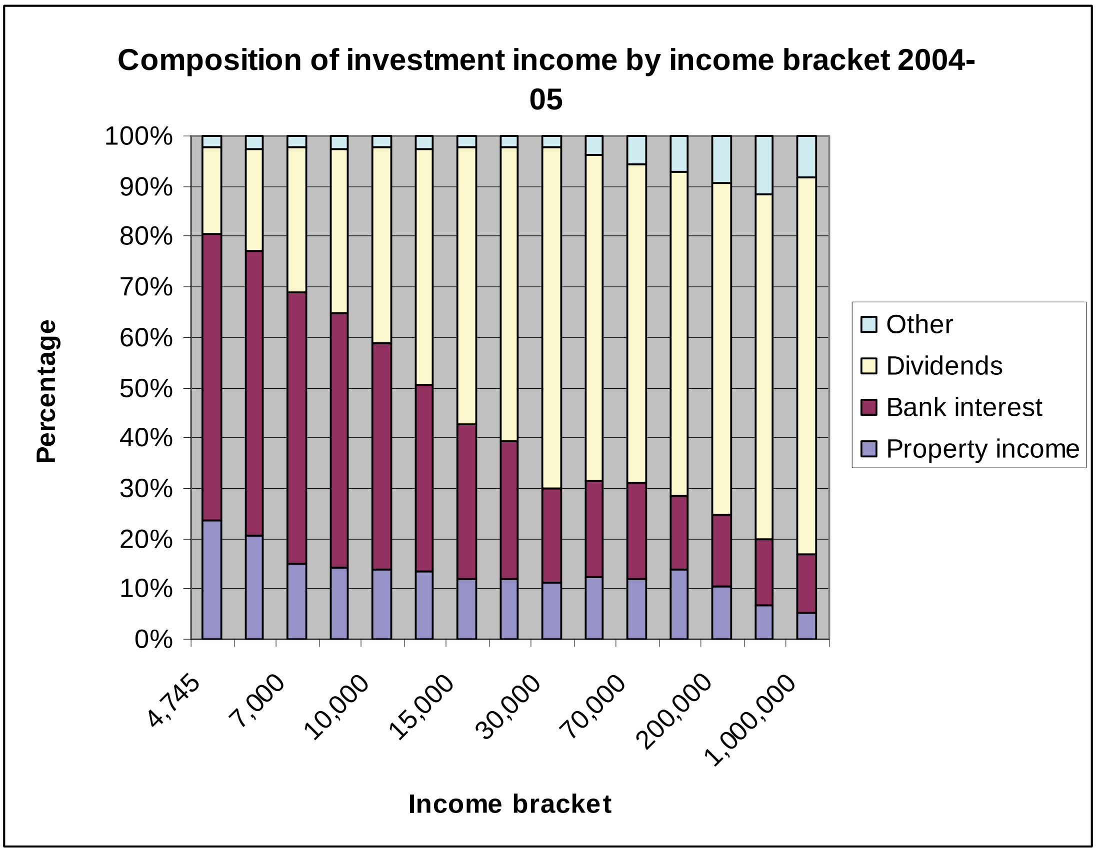
Since it is investment activity that attracts many tax reliefs these must, inevitably, be given to the wealthiest in society.

The significance of this trend is, however, understated if only income tax reliefs are considered. Earned income is for the vast majority of people in the UK subject to national insurance charges on top of income taxation. For those earning between £5,000 and £35,000 in the UK in 2007/08 national insurance effectively increases the basic rate of tax from 22% to 33%. Investment income does not suffer this 50% increase in tax rate and is therefore massively favoured by the tax system. This benefit is unfairly distributed. Many more of the wealthiest, unsurprisingly, on average enjoy having investment income:



Perhaps it is no surprise that 100% of the wealthiest in society have investment income but this ratio is not achieved by any other group.

The composition of investment income also changes dramatically with income:

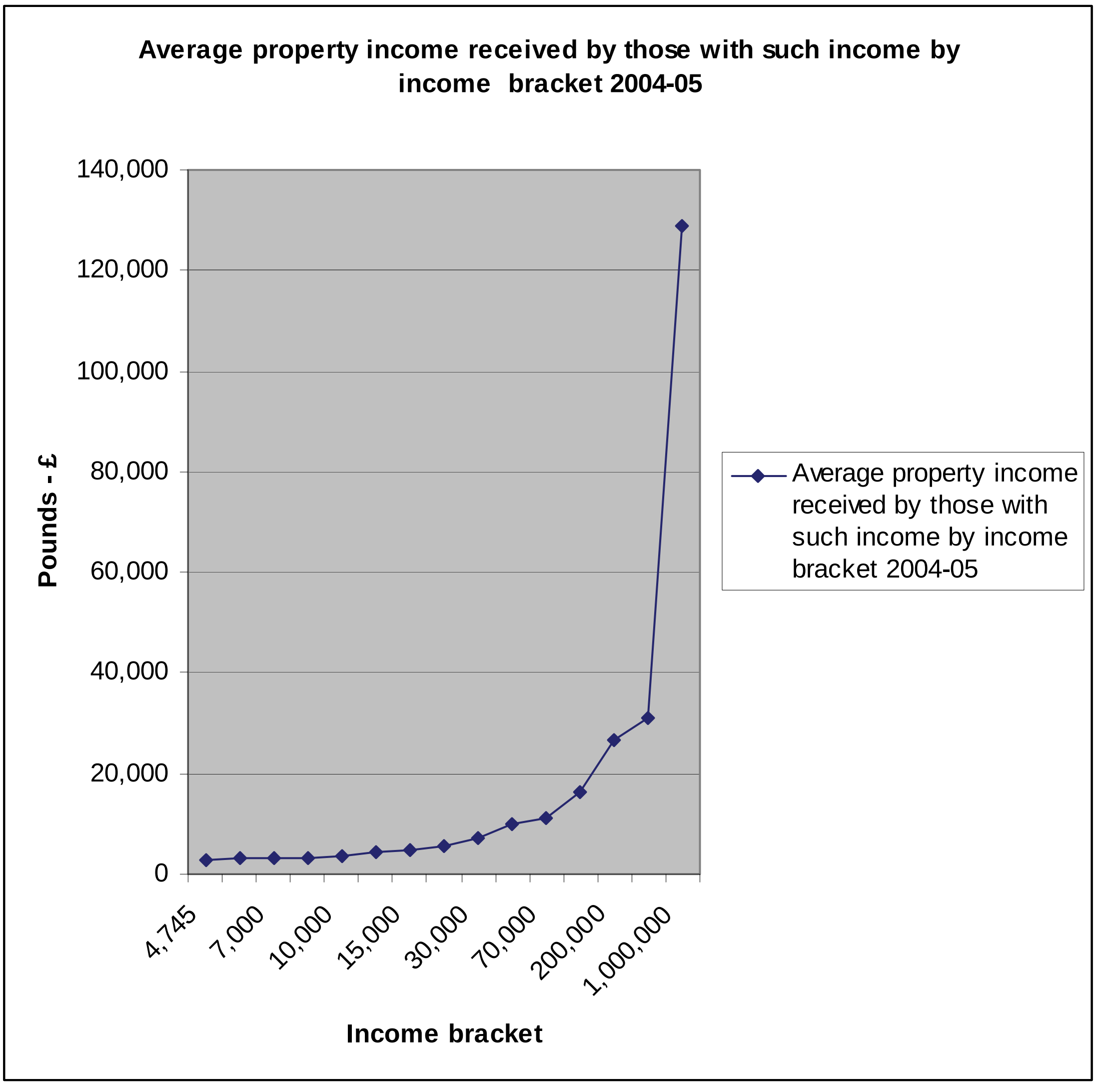


The starkest change is the massive increase in the importance of dividend income as wealth rises. This has another consequence entirely unseen within this data though: many of the most well off in society own their own companies and as such can decide how they will pay themselves. As noted above, dividends do not attract national insurance charges but earned income paid as a salary does. Therefore many people try to set up their own companies to avoid national insurance charges. In April 2007 alone some 35,000 new companies were registered in the UK, at least in part for this reason[9].

Such arrangements have also been used to divert income from a 'working partner' to a non working partner who suffers a lower rate of tax by way of paying them a dividend on the nominal value of shares they hold in the company. One estimate has suggested that the tax lost as a result of this arrangement might be as much as £1.2 billion a year[10]. The 2007 Pre-Budget report suggests it is much lower at about £260 million a year[11] but considered only a part of the issue. Either way, it is clear that income shifting of this sort is very costly and is not reflected in any official data.

[9] http://www.companieshouse.gov.uk/about/busRegArchive/statsAprilWorkload07.pdf accessed 30-10-07
[10] http://www.taxresearch.org.uk/Documents/TRLLPSmallBusinessTax8-08.pdf accessed 30-10-07
[11] http://www.hm-treasury.gov.uk/media/F/9/pbr_csr07_annexb_305.pdf accessed 30-10-07

Surprisingly the graph shows that property income is of greatest proportionate value to the very lowest earning in society. However, it must be stressed that those receiving such income received the following sums, on average, each in 2004/05:



The significance of property income might appear highest to those on low incomes but until incomes exceed £50,000 the amounts earned by those in receipt of such income are relatively modest. The proportion receiving them is more modest still, as also shown above. 2.2% of the poorest in society have property income. 18.8% in the income bracket starting at £500,000 do so.

There is a further explanation for the apparent disparity in the relative proportion of property income in the wealthiest and poorest's income portfolios. Almost certainly those with high levels of property income will have borrowed to buy such property, so reducing the apparent value of their income return since the income they receive from property will be reduced by the amount of tax relief that they enjoy on the interest that they pay on their borrowings. Those on lower incomes are unlikely to have such borrowings for three reasons. Firstly they are almost certainly more risk averse. Secondly, they may well not be able to secure the borrowings from banks and other such lenders. Third their income may arise from letting rooms rather than a whole property. The average income at this level is within the limit for the Rent-a-Room scheme. If this reasonable analysis is correct then the amount of tax relief provided to the well off may be considerably in excess of the ratios already noted.

If, as seems reasonable the proportion of gross income from property might be as significant for the well off in society as it is for the least well off, then the difference in the taxable figures must be due to the offset of expenses, most of which will be interest. If the gross income was restated so that a constant proportion of gross (pre-expenses) investment income were attributed to property then that sum by income bracket would increase as follows:

Income bracket	Declared property income	Required property income to be 23.7% of portfolio	Additional income
4745	93	93	0
6000	80	95	15
7000	109	192	83
8000	213	405	192
10000	229	442	213
12000	355	720	365
15000	580	1,315	735
20000	1,010	2,260	1,250
30000	1,420	3,500	2,080
50000	629	1,365	736
70000	427	960	533
100000	631	1,225	594
200000	377	995	618
500000	95	402	307
1000000	146	795	2,030
Total	6,394	14,764	9,751

This can of course be, at best, a crude approximation to the amount of interest paid on buy-to-let properties. However, its relevance might be gauged from the reported fact that 330,000 buy-to-let loans, worth a total of £38.4 billion, were agreed during 2006[12]. Given that the average life of a mortgage before refinancing is now around four years on average[13], this suggests a loan balance for buy to let mortgages of up to £150 billion. In practice it is likely to be a little less because loan life in this market might be shorter as it is highly commercial and because average loans taken have increased with property prices. Even so, a balance of buy-to-let mortgages somewhat in excess of £100 billion is likely, on which interest

[12] http://www.iii.co.uk/articles/articledisplay.jsp?article_id=7183071&section=Tax accessed 30-10-07
[13] http://www.perspecta.com/whitepaper/consequences_of_remortgaging.pdf accessed 30-10-07

of more than £7 billion per annum is likely. In that case the table noted above may mildly overstate the situation on gross as opposed to net incomes arising from property letting, but not by much. Either way, the total value of reliefs granted to those making claim has to increase from approximately £22 billion as noted by HM Revenue & Customs to almost £30 billion.

It is therefore important to estimate who gets most benefit from these reliefs. In doing so it is recognised that information on reliefs claimed is only available until 2004/05 and data on reliefs given is for the later year of 2006/07, but the resulting distortion is highly unlikely to be significant. If, using the data noted, the value of reliefs given is calculated dependent upon the amount claimed weighted by the tax rate likely to be attributable to it then the following percentage allocation of reliefs by value results:

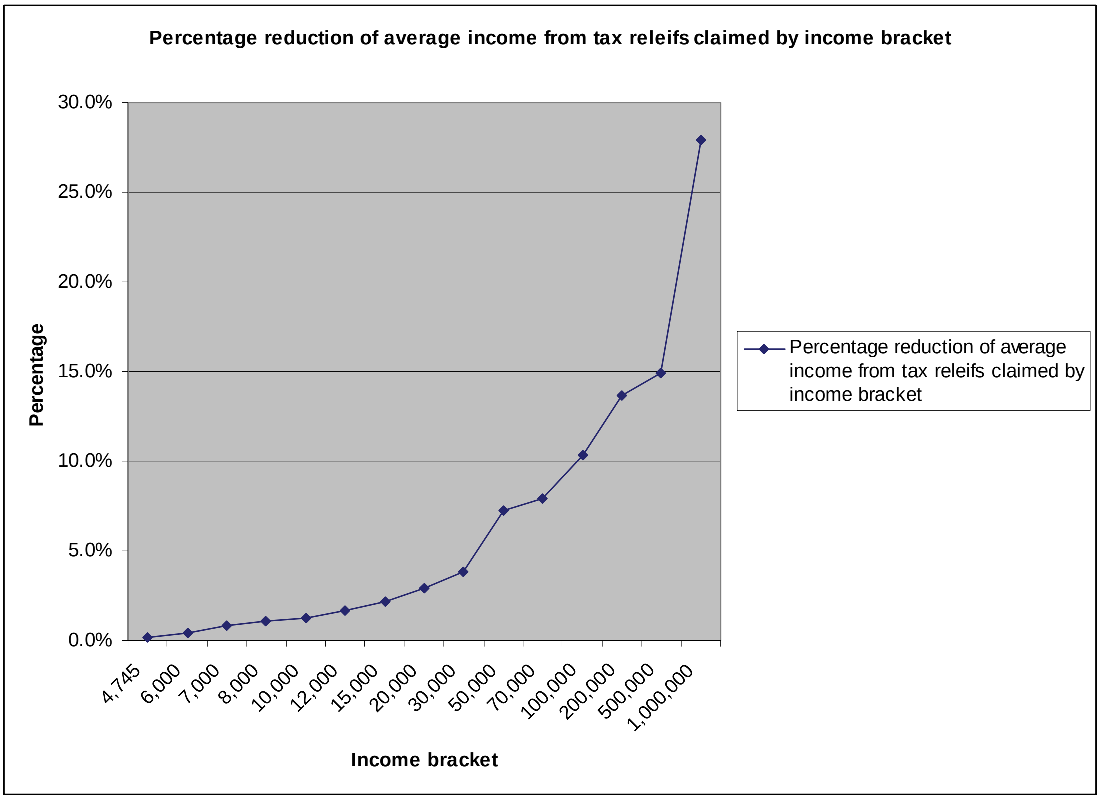
Income bracket	% of pension relief attributed	% of other reliefs attributed	% of rental reliefs attributed
4,745	0.1%	0.0%	0.0%
6,000	0.1%	0.0%	0.1%
7,000	0.4%	0.2%	0.7%
8,000	1.1%	0.6%	1.7%
10,000	1.6%	0.8%	1.9%
12,000	3.4%	1.2%	3.3%
15,000	8.1%	2.3%	6.6%
20,000	18.2%	4.3%	11.2%
30,000	23.4%	6.2%	18.6%
50,000	14.3%	7.5%	12.0%
70,000	10.0%	7.1%	8.7%
100,000	11.8%	14.9%	9.7%
200,000	5.5%	20.6%	10.1%
500,000	1.5%	13.2%	5.0%
1,000,000	0.5%	21.1%	10.6%
	100.0%	100.0%	100.0%

