

IFS RESIDENTIAL CONFERENCE 2016 – CORPORATE TAX AVOIDANCE: WHERE NEXT FOR POLICY AND PRACTICE?

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The annual IFS Residential Conference was held on 9-10 September, 2016 at Magdalen College, Oxford. This was organised with the support of the Chartered Institute of Taxation (CIOT), the Economic and Social Research Council (ESRC), and the Tax Journal. Speakers and delegates from academic institutions, government departments, NGOs and the tax profession were welcomed by Malcolm Gammie (QC, IFS Tax Law Review Committee and One Essex Court) and Paul Johnson (IFS).

The focus of first day of the conference was primarily on the UK context. The first plenary session, chaired by Helen Miller (IFS), was dedicated to the design and assessment of measures to stop tax avoidance. The agenda for the panel was stated as follows:

There have been many new anti-avoidance measures in recent years. This panel will explore what we know about how effective such policies have been to date, and whether policy – including the use of soft law – is moving in the right direction. An overarching question is whether assessments of past and proposed policies are fit for purpose, including to what extent they form the basis for designing more effective laws.

Surjinder Johal, from the Office for Budget Responsibility (OBR), revealed that the OBR has evaluated 59 anti-avoidance and operational measures announced since 2010, and concluded that there were more underperforming than over-performing measures. The number of anti-avoidance measures has been increasing since 2012. The cost-benefit analysis is characterised by high uncertainty - up to 74%, as estimated by the OBR - with a large proportion coming from the behavioural uncertainty. Continuing on this topic, John Whiting, from the Office for Tax Simplification (OTS), spoke about the effectiveness of anti-avoidance measures, and the links between the complexity of tax law and tax avoidance. One of the key recommendations of the research carried out by the OTS refers to tax policy design: it should not incentivise avoidance, for example, by tax rate differentials. The OTS research also suggests that tax law complexity can encourage avoidance.

Bill Dodwell (CIOT & Deloitte) talked about the role of the “soft law” in countering tax avoidance. He used two examples: the OECD guidelines on transfer pricing; and the EU Code of Conduct on harmful tax practices, such as the diversion of taxes by large multinational corporations (MNCs). A global forum on transparency could play a role in policing international agreements that are not part of legislation for some countries. Gentle enforcement of the “soft law” could be achieved by peer review, for example, of a country's tax collection methods or its ability to provide tax data on request. One way of influencing the behaviour of corporate taxpayers could be the publication of “tax strategy” by large companies. However, companies that are less in the public eye are likely to be less influenced.

In opposition to these practices, the General Anti-Abuse Rule, or GAAR, is “hard law”, and was discussed in a subsequent presentation by Patrick Mears (GAAR Advisory Panel), who

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spoke about the role of the Advisory Panel as a safeguard against an over-zealous tax authority, and the impact on taxpayers and the promoters of tax avoidance schemes.

Jennie Granger (HMRC) emphasised that voluntary compliance is strong in the UK, but more needs to be done to close the 6.4% tax gap. She outlined the importance of the behavioural insights and customer-based approach to compliance. One recent change introduced by the HMRC is the Accelerated Payment Notice (APN), which requires that taxpayers pay the avoided tax in full and then can challenge the decision in court. This has led to a £3 billion revenue increase, and all 5 GAAR cases that have been to court have been won by HMRC. Furthermore, HMRC publicises the cost of being involved in tax avoidance schemes, which deters taxpayers from taking risks. Another development is a shift in public attitudes: the focus is now on fairness, rather than the issue of legality, which means that aggressive tax planning activities may impact on the reputations of the businesses undertaking them.

The session concluded with a panel discussion, during which the conference participants asked questions and commented on issues raised in the presentations, such as: the accuracy and the components of the tax gap measure; the definition and the size of legal tax avoidance; the design of a good GAAR (with some discussion of the features of the Scottish GAAR); and the role of consultations between tax authority and taxpayers.

The keynote speech was delivered by Jane Ellison MP, Financial Secretary to the Treasury. She talked about the role of the tax system in creating a productive environment for businesses in the UK and helping them to succeed. She also emphasised the strong tax morale in society - the latest surveys have shown that more businesses believe that not paying tax is unacceptable - and the necessity to distinguish between competitiveness and unfair advantage in tax treatment. She also spoke about the importance of consultations and the effect of APNs on tax revenues. Questions and comments from the audience concerned: the review of the anti-avoidance provisions; tax exemptions and tax reliefs; the challenges of tax simplification; the post-Brexit opportunities for the UK; and importance of balancing the language and the context in the discussion of the tax gap (e.g. the tendency for “big company” to become a pejorative term).

