

Austin Mitchell

Prem Sikka

**THE PIN-STRIPE MAFIA: HOW
ACCOUNTANCY FIRMS
DESTROY SOCIETIES**

Association for Accountancy & Business Affairs

*Shedding light on darker practices
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THE PIN-STRIPE MAFIA: HOW ACCOUNTANCY FIRMS DESTROY SOCIETIES

**Austin Mitchell MP
Member for Grimsby
UK House of Commons**

**Prem Sikka
University of Essex, UK**

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EXECUTIVE SUMMARY

Tax revenues are the life-blood of all democracies. Without these no state can alleviate poverty or provide social infrastructure, healthcare, education, security, transport, pensions and public goods that are necessary for all civilised societies. All over the world tax revenues are under relentless attack from a highly organised tax avoidance industry dominated by four accountancy firms: Deloitte & Touche, PricewaterhouseCoopers, KPMG and Ernst & Young. They employ thousands of individuals for the sole purpose of undermining tax laws which does not create any social value, but enables corporations and wealthy elites to dodge corporate tax, income tax, National Insurance Contributions (NIC), Value Added Tax (VAT) and anything else that might enable governments to improve the quality of life.

The loss of tax revenues is a major cause of the current economic crisis that is inflicting misery on millions of people. Tax avoidance is part of the guerrilla warfare conducted by accountancy firms against the people. Each year, about 30%-40% of the financial legislation outlaws tax dodges dreamt up by accountancy firms. The UK tax tribunals and courts hear around 11,000 cases and many of these relate to dodges that have no economic substance. The UK is estimated to be losing around £100 billion of tax revenues each year and a large part of this is due to the activities of the Big Four accountancy firms. Despite record number of millionaires, billionaires and levels of corporate profitability, the UK tax take in 2010-11 added up to 37.2% of the GDP, compared to 43% in 1976. Rather than challenging the tax avoidance industry successive governments have shifted the tax burden to less mobile capital, labour, consumption and savings, as evidenced by higher NIC and VAT and the lowering of thresholds for higher rates of income tax.

In the US, some accountancy firms have been fined for facilitating tax evasion and their partners have been sent to prison. They have paid large amounts to settle allegations of bribery and corruption. Other countries have fined them for operating price-fixing cartels. There is little retribution in the UK. Despite judges outlawing their tax dodges, successive governments have failed to investigate the firms, or prosecute their partners. Instead, the partners of major accountancy firms are given peerages, knighthoods, public accolades and government consultancies, all funded by taxpayers. The same firms have colonised regulatory bodies, fund political parties and provide jobs for former and potential ministers. This penetration of the state has bought them political insurance and their anti-social practices continue to inflict enormous social damage.

CHAPTER 1

EPICENTRES OF SLEAZE AND CORRUPTION

The triumph of neoliberalism and light-touch regulation has shifted power to the private sector. The state has been rolled-back and hollowed-out to serve multinational corporations. What the state and people lost, the private sector gained. The beneficiaries include the big accountancy firms. First the big eight, then six, five and now four, known as PricewaterhouseCoopers (PwC), KPMG, Deloitte & Touche and Ernst & Young. They have become the new masters of the universe and have close links with the UK government, advising it on privatisations, Private Finance Initiative (PFI) and the demise of the National Health Service.

The new masters of the universe are all multinationals, accountable to no particular jurisdiction. They dominate accountancy and audit. They're setting the standards to suit themselves hyping corporate profits by selling creative accounting practices, working in collusion with company executives to boost their rewards by hyping shareholder value at the expense of investment, social interests and long term survival. They provide consultancy services to local and central government departments. They permeate the public sector with their people and they do much of the advice, enquiry and policy work, which the public sector used to do for the good of the nation, for private profit, for themselves, and their partners.