If these proportions are used to allocate the government's own published data on the cost of reliefs given and assuming that all tax reliefs other than pensions relief are weighted in accordance with the "other" category noted above, excepting rental interest relief which is allocated as noted in the calculations shown above, then the value of reliefs provided divided by the number of people in the band to calculate the average value of the relief to each person in a tax band suggests that these values are as follows by category of relief:

Income bracket £	Pension per head £	Other per head £	Rental interest per head £	Total value per person in band £
4,745	8	1	0	9
6,000	20	2	1	23
7,000	41	6	11	59
8,000	60	13	14	87
10,000	93	18	17	128
12,000	153	21	22	196
15,000	268	29	33	330
20,000	495	45	46	586
30,000	931	96	112	1,139
50,000	2,713	551	343	3,607
70,000	3,964	1,085	520	5,569
100,000	6,430	3,139	792	10,361
200,000	10,016	14,556	2,778	27,349
500,000	14,925	51,963	7,675	74,563
1,000,000	13,961	221,711	43,267	278,938

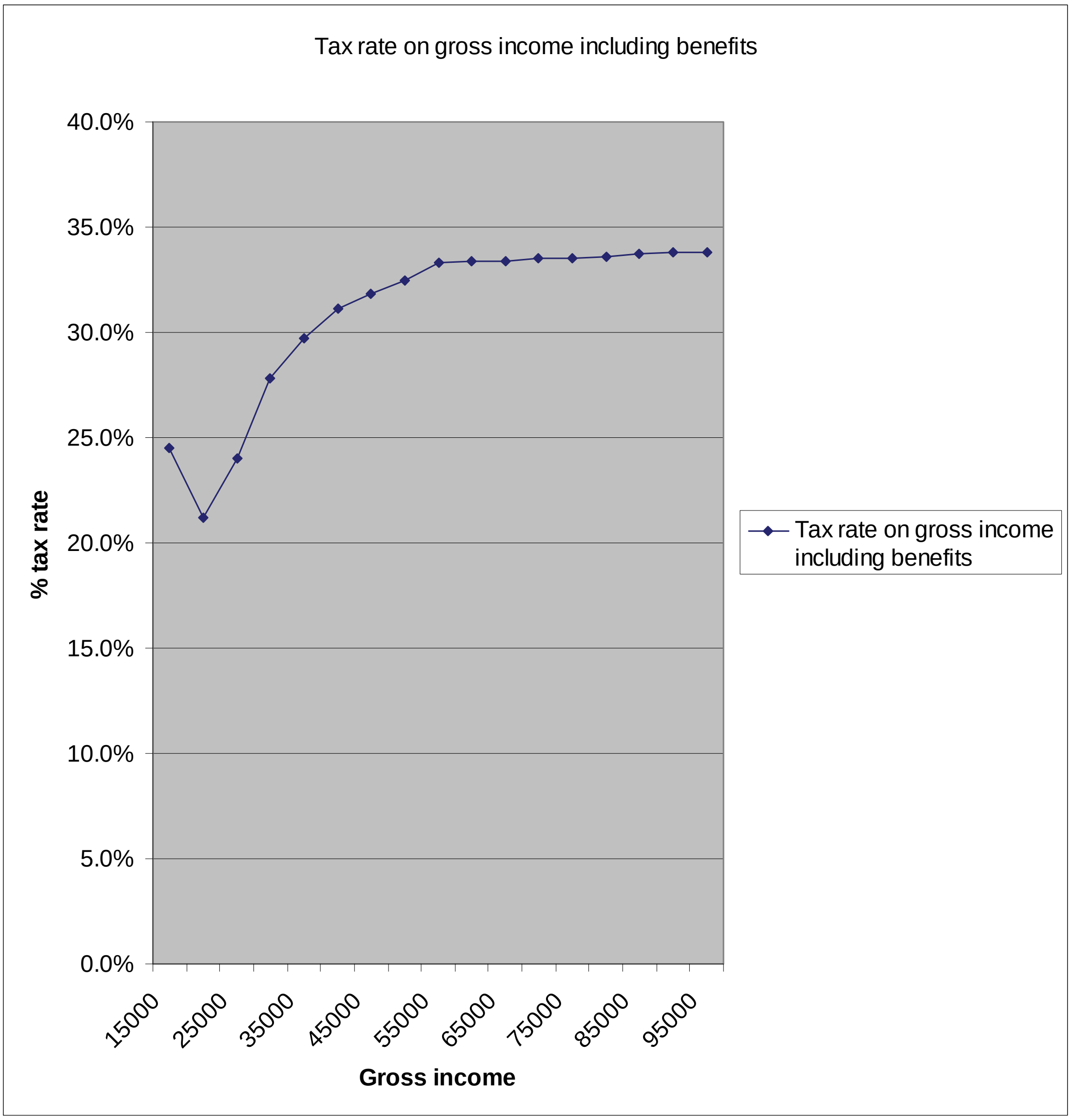
Quite clearly the data is heavily distorted by the extraordinary proportion of "other reliefs" that the well off claim but since these do include many incentives for saving and the cost of exempting the income of charities from tax (which is effectively created by giving tax relief to the donors, and those who claim tax relief on their gifts are almost invariably higher rate tax payers since they actually enjoy a personal tax rebate as a result of gifting to charity which basic rate tax payers do not) this pattern of claim is highly likely to be correct.

As a percentage of the base level of income in each band this data is as follows:



The point is now very clear. Those who are wealthiest in society do most tax planning, by far. And they benefit most, by far. Which explains why, despite the UK having what appears to be a progressive tax system the effective tax rates of households enjoying income of over £50,000 appears to be almost constant, as this graph based on UK household data information shows[14]:

[14] http://www.statistics.gov.uk/STATBASE/DatasetType.asp?vlnk=9619 restated to show even income bands



The effect of tax reliefs flattens the apparent impact of higher tax rates over £55,000. It is quite possible that if the household income survey had been broad based enough to collect data on those earning much higher rates the trends noted above would suggest that the effective rates of tax of the very best off in society would fall as incomes exceeded £100,000.

In absolute value the reliefs likely to be granted to the best off in society to achieve this result (those earning over £100,000 being considered in this category) amount to about £8.4 billion on the basis of the calculation used here taking all factors both recognised in published data and calculated here based on that data into account. Given that 79% of all other reliefs given to those earning less relate to pensions which is not considered abusive practice, and that the cost of pension reliefs is restricted to the best off because the amount they can contribute is limited by law then it follows that this figure might be considered the cost of individual tax planning each year in the UK.

The relevance of this sum has therefore to be reiterated. It is because these reliefs are given that the UK tax system lacks vertical equity at its higher end. If that equity is important to the credibility and universal acceptability of the tax system, and it is clear from the design of the tax system that this assumption is implicit within it, then the allocation of this level of relief to those earning over £100,000 undermines that credibility. Tax planning is acceptable, but only when it is of insufficient amount to avoid damage to the system as a whole. The evidence shows that it is damaging the integrity of the UK tax system and as such it is a problem needing to be addressed in its own right for this group of tax payers alone.

Technical Appendix 2

Income shifting

The relative importance of earned and investment income by income bracket is as follows in the UK[15], each proportion relating to the part of total income of that type that is earned by people in the bracket in question:

Income bracket £	% of earned income	Cumulative % of earned income	% of investment income	Cumulative % of investment income
4,745	1.1%	1.1%	0.7%	0.7%
6,000	1.1%	2.3%	0.7%	1.4%
7,000	1.8%	4.0%	1.3%	2.8%
8,000	3.9%	8.0%	2.8%	5.6%
10,000	4.5%	12.5%	3.0%	8.6%
12,000	7.3%	19.8%	4.9%	13.5%
15,000	12.8%	32.5%	8.9%	22.4%
20,000	21.7%	54.2%	15.3%	37.7%
30,000	21.9%	76.1%	23.5%	61.2%
50,000	7.0%	83.1%	9.4%	70.6%
70,000	4.7%	87.9%	6.6%	77.2%
100,000	5.6%	93.4%	8.6%	85.7%
200,000	3.5%	96.9%	6.7%	92.4%
500,000	1.5%	98.4%	2.6%	95.0%
1,000,000	1.6%	100.0%	5.0%	100.0%
	100.0%		100.0%	

Expressed in terms of deciles[16] (with sufficient accuracy for the analysis that follows) this is as follows:

Decile bands £	Percentage of total investment income	Cumulative proportion Of investment income
8300	2.8%	2.8%
13100	10.7%	13.5%
16000	8.9%	22.4%
19100	15.3%	37.7%
23400	11.7%	49.5%
29500	11.7%	61.2%
35000	2.3%	63.5%
42300	4.7%	68.2%

[15] Source: http://www.hmrc.gov.uk/stats/income_distribution/table3-5.xls for 2004-05, which is the most recent available

[16] Decile data from http://www.statistics.gov.uk/STATBASE/DatasetType.asp?vlnk=9619

52500	2.3%	70.6%
88300	29.4%	100.0%
	100.0%	

Astonishingly this data, based on tax return information, suggests that half of all investment income is earned by those in the lower half of the income distribution. Each would have, on average, investment income of about £1,400. The top half of the income distribution would earn a little over £8,600 each on average. Some though, would earn considerably more. The wealth allocation to the two groups would, though, in total be remarkably alike.

However, this tax return based data makes no sense. As data on marketable wealth distribution (i.e. total wealth less the value of domestic properties) shows, wealth in the UK is not distributed in the way the income tax return data implies. The latest data available from HM Revenue & Customs[17] shows that the top 1% of wealth holders have 21% of all marketable assets, the top 10% have 53% of marketable assets and the top 50% have 93%. The bottom half of the profile therefore have 7% between them. Admittedly, the deciles in each distribution need not coincide for statistical reasons, but the reality is that the disparity is so marked that there must be an explanation for the wealth distribution and income distributions being so markedly out of line.

According to the best reported estimate of UK wealth, prepared by the Halifax Bank in 2006[18], cash savings doubled in the decade from 1996, and together with other assets such as shares and pensions were worth £3.634 trillion in 2006. That is £3,634 million million. Fifty five per cent of this sum was held in pension and life assurance products, leaving income generating assets likely to be taxed as investment income on tax returns, having a worth of approximately £1.6 trillion. At an estimated rate of return of a modest 5% this would suggest that at least £80 billion of investment income in total should be declared in the UK. This, however is not the case as a consequence of the split of that sum into different asset types.

Cash represented £960 billion of this sum. In the 2004/05 tax year the Halifax suggests that this sum might, on average, have been about £130 million lower at £830 million on which HM Revenue & Customs suggest £12,600 million of income was declared[19] at an apparent average rate of return of 1.5%. It is obvious as a result that income yields on cash are low. Much must be held on current accounts paying little return.

In contrast, some £32.6 billion of dividend income was declared on all the other assets apparently worth about £550 billion. This implies a rate of return of approximately 5.9%. Given the relative importance of share portfolios to the

[17] Source: http://www.hmrc.gov.uk/stats/personal_wealth/table13_5.pdf accessed 1-11-07
[18] http://news.bbc.co.uk/1/hi/business/7018253.stm and http://www.hbosplc.com/media/includes/29.09.07%20UK%20Household%20Sector%20Wealth%20Position.doc accessed 1-11-07
[19] http://www.hmrc.gov.uk/stats/income_distribution/table3-7.xls accessed 1-11-07

wealthy, as noted above, this suggests that the distribution of declared income distributions is even more out of line with underlying wealth. Tax free accounts, such as ISAs, with a total value in 2007 of £33 billion[20], do not materially distort this analysis.

Applying these rates of return to declared incomes in 2004/05 the results are:

Income bracket	Bank interest	Dividends	Rate of return - cash	Rate of return - shares	Implicit asset value - cash	Implicit asset value - shares	Total asset value	Propor-tionate holding	Cumulative holding
£	£'mil	£'mil			£'mil	£'mil	£'mil		
4745	223	67	1.50%	5.90%	14,867	1,136	16,002	1.1%	1.1%
6000	218	78	1.50%	5.90%	14,533	1,322	15,855	1.1%	2.3%
7000	393	209	1.50%	5.90%	26,200	3,542	29,742	2.1%	4.4%
8000	767	493	1.50%	5.90%	51,133	8,356	59,489	4.2%	8.6%
10000	747	639	1.50%	5.90%	49,800	10,831	60,631	4.3%	13.0%
12000	993	1250	1.50%	5.90%	66,200	21,186	87,386	6.2%	19.2%
15000	1480	2640	1.50%	5.90%	98,667	44,746	143,412	10.2%	29.4%
20000	2240	4850	1.50%	5.90%	149,333	82,203	231,537	16.5%	45.9%
30000	2400	8590	1.50%	5.90%	160,000	145,593	305,593	21.8%	67.7%
50000	955	3240	1.50%	5.90%	63,667	54,915	118,582	8.5%	76.1%
70000	668	2230	1.50%	5.90%	44,533	37,797	82,330	5.9%	82.0%
100000	673	2940	1.50%	5.90%	44,867	49,831	94,697	6.7%	88.8%
200000	511	2360	1.50%	5.90%	34,067	40,000	74,067	5.3%	94.0%
500000	182	953	1.50%	5.90%	12,133	16,153	28,286	2.0%	96.1%
1000000	314	2030	1.50%	5.90%	20,933	34,407	55,340	3.9%	100.0%
	12,764	32,569			850,933	552,017	1,402,950		

Again, according to this analysis almost half of the wealth owned in the UK is attributable to those whose pay is at or below national average earnings.

This is however inconsistent with the most recent data on wealth distribution[21], data which has not, regrettably been updated since 2003 although available on a yearly basis prior to that date. Extending the above table and then comparing this with the data from the 2003 wealth analysis, the following can be estimated:

Income bracket	Number in bracket	Proportion in bracket	Cumulative proportion	Wealth each	Likely wealth distribution per HMRC data
£	'000			£	
4745	1,440	4.8%	4.8%	11,113	2000
6000	1,160	3.8%	8.6%	13,668	3000
7000	1,590	5.3%	13.8%	18,706	4000
8000	2,950	9.7%	23.6%	20,166	5000
10000	2,760	9.1%	32.7%	21,968	15000
12000	3,650	12.1%	44.8%	23,941	36000
15000	4,950	16.4%	61.1%	28,972	*56000*

[20] http://www.hmrc.gov.uk/stats/isa/table9-4-2006-07.pdf accessed 1-11-07
[21] http://www.hmrc.gov.uk/stats/personal_wealth/table13_5.pdf accessed 1-11-07

20000	6,000	19.8%	80.9%	38,589	76000
30000	4,090	13.5%	94.4%	74,717	270000
50000	859	2.8%	97.3%	138,046	460000
70000	410	1.4%	98.6%	200,805	*600000*
100000	300	1.0%	99.6%	315,657	
200000	89	0.3%	99.9%	832,210	
500000	16	0.1%	100.0%	1,767,867	
1000000	6	0.0%	100.0%	9,223,352	
	30,270	100.0%			

It is apparent by comparing income tax data with HM Revenue & Customs wealth data in this table that for those on very low incomes, apparent wealth is overstated by tax return declarations in proportion to expectation and for those on higher incomes apparent wealth reflected in tax returns is understated. At the very highest levels of income meaningful data cannot be extrapolated.

The only reasonable explanation for this anomaly is that there is clear evidence of income shifting by those with wealth from those who should be taxed upon the wealth derived from it at higher rates to those who are taxed on it at very low rates. Non working spouses and, maybe, children must be the recipients of this apparent largesse.