The second plenary session, chaired by Heather Self (Pinsent Masons), focussed on what drives decisions, and included presentations from the HMRC and large corporate taxpayers. The agenda stated:

Governments seek to shape the tax environment, including through legislation and regulation, while responding to the behaviours of businesses and the actions of other governments. Businesses in turn respond to government actions, but also to the demands of boards, investors and customers. This panel asks what drives the tax decisions of government and businesses. How do incentives differ, how are they shaped and how are they changing? The discussion will pick up on the role of institutions, including the audit committee and professional bodies, and on the effect of attempts to define and implement ‘responsible tax’ practices.

Jim Harra (HMRC) spoke about the drivers of taxpayers’ decisions not to evade or avoid tax, such as social norms, as well as the detection and intervention by the tax authority and the reaction of public. He emphasised the importance of strengthening the social norm of compliance and public transparency, the link between the “Tax in the Boardroom” initiative and corporate social responsibility (CSR), and the related challenges involved in reaching small

businesses. Ian Brimicombe of AstraZeneca's presentation asked the question "Is the relationship between the corporate sector and the tax authority working properly?" He went on to talk about the role of the audit committee in risk management and its increased engagement in tax issues.

John Connors (Vodafone) expressed regret at how the debate on tax and the CSR is not always well informed, and noted the absence of recognition of good practices. Much of the tax avoidance debate is focussed on history, but the environment and attitudes have changed: a significant change, for example, was the introduction of the Disclosure of Tax Avoidance Scheme (DOTAS). In a global economic environment, in which countries compete to attract businesses, and small countries try to remain competitive without the benefits of large consumer and workforce bases, ensuring that rewards from outward investment are not penalised and that entrepreneurial activities are not distorted by tax are important issues for governments and businesses. Broad-based, efficient tax administration contributes to the stable environment for businesses who wish to avoid unnecessary disputes with the government. John Connors also touched upon the rhetoric of "fair", as opposed to "correct", amounts of tax. He emphasised the importance of economic rationale behind business transactions, and of fostering the culture of cooperative compliance and transparency.

Kate Thomson (BP) talked about BP's approach to tax planning, and the similarities between its risk management methods and those used by AstraZeneca and other corporate taxpayers. Tax cost and fiscal predictability, amongst other factors, play important roles when ranking feasible projects. She spoke about the need for the tax lawmakers to recognise changes in the ways in which value is created, and about the challenges involved in modernising tax law to reflect ongoing changes in technology and consumer behaviour. Other recurring issues were: the need to distinguish legitimate tax planning from illegal tax avoidance; the rhetoric of "illegal" and "immoral" tax behaviour, and the differentiated understanding of what is moral or fair among different groups in a society; and the related issue of the importance of educating the public in order to improve their understanding of the tax system and business activities.

The questions posed and comments made during the panel discussion were about the publicity, transparency and dubious merits of placing large volumes of data about business activities and taxes in public domain when this data may not be directly useful for the tax authority or understood by public. While Jim Harra (HMRC) said that he understood the burden of corporate tax reporting and sympathised with businesses, he called for the corporate world to act together in order to help to improve the public perception of their activities. Kate Thomson (BP) and Ian Brimicombe (AstraZeneca) mentioned the misplaced focus of public attention on corporation tax while issues such as, for example, BP's multi-billion investment in capital-generating operations in the North Sea and AstraZeneca's contributions to pensions were ignored. Other questions and comments concerned: country-by-country reporting and ways in which it could be improved, given that large companies have only global tax strategies; changes in the tax law improving the alignment of the NIC rates and transparency in income tax; the need for the tax authorities to be more transparent with their calculation of the "reasonable" tax due; and the feasibility of a "clearance" system, whereby the legality of a tax scheme is known in advance.

Discussion of various issues continued at five parallel breakout sessions. John Cullinane (CIOT) and Ian Young (ICAEW) chaired two parallel sessions on tax avoidance, and the professional standards applying to tax agents and advisers. Gareth Myles (University of Exeter/TARC) and Helen Miller (IFS) chaired two parallel sessions about trends in anti-

avoidance policies. Gary Coombs (HMRC) chaired a session about changes in taxpayers' attitudes.