The power of the big accountancy firms has increased, is increasing, and must be diminished because they are using it to undermine democracy, law and welfare of the people. Its result is that over the world millions of people are facing erosion of living standards and hard won social rights. People are either paying more in taxes for diminishing social rights, pensions, education and healthcare, or foregoing them altogether. A key reason is that major corporations and wealthy elites are avoiding and even evading taxes. A popular myth is that accountancy firms are in the front-line of the war against white-collar crime, but too many have become key players in white-collar crime. Their values are summed-up by a partner who declared¹, "No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken". Just imagine the dire consequences if doctors, nurses and manufacturers of medicine and food adopted the values of accountancy firms. Evidently, for accountancy firms undermining societies is considered to be badge of pride rather than shame. Some countries, most notably the US, are levying fines on firms and sending their partners to prison, but they simply treat it as just another cost of doing their predatory business.

¹ The Guardian, 'Be fair' plea as tax loopholes targeted, 18 March 2004.

This monograph shows that accountancy firms are engaged in tax avoidance/evasion, bribery, corruption and cartels to inflict enormous harm on societies. Accountancy firms are the new mafia, taking its toll from every city, town and street. Their well-paid partners do not reside in some Dickensian den of thieves. Rather they wear smart suits, drive expensive cars, wine and dine at elite restaurants, live in big houses in leafy suburbs, advise governments and huddle around gleaming city centre offices to plan the next hit on the public purse. This mafia does not shoot people, but its activities are just as deadly. They deprive millions of jobs, education, savings, pensions, security, food, healthcare, clean water and social infrastructure necessary for living fulfilling lives.

PricewaterhouseCoopers, KPMG, Deloitte & Touche and Ernst & Young are the driving force behind the creation of complex corporate structures, tax avoidance schemes and creative compliance, and are the centres of the global tax avoidance industry. They operate from hundreds of cities, including over 80 offices in offshore tax havens² which do not levy taxes or require companies to file audited accounts.

ACCOUNTANCY FIRM INCOME AND SIZE- 2010

<u>Firm</u>	<u>Global Fee US\$bn</u>	<u>Employees</u>	<u>Countries</u>	<u>Offices</u>
PricewaterhouseCoopers	26.6	161,718	150	766
Deloitte & Touche	26.6	170,000	140	670
Ernst & Young	21.3	141,000	140	700
KPMG	20.6	138,000	150	717
BDO	5.3	38,922	119	1,082
Grant Thornton	3.6	30,000	113	521

Source: Annual reviews published by the firms

The Big Four accounting firms have gross global annual revenues of over \$95 billion (£61 billion), making them then 54th largest economy in the world. £6.97 billion comes from the UK³, and of this £4.2 billion comes from consultancy services, including sale of tax avoidance schemes. They portray themselves as ethical, public-spirited and pillars of the financial

²Daily Mail, Big four auditors 'embedded in tax haven world', 29 January 2011.

³Financial Reporting Council, (2011). Key Facts and Trends in the Accountancy Profession, London: FRC.

system, but are experts at circumventing laws. In the words of a former Commissioner of the US Internal Revenue Service (IRS)

“Companies (and wealthy individuals) pay handsomely for tax professionals not just to find the lines, but to push them ever outward. During my tenure at the Internal Revenue Service, the low point came when we discovered that a senior tax partner at KPMG (one of the Big Four, which by virtue of their prominence set standards for the others) had advocated — in writing — to leaders of the company’s tax practice that KPMG make a “business/strategic decision” to ignore a particular set of I.R.S. disclosure rules. The reasoning was that the I.R.S. was unlikely to discover the underlying transactions, and that even if we did, any penalties assessed could be absorbed as a cost of doing business”.

Source: Everson, M.W. Lawyers and Accountants Once Put Integrity First, New York Times, 18 June 2011

The state guaranteed market of external auditing provides the springboard for easy access to corporate clients and sell lucrative non-auditing services to audit clients, including tax avoidance. The pin-stripe suited beancounters charge clients hundreds of pounds per hour for services that hurt the social fabric. In 2005, an internal HMRC study⁴ concluded that the UK-based Big Four accounting firms generated around £1 billion in fees each year from "commercial tax planning" and "artificial avoidance schemes".