Calculating a precise sum involved is bound to involve approximation, as do the above tables, but by simply assuming that wealth is only reallocated to those with income levels up to £10,000 (at which point 22% tax is almost always going to be paid, reducing the attraction of shifting for many) then the result is that income is shifted and tax saved as follows (assuming those shifting all pay at 40%, as is, on balance, likely):

Income bracket £	Wealth each	Likely wealth distribution per HMRC	Difference	Total £'mil	Rate of return	Income shifted	Effective tax rate on band %	Rate otherwise due at %	Tax lost £'mil
4745	11,113	2000	9,113	13,122	3.23%	424	1.1	40	165
6000	13,668	3000	10,668	12,375	3.23%	400	2.5	40	150
7000	18,706	4000	14,706	23,382	3.23%	756	3.4	40	277
8000	20,166	5000	15,166	44,739	3.23%	1,446	6.1	40	490
10000	21,968	15000	6,968	19,231	3.23%	621	8.5	40	196
						3,646			1,277

£3.6 billion of income is shifted and maybe £1.3 billion of tax is lost as a result of this one component of income shifting.

The figure might well be higher in practice for these reasons:

1. The rate of return used is the composite rate over both cash and share portfolios. Since those who are most likely to shift assets are more likely to own shares this rate of return may be understated;

2. The shifting of income from property is not noted in the above, but is likely to be actively undertaken and would suggest the apparent high rates of property income amongst those on low incomes. Over £1.2 billion of property income is declared by those in the income bands were income shifting appears to be a significant factor in income declared: the tax lost might be over £400 million as a result;

3. It is known from Treasury data published in the pre-Budget Report for 2007 that at least £250 million a year has been lost from income shifting between spouses within privately owned limited companies[22];

4. It is now possible to purchase pensions for non-earning spouses and even children. The effect cannot be quantified.

The result is that total income shifting is likely to exceed £2 billion per annum before the impact of shifting income to trusts and companies is taken into account.

The total impact of shifting income from self employed persons into companies has been estimated to be up to £1.2 billion per annum[23].

In 2004-05 approximately £1.1 billion was declared as income by trusts that might have enjoyed favourable tax arrangements[24], but since that time most income tax advantages from using trusts have been abolished and as such tax saved through income shifting to trusts is now likely to be small and is not considered further here.

Income shifted offshore is dealt with in the next section.

In total, based on this analysis income tax lost through tax avoidance from income shifting is likely to be not less than £3.2 billion per annum.

[22] http://www.hm-treasury.gov.uk/media/F/9/pbr_csr07_annexb_305.pdf page 164, accessed 1-11-07
[23] http://www.taxresearch.org.uk/Documents/TRLLPSmallBusinessTax8-08.pdf page 14 accessed 1-11-07
[24] http://www.hmrc.gov.uk/stats/trusts/table13-2.xls accessed 1-11-07

Technical Appendix 3

The cost of the domicile rule[25]

Data

According to HM Treasury[26] there are 112,000 registered non-domiciled people in the UK having an average income of about £87,500 a year and who pay about £26,800 each in tax, a sum which almost coincides with a simple calculation of the liability due by anyone on that income. The total approximates to £3 billion.

This information does not, of course, suggest anything about tax lost, only about tax paid. Table 2.5[27] of the HMRC statistics for 2006-07 provides a basis for estimating the tax lost.

Assumptions

Using data solely in that table, the average income of people in the various income bands it refers to and the average tax they paid can be calculated. In the income band from £50,000 to £100,000 the average income is £66,452 and the average tax paid is £16,581. This income is obviously a lot less than that of the average non-domiciled person. But they do fall into this band as a whole, on average. That locates them for the purpose of this analysis.

Claiming non-domicile status is, of course, of no benefit if you have no income or gains arising out of the UK. So, it logically follows that those who claim this status must have higher income than that which they declare in the UK. The data disclosed by the Treasury clearly refers to the income these people declare in the UK. Since their average income is already £87,500 it's reasonable to assume two things.

The first is that their real income is going to be, on average, in excess of £100,000.

The second is that because of their ability to use the domicile rule they don't, on average, appear in the data relating to those falling into the £50,000 - £100,000 income bracket as published by HMRC in their table 2.5. In other words, statistically they do not significantly distort the data for those who declare income in that band and above and as such it is statistically acceptable to base an analysis on that data set and to extrapolate it to calculate tax lost without having to allow for the presence of non-domiciled people in that data set.

I stress these are important assumptions. I also stress that I think that they are fair.

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[25] Based on http://www.taxresearch.org.uk/Blog/2007/09/06/the-domicile-rule-costs-£4.3-billion/ accessed 7-12-07

[26] Data reported at http://www.taxresearch.org.uk/Blog/2007/07/12/jane-kennedy-adding-nothing-to-the-domicile-debate/ accessed 7-12-07

[27] http://www.hmrc.gov.uk/stats/income_tax/table2-5.xls accessed 7-12-07

Calculations

There were 507,000 people in the UK who declared income above £100,000 in 2006 - 07. Data on them might look like this based on Table 2.5:

Band start point £	Mid point £	Average £	Tax each £	Tax rate	Number '000	Weighted Average £
100,000	150,000	133,693	41,509	31.0%	371	97,830
200,000	350,000	287,273	98,182	34.2%	110	62,327
500,000	750,000	689,474	244,737	35.5%	19	25,838
1,000,000		2,242,857	807,143	36.0%	7	30,966
					507	216,963

The average tax rate in this group is about 33%. To be more precise is to add spurious accuracy. The weighted average of their income is £216,963. So, the average tax payable might be £71,598. If UK tax rates were applied as set out in law the tax payable would be more: it is assumed tax reliefs and planning takes place to reduce the sum paid.

Given that all 112,000 people who are non-domiciled should on the basis of the assumptions made fall into this income bracket, but do not at present, we can extrapolate this liability to suggest that if those non-domiciled people did declare their likely average worldwide incomes here (assuming they are distributed in the same way as those of UK domiciled people, which seems if anything an assumption likely to underestimate their actual liability) then their total tax liability would be £8.019 billion a year. But we have been told that the tax paid by non-domiciled people in the UK is just £3 billion. This suggests there is just over £5 billion of tax unpaid as a result. Logically this has to be true.

Allowing for those who'd leave

But logic is not, of course everything. It's been argued that some non-domiciled people will leave if the domicile rule goes. However, since many work in the City of London that's unlikely. There is nowhere else for these people to go to get the experience they want assuming they cannot or do not want to go the United States. They will stay.

So will all US citizens now here. They pay US tax on their worldwide income anyway.

And all those who are not domiciled here but who are in the UK because it's a great place to do business will stay. As will all those who would pay more tax if they lived just about anywhere else in the world that charges resident people to tax on their worldwide income and also provides a decent environment in which a person would want to live. But, assuming 20% of all non-domiciled people decide to go as a result of a rule change to allow for the argument of those who say this would happen then the total tax paid by this group would go down to £6.4 billion. That still leaves an apparent gain of £3.4 billion from getting rid of the domicile rule.

Inheritance Tax and Capital Gains Tax

But there are two further taxes that must be considered. One is Inheritance Tax. Non-domicile people are older than average when they make their claim for this status. And they do die. Those that do will, if the domicile rule is abolished, fall within the net of this tax. Most do not now. Suppose just 2,000 non-domiciled people a year will die here. Their estates are highly likely to be chargeable to Inheritance Tax. 37,000 estates are chargeable on average a year now. If these estates just paid the same as each of these on average the tax yield would go up by £215 million. A much higher yield is likely.

We must also consider capital gains tax. In 2006-07 the total yield from this tax was £3.8 billion. This would have been very largely paid by people earning more than £100,000 a year: they have the cash to invest in assets that result in chargeable gains. If the population chargeable to this tax went up by 80% of 112,000 then the yield would increase by 17.7%, or about £670 million. In combination with Inheritance Tax that is £785 million extra tax a year.

The non-declared non-domiciles

Add to that the fact that 112,000 is the number currently claiming to be non-domicile. As has become clear as a result of the recent UK 'tax amnesty' quite a number of those who have not declared their offshore income have not done so assuming they were non-domiciled but without having told the Revenue of that fact. 60,000 people have so far come forward under that scheme. Suppose 20% of them use this defence then 12,000 extra people will fall into the net if the domicile rule goes. To be cautious suppose they aren't as wealthy as those who have declared their non-domiciled status and only, on average, have extra tax of £20,000 of income a year to declare (I gather that this is not uncommon amongst those making declaration). That's £8,000 of tax each. That's £96 million extra income tax. And another £90 million of potential capital gains too, which is reasonable because non-domiciled people find these very easy to avoid at present.

£4.3 billion

So now we have (within reasonable grounds of estimation) almost £1 billion of extra tax to compensate for the losses from those who leave. That brings the extra income arising from the abolition of this rule to a sum in excess of £4.3 billion calculated with caution throughout.

Technical Appendix 4

Company taxation

A number of definitions of tax unpaid by companies are available[28]. For the purposes of this report the most important is the Expectation Gap, which is the difference between the rate of tax set by the government in which the company operates and the actual rate of tax they pay. This Gap is a measure of the difference between the contribution society expects business to make by way of tax paid, and what is actually paid. It so happens that throughout the whole period surveyed, the UK corporation tax rate for the companies reviewed was 30%.

This comparison of the headline rate of tax with tax actually paid might seem a crude measure but in fact numerous academic studies have found that the headline rate appears to be a major influence on business decision making and that the effective rate is also of significance[29] whilst not much else is. If therefore business takes account of this difference in making their decisions it is entirely appropriate to do so for other purposes.

Unfortunately, when considering the Expectation Gap it is important to be aware that accounting for tax and paying tax are far from the same thing. Without appreciating this much of what follows will make little sense. The glossary of terms used for these appendices, may therefore be useful on occasion whilst reading this part of the report.

It has been customary to assess the tax rate a company pays by looking at its profit and loss account. Conventionally a profit and loss account looks like this (although International Financial Reporting Standards now mean that some of this data is harder to find within published accounts):

	£
Turnover	A
Distribution costs	(B)
Administrative expenses	(C)
Operating profit	D
Interest income	E
Interest paid	(F)
Profit or loss on sale of assets	G

[28] For a discussion of 20 possible Gaps see http://www.taxjustice.net/cms/upload/pdf/Mind_the_Tax_Gap_-_final_-_15_Jan_2006.pdf accessed 5-11-07

[29] For example, see Do Countries Compete over Corporate Tax Rates?, Michael P. Devereux, Ben Lockwood, Michela Redoano, 2005 http://www.sbs.ox.ac.uk/NR/rdonlyres/ACE5A5B5-1508-4F65-8F11-136CDB5C84C7/0/DevereuxLockwoodRedoano.pdf accessed 5-11-07

Profit before taxation	H
Taxation	(J)
Profit after taxation	K
Dividends paid and proposed	(L)
Profit retained for the year	M

Letters in brackets represent what are usually negative numbers to be subtracted from the total above them. The conventional profit and loss account tax rate is the ratio of the taxation charge (J) to the profit before taxation (H).

In preparing this report accounting data of the fifty largest companies in the FTSE 100 in July 2007 was reviewed in depth[30]. That review involved collecting extensive information on their financial reporting for each of their financial years ending in 2000 to 2006 inclusive (or a shorter period if they were formed after 2000 with no obvious predecessor, as was true in several cases). This involved three hundred and forty four sets of accounts in all spread over a seven year period. *

For the companies included in the survey the resulting conventional profit and loss tax ratios of the type noted above are as follows (with the companies surveyed being listed in the order of their market worth):

Table 1		2000	2001	2002	2003	2004	2005	2006	Average
Declared tax rate - percentage		%	%	%	%	%	%	%	%
1	Royal Dutch Shell plc	46.9	43.7	44.3	43.2	46.7	40.4	41.0	43.7
2	BP plc	29.4	38.3	38.5	34.6	34.2	29.7	35.6	34.3
3	HSBC Holdings plc	22.9	19.7	26.3	24.3	25.6	24.3	23.6	23.8
4	Vodafone Group plc	50.8	-15.9	-15.8	-47.6	-62.5	-44.3	-12.2	-21.1
5	GlaxoSmithKline plc	28.2	29.4	26.5	27.5	27.8	28.5	29.5	28.2
6	Royal Bank of Scotland Group plc	34.3	36.0	32.7	31.0	31.2	30.0	29.3	32.0
7	Barclays plc	27.0	28.0	29.8	28.0	28.0	33.6	27.2	28.8
8	Anglo American plc	26.1	24.7	33.3	27.5	27.6	24.5	27.6	27.3
9	AstraZeneca plc	33.8	27.0	29.2	27.2	24.7	29.1	29.0	28.6
10	Rio Tinto plc	32.6	36.2	54.0	27.1	23.4	24.8	23.2	31.6
11	HBOS plc	0.0	29.1	28.7	29.0	28.5	32.2	31.1	29.7

*Every effort has been made to avoid errors during the complex process of calculating tax rates from company accounts; any error which may exist is entirely unintentional.

[30] There was one exception: Standard Life should have appeared at 49 in the list but had been a quoted company for less than a year at the time the data was collected. Prior to 2006 it has a completely non-comparable reporting basis to all other companies in the survey as it was a mutual company. As a result it was excluded from the survey and the 51st company, Shire plc was substituted in its place.

12	British American Tobacco plc	44.9	42.9	38.7	49.7	35.1	26.7	25.9	37.7
13	BHP Billiton plc	0.0	39.3	36.3	33.6	23.1	24.2	22.6	29.9
14	Tesco plc	27.8	27.3	30.9	30.5	31.1	30.2	29.0	29.6
15	Lloyds TSB Group plc	28.6	27.4	29.3	23.6	28.7	33.1	31.6	28.9
16	Xstrata plc	0.0	0.0	16.8	13.1	12.9	22.1	39.9	21.0
17	BG Group plc	31.9	31.8	47.1	38.9	39.6	37.5	44.5	38.8
18	Diageo plc	27.6	24.2	27.1	74.5	24.7	21.0	8.4	29.6
19	BT Group plc	30.5	-63.2	30.3	14.5	27.7	22.3	24.1	12.3
20	Standard Chartered plc	26.2	32.9	30.7	32.1	29.5	26.5	25.9	29.1
21	Unilever PLC	51.5	42.7	38.7	33.6	27.5	26.3	23.7	34.9
22	Reckitt Benckiser PLC	29.5	28.3	25.1	25.9	23.9	23.6	22.9	25.6
23	Aviva plc	-18.1	82.5	-73.0	26.4	23.9	24.9	19.8	12.3
24	National Grid plc	0.0	0.0	-29.9	36.7	19.2	21.3	31.6	15.8
25	SABMIller plc	24.3	28.8	34.3	45.3	41.6	38.7	31.8	35.0
26	Prudential plc	30.0	5.5	9.1	41.1	35.7	24.1	28.4	24.8
27	Imperial Tobacco Group plc	28.2	28.1	33.1	35.4	34.6	33.2	26.5	31.3
28	BAE Systems plc	103.9	282.9	-11.4	96.6	-100.9	16.2	24.8	58.9
29	Cadbury Schweppes plc	29.6	29.6	30.7	30.7	29.4	16.6	15.6	26.0
30	Centrica plc	24.9	33.1	34.8	34.2	17.9	24.5	-158.8	1.5
31	Scottish & Southern Energy plc	21.5	21.9	26.4	27.6	26.3	39.8	29.2	27.5
32	Man Group plc	-45.8	21.9	21.2	21.0	22.0	22.4	18.0	11.5
33	British Sky Broadcasting Group plc	-3.3	-4.7	-8.3	-48.9	32.9	32.6	31.0	4.5
34	Marks & Spencer Group plc	37.9	98.1	54.3	29.1	29.3	21.2	30.2	42.9
35	J Sainsbury Plc	31.8	38.7	35.0	30.9	33.8	-333.3	44.2	-17.0
36	Rolls-Royce Group plc	50.0	44.8	49.5	35.6	33.0	27.3	28.5	38.4
37	Legal & General Group plc	36.3	-28.2	-69.8	13.9	28.2	36.3	15.4	4.6
38	WPP Group plc	30.0	30.7	50.3	34.9	30.7	32.8	29.2	34.1
39	Old Mutual plc	18.0	343.2	52.7	54.4	32.8	30.1	36.2	81.1
40	Land Securities Group plc	23.1	25.9	27.5	28.1	22.7	-77.0	29.0	11.3
41	Wm Morrison Supermarkets plc	36.7	34.5	36.1	34.1	38.2	30.8	20.0	32.9
42	Reed Elsevier PLC	82.8	53.8	37.0	35.3	45.7	33.8	13.3	43.1
43	Wolseley plc	35.9	36.4	29.8	30.0	29.0	28.8	30.2	31.4
44	Reuters Group plc	19.0	67.7	-4.7	44.9	16.7	13.0	6.2	23.3
45	Hanson plc	22.8	-1.2	31.5	-31.3	9.2	6.7	17.0	7.8
46	Imperial Chemical Industries plc	-134.5	27.3	35.0	48.2	32.3	16.0	17.2	5.9
47	British Land Company plc	17.6	11.9	6.9	19.2	7.8	-169.3	21.4	-12.0
48	Associated British Foods plc	44.9	29.7	22.6	28.0	29.6	29.0	26.5	30.0
49	Compass Group plc	25.1	36.2	36.1	39.9	41.1	78.4	18.4	39.3
50	Shire plc	4.7	56.1	-11.7	-21.8	123.3	-27.7	67.0	27.1
		1,207.9	1,964.9	1,163.8	1,421.3	1,305.2	617.6	1,131.3	1,258.8

Number in population	46	48	50	50	50	50	50	
Average	26.3	40.9	23.3	28.4	26.1	12.4	22.6	25.2

Negative rates usually indicate the existence of a loss, not a tax refund.