The sessions on anti-avoidance policies focussed on the effectiveness of these policies, the balance between hard and soft law, and future developments. One issue raised in the discussions was that of the timeliness of legislation: the court cases in the focus of the debate are 10 to 15 years old, so is legislation currently being brought in to deal with behaviour that has already changed? Another important question was about level playing fields: while European corporate tax directors are concerned with reputation and social responsibility in tax matters, American CFOs are explicitly instructed to minimise tax. The US government promotes and subsidises their multinationals who avoid paying tax in Europe. The right amount of tax, in the US understanding, is the smallest amount possible. While tax strategy in the US is to minimise tax, for corporate taxpayers in the UK, for example, the tax strategy amounts to "doing everything not to be criticised". It is difficult for British politicians to say that, by and large, the multinationals pay the right amount of tax. Cultural and political differences in attitudes make it difficult for companies to have global tax strategies - whether or not a company's financial strategy should be based on the tax system is questionable.

An interesting discussion revolved around the purpose test, or economic substance doctrine, as a philosophical concept: is it possible to have an objective test of subjective intention? Was the OECD's BEPS initiative caused by public discontent, or was it a natural evolution of the national tax systems into international coordination? What is the right balance of responsibilities between advisors, corporations and governments? The debate about future developments focussed on: uncertainty; the questionable necessity of GAARs; the growing complexity of tax laws: reasonable justification of tax reliefs as means to support certain economic activities, instead of direct spending programmes, for political reasons.

In the evening plenary session, Edward Troup, the Executive Chair and First Permanent Secretary (HMRC), delivered a keynote speech titled "Reflections on avoidance: From Bede to Wittgenstein and back again". It started with a historical excursion which took us as far back as the year 731, when Bede complained about "false monasteries" which, in reality, served the "own desires of laymen", thus abusing the law. The speaker also discussed Adam Smith's quote on "bounties" (subsidies) to fisheries (similar to business expansion schemes) and Wittgenstein's 1921 quote: "the limits of my language mean the limits of my world". There were more quotes about words and their meanings, with an interesting excerpt from Samuel Johnson's dictionary, which defined excise as a "hateful tax".

According to the speaker, however, in the UK, the current attitude to paying tax is remarkably strong: about 90% of tax is paid, some 3% is enforced, and about 7% is lost in the tax gap. He went on to talk about a change in attitude, especially among the corporate taxpayers, where the language of "impose" has been replaced by "contribute". The final quotes in the talk referred, once again to Bede and to the Bible, and mentioned various punishments for the sin of greed, in the context of the deterrence measures.

The talk was followed by a brief discussion between Edward Troup and Paul Johnson (IFS). One question raised was whether the cause of the change in the tax culture was as a result of campaigning, Margaret Hodge, or the work carried out by the HMRC: the answer was that it was a greater awareness of the taxpayers about how they were part of the society, and of how taxes represented a shift of resources from one set of people to another, rather than from people to the state. A discussion also took place about the role of the HMRC and the government in

cases where it has been emphasised that the authorities should relentlessly go out with information about the work of corporations and wealthy individuals (such as famous footballers stars and film-makers), and how communication and explanation are important parts of this work.

The second day of the conference was dedicated to international issues. The keynote speaker, Stephen Quest (DG Taxation and Customs Union, European Commission), outlined Brussels' perspective on tax avoidance issues. He mentioned economic and financial crisis, migration, security concerns, and Brexit as a backdrop for the debate, and talked about the frictions between the modern economy and the international tax law designed in the past. One positive development within the international scene is that coordination has become an accepted approach: more than 100 countries have signed up to the BEPS initiative, and a new political appetite for working together on corporate taxation has emerged amongst EU countries. There have also been visible changes in pace: new legislation is passed within months and weeks. The speaker emphasised how important it was for the member states to coordinate their actions in order to protect their tax bases and thus to reinforce the sovereign rights eroded by tax competition and tax avoidance. He also talked about what he identified as the two drivers behind the current process: social justice and fairness, and economic growth and prosperity. Transparency is seen as essential for fair taxation; however, not all countries show support for country-by-country reporting. As the natural next step, he mentioned transparency in beneficial ownership (following the "Panama Papers" revelations) and for tax advisers. Growth is important: anti-avoidance does not mean anti-business; businesses need simplicity, certainty and level playing fields. Simplicity can be achieved by coordination within the EU; certainty comes from using a binding EU law, rather than soft law; and the level playing field is achieved by ensuring that tax burdens on local companies are the same as on the multinationals (currently estimated as 30% higher for locals).