The public face is that accountancy firms advise clients on tax planning, but too many manufacture tax dodging schemes on an industrial scale. These schemes create nothing of value to society and force elected governments to shift taxes away from giant corporations and wealthy elites to labour, consumption and savings, depressing ordinary people’s purchasing power and causing economic crises. There is no organised industry openly devoted to enabling clients to dodge health and safety, food hygiene, building, immigration, transport or other laws, but big accountancy firms employ and train thousands of people for the sole purpose of undermining elected governments and depriving millions of people of much needed healthcare, education, pensions, security and other essentials. Occasionally, courts brand some dodges marketed by accountancy firms as ‘unacceptable’ but UK governments have not followed it up by prosecuting the firms or closing them down for shady practices. Instead, partners of the same firms are given public contracts,

⁴ The Guardian, Gilt-edged profits for profession's 'big four', 7 February 2009.

knighthoods, peerages and public accolades. Their influence runs deep into the UK state and shields them from retribution.

The tax avoidance industry is inflicting enormous harm on people all over the world. The US Treasury is estimated to be losing between \$345 billion and \$500 billion of tax revenues each year⁵. A large part of this is due to organised tax avoidance. For 1998-2005, nearly 66% of the US domestic and 68% of foreign corporations did not pay any federal corporate taxes⁶. In 2005, 28% of large foreign companies, generated gross revenues of \$372 billion, but paid no federal corporate taxes. An inquiry by the US Senate Permanent Subcommittee on Investigations found that

“The sale of potentially abusive and illegal tax shelters is a lucrative business ... accounting firms ... have been major participants in the development, mass marketing, and implementation of generic tax products sold to multiple clients. ... tax shelter industry was no longer focused primarily on providing individualized tax advice to persons who initiate contact with a tax advisor. Instead, the industry focus has expanded to developing a steady supply of generic “tax products” that can be aggressively marketed to multiple clients. In short, the tax shelter industry had moved from providing one-on-one tax advice in response to tax inquiries to also initiating, designing, and mass marketing tax shelter products ... dubious tax shelter sales were no longer the province of shady, fly-by-night companies with limited resources. They had become big business, assigned to talented professionals at the top of their fields and able to draw upon the vast resources and reputations of the country’s largest accounting firms, law firms, investment advisory firms, and banks.”

Source: US Senate Permanent Subcommittee on Investigations (2005), *The Role of Professional Firms in the US Tax Shelter Industry*, Washington DC: USGPO, p. 6 and 9.

Another US Senate Committee report concluded that “a sophisticated offshore industry, composed of a cadre of international professionals including tax attorneys, accountants, bankers, brokers, corporate service providers, and trust administrators, aggressively promotes offshore jurisdictions to U.S. citizens as a means to avoid taxes and creditors in their

⁵Feige, E.L. and Cebula, R. (2011). Working Paper: America's Underground Economy: Measuring the Size, Growth and Determinants of Income Tax Evasion in the U.S, University of Wisconsin-Madison.

⁶ US Government Accountability Office, (2008). *Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations, 1998-2005*. Washington DC: GAO.

home jurisdictions⁷”. The US loses around \$100 billion of tax revenues each year from offshore avoidance schemes⁸.

The same mafia operates in the UK too. Experienced observers say that “There are armies of accountants in the City of London trained in the dark arts of tax minimisation”⁹ and that “Britain's corporation tax revenues are under relentless attack from several multinational companies and the global accountancy firms' mass production of tax avoidance¹⁰”. Lord Haskell told the UK House of Lords that

“There are armies of bankers, lawyers and accountants who ensure that even though the letter of the law is respected, increasingly immoral ways are found of perverting the spirit of the law to ensure that tax is avoided. ... To hide its true purpose, the tax avoidance industry adopts the language of real business, so technical innovation and reinventing your business model do not mean finding new products, services and markets, and new ways of supplying them. No, they mean registering your business in a tax haven and becoming a non dom to avoid tax while still enjoying the, admittedly decreasing, benefits and services which make this country the civilised place that it is.