What is readily apparent is that there is significant volatility both within companies over time and between companies on the declared rates of tax. This is because this ratio is a poor indication of the tax actually due by companies.

Whilst the ratios for average tax declared suggest that there is a Tax Gap in six of the seven years under review, in 2001 it actually suggests companies paid 10% more tax than required by UK law. This is misleading, as the data that follows will show. That is because better approaches are needed to establish what is really happening.

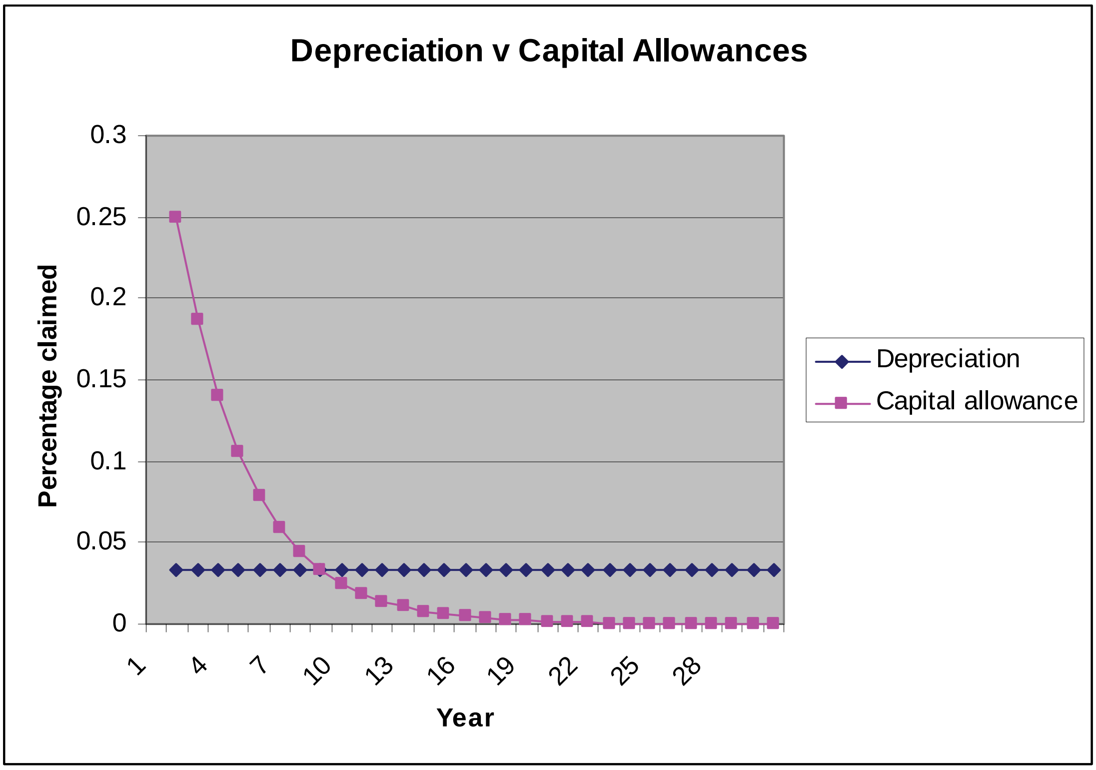
The first thing that is misleading about the above result is that some of the tax charged in the profit and loss account will almost certainly never be paid. This is because that tax charge is usually made up of two components. The first is the current tax charge and the second the deferred tax charge. In this case these terms are useful. It is only the current tax charge is likely to be paid by the company in the near future, which for these purposes usually means within twelve months of the end of the period for which the accounts have been prepared. Deferred tax might be defined as tax that might be payable at some time in the future as a consequence of transactions that have already occurred, but with there being no certainty as to when, if, or ever that tax might be paid.

It must be stressed, deferred tax is a notoriously difficult concept to grasp. It is however important to understand what it is and why it has come about.

A deferred tax charge can arise in a set of accounts whenever the tax treatment of a particular transaction is different from that used in the accounts themselves. For example, the tax treatment of the purchase of equipment is usually very different for tax and accounting purposes, and this difference by itself is of considerable significance in generating the deferred tax charges in the companies surveyed. The difference is that a company charges depreciation on the cost of buying equipment for use in its business. It can set whatever rate it thinks appropriate (and which it can persuade its auditors is appropriate) for depreciation to reflect the life of the asset. Very often this charge will be spread evenly over the life of the asset in fixed annual instalments.

But for tax the rules are rigid: in most cases tax relief is given at 25% of the cost of the equipment in the year it is acquired and for each year thereafter an allowance of 25% of the remaining worth of the asset for tax purposes is given. This means that the relief is 18.75% of cost in the second year, 14.06% in the third year and so on.

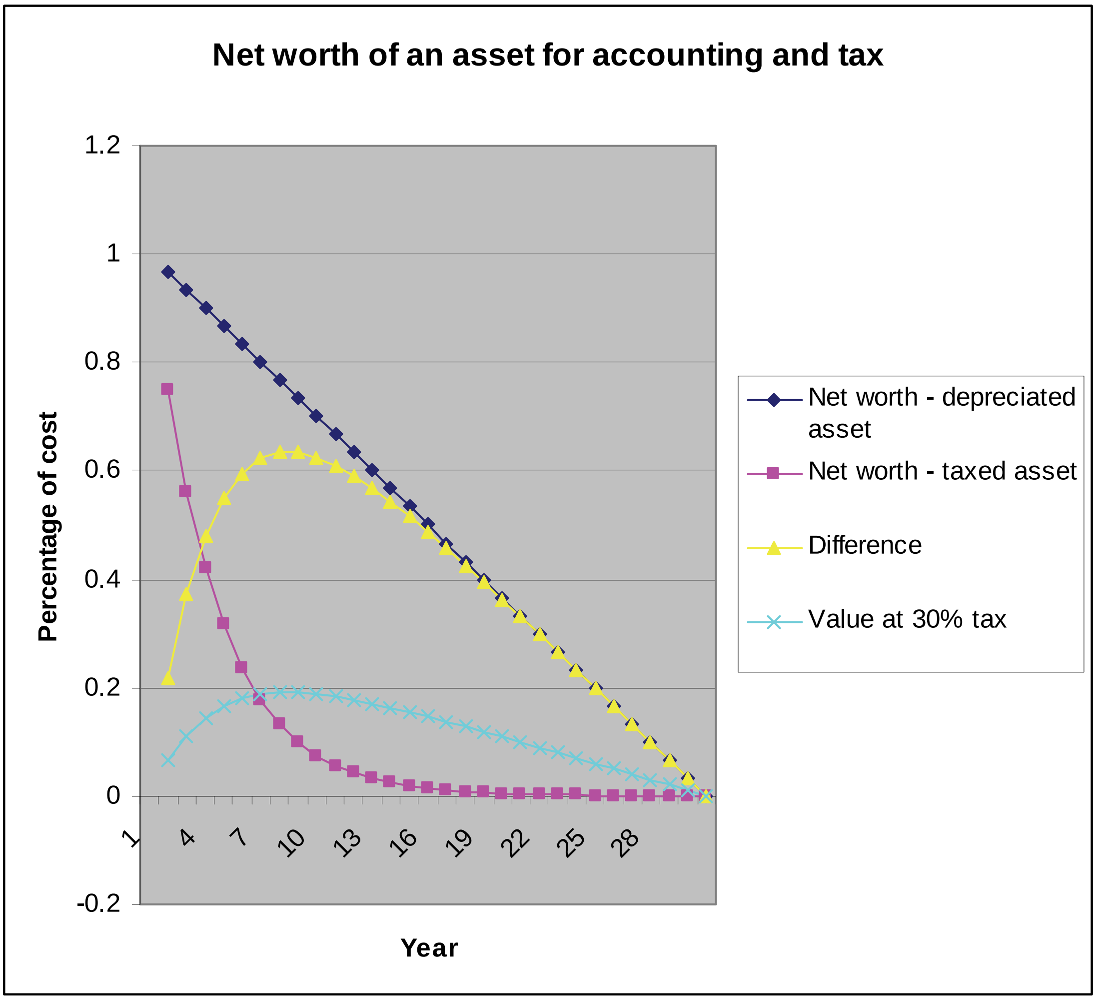
If, as is very often the case the tax relief is more generous than the accounting depreciation charge then very different patterns of expense occur for tax and accounting. The following graph happens to compare these differences for leased assets used by UK rail companies with a life of around 30 years. Some of the asset leasing companies involved are subsidiaries of companies in this survey[31]:



The depreciation is the same every year. That is not true of the capital allowance, which is high at the outset, falls below the rate of depreciation by year 9 and becomes negligible from about year 20.

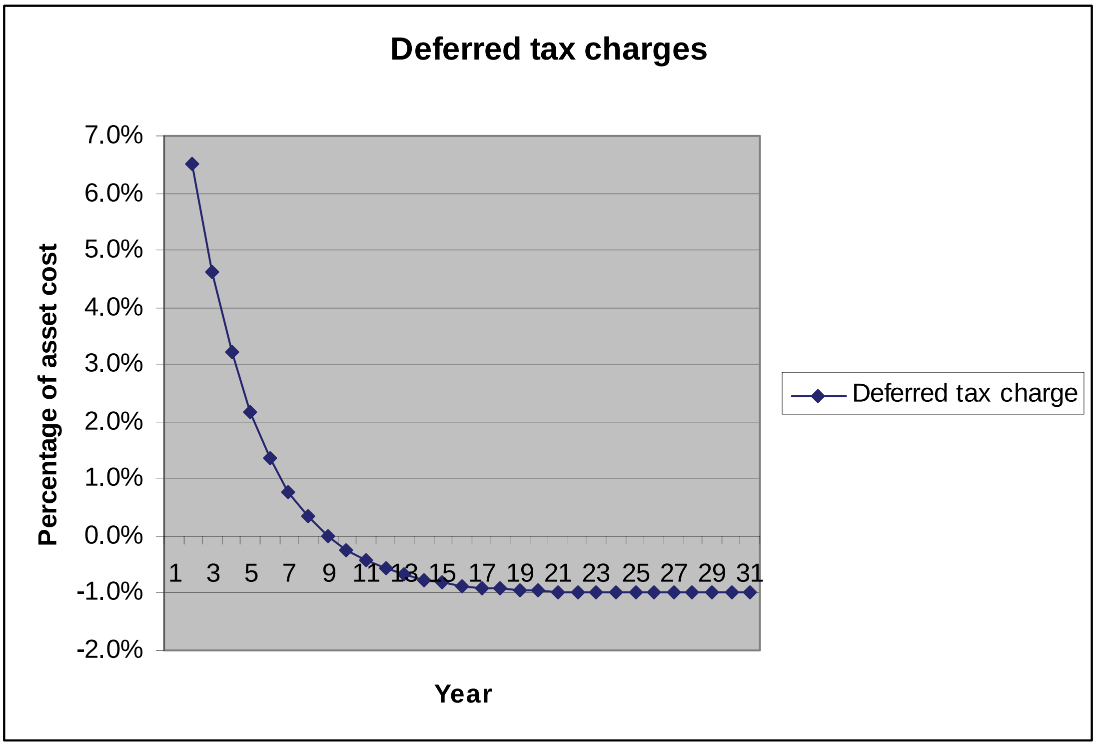
This has a significant impact on the value of the asset for the different purposes of tax and accounting:

[31] This work was originally prepared and published in Tax paid by Railway Companies: A report for the RMT by Richard Murphy FCA of Tax Research LLP available from http://www.taxresearch.org.uk/Blog/2007/10/05/rail-companies-pay-79-corporation-tax/ accessed 7-12-07



The value for accounting falls away in a straight line. For tax it tumbles down and becomes negligible from year 20. The difference is marked. But, most important, this has a tax consequence. 30% of the difference between the values is saved in tax. From years 1 to 9 the tax relief on the asset is more than the depreciation charged. From year 10 on it is less.

Accountancy however requires that costs and their benefits be matched in a set of accounts. This is called the 'accruals' concept. What this means is that in the accounts of a company relief can only be recognised for tax for the expense claimed in the year in the accounts. So, tax relief for accounting purposes is claimed on the depreciation even though in reality tax relief will actually be claimed under the much more generous tax rules. The conundrum of how to account for the difference between the two has to be solved, and the result is the mysterious art of deferred tax accounting. The deferred tax charge is 30% of the difference between the accounting and tax charges each year (30% being the expected UK tax rate for the period considered in this report – although as the rate is now falling to 28% this will be used in future). These charges have this pattern:



Note that whilst tax relief exceeds depreciation there is a charge and when the situation is reversed deferred tax becomes an income stream for the company. However, these charges are not actually due to anyone. So they are simply put on the balance sheet of the company as a 'provision' against a possible cost. This is the deferred tax balance noted above. So long, however, as a company keeps buying new equipment the position where the overall level of deferred tax reverses does not arise and the balance keeps on rising. This is possible because the assets are considered as whole for this purpose, not individually.

The result is that the more a company spends on equipment the more tax subsidy it gets from the government. And the more fictitious its tax charge becomes because the bigger the component of that charge that will be made up of deferred tax. This is obvious from the graphs noted above.

The result is twofold. There is a substantial and continuing subsidy for replacing people with equipment in business, which is harmful for labour prospects. Secondly, labour is doubly suffering in this scenario because it is both losing employment prospects as companies seek to avoid paying tax by pursuing ever more automation and yet it is labour that is picking up the resulting tax bill to provide this subsidy which is, in turn, passed to those who own the companies in question.

In addition there is no seeming prospect that deferred tax provisions will be paid at any time in the future. As such they can be ignored in all the calculations of the real tax paid by these companies. Tax that will not be paid is not a tax at all. It is a figment of an accountant's imagination invented to make sure that it looks like companies are paying tax when in fact they're receiving interest free loans from the government instead.

For current purposes its most important feature is the fact that for many companies it is very unlikely that the deferred tax charges made in their profit and loss accounts will result in real tax liabilities being paid at any time in the foreseeable future. In that case, for all practical purposes deferred tax charges included in the profit and loss account can be, and should be, excluded from any consideration of taxes to be paid when measuring the Tax Gaps.

This is confirmed by the following table of the deferred tax balances owing by the companies in the survey, in this case sorted by the average balance owing over the period:

Table 2		2000	2001	2002	2003	2004	2005	2006	Average
Deferred tax owing at year end		£m	£m	£m	£m	£m	£m	£m	
1	GlaxoSmithKline plc	-889	-871	-631	-835	-827	-1,645	-1,528	-1,032
2	HSBC Holdings plc	495	206	10	-691	-280	-1,159	-1,164	-369
3	Unilever PLC	-556	-525	-538	75	-315	-525	-179	-366
4	BAE Systems plc	-37	-59	-51	-1	89	-1,308	-1,062	-347
5	Reuters Group plc	-52	-154	-233	-240	-205	-210	-171	-181
6	Standard Chartered plc	-16	-17	-128	-147	-175	-270	-292	-149
7	Compass Group plc	-141	-122	-85	-132	-95	-60	-219	-122
8	British Sky Broadcasting Group plc	0	0	-39	-190	-151	-100	-100	-116
9	British American Tobacco plc	-84	-12	-4	-118	-20	-13	23	-33
10	Imperial Chemical Industries plc	-32	10	140	79	82	-232	-211	-23
11	Shire plc	0	-22	-26	-35	-44	33	15	-13
12	Man Group plc	8	7	6	-4	-5	-5	-2	1
13	Wolseley plc	0	-16	0	-13	-3	45	72	14
14	Old Mutual plc	-234	-203	-142	-280	-57	153	882	17
15	Rolls-Royce Group plc	49	52	74	97	115	-261	111	34
16	Imperial Tobacco Group plc	20	16	59	40	40	20	64	37
17	Marks & Spencer Group plc	48	44	106	105	-4	36	-29	44
18	Diageo plc	-18	28	104	193	208	245	-439	46
19	WPP Group plc	-57	-62	-62	-70	-77	403	359	62
20	Wm Morrison Supermarkets plc	39	42	40	37	18	93	423	99
21	J Sainsbury Plc	-3	-4	172	190	234	173	-55	101
22	SABMIller plc	14	9	53	24	32	21	616	110
23	Associated British Foods plc	0	0	79	84	134	72	316	137
24	AstraZeneca plc	-121	10	195	376	434	-3	184	154
25	Reed Elsevier PLC	37	-126	-69	-3	-21	714	680	173
26	Centrica plc	109	43	242	188	237	447	15	183
27	Hanson plc	163	153	215	134	112	256	333	195
28	Legal & General Group plc	17	27	51	170	206	492	472	205
29	Reckitt Benckiser PLC	-23	-24	235	238	241	300	622	227
30	British Land Company plc	87	78	90	93	101	101	1,331	269

31	BHP Billiton plc	0	478	601	524	329	40	-129	307
32	Land Securities Group plc	0	1	125	173	173	116	1,968	365
33	Tesco plc	19	24	440	505	572	731	308	371
34	Barclays plc	631	630	461	646	738	14	-482	377
35	Cadbury Schweppes plc	105	262	318	224	196	831	880	402
36	Scottish & Southern Energy plc	40	50	427	462	513	530	833	408
37	BG Group plc	98	403	597	666	633	649	1,072	588
38	Xstrata plc	0	0	30	6	-44	723	2,770	697
39	Aviva plc	429	364	243	319	623	1,440	1,878	757
40	Rio Tinto plc	496	466	546	750	741	1,163	1,148	758
41	HBOS plc	0	628	648	662	726	1,751	2,591	1,168
42	Anglo American plc	94	47	859	1,265	1,579	2,641	1,800	1,183
43	BT Group plc	354	270	2,140	2,017	2,191	2,174	741	1,412
44	Lloyds TSB Group plc	1,559	1,719	1,317	1,376	1,473	1,145	1,416	1,429
45	Prudential plc	332	2,005	696	1,154	1,522	2,322	2,870	1,557
46	Vodafone Group plc	-224	-3	1,294	2,008	2,643	2,397	5,530	1,949
47	Royal Bank of Scotland Group plc	1,224	1,456	1,795	2,238	2,826	1,539	3,108	2,027
48	National Grid plc	0	0	2,996	3,031	2,952	3,036	2,002	2,803
49	Royal Dutch Shell plc	3,805	3,879	6,770	7,250	6,976	4,452	5,497	5,519
50	BP plc	989	898	7,337	8,292	7,237	8,927	9,835	6,216
	Total	8,772	12,086	29,504	32,933	34,603	34,433	46,699	
	Number in population	42	46	50	50	50	50	50	
	Average	209	263	590	659	692	689	934	

The evidence is clear: over seven years the deferred tax due by this group of companies has risen year on year from an average of £209 million each to an average of £934 million each. By 2006 the amount of deferred tax on the balance sheets of these companies, for which no payment date was known amounted to £47.7 billion, and as such exceeded by more than £2 billion the total corporation tax paid in the UK in the tax year 2006/07[32].

This fact, by itself, shows three things. This first is that the figure for tax due in the profit and loss account of the quoted companies almost invariably includes tax that will not be paid. Second, this figure for deferred tax not paid shows that deferring tax is growing in significance. Finally it suggests caution should always be exercised when a company declares that it has a high tax rate. This is a clear indication that some modifications to the reported numbers are needed to give a better indication of the real tax rates due on profits earned by these companies.

The first such modification in the light of this evidence is to only use the current element of the tax charge when considering what is likely to be paid. After all, tax is of no benefit to governments unless it is paid to them.

The second modification is to reconsider the figure for profit declared by these companies. As a matter of fact in most developed countries (but admittedly less so

[32] http://www.hmrc.gov.uk/stats/tax_receipts/table1-2.pdf accessed 9-11-07

in developing countries) declared profit as per the accounts is not the sum on which a company is charged to tax. Instead a taxable profit is used. The differences between the two are numerous, and vary from country to country, but in general terms the following hold true:

1. Charges for the use of fixed assets (called depreciation) included in accounts are disallowed for taxation purposes, and different (usually more generous) taxation allowances are given in their place. These are called capital allowances;
2. Almost no tax relief is given for the write off of goodwill in accounts. Goodwill is the difference between the price paid when buying a company and the actual value of the assets that are acquired. This sum has to be written off over time under most accounting rules and substantial goodwill write-off charges are included in the profit and loss accounts of many of the companies in this survey;
3. Some expenses a company incurs may not be offset against its income for tax purposes. These might include some legal costs; entertaining expenses in the UK; some costs of fundraising; and a wide range of other items;
4. Some income is not taxable (for example, dividends from other UK companies) or may be subject to tax at low effective rates (for example, capital gains);
5. Some income earned overseas is not subject to tax in the UK. For example, if profits are earned in a subsidiary company, and the UK parent company can satisfy the UK's taxation authorities that the subsidiary is really undertaking a trade, then the fact that the profits of the subsidiary company may be taxed at rates lower than those charged in the UK does not prevent the subsidiary being able to enjoy these lower tax rates in the country in which it operates, so long as the profits it earns are not paid back to the UK parent company via dividends.

For all these reasons, accounting profit can be the wrong basis for assessing the Tax Gap.

There is another very good reason why the accounts of a consolidated group of companies (as are all the companies reviewed in this report) do not form a perfect base for assessing the Tax Gap. That is because consolidated accounts are not for any legal entity that actually exists. Consolidated accounts are instead a way of presenting the third party transactions of a group of companies which are either under common control, or under some degree of shared control (since the results of associated companies in which the parent company has a stake of more than 20% are also included in the parent company's accounts, at least in part). This view quite successfully represents the economic resources over which the group parent company has some control and how those resources have been managed with regard to third parties. But groups of companies are not, at least as yet, taxed on the basis of their consolidated accounts. They are instead taxed on the basis of the profits each constituent member of the group of companies makes, and this can provide a very different view of the tax liabilities owing for two reasons:

1. Tax rules vary significantly from country to country, and groups tend to have an international orientation (there are only a couple of exceptions amongst the companies covered by this report, most notably BSkyB and Scottish & Southern Energy plc which are both almost entirely UK based);

2. Group companies trade with each other. In fact, the OECD has estimated that 60% of all world trade is undertaken between companies who are constituent members of the same trading group. None of these inter-group transactions are reflected in consolidated accounts. Indeed, the main purpose of consolidating the accounts is to remove all inter-group transactions from view. But as a result the underlying economic transactions which actually give rise to the group's tax liabilities are much harder to identify and analyse.

That said though there is currently no more satisfactory basis for assessing the Tax Gap than the data made available in companies' consolidated accounts, whatever their known shortcomings and despite the fact that many of the shortcomings with these accounts are incapable of remedy when undertaking the exercise. For example, although figures for depreciation of fixed assets are disclosed in accounts the replacement figures for taxation purposes called capital allowances are not, and as such no adjustment for this can be made.

In practice just two changes can be made to secure a better view of the tax liabilities due by companies. Both are accepted as normal practice when undertaking analysis of taxation issues, and both can be done using published accounting data. As such they are not controversial. They are:

- To remove deferred tax from the reported tax charge for the simple reason that it is unlikely to be paid, and;

- To add goodwill amortisation charged in the profit and loss account back to profit since it is almost invariably not tax allowable.

As was mentioned above, goodwill is the difference between the price paid when buying a company and the actual value of the tangible assets that are acquired. This sum has to be written off over time under most accounting rules. This charge is called amortisation and is equivalent to the depreciation charge on tangible equipment. Substantial goodwill amortisation charges are included in the profit and loss accounts of many of the companies in this survey, and like depreciation charges they are not tax allowable.

Very different figures for the Expectation Gap emerge if these two adjustments are made, as the following table shows:

Table 3 **Declared current tax rate to pre-goodwill profit - percentage**		2000 %	2001 %	2002 %	2003 %	2004 %	2005 %	2006 %	Average %
1	Royal Dutch Shell plc	44.4	43.8	44.6	43.2	47.8	43.3	38.6	43.7
2	BP plc	28.2	35.2	24.0	25.9	30.0	20.4	26.0	27.1
3	HSBC Holdings plc	22.5	22.7	18.2	22.1	18.6	21.7	22.8	21.3
4	Vodafone Group plc	39.9	70.1	-25.3	37.7	30.0	31.5	44.5	32.7
5	GlaxoSmithKline plc	29.8	30.6	26.0	31.6	27.8	29.2	33.8	29.8
6	Royal Bank of Scotland Group plc	23.9	26.0	22.6	19.5	22.0	23.8	23.3	23.0
7	Barclays plc	26.4	25.9	28.6	21.5	24.5	34.9	26.6	26.9
8	Anglo American plc	25.9	24.4	26.0	19.6	21.3	25.1	24.6	23.9
9	AstraZeneca plc	28.0	19.2	23.6	20.6	21.8	26.8	30.5	24.4
10	Rio Tinto plc	28.0	36.3	51.7	27.3	26.0	23.4	23.6	30.9
11	HBOS plc	0.0	23.9	22.6	25.1	25.4	20.2	18.9	22.7
12	British American Tobacco plc	41.9	36.6	33.0	41.9	25.2	28.0	24.8	33.1
13	BHP Billiton plc	0.0	41.6	28.3	29.7	30.3	27.1	27.4	30.7
14	Tesco plc	27.3	26.6	27.7	25.5	25.9	21.8	28.7	26.2
15	Lloyds TSB Group plc	25.7	25.0	32.6	20.6	24.3	20.2	18.1	23.8
16	Xstrata plc	0.0	0.0	14.8	5.5	19.1	19.7	35.2	18.9
17	BG Group plc	28.4	28.8	32.8	31.8	37.0	40.4	30.5	32.8
18	Diageo plc	25.5	21.2	21.3	70.4	18.6	17.4	12.1	26.6
19	BT Group plc	29.7	26.5	10.0	17.6	18.6	22.8	15.2	20.1
20	Standard Chartered plc	27.7	27.6	30.3	29.6	26.2	24.4	20.9	26.7
21	Unilever PLC	52.9	28.3	34.9	23.0	32.9	21.4	19.3	30.4
22	Reckitt Benckiser PLC	28.9	28.3	20.8	23.8	21.6	24.1	22.4	24.3
23	Aviva plc	-24.7	78.9	-226.3	23.7	17.7	-12.3	12.1	-18.7
24	National Grid plc	0.0	0.0	-82.9	5.7	12.1	8.3	23.5	-6.6
25	SABMIller plc	24.4	28.7	31.1	31.8	33.2	34.7	30.5	30.6
26	Prudential plc	25.3	8.3	15.1	39.1	34.0	-45.9	-15.9	8.6
27	Imperial Tobacco Group plc	26.6	26.5	33.0	27.5	26.8	28.7	26.5	27.9
28	BAE Systems plc	35.6	50.3	-1,500.0	22.1	10.5	16.0	22.5	-191.9
29	Cadbury Schweppes plc	27.3	22.5	26.1	25.0	14.0	21.4	14.8	21.6
30	Centrica plc	31.9	20.9	23.4	31.8	14.4	16.1	67.7	29.5
31	Scottish & Southern Energy plc	18.5	19.9	21.6	22.5	23.5	35.6	28.0	24.2
32	Man Group plc	-137.5	21.9	21.1	19.1	20.1	20.1	18.3	-2.4
33	British Sky Broadcasting Group plc	-3.5	0.0	-1.5	35.6	19.9	20.7	16.6	14.6
34	Marks & Spencer Group plc	38.5	101.5	28.5	29.3	26.3	13.9	20.3	36.9
35	J Sainsbury Plc	31.3	38.4	30.9	28.6	27.9	21.7	28.8	29.7
36	Rolls-Royce Group plc	41.5	22.9	24.0	18.1	22.0	11.6	4.4	20.7
37	Legal & General Group plc	35.8	-32.3	-108.3	8.2	24.1	22.5	15.5	-4.9

38	WPP Group plc	31.6	30.9	27.4	30.6	28.2	29.5	26.1	29.2
39	Old Mutual plc	24.1	26.6	21.7	29.4	25.8	18.2	19.6	23.6
40	Land Securities Group plc	22.8	25.8	25.1	12.0	23.0	-117.1	24.3	2.3
41	Wm Morrison Supermarkets plc	34.6	33.1	37.0	35.2	37.6	50.9	-4.3	32.0
42	Reed Elsevier PLC	21.2	29.4	6.0	12.8	19.9	22.1	11.1	17.5
43	Wolseley plc	34.4	33.3	24.7	25.9	25.6	20.5	27.3	27.4
44	Reuters Group plc	19.1	65.7	-57.3	24.7	7.8	6.8	0.5	9.6
45	Hanson plc	20.5	-4.7	6.4	19.2	14.4	6.0	15.0	11.0
46	Imperial Chemical Industries plc	-188.5	7.4	9.6	76.9	19.8	16.2	1.1	-8.2
47	British Land Company plc	13.7	22.0	0.1	17.4	4.8	-174.1	0.4	-16.5
48	Associated British Foods plc	43.9	24.7	24.4	23.8	23.3	24.2	18.0	26.1
49	Compass Group plc	24.6	16.0	3.3	13.4	20.9	17.7	23.5	17.1
50	Shire plc	3.6	24.8	27.8	32.9	37.7	17.6	49.4	27.7
		862.0	1,392.3	-958.9	1,336.0	1,190.5	719.2	1,093.5	804.9
	Number in population	46	47	50	50	50	50	50	
	Average	18.7	29.6	-19.2	26.7	23.8	14.4	21.9	16.1

The position shown is already quite different from the first table, but some statistical aberrations also arise, such as the impact of the high tax charge in relation to the loss made by BAE in 2002. To limit the impact of these statistical aberrations two further changes are needed to give the best indication of the underlying trend in tax paid. The first is to rank this data in terms of average rates, which results in the following table:

Table 4 **Declared current tax rate to pre-goodwill profit - percentage** **Ranked by average**		2000 %	2001 %	2002 %	2003 %	2004 %	2005 %	2006 %	Average %
1	BAE Systems plc	35.6	50.3	-1,500.0	22.1	10.5	16.0	22.5	-191.9
2	Aviva plc	-24.7	78.9	-226.3	23.7	17.7	-12.3	12.1	-18.7
3	British Land Company plc	13.7	22.0	0.1	17.4	4.8	-174.1	0.4	-16.5
4	Imperial Chemical Industries plc	-188.5	7.4	9.6	76.9	19.8	16.2	1.1	-8.2
5	National Grid plc	0.0	0.0	-82.9	5.7	12.1	8.3	23.5	-6.6
6	Legal & General Group plc	35.8	-32.3	-108.3	8.2	24.1	22.5	15.5	-4.9
7	Man Group plc	-137.5	21.9	21.1	19.1	20.1	20.1	18.3	-2.4
8	Land Securities Group plc	22.8	25.8	25.1	12.0	23.0	-117.1	24.3	2.3
9	Prudential plc	25.3	8.3	15.1	39.1	34.0	-45.9	-15.9	8.6
10	Reuters Group plc	19.1	65.7	-57.3	24.7	7.8	6.8	0.5	9.6
11	Hanson plc	20.5	-4.7	6.4	19.2	14.4	6.0	15.0	11.0
12	British Sky Broadcasting Group plc	-3.5	0.0	-1.5	35.6	19.9	20.7	16.6	14.6
13	Compass Group plc	24.6	16.0	3.3	13.4	20.9	17.7	23.5	17.1
14	Reed Elsevier PLC	21.2	29.4	6.0	12.8	19.9	22.1	11.1	17.5

15	Xstrata plc	0.0	0.0	14.8	5.5	19.1	19.7	35.2	18.9
16	BT Group plc	29.7	26.5	10.0	17.6	18.6	22.8	15.2	20.1
17	Rolls-Royce Group plc	41.5	22.9	24.0	18.1	22.0	11.6	4.4	20.7
18	HSBC Holdings plc	22.5	22.7	18.2	22.1	18.6	21.7	22.8	21.3
19	Cadbury Schweppes plc	27.3	22.5	26.1	25.0	14.0	21.4	14.8	21.6
20	HBOS plc	0.0	23.9	22.6	25.1	25.4	20.2	18.9	22.7
21	Royal Bank of Scotland Group plc	23.9	26.0	22.6	19.5	22.0	23.8	23.3	23.0
22	Old Mutual plc	24.1	26.6	21.7	29.4	25.8	18.2	19.6	23.6
23	Lloyds TSB Group plc	25.7	25.0	32.6	20.6	24.3	20.2	18.1	23.8
24	Anglo American plc	25.9	24.4	26.0	19.6	21.3	25.1	24.6	23.9
25	Scottish & Southern Energy plc	18.5	19.9	21.6	22.5	23.5	35.6	28.0	24.2
26	Reckitt Benckiser PLC	28.9	28.3	20.8	23.8	21.6	24.1	22.4	24.3
27	AstraZeneca plc	28.0	19.2	23.6	20.6	21.8	26.8	30.5	24.4
28	Associated British Foods plc	43.9	24.7	24.4	23.8	23.3	24.2	18.0	26.1
29	Tesco plc	27.3	26.6	27.7	25.5	25.9	21.8	28.7	26.2
30	Diageo plc	25.5	21.2	21.3	70.4	18.6	17.4	12.1	26.6
31	Standard Chartered plc	27.7	27.6	30.3	29.6	26.2	24.4	20.9	26.7
32	Barclays plc	26.4	25.9	28.6	21.5	24.5	34.9	26.6	26.9
33	BP plc	28.2	35.2	24.0	25.9	30.0	20.4	26.0	27.1
34	Wolseley plc	34.4	33.3	24.7	25.9	25.6	20.5	27.3	27.4
35	Shire plc	3.6	24.8	27.8	32.9	37.7	17.6	49.4	27.7
36	Imperial Tobacco Group plc	26.6	26.5	33.0	27.5	26.8	28.7	26.5	27.9
37	WPP Group plc	31.6	30.9	27.4	30.6	28.2	29.5	26.1	29.2
38	Centrica plc	31.9	20.9	23.4	31.8	14.4	16.1	67.7	29.5
39	J Sainsbury Plc	31.3	38.4	30.9	28.6	27.9	21.7	28.8	29.7
40	GlaxoSmithKline plc	29.8	30.6	26.0	31.6	27.8	29.2	33.8	29.8
41	Unilever PLC	52.9	28.3	34.9	23.0	32.9	21.4	19.3	30.4
42	SABMIller plc	24.4	28.7	31.1	31.8	33.2	34.7	30.5	30.6
43	BHP Billiton plc	0.0	41.6	28.3	29.7	30.3	27.1	27.4	30.7
44	Rio Tinto plc	28.0	36.3	51.7	27.3	26.0	23.4	23.6	30.9
45	Wm Morrison Supermarkets plc	34.6	33.1	37.0	35.2	37.6	50.9	-4.3	32.0
46	Vodafone Group plc	39.9	70.1	-25.3	37.7	30.0	31.5	44.5	32.7
47	BG Group plc	28.4	28.8	32.8	31.8	37.0	40.4	30.5	32.8
48	British American Tobacco plc	41.9	36.6	33.0	41.9	25.2	28.0	24.8	33.1
49	Marks & Spencer Group plc	38.5	101.5	28.5	29.3	26.3	13.9	20.3	36.9
50	Royal Dutch Shell plc	44.4	43.8	44.6	43.2	47.8	43.3	38.6	43.7
		862.0	1,392.3	-958.9	1,336.0	1,190.5	719.2	1,093.5	804.9
	Number in population	46	47	50	50	50	50	50	
	Average	18.7	29.6	-19.2	26.7	23.8	14.4	21.9	16.1

The second change is to eliminate the statistically outlying data that distorts the underlying trend. This is done first of all by eliminating all negative data resulting from the declaration of losses (which is likely to increase the overall declared rates of tax paid) and to eliminate from the sample the top and bottom three companies. The average ranking in the following table has, however, been kept constant for ease of comparison. The following table results:

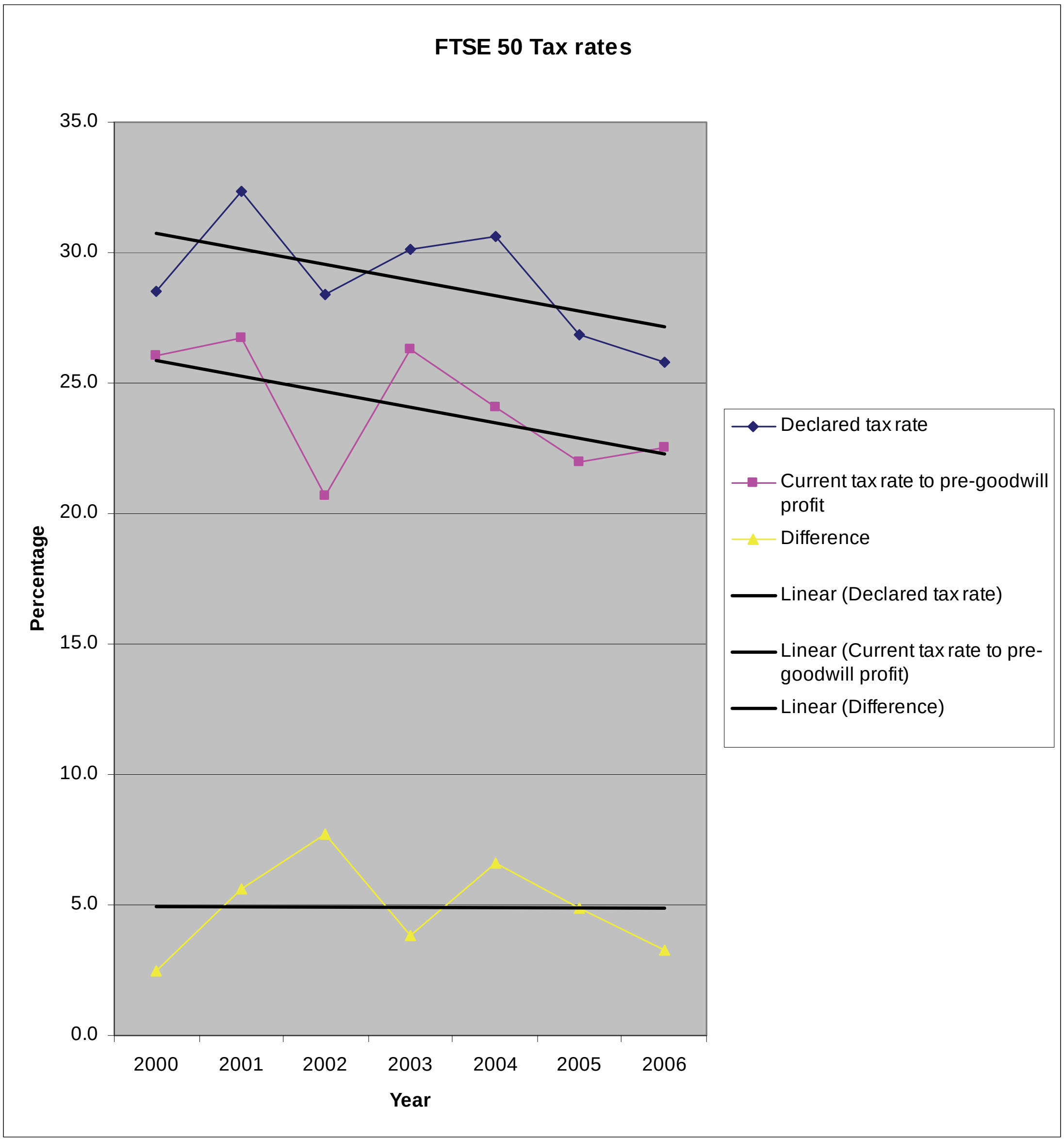
Table 5 **Declared current tax rate to pre-goodwill profit - percentage** **Ranked by average - top and bottom 3 of sample eliminated**		2000	2001	2002	2003	2004	2005	2006	Average
		%	%	%	%	%	%	%	%
Losses eliminated									
4	Imperial Chemical Industries plc		7.4	9.6	76.9	19.8	16.2	1.1	-8.2
5	National Grid plc	0.0	0.0		5.7	12.1	8.3	23.5	-6.6
6	Legal & General Group plc	35.8			8.2	24.1	22.5	15.5	-4.9
7	Man Group plc		21.9	21.1	19.1	20.1	20.1	18.3	-2.4
8	Land Securities Group plc	22.8	25.8	25.1	12.0	23.0		24.3	2.3
9	Prudential plc	25.3	8.3	15.1	39.1	34.0			8.6
10	Reuters Group plc	19.1	65.7		24.7	7.8	6.8	0.5	9.6
11	Hanson plc	20.5		6.4	19.2	14.4	6.0	15.0	11.0
12	British Sky Broadcasting Group plc		0.0		35.6	19.9	20.7	16.6	14.6
13	Compass Group plc	24.6	16.0	3.3	13.4	20.9	17.7	23.5	17.1
14	Reed Elsevier PLC	21.2	29.4	6.0	12.8	19.9	22.1	11.1	17.5
15	Xstrata plc	0.0	0.0	14.8	5.5	19.1	19.7	35.2	18.9
16	BT Group plc	29.7	26.5	10.0	17.6	18.6	22.8	15.2	20.1
17	Rolls-Royce Group plc	41.5	22.9	24.0	18.1	22.0	11.6	4.4	20.7
18	HSBC Holdings plc	22.5	22.7	18.2	22.1	18.6	21.7	22.8	21.3
19	Cadbury Schweppes plc	27.3	22.5	26.1	25.0	14.0	21.4	14.8	21.6
20	HBOS plc	0.0	23.9	22.6	25.1	25.4	20.2	18.9	22.7
21	Royal Bank of Scotland Group plc	23.9	26.0	22.6	19.5	22.0	23.8	23.3	23.0
22	Old Mutual plc	24.1	26.6	21.7	29.4	25.8	18.2	19.6	23.6
23	Lloyds TSB Group plc	25.7	25.0	32.6	20.6	24.3	20.2	18.1	23.8
24	Anglo American plc	25.9	24.4	26.0	19.6	21.3	25.1	24.6	23.9
25	Scottish & Southern Energy plc	18.5	19.9	21.6	22.5	23.5	35.6	28.0	24.2
26	Reckitt Benckiser PLC	28.9	28.3	20.8	23.8	21.6	24.1	22.4	24.3
27	AstraZeneca plc	28.0	19.2	23.6	20.6	21.8	26.8	30.5	24.4
28	Associated British Foods plc	43.9	24.7	24.4	23.8	23.3	24.2	18.0	26.1
29	Tesco plc	27.3	26.6	27.7	25.5	25.9	21.8	28.7	26.2
30	Diageo plc	25.5	21.2	21.3	70.4	18.6	17.4	12.1	26.6
31	Standard Chartered plc	27.7	27.6	30.3	29.6	26.2	24.4	20.9	26.7
32	Barclays plc	26.4	25.9	28.6	21.5	24.5	34.9	26.6	26.9
33	BP plc	28.2	35.2	24.0	25.9	30.0	20.4	26.0	27.1
34	Wolseley plc	34.4	33.3	24.7	25.9	25.6	20.5	27.3	27.4
35	Shire plc	3.6	24.8	27.8	32.9	37.7	17.6	49.4	27.7

36	Imperial Tobacco Group plc	26.6	26.5	33.0	27.5	26.8	28.7	26.5	27.9
37	WPP Group plc	31.6	30.9	27.4	30.6	28.2	29.5	26.1	29.2
38	Centrica plc	31.9	20.9	23.4	31.8	14.4	16.1	67.7	29.5
39	J Sainsbury Plc	31.3	38.4	30.9	28.6	27.9	21.7	28.8	29.7
40	GlaxoSmithKline plc	29.8	30.6	26.0	31.6	27.8	29.2	33.8	29.8
41	Unilever PLC	52.9	28.3	34.9	23.0	32.9	21.4	19.3	30.4
42	SABMIller plc	24.4	28.7	31.1	31.8	33.2	34.7	30.5	30.6
43	BHP Billiton plc	0.0	41.6	28.3	29.7	30.3	27.1	27.4	30.7
44	Rio Tinto plc	28.0	36.3	51.7	27.3	26.0	23.4	23.6	30.9
45	Wm Morrison Supermarkets plc	34.6	33.1	37.0	35.2	37.6	50.9	-4.3	32.0
46	Vodafone Group plc	39.9	70.1	-25.3	37.7	30.0	31.5	44.5	32.7
47	BG Group plc	28.4	28.8	32.8	31.8	37.0	40.4	30.5	32.8
		1,042.1	1,096.2	911.1	1,158.3	1,058.1	967.4	990.8	0.0
	Number in population	40	41	44	44	44	44	44	
	Average	26.1	26.7	20.7	26.3	24.0	22.0	22.5	24.1

A clear trend is now seen. Effective tax rates are falling over the period. If these effective tax rates are compared with the tax rates as shown by the original table, but with that in turn having losses eliminated and the top and bottom three companies eliminated from the sample for the sake of consistency then the following table results:

Table 6		2000	2001	2002	2003	2004	2005	2006
Declared tax rate	%	28.5	32.3	28.4	30.2	30.6	26.9	25.8
Current tax rate to pre-goodwill profit	%	26.1	26.7	20.7	26.3	24.0	22.0	22.5
Difference	%	2.5	5.6	7.7	3.8	6.6	4.9	3.3

If expressed as a graph the following trends are clear:



Declared tax rates in the UK are on average a consistent 5% higher than current tax rates. Both have fallen over a seven year period.

In 2000 the effective current tax rate was 26% and in 2006 it was 22.4%.

Declared rates were, on a trend basis 5% higher in both cases.

The average decrease in current tax rates a year was just over 0.5% per annum throughout the period.

Throughout the period the UK tax rate was 30%.

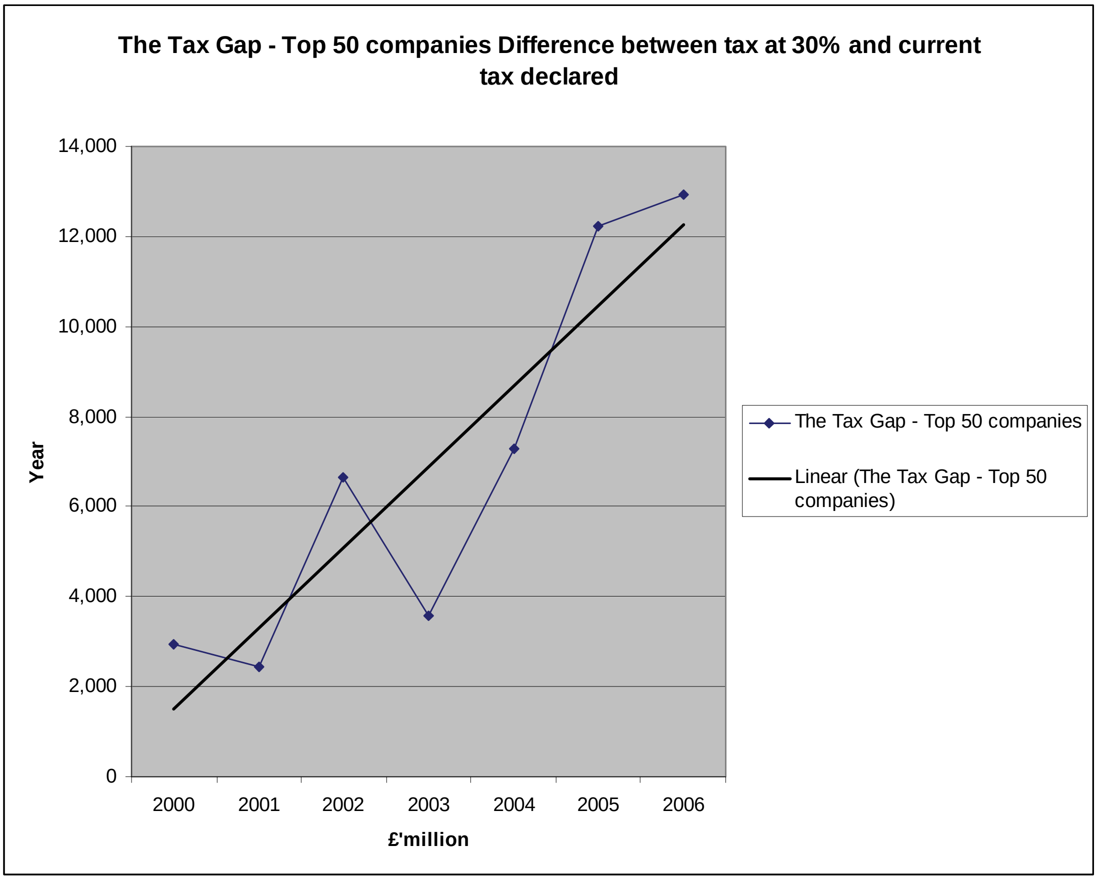
To give some indication of the value of both this trend and the tax not paid the following table compares the pre-goodwill profits of the sample companies (this profit being the closest indicator of taxable profit available) with the percentage average tax gap for each year reviewed to calculate the potential tax lost:

Table 6		2000	2001	2002	2003	2004	2005	2006
Pre Goodwill profits of sample group	£'m	59,842	60,243	58,894	80,138	98,986	121,359	138,915
% tax gap	%	3.9	3.3	9.3	3.7	6.0	8.0	7.5
Difference	£'m	2,362	1,966	5,474	2,946	5,892	9,725	10,395

If the same ratio is applied, as is reasonable, to the whole sample then the following calculation results:

Table 7		2000	2001	2002	2003	2004	2005	2006
Pre Goodwill profits of top 50 companies	£'m	74,665	74,996	71,546	97,459	122,506	152,665	172,919
% tax gap	%	3.9	3.3	9.3	3.7	6.0	8.0	7.5
Difference	£'m	2,947	2,447	6,649	3,583	7,292	12,234	12,939

Expressed graphically, this is shown as follows:



It would seem that just fifty companies have a tax gap of almost £13 billion by 2006.

It does, however, have to be recognised that the situation is a little more complicated than this. First of all, out of the total tax gap over the period of some

£48 billion at least £38 billion can be explained (at least in part) by the increase in deferred tax balances over the same time period. To this extent, and because these deferred tax balances suggest that these companies recognise that they might owe this tax at some point this proportion can be said to represent a mix of tax planning and tax avoidance and only the difference between these figures of £10 billion can be said with certainty to be tax that has been wholly avoided.

That said though, the analysis of what makes up the deferred tax balances of these companies varies widely, is not subject to any systematic pattern and can vary from the complex to the absurdly simplistic. This suggests that what is disclosed is very much chosen to suit the whim of the company, and not any desire to impart meaningful information.

This is also the case of the reconciliation between the effective rate of tax charged in these companies' accounts and the UK standard rate of 30%. For example, a summary of this reconciliation shows that these reconciliations show that in 2006 across all fifty companies just £89 million of the tax not paid apparently arose because of differences between the UK rate of corporate tax and that of overseas jurisdictions. What is more, the difference in question increased the companies' liabilities, and did not decrease them. This suggests that none of these companies undertake any offshore tax planning, transfer pricing planning or tax rate arbitrage arrangements, an impression which runs completely counter to that gained from the enormous literature on these subjects in the taxation press. There is only one obvious explanation for this apparent dichotomy and that is that all tax avoidance is discreetly hidden, and the accounting rules that apply to these companies allow for this to happen.

Alternative analysis is, therefore, needed, in particular to work out how much of this expectation gap with regard to tax relates to the UK. This exercise is hindered, yet again, by the way in which these companies report. It is not obligatory for a UK based company to disclose what its activities are in the UK, even if incorporated here. It has only to do so if they are 'material' (which is accounting speak for relevant) to an understanding of its accounts. Roughly half the sample surveyed do make disclosure of their UK activities but those that do tend to be the smaller companies. This clearly hinders analysis, and is a major impediment to understanding the contribution these companies make to the UK economy. In itself this is a powerful reason for suggesting that country-by-country based reporting would add enormous value to these accounts[33].

Based on data from those that do make such declaration, 52.5% of all employees worked in the UK, 41.9% of profits were in the UK and 41.6% of their tangible assets were UK located. It is very difficult to make profit without these three essential business components being present, and there is a theory of international taxation that suggests that profits should be allocated to countries in accordance with the weighted average of these three present in that state rather than on the basis of

[33] See http://www.taxresearch.org.uk/Documents/CountrybyCountryReporting.pdf accessed 22-11-07 for more on this theme

the accounting profits that a company decides to allocate to a particular country. This basis of taxation is called unitary taxation and if it was to apply to this data it would suggest 45.4% of the profits of the companies surveyed should be allocated to the UK.

Based on data for tax paid though this is not happening. Almost all the companies in the survey did disclose the split in their tax liability between that arising in the UK and that arising elsewhere and the ratio is markedly different: 27.1% of current tax charges disclosed by these companies are declared as arising in the UK. Since profit is not analysed at this level this has to be the best indication of profit allocation available.

Just to complicate matters further, when this same ratio was calculated for those companies that had provided an analysis of UK employees, sales or assets the situation becomes even harder to interpret. In the case of both staff and sales the ratios of UK tax paid to total tax paid were lower than the ratio of UK staff to total staff and UK sales to total sales, and both by several percentage points. This reversed though when it came to assets, where asset holdings in the UK where higher in proportion to total assets than was the ratio of UK tax paid to total tax.

What all these differences indicate is the presence of tax planning: profits are under-declared in the UK compared to economic activity being undertaken but assets are higher in the UK than expected because the UK has a well known and liberal tax regime when it comes to the deduction of interest from profits which encourages the location of assets in the UK to attract interest relief on the cost of financing them, so disproportionately reducing UK taxes.

What is not clear though due to the incomplete nature of the sample is how significant overall this trend is. What is clear though is that UK companies appear to be shifting profits from the UK for tax purposes, or are exploiting the UK tax system to pay lower taxes than they might elsewhere in the world, or both, a process assisted by not being required to give indication as to overall what proportion of profits relate to the UK.

That proportion must then be estimated in another way. The following table shows the previously noted current tax rate of the sample companies when compared to their pre-goodwill profits; the same ratio for dividends (having eliminated those with rates in excess of 100% to reduce statistical aberrations) and the deduced approximate rate of profit retention by the companies in question:

Table 8		2000	2001	2002	2003	2004	2005	2006
Current tax rate of sample companies	%	26.1	26.7	20.7	26.3	24.0	22.0	22.5
Dividend payment rate	%	34.0	40.8	30.7	38.0	32.7	27.8	26.3
Retention rate (by deduction)	%	40.0	32.5	48.6	35.7	43.3	50.2	51.2

The significance of dividend payments is that these are likely to pass through the parent company and within this sample this is likely to mean that these sums should be subject to UK taxation. On average dividends represented 32.9% of pre-goodwill profits in this period and taxes represented 24.1% of the same profit. The grossed up (i.e. pre tax) value of dividends paid was therefore, using this tax rate, 43% of total profit (further degrees of accuracy being irrelevant in such an estimate). This, by chance, is not dissimilar to the 45.4% that a unitary allocation of profit, noted above, suggested should be paid in the UK. A figure of 44%, being a compromise between the two, will therefore be used for this purpose as the best estimate available of profits that should be declared in the UK by the companies surveyed.

If that is the proportion of profit attributable to the UK within the sample, the UK tax gap for these companies might be as follows:

Table 9		2000	2001	2002	2003	2004	2005	2006
Pre Goodwill profits of top 50 companies	£'m	74,665	74,996	71,546	97,459	122,506	152,665	172,919
% tax gap	%	3.9	3.3	9.3	3.7	6.0	8.0	7.5
Difference	£'m	2,947	2,447	6,649	3,583	7,292	12,234	12,939
Attributable to UK	44%	1,297	1,077	2,926	1,576	3,208	5,383	5,693

An expectation tax gap of £5.7 billion might arise from these companies alone in the UK, and that gap is increasingly significantly over time. This represents a UK effective rate of loss of approximately 33% of expected tax given that the companies in question declared £11.5 billion of UK tax liability in 2006. This is higher than the overall rate of loss suggesting that these companies whilst located in the UK are in fact effectively managing the relocation of their profits from this country to other locations where the tax rate is lower, a trend that is certainly consistent with strong, consistent and similar trends found in the USA[34] and with the evidence of individual company behaviour noted above.

Extrapolating this data to the rest of the UK requires some further consideration. First of all, it is unlikely that the same opportunities for tax planning are available to small companies as are available to large ones. They are more likely to tax evade, and HM Revenue & Customs data suggests that they do partake in this activity which is, however, beyond the scope of this report.

Extrapolation of the sample result across all companies is not, therefore appropriate. Extrapolation across all large companies is, however possible. These

[34] In 2004 Former US Treasury Economist Martin Sullivan noted in Tax Analysts in the USA that U.S. multinational corporations were increasingly shifting tens of billions of dollars of their profits to such tax havens as Bermuda, Ireland, Luxembourg and Singapore, keeping those profits from U.S. tax collectors. He found that profits of foreign subsidiaries of U.S. corporations in 18 tax havens increased from $88 billion in 1999 to $149 billion in 2002. http://www.taxanalysts.com/www/pressrel.nsf/Releases/4BD31CEDCC0DB2A385256F180060FC65?OpenDocument accessed 12-11-07

companies are approximately 700 in number for corporation tax purposes and have their affairs managed by the Large Business Service of HM Revenue & Customs, about whom the National Audit Office issued a report in July 2007[35].

In 2006-07, HM Revenue & Customs raised £44.3 billion in Corporation Tax, of which £23.8 billion came from those businesses within the Large Business Service. In 2006 the companies in this survey declared UK current tax liabilities of £11.5 billion, or just under half the total tax managed by this unit. That this might be commonplace may be indicated by the fact that, as the NAO report noted, in 2005-06 around 220 businesses whose affairs were managed by the Large Business Service paid no Corporation Tax and a further 210 businesses each paid less than £10 million. Some would appear to be in the companies surveyed in this report. Others clearly cannot be, but given this preponderance of companies not paying corporation tax at all and the individual examples provided above that this need not suggest limited economic activity in the UK, it seems reasonable to extrapolate the tax loss from the sample survey across the entire payment of corporation tax made by large companies in the UK. If this is done the total corporation tax loss might be some £11.8 billion. This is an increase from £9.2 billion, which was the estimate made the last time a similar exercise to that undertaken here was completed, relating to the period to 2004[36].

As a proportion this may be the highest gap of all. Much may be due to legitimate tax planning, but by no means all is. The disproportionate size of the UK gap suggests significant avoidance is taking place too. Guessing a split is, however, to apportion what cannot be allocated: the data to undertake this calculation is not available.

[35] http://www.nao.org.uk/publications/nao_reports/06-07/0607614.pdf accessed 12-11-07
[36] http://www.taxjustice.net/cms/upload/pdf/Mind_the_Tax_Gap_-_final_-_15_Jan_2006.pdf accessed 12-11-07

Technical Appendix 5

Savings calculations

The total cost of tax avoidance is £25 billion. The total cost of tax planning by those earning over £100,000 is £8 billion.

- One half of the amount lost to tax planning alone by those earning over £100,000 could increase the child tax credit by enough to halve child poverty in the UK.

According to a study by the Institute of Fiscal Studies[37] and one by the Joseph Rowntree Foundation[38], it will cost between £4 billion and £5 billion p.a. to increase the child tax credit by a proportion significant enough for the Government to stand a chance of meeting its target of halving child poverty in the UK by 2010.

- Just under half of the total amount lost to tax avoidance would pay for a 20% increase in the state pension or could reduce the basic rate of income tax by 3p in the pound, or could build an extra 50 hospitals.

The cost of state pensions was £53.6 billion in 2006/07 [39]. A 20% increase would cost approximately £11 billion.

The cost of reducing the basic rate of income tax by 1p is about £4 billion on average [40]. So the cost of a 3p cut would be about £12 billion.

There is no fixed price for a hospital, but the price of current PFI funded hospitals suggests an average cost of approximately £200 million a hospital[41]. Thus the cost of building fifty new hospitals would be approximately £10 billion.

- One quarter of the total tax income lost to avoidance activities would be enough to provide five-and-a-half million public service staff, who are currently facing the prospect of a real terms pay cut, with a pay settlement equivalent to the rise in average earnings across the economy in 2007.

The public sector pay bill in 2005-06 was £138 billion[42]. Average earnings increased by 4% in 2007[43]. So it would cost approximately £5.5 billion to increase public sector pay in line with average earnings.

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[37] http://www.ifs.org.uk/bns/bn73.pdf
[38] http://www.jrf.org.uk/bookshop/eBooks/9781859355008.pdf
[39] http://www.dwp.gov.uk/publications/dwp/2007/res_acc/report_2006_07.pdf note 16a
[40] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-6.pdf table 1.6
[41] See, for example, http://www.guardian.co.uk/society/2007/feb/27/hospitals.health
[42] According to a study by Oxford Economics http://www.cbi.org.uk/ndbs/Press.nsf/38e2a44440c22db6802567300067301b/2273bad679b4265f802573a8003780dd?OpenDocument

• Just over a quarter of the total amount lost to tax avoidance could be used to increase the education budget by 10% or to increase the health budget by 6%.

The total UK education budget is £78 billion for 2007-08[44]. A 10% increase would require £7.8 billion.

The total public sector health budget is £104.8 billion for 2007-08[45]. A 6% increase would require £6.2 billion.

• Half of the total amount lost to tax avoidance could raise the level at which the higher rate tax is paid by £10,000.

It would cost £2.5 billion to £3 billion to change the basic rate limit by 10%[46]. In 2007-08 the basic rate band runs to income of £34,600. £10,000 is therefore about 30% of this. However, we cannot assume an even extrapolation. We have been generous and assumed it will rise as the band is extended although it could be argued as the number of taxpayers affected will fall it will decrease. We have therefore multiplied the government figure for 10% upward change in the upper band by 5 to allow for this and can still use half of the figure for tax avoidance to achieve this. The estimate is cautious.

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43 http://www.statistics.gov.uk/cci/nugget.asp?id=10
44 http://www.hm-treasury.gov.uk/pbr_csr/report/pbr_csr07_repindex.cfm
45 http://www.hm-treasury.gov.uk/pbr_csr/report/pbr_csr07_repindex.cfm
46 http://www.hmrc.gov.uk/stats/tax_expenditures/table1-6.pdf

Technical Appendix Glossary

Aggressive tax avoidance	The use of complex schemes of uncertain legality to exploit taxation loopholes for the benefit of taxpayers who can afford the fees charged by professional advisers who create such arrangements.
Arms length pricing	See transfer pricing
Capital gains tax	A tax on the profits from the sale of capital assets such as stocks and shares, land and buildings, businesses and valuable assets such as works of art.
Charitable trust	A trust established for purposes accepted by law as charitable.
Company or corporation	An entity treated as a separate legal person from those who set it up, established under the rules of the country in which it is registered.
Coordination centres	A special form of company with taxation advantages, often used to attract corporate headquarters to a country. Most notably found in Belgium, the Netherlands and Ireland.
Corporation tax	A tax on the profits made by limited liability companies and other similar entities in some countries, but otherwise usually being similar in application to income tax.
Deferred tax	A fictional tax which only exists in company accounts and is never paid. Deferred tax does not, as such, exist. But the rules of accountancy generally require that income be matched with expenses. If an expense is recognised for tax purposes more quickly than it is for accounting purposes (which is common with much plant and equipment) this means that the tax cost for the years when this happens are understated. Conversely, when all the tax allowances have been used on the assets there might still be accounting charges to make and the tax cost would then be overstated. To balance this equation a notional tax charge called deferred tax is charged to the profit and loss account in the earlier years and put on the company's balance sheet as a liability. The liability is released as a credit to profit and loss account in the later years and supposedly over the life of the asset all should balance out.
Discretionary trusts	Most offshore trusts permit payments to be made at the discretion of the trustees, which means that the identity of beneficiaries can remain a secret. In practice, trustees normally follow a "letter of wishes", provided by the settlor, instructing them whom they are to pay money to, when and how.
Domicile	The country identified as a person's natural home, even if that person has not been resident there for extensive periods of time. This concept, which is almost uniquely British and

	unknown in the tax law of other countries bar Ireland, says that a person acquires their father's domicile on birth if their parent's were married and their mother's if not. This means a person born in the UK can have a natural home in another country even if they have never lived there so long as they, or their parents before they reached the age of 18 took no steps to prove that they intended to live in the UK forever and that they had severed all contact with their previous natural home. Because the UK does not wish its citizens to lose their UK domicile, which does, for example, theoretically mean that their estates remain subject to Inheritance Tax even if they left the UK for some time before dying, the government also makes it quite hard for a person to acquire UK domicile. Harder, in fact, than becoming a citizen in most cases, a concept to which it has no relationship.
Double tax relief	Tax relief given by the country in which the tax payer resides for tax paid in another country on a source of income arising in that other country.
Double tax treaty	An agreement between two sovereign states or territories to ensure, as far as possible, that income arising in one and received in the other is taxed only once. Includes rules to define Residence and Source, and limits on Withholding Taxes. Also usually includes provisions for cooperation to prevent avoidance, especially information exchange.
Effective tax rate	The percentage of tax actually paid in relation to the total income of the person paying the tax.
Flat tax	A tax system in which as income increases above an agreed tax free sum the amount of tax paid remains constant in proportion to total income. Compare with progressive taxes.
General anti-avoidance principle	A law that seeks to prevent a tax payer from obtaining the taxation benefit arising from any transaction if they undertook it solely or mainly to obtain a tax benefit. If they did they lose that benefit. Interpretation of intention is the key to the effectiveness of this principle. As a result it does not need to be updated for changes in other tax laws, making it enduring and effective.
General anti-avoidance rule	A general anti-avoidance rule seeks to tackle those who try to break the rules of taxation through the use of further rules. Rather than considering intention, it lays downs ways of interpreting a series of events to determine whether the benefit of tax legislation can be given to the tax payer. Because rules are invariably open to interpretation a general anti-avoidance rule runs the risk of increasing the opportunity for abuse.
Holding companies	A company that either wholly owns or owns more than 50 percent of another company, the latter being called a subsidiary. An intermediate holding company is a holding

	company which has one or more subsidiaries but is itself owned by another company. The term 'ultimate holding company' refers to the one that is finally not controlled by another company.
Horizontal equity	One of the two measures of the inherent justice within a tax system. Horizontal equity requires that those with similar income pay similar tax. The second measure is that of vertical equity (see below). These equitable principles are considered paramount in a just tax system. When tax planning interacts with them it too has to be the subject of consideration.
Income tax	A tax charged upon the income of individuals. It can also be extended to companies, but is not in the UK. The tax is usually charged upon both earned income from employment and self employment and unearned income e.g. from investments and property.
Inheritance tax	A form of gift tax charged upon the estates of people upon their death.
Limited liability partnerships (LLP)	A partnership that provides its members with limited liability.
Loophole	A technicality that allows a person or business to avoid the scope of a law without directly violating that law.
National insurance contributions	See social security contributions. Often called NIC.
Offshore	Offshore relates to any jurisdiction (regardless of whether they are islands) which provides tax and regulatory privileges or advantages, generally to companies, trusts and bank account holders on condition that they do not conduct active business affairs within that jurisdiction. The term "offshore" is very broad and normally includes "onshore" tax havens such as Andorra, Lichtenstein, etc. The IMF considers the UK to be a tax haven.
Offshore financial centre	Although most tax havens are Offshore Finance Centres (OFCs) the terms are not synonymous. Tax havens are defined by their offering low or minimal rates of tax to non-residents but may or may not host a range of financial services providers. An OFC actually hosts a functional financial services centre, including branches or subsidiaries of major international banks. States and microstates that host tax havens and OFCs dislike both terms, preferring to use the term International Finance Centres.
Partnerships	Any arrangement where two or more people agree to work together and share the resulting profits or losses.
Payroll taxes	See social security contributions.
Private company	A company not quoted on a stock exchange. Shares cannot usually be sold without the consent of the company or its owners; in many countries little or no information need be

	disclosed on the activities of such companies even though their members enjoy the benefit of limited liability.
Progressive taxes	A tax system in which as income rises the amount of tax paid increases in proportion to the income as well as in absolute amount i.e. the percentage tax rate increases as the income rises. Also referred to as Graduation. Compare with flat and regressive taxes.
Public company	A company whose shares are quoted on a recognised stock exchange and are available to be bought and sold by anyone who wishes without consent being required from the company itself. Generally required to be more transparent than private companies.
Quoted company	See public company.
Regressive taxes	A tax system in which as a person's income from all sources increases the amount of tax they pay reduces in proportion to their income even if it increases in absolute amount i.e. their percentage tax rate falls as their income goes up. Compare with progressive taxes and flat taxes.
Residence	For an individual, the person's settled or usual home; for simplicity a presumption may be applied based on a rule-of-thumb, such as presence within the country for six months or 183 days in any tax year. It may be possible to be resident in more than one country at one time (though double tax treaties aim to prevent this). Some individuals may also try to avoid being resident anywhere. For companies, residence is usually based on the place of incorporation but can also be where the central management and control of the company is located, if they are different. Tax haven companies formed for non resident owners are usually defined not to be resident in their country of incorporation.
Social security contributions	Payments made towards a fund maintained by government usually used to pay pension and unemployment benefits. Health benefits are sometimes covered as well. Social security contributions are generally considered to be taxes.
Stamp duty	A tax on the value of contracts. Usually charged on contractual dealings on shares and other stocks and securities and on dealings in land and property.
Subsidiary company	A company 50% or more owned by another company which is its parent company.
Tax avoidance	The term given to the practice of seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud). The term is sometimes used to describe the practice of claiming allowances and reliefs clearly provided for in national tax law. It is, however, now generally agreed that this is not tax avoidance. If the law provides that no tax is due on a transaction then no tax can have been avoided by undertaking it. As such this practice is now generally seen as

	tax planning. So what the term tax avoidance now usually refers to is the practice of seeking to not pay tax contrary to the spirit of the law. This is also called aggressive tax avoidance. Aggressive tax avoidance is the practice of seeking to minimise a tax bill whilst attempting to comply with the letter of the law while avoiding its purpose or spirit. It usually entails setting up artificial transactions or entities to recharacterise the nature, recipient or timing of payments. Where the entity is located or the transaction routed through another country, it is international avoidance. Special, complex schemes are often created purely for this purpose. An avoidance scheme which is found to be invalid entails repayment of the taxes due plus penalties for lateness.
Tax base	The range of transactions that a country chooses to tax. A broad base includes a wide range of transactions. A narrow base includes relatively few transactions.
Tax competition	This is the pressure on governments to reduce taxes usually to attract investment, either by way of reduction in declared tax rates, or through the granting of special allowances and reliefs such as tax holidays or the use of export processing zones. Applies mainly to mobile activities or business, but the competition to attract investment may result in an overall decline of corporation tax rates and in the amounts of corporation tax paid, often resulting in an increased burden on individuals.
Tax compliance	A term that is acquiring a new use. It can mean payment of tax due without engaging in tax avoidance or evasion. It is also now being used in contrast to the terms tax avoidance and tax evasion. Tax compliance in this context is used as a test of a person's intention before they undertake a transaction. It asks whether the person is seeking to comply with the spirit of the legislation concerning the transaction into which they are entering. If they are, then it should be presumed their intent was to be legal. If they are seeking to comply with the letter but not the spirit of the law (and it is usually possible to determine this from the form the transaction takes) then it should be presumed their intent was to break that law, the onus of proof otherwise falling upon them. This test is then used in connection with a general anti avoidance principle to determine whether that principle should be applied to a transaction, or not. A person who has used an appropriate motive is "tax compliant".
Tax evasion	The illegal non payment or under-payment of taxes, usually by making a false declaration or no declaration to tax authorities; it entails criminal or civil legal penalties.

Tax haven	Any country or territory whose laws may be used to avoid or evade taxes which may be due in another country under that country's laws. The Organisation for Economic Cooperation and Development defines tax havens as jurisdictions where: - non-residents undertaking activities pay little or no tax; - there is no effective exchange of information with other countries; - a lack of transparency is legally guaranteed to the organisations based there; - there is no requirement that local corporations owned by non-residents carry out any substantial domestic (local) activity. Indeed, such corporations may be prohibited from doing business in the jurisdiction in which they are incorporated. Not all of these criteria need to apply for a territory to be a haven but a majority must.
Tax non-compliant	A person who is not seeking to be tax compliant.
Tax planning	A term used in two ways. It can be used as another term for tax compliance. When, however, tax legislation allows more than one possible treatment of a proposed transaction the term might legitimately be used for comparing various means of complying with taxation law.
Tax shelter	An arrangement protecting part or all of a person's income from taxation. May result from pressures on government or a desire to encourage some types of behaviour or activity, or may be a commercial or legal ruse, often artificial in nature, used to assist tax avoidance.
Transfer-pricing	A transfer pricing arrangement occurs whenever two or more businesses (whether corporations or not) which are owned or controlled directly or indirectly by the same people trade with each other. The term transfer pricing is used because if the entities are owned in common they might not fix prices at a market rate (or what is called an arms-length price) but might instead fix them at a rate which achieves another purpose, such as tax saving. If a transfer price can be shown to be the same as the market price then it is always acceptable for tax. What are not acceptable for tax purposes are transfer prices which increase the cost or reduce the sales value in states which charge higher tax rates and increase the sales value or reduce the costs in states with lower tax rates. The difficulty for many corporations at a time when over 50% of world trade is within rather than between corporations is that there is no market price for many of the goods or services that they trade across national boundaries because they are never sold to

	third parties in the state in which they are transferred across national boundaries within the corporation. This gives rise to complex models in which attempts are made to allocate value to various stages within the supply chain within a company, which process is open to potential abuse. For this reason it is argued that such firms should be taxed on a unitary basis.
Transnational corporations (TNCs)	A corporation with subsidiaries or divisions in two or more nations. Also known as multinational corporation (MNC).
Trusts	A trust is formed whenever a person (the settlor) gives legal ownership of an asset (the trust property) to another person (the trustee) on condition that they apply the income and gains arising from that asset for the benefit of a third person (the beneficiary). Trusts can be established verbally but typically take written form. Trustees are frequently professional people or firms charging fees. Trusts are usually of one of three types: • discretionary trust • charitable trust • interest in possession trust.
Trustees	The people who hold the legal title to assets held in a trust and administer it.
Trust beneficiary	Anyone who may obtain a benefit from a trust. A person who has the right to a benefit has an 'interest in possession'; a discretionary beneficiary can get income or benefits only when and if the trustees decide to pay it to them.
Trust settlor	The person who establishes a trust by gifting assets to it.
Unitary basis	Treating the income of related entities within a single firm or corporate group on a combined or consolidated basis, and applying a formula to apportion it for taxation by the different countries or territories from which it derives. Each may apply the rate of tax it wishes. It has been used in federal countries such as the USA, applying an allocation formula based on a ratio of sales, employment costs and assets employed within each state. It has been opposed by tax authorities (and TNCs) because they consider that it would be too difficult to reach international agreement especially on the formula. However, taxation of highly integrated TNCs may in practice entail a formula-based allocation of profits, due to the difficulty of finding appropriate arm's length transfer prices.
Value Added Tax	Known as VAT. A value added tax is charged by businesses on their sales and the supply of services. It allows those same businesses to claim credit from the government for any tax they are charged by other businesses incurred by them in the course of their trade. The burden of VAT therefore falls almost entirely on the ultimate consumers. VAT is a regressive tax since lower income households always spend a higher

	proportion of their income on consumption and therefore invariably spend a greater proportion of their income on this tax than do the better off. Because of the role of VAT in the economy, income and other taxes have to be progressive to ensure that the tax system as a whole is equitable.
Vertical equity	One of the two measures of the inherent justice within a tax system. Vertical equity requires that those with higher income pay proportionately more tax. The second measure is that of horizontal equity (see above). These equitable principles are considered paramount in a just tax system. When tax planning interacts with them it too has to be the subject of consideration.
Wealth tax	A tax on a person's declared wealth, typically imposed annually at a very low rate. Once commonplace in Europe these are now little used since they are thought to encourage people to hide assets offshore.
Withholding tax	Tax deducted from a payment made to a person outside the country. Generally applied to investment income, such as interest, dividends, royalties and licence fees.