According to the speaker, another step that the EU could take would be to implement a single, simple, effective tax system, with the uniform corporate tax base. The Common Consolidated Corporate Tax Base (CCCTB) will eliminate cross-border losses, reducing compliance costs by at least 2.5% and possibly by as much as 10%. Double-taxation and related disputes will be eliminated, and simple resolution procedures will be in place for the remaining disputes. By focussing on fairness and tax system efficiency, a transparent common corporate tax rate will eliminate tax competition. It is important to ensure that tax does not distort investment: it is necessary to remove debt bias and to encourage equity investment. Finally, research and development can be encouraged by using tax incentives. All of these can be implemented in two stages: the first - and easiest one - is to establish a common tax base, and the second is to transform it into a consolidated tax base. While talking about new challenges, the speaker mentioned the digital economy, the sharing economy and the virtual economy.

The questions put to the speaker from the conference participants and the ensuing discussions concerned: the conflict between the transparency in beneficial ownership and privacy in tax; the assertion that the EU and the ECJ were disruptive forces, especially with regard to tax policy and the role of the UK in shaping the international agenda; the possibility of higher taxes on the digitized EU businesses pushing these businesses outside the EU; the EU's business interests in Asia and Africa, and the corporate tax base without consolidation; and the differences in the way in which the CCCTB was being implemented by EU member states.

The third plenary session, chaired by Paul Morton (RELX), was dedicated to the topics of international institutions and new directions in policy. The aim of the session was to:

...address the key questions in international tax, including: after the BEPS agenda and proposals by the European Commission, where next for international coordination? Do we need a global tax body? How will the UK respond to international developments, and to what extent are policy choice constrained by other governments' actions? What are the views in favour and against the use of state aid rules in tax matters and how does competition policy interact with tax policy?

Jon Sherman (HMRC) spoke about the key role that the UK government played in the BEPS initiative in 2013, especially in terms of engaging with businesses. He outlined a number of HMRC developments, including the digital economy project, operational and policy collaboration, and capacity building in the developing countries with the Department for International Development (DfID). Commenting on BEPS, Paul Morton (RELX) pointed out that a concrete set of deliverables emerged after only two years of negotiations, thanks to active participation of tax authorities, and, primarily, the HMRC.

Diarmid O'Sullivan (ActionAid) started by providing delegates with basic information about his organisation, a development charity which works in 40 countries, and whose main concern is with poverty, especially among women and girls. He spoke about the central place of corporation tax in low-income developing countries (the source of 16% of total revenues, compared with 8% in the developed countries) because of inability to collect income tax. Thus, developing countries are more vulnerable to changes in taxation in other countries, but have little say on a global level; even the key decisions about BEPS were made before the developing countries joined in. According to the speaker, the anti-avoidance clauses "copied and pasted" in international tax treaties do not account for taxing rights and larger developing countries will inevitably come up with their own versions; hence, the necessity of a global institution. The interests of China, India and Brazil are not the same as, for example, the interests of African countries, and special economic zones may be worthwhile in China but not in Africa. Overall, countries need to move away from tax holidays to non-tax measures and, as a global economic power, the UK has a responsibility in this process.

Conor Quigley QC (Serle Court) spoke on the issue of state aid. While the basic definition of state aid is "the aid granted by state", the European Commission (EC) has offered its own interpretation, especially on tax ruling. The following five criteria apply:

- (1) an intervention by the state equivalent to the deviation from the norm and constituting burden on state resources;
- (2) an economic advantage by the virtue of that measure;
- (3) selectivity, or favouring certain undertakings, while others do not benefit in a similar situation;
- (4) distortion of competition;
- (5) effect on trade.

Overall, these criteria include three types of advantages: economic, selective, and competitive. The question is, does it apply to tax? For example, lower tax rates or tax reliefs, or the discretion of the tax authority might be viewed as state aid. An important distinction in the case of tax ruling is that the assessment process is a norm and not a deviation. For example, a tax authority can agree with multinational corporation (MNC) on a particular split of profits across jurisdictions, but this is not an intervention or deviation. According to the speaker, the EC is

wrong in calling it state aid; the EC interprets any government action as intervention, but there must be a deviation from the norm. This was not, for example, the case in the agreement between Apple and the government of Ireland; other examples mentioned in this context were Starbucks and McDonald's. The repercussions were the recovery issues, whereby other countries were invited to submit claims; however, if a country's claim is based on its own assessment, this should be similarly classed as state aid, as was Ireland's assessment. Also, as a result, everybody can sue for damages from the tax authority for awarding state aid.