Source: Hansard, House of Lords Debates, 17 March 2011, col. 375.

The UK Treasury estimates that it may be losing £40 billion of tax revenues each year¹¹, but leaked government papers¹² suggest that the amounts may be between £97 billion and £150 billion. Some economic models¹³ suggest that around £100 billion, and possibly £120 billion¹⁴ of tax revenues are lost each year, large enough to cover the annual cost of

⁷US Senate Permanent Subcommittee on Investigations (2006). Tax haven abuses: The enablers, the tools and secrecy, Washington DC: USGPO, p. 1.

⁸ Wall Street Journal, Offshore Account Holders Here's Some Advice, 21 May 2008.

⁹The Daily Telegraph, How to make £1bn go up in smoke, 2 September 2007.

¹⁰ Hansard, House of Commons Debates, 3 February 2005, col. 992.

¹¹ HMRC, (2010). Measuring Tax Gaps 2009, London: HMRC.

¹² Sunday Times, Brown targets celebrities' tax perk, 4 June 2006.

¹³ Lyssioutou, P., Pashardes, P., and Stengos, T., (2004). Estimates of the Black Economy Based on Consumer Demand Approaches, Economic Journal, July, pp. 622-640.

¹⁴ Murphy, R. (2010). Tax Justice and Jobs: The business case for investing in staff at HM Revenue & Customs (available at <http://www.taxresearch.org.uk/Documents/PCSTaxGap.pdf>).

running the National Health Service. A large proportion of this is due to organised tax avoidance and more than enough to avoid the current austerity programme that is consigning millions of people to economic hardship. In his 2011 budget speech UK Chancellor George Osborne told parliament that “Some of the richest people in this country have been able to pay less tax than the people who clean for them¹⁵”. A UK government report¹⁶ showed that for the year 2005-2006, 220 of the 700 biggest companies paid no corporation tax and a further 210 companies paid less than £10 million each and 12 of the UK's largest companies extinguished all liabilities in 2005-2006 and scores more claimed tax losses. The UK's top 20 companies operate over 1,000 subsidiaries from secretive tax havens¹⁷, often formed with advice from accountancy firms to create opportunities to craft tax avoidance schemes.

Developing countries, often some of the poorest, receive around \$120 billion in foreign-aid¹⁸ from G20 countries, but may be losing up to \$1 trillion through illicit financial outflows each year, mainly to western countries¹⁹. Around \$500 billion is estimated to be lost through a variety of tax avoidance schemes²⁰, of which some \$365 billion is attributed to transfer pricing practices that shift profits from developing to developed countries²¹. An OECD official has estimated that Africa alone may be losing between 7% and 8% of its GDP, or \$250 billion each year, through tax avoidance schemes²². Such resources could be used to provide, sanitation, security, clean water, education, healthcare, pensions and social infrastructure to improve the quality of life for millions of people.

Major accountancy firms have become the unacceptable face of capitalism. Self-interest and shady practices triumph over any concern about social

¹⁵ See http://www.hm-treasury.gov.uk/junebudget_speech.htm

¹⁶ National Audit Office, (2007). Management of large business corporation tax. London: NAO.

¹⁷ Daily Mail, Revealed: Tax havens of the top 20 UK companies, 22 January 2011

¹⁸ <http://www.oecd.org/dataoecd/48/34/42459170.pdf>.

¹⁹ Kar, D. and Cartwright-Smith, D. (2008). Illicit Financial Flows from Developing Countries: 2002-2006. Washington DC: Global Financial Integrity.

²⁰ Baker, R.W. (2005), Capitalism's Achilles Heel, New Jersey: John Wiley.

²¹ Christian-Aid, (2009). False Profits: robbing the poor to keep the rich tax-free. London: Christian Aid

²² Interview with Jeffrey Owens (Director of the Centre for Tax Policy Administration at the OECD) on 28 November 2008; available at <http://www.reuters.com/article/latestCrisis/idUSLS349361>

welfare and obligations to citizens. Scratch the surface of any financial scandal or a tax dodge and the visible hand of major accountancy firms is highly evident. Accountancy firms are capitalist organisations and their success is measured by increases in fees and profits. They have shown willingness to do almost anything to make a fast buck. They are the promoters and beneficiaries of an enterprise culture where ‘bending the rules’ to make profits at almost any cost is considered to be entrepreneurial skill. Their organisational culture is rotten and the “emphasis is very firmly on being commercial and on performing a service for the customer rather than on being public spirited on behalf of either the public or the state²³”. Employees of major firms are inculcated into prioritising the interests of the firm and its clients and know that their career progression depends on this. In the words of a senior partner, “a firm like ours is a commercial organization and the bottom line is that ... the individual must contribute to the profitability of the business ... essentially profitability is based upon the ability to serve existing clients well²⁴”.

All over the world, governments struggle in vain to combat the predatory practices of major accountancy firms, but many poor countries do not have the resources to take on them. Each year, between 30%-40% of the UK Finance Bill (the Budget) strives to deal with abusive schemes designed by the tax avoidance industry. The UK tax tribunals and courts hear about 11,000 cases each year²⁵ and many of these relate to tax dodges designed by accounting firms. As part of its armoury, the UK Finance Act 2004 introduced the “Disclosure of Tax Avoidance Schemes” (DOTAS) rules and required promoters of avoidance schemes to disclose the main elements of the schemes to Her Majesty’s Revenue and Customs (HMRC) within a specified time period. The UK disclosure requirements are themselves modelled on the US Tax Disclosure Regulations. The UK government claims²⁶ that the disclosures during the first five years of the schemes have enabled it to introduce 49 anti-avoidance measures and close-off over £12 billion in avoidance opportunities, a welcome but a small drop in the tax avoidance ocean.

²³ Hanlon, G., (1994). *The Commercialisation of Accountancy: Flexible Accumulation and the Transformation of the Service Class*, London: Macmillan, p. 150.

²⁴ Hanlon *op cit*, p. 121.

²⁵ Hansard, House of Commons Debates, 4 May 2011, col. 792.

²⁶ HMRC, (2009). *Disclosure of Tax Avoidance Schemes (DOTAS): Consultation Document 9th December 2009*. London: HMRC.

The UK is a soft touch for the tax avoidance industry. In the US, the Securities and Exchange Commission (SEC) and the Department of Justice have prosecuted and fined a number of accountancy firms and sent their partners to prison though even this has failed to curb their usual predatory business. With increasing public exposure of sleaze and scandals, the UK government departments and regulators, such as the Department of Business Innovation and Skills (BIS), HM Treasury, the Office of Fair Trading (OFT) and the Financial Reporting Council (FRC) have shown little sign of getting off their bended-knees to investigate sleazy practices though plenty of noises are made. The regulatory inertia and the domination of institutions have encouraged the firms to engage in cartels, tax avoidance/evasion, bribery and corruption. In previous publications we drew attention to the involvement of accountancy firms in money laundering²⁷. The regulators simply look the other way. We now supplement that by providing a glimpse of their predatory practices in other fields.

The Structure of the Monograph

This monograph contains four further chapters. Chapter 2 focuses on the role of the Big Four accounting firms in facilitating tax avoidance and evasion. In the space available it is only possible to present some of the publicly available evidence to draw attention to the global trail of their destructive practices. They devise ingenious but socially useless schemes to attack the public purse. In many cases, the schemes are portrayed as ‘tax avoidance’ but the courts have declared those to be unlawful. The firms have been fined and their partners have been sent to prison for unlawful practices, but the firms continue to devise tax avoidance schemes. Chapter 3 shows how the Big Four firms combine to thwart regulation and advance their common interests. Despite the fiction of competition, the major have colluded to fix prices and carve-up the markets. Chapter 4 draws attention to the silence of accountancy firms on alleged corruption and bribery at their audit clients. It also shows that major firms are not averse to corrupt practices themselves. As you read the evidence cited in this monograph try to imagine the mentality and greed of individuals in major firms, often at senior levels, who dream-up novel ways of dodging taxes, picking the pockets of consumers and developing corrupt practices, for the sole purpose of increasing their profits and income. Chapter 5 summarises the evidence and arguments and also suggests the steps that citizens can take to curb the predatory practices of major accounting firms.

²⁷ Mitchell, A., Sikka, P. and Willmott, H. (1998). *The Accountants’ Laundromat*, Basildon: AABA.

CHAPTER 2

TAX DODGING IS THEIR BUSINESS

Tax revenues are the basis of democracy. They are crucial to any attempt by the state to redistribute wealth, alleviate poverty and provide education, healthcare, security, pensions, public transport, clean water and other services that make a difference to quality of life and even survival. Major accountancy firms undermine elected governments and social welfare.

Unlike the UK, the US Senate Permanent Subcommittee on Investigations has investigated the development, marketing and implementation of abusive tax shelters marketed by accountancy firms. The schemes created complex transactions to enable corporations and rich individuals to obtain tax benefits which were not intended by the relevant legislation. The transactions gave the appearance of complying with the literal language of the relevant tax legislation, but often had no economic substance. Their sole aim was to reduce taxes for wealthy clients. The Committee's findings exposed the sham of professional ethics.

KPMG devoted substantial resources and maintained an extensive infrastructure to produce a continuing supply of generic tax products to sell to clients, using a process which pressured its tax professionals to generate new ideas, move them quickly through the development process, and approve, at times, illegal or potentially abusive tax shelters.

Ernst & Young sold generic tax products to multiple clients despite evidence that some, such as CDS²⁸ and COBRA, were potentially abusive or illegal tax shelters

PricewaterhouseCoopers sold generic tax products to multiple clients, despite evidence that some, such as FLIP, CDS, and BOSS, were potentially abusive or illegal tax shelters.

Source: US Senate Permanent Subcommittee on Investigations (2005). *The Role of Professional Firms in the US Tax Shelter Industry*, Washington DC: USGPO, pp. 6-7.

The organisational culture of major accountancy firms is to pursue profits at almost any cost. To give the readers an idea of how they destroy societies we provide a glimpse of the practices and values of KPMG, a key player in the global tax avoidance industry which has admitted “criminal

²⁸ CDS, COBRA, FLIP, BOSS, etc., are acronyms for tax avoidance schemes.

wrongdoing” to the US authorities. After this, we will focus on Ernst & Young, identified by the UK tax authorities as "probably the most aggressive, creative, abusive provider" of avoidance schemes²⁹. This is followed by a focus on PricewaterhouseCoopers and Deloitte & Touche.

KPMG AND ITS WORLD OF TAX AVOIDANCE

In March 2011, General Electric (GE), the largest corporation in the US, hit the headlines for its tax avoidance strategies. It also has operations in the UK. The company reported worldwide profits of \$14.2 billion, including \$5.1 billion from its operations in the US. Its US corporate tax bill was zero. The company used a series of complex transactions and accounting gimmicks to make its tax liability vanish³⁰. The auditors could have highlighted the unusual transactions to reassure stakeholders, especially as in 2009 GE paid \$50 million penalty to settle accounting charges by SEC³¹. KPMG has been auditing GE since 1909 and for 2009 and 2010 it firm received \$219 million in fees, including \$17 million for advice on tax. GE received a clean bill of health from KPMG.

Another KPMG client Citigroup, which also has operations in the UK, has been in the news for the way it accounts for its taxes. The bank has been bailed out by the US taxpayer several times. It has been audited by KPMG since 1969. In 2010, the bank boosted its profits by reducing its loan loss reserve. Market analysts say that the company should have set aside funds to cover \$50 billion of deferred taxes, which would have reduced its capital buffer and weakened its balance sheet³². Lynn Turner, a former chief accountant at the Securities and Exchange Commission told Financial Times that “Citi’s position defies imagination and logic”. The bank acquired a clean bill of health from its auditors. KPMG received \$280 million in fees for the period 2007-2009. The firm’s procedures for auditing deferred tax have been criticised by the Public Company Accounting Oversight Board (PCAOB), US audit regulator, in its assessment of the quality of audits by the firm.

²⁹ The Guardian, 7 February 2009;
<http://www.guardian.co.uk/business/2009/feb/07/tax-gap-avoidance-schemes>

³⁰ New York Times, 24 March 2011.

³¹ US Securities Exchange Commission press release, 4 August 2009.

³² Financial Times, 6 September 2010.

“The Firm failed to sufficiently test the issuer's valuation of deferred income tax assets. The issuer concluded that realization of the recognized net deferred tax asset was more likely than not based on projections of future taxable income and available tax planning strategies. Despite recent losses, the Firm failed to test, beyond inquiry of management, certain significant assumptions underlying the projections of future taxable income”

Source: Public Company Accounting Oversight Board (2010). Release No. 104-2010-132: 2009 Inspection of KPMG LLP, October 5, p.7.

KPMG is no stranger to negative public exposure. It received considerable exposure from the collapse of WorldCom, a giant US communications corporation. For a fee of US\$9.2 million KPMG advised WorldCom to increase its profits by adopting an intangible asset transfer pricing program. Under this, the company created the asset “management foresight, a previously unknown intangible asset. Management foresight is little more than providing various bundles of services. The trick was that WorldCom registered this new asset to a subsidiary in a low-tax jurisdiction. This subsidiary in turn licensed it to other companies in the WorldCom group of companies for annual royalty payments. The paying subsidiaries treated royalty charges as an expense that qualified for tax relief whilst the income in the hands of the receiving company attracted tax at a low rate. In effect, no cash went outside the corporate group, but such a transfer pricing arrangement may have saved the company between US\$100 million and US\$350 million in taxes. WorldCom’s insolvency examiner³³ found that in some cases the royalties charged actually exceeded the company’s consolidated net income in each of the years 1998-2001 and in other cases represented 80 to 90 percent of a subsidiary’s net income. Over a four year period covering 1998-2001, more than US\$20 billion was accrued in royalty fees for use of the company’s intangible assets and most of the fees resulted from the licensing of “management foresight”.

KPMG is prolific and UK tax authorities struggle to keep up with its devious and cunning schemes. The misguided ingenuity of KPMG is highlighted by the 2007 case of *John Astall and Graham Edwards v Her Majesty’s Revenue and Customs*³⁴. The case involved attempts by two

³³ United States Bankruptcy Court Southern District of New York, (2004). In re WORLDCOM, INC., et al, Chapter 11, Case No. 02-13533 (AJG), Washington DC: Kirkpatrick & Lockhart LLP.

³⁴<http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j3422/SPC00628.doc>

wealthy entrepreneurs to shield almost £5 million of income from UK income tax. Under the scheme cash was loaned to specially-created trusts, and the resultant IOUs then traded to banks at an apparent loss. The "loss" could then be offset against personal tax bills.

“In outline the scheme consists of each of the Appellants settling a small sum in a trust under which he has a life interest. The settlor lends money to the trust in return for a security issued by one of the trustees, a company. The terms of the security are that it is redeemable in 15 years at 118% of the issue price but the Appellant can redeem the security at 100.1% of the issue price between one and two months after issue. If a condition relating to the dollar-pound exchange rate, which is designed to have an 85% chance of being satisfied, is satisfied within one month and a notice to transfer the security is given, the term of the security becomes 65 years (with the same redemption price) but the purchaser can redeem it at 5% of the redemption price (about 6% of the issue price) on seven days’ notice. The redemption terms are designed to satisfy the definition of a relevant discounted security within Schedule 13 to the Finance Act 1996. The object is that the Appellant claims the difference between the issue price and 6% of the issue price (less a turn for the purchasing bank) as a loss on a relevant discounted security, while the difference remains in the trust for the benefit of the Appellant.”

Source: John Astall & Graham Edwards v Revenue & Customs Commissioners [2007] SpC00628; LTL 6/9/2007

KPMG stood to make a profit of £15 million from the scheme. The scheme relied on financial manoeuvres eagerly provided by Hambros Bank & Trust (Jersey) Limited and Kleinwort Benson. The Special Commissioner quashed the claims for losses because they were not genuine economic losses. The case went to Court of Appeal³⁵, but the original judgement was upheld. The case was important because a number of millionaires had purchased blueprints of the same scheme to shield some £156 million of income from the UK taxes³⁶, resulting in a loss of £50 million of tax revenues, enough to restore the eye-sight of 70,000 cataract sufferers.

Another KPMG scheme enabled internet entrepreneur Jason Drummond to create £1.9 million tax loss by taking advantage of the rules concerned with the taxation of surrendered second-hand life assurance policies. Jason Drummond had asked KPMG to proactively advise him.

³⁵ Astall v Revenue & Customs (2009) LTL 9/10/2009

³⁶ The Guardian, Sheltering cash: the intricate schemes drawn up by KPMG, 7 February 2009.

“London & Oxford Capital Markets (“London & Oxford”), a small corporate finance and investment company, operated as a market maker in second hand life assurance policies. It created a stock of such policies by procuring an interest free loan to be made to one of its employees (Ms Sedgley) who used the loan to effect non-qualifying policies on her life with American Life Insurance Company (“AIG”) on 23 February 2001. The policies were in every respect real. The insurance company was a major institution. The underlying investments were genuine and potentially long term. The rights of the policyholder were in all respects of an arm’s length nature. On 26 March 2001 Ms Sedgley assigned the AIG policies to London & Oxford for a small profit. The Special Commissioner found that this had been intended from the outset, and that Ms Sedgley’s taking of independent financial advice in respect of apparently personal investments by her had been “a charade”. On 28 March 2001 London & Oxford charged the AIG policies as security for an overdraft from its bankers. On 30 March 2001 London & Oxford then drew down on this overdraft facility and used the advance to pay substantial additional premiums on the AIG policies. On 4 April 2001 Mr Drummond agreed to buy five of the AIG policies from London & Oxford for £1.962 million, £1 million being payable that day and the balance of the consideration the following day. The five policies had a surrender value of £1.751 million (equivalent to the premiums paid). The difference between the cost to Mr Drummond of the five AIG policies (£1.962 million) and the surrender value of the five AIG policies (£1.751 million) represented the scheme costs (consisting of London & Oxford’s profit, an introductory commission, fees for “independent financial advice”, a contribution to a fighting fund, and a contingency fund of about £98,000). On 5 April 2001 (as had been intended from the outset) Mr Drummond surrendered the five policies to AIG, part of the surrender money being used to discharge the obligation to pay the outstanding consideration payable that day. Thus the five policies acquired by Mr Drummond on 4 April were turned into cash on 5 April 2001. The process had cost Mr Drummond about £210,000. The object of the process had been to create an allowable capital gains tax loss of £1.962 million to off set against a capital gain of £4.875 million which Mr Drummond had made on the sale of his shares in Virtual Internet