Stef van Weeghel (PwC), speaking on "Where Next for International Coordination?" painted a bleak picture: tax competition persists in spite of all talks; tax consequences of tax planning and accommodation for other countries continue; taxpayers and their advisers exploit tax system differences; anti-avoidance measures are not coordinated and lead to a "Not In My Back Yard" (NIMBY) attitude; the public perception is that the MNCs pay no tax, contrary to the facts in several independent reports. There seems to be a crisis of trust in taxation, partly due to lack of available information. With the development of the digital economy, profits will not be raised in EU or OECD countries, and so will not be taxed according to their rules.

Paul Oosterhuis (Skadden) talked about the U.S. perspective. The position of the USA on state aid is less concerned with the legality under the EU law, but more on the retroactivity, and on the international coordination and institutions, with some possible changes in the U.S. law. The U.S. views residual profits as a function of risk. The OECD transfer pricing guidelines are not part of U.S. tax law, although they are, for example, included in the U.S.-Japan treaty. As a result, U.S. multinationals will start moving their employees overseas, or hire locals in order to retain profits and pay low local taxes. Also, a new proposal on taxing destination cash flows causes serious issues with the WTO, but the U.S. may not care about this in the current climate. A comment from Jon Sherman (HMRC) concerned the possibility of tensions caused by the UK perspective on the U.S. position. There was a further brief discussion of the recovery of tax from Apple under Irish law, which has a time limit of 4 years, compared to 10 years under the EC regulation. An alternative interpretation of tax is the debt to the state; Irish parliament would have to pass a new law that differed from the national recovery rule. The speaker agreed that this case has raised a whole range of unique issues.

The wrap-up session, chaired by Malcolm Gammie QC (IFS Tax Law Review Committee and One Essex Court) focussed on the questions: "What are the lessons and what will be the challenges going forward?" Mike Williams (HMT) spoke on BEPS and transfer pricing, and the unresolved issues of source versus residence. Regional differences pose another challenge; the U.S. focusses on capital, Europe on labour, and large developing countries on consumers. To what extent is tax avoidance yesterday's problem? Settlements take time, and the rules developed in the past may not work in the changing economies. The speaker noted that there is no intrinsic virtue in having high corporate tax, and no wickedness involved in reducing the corporate tax rate. With regards to the state aid, he emphasised the importance of level playing fields and the support of the EC by the UK government in policing the state aid rules. He also warned that the UK needs to remain vigilant in ensuring that the "police" do not overstep the mark: there should be no place for creating parallel rules instead of enforcing the existing ones, for second-guessing the decisions of tax authorities, or for land-grabs being behind the decisions. Increased public scrutiny means that HM Treasury and tax professionals need to do more to explain the basis of various decisions; however, more transparency will not make everyone happy.

Heather Self (Pinsent Masons) gave a summary of the views of several speakers. She pointed out that the Parliamentary Commission chaired by Margaret Hodge is not particularly useful or necessary, and that putting more data into the public domain will not necessarily help, as the general public may not understand, for example, the tax treatment of losses. A bigger underlying problem is the meaning of tax avoidance: is it the same for the public as it is for HMRC or tax lawyers? Judith Freedman (University of Oxford) also spoke about the confusion in the public debate due to the usage of the term “tax avoidance” for many different issues. She also said that GAAR was not designed to deal with the BEPS-type behaviour, and so high expectations will eventually lead to disappointment. She added that transparency may create distrust if it does not come with good explanations, and that businesses should be more proactive in delivering information, as public opinion is currently based on information obtained from other sources. Paul Morton (RELX) noted that certainty is better than simplification, but that more rulings do not always reduce uncertainty: it is possible that negative rulings create more uncertainty.

Responding to a question about whether more policies should be introduced, the panel members spoke about: the need to understand the logic behind visible policies and to revisit issues such as source versus residence-based taxation; the number of anti-avoidance measures that were disproportionately large in the UK; the need for a more rigorous cost-benefit justification; and the need to think more holistically about policies. The discussion with the audience focussed on: direct communication to public; the irresponsibility of political rhetoric, especially in the mass media; and the need to resolve the crisis in trust.

In the concluding remarks, Sam Mitha (Charity Trustee), Malcolm Gammie, and Paul Johnson thanked the participants and organisers for an interesting and useful conference, and announced that the next conference will be held in 2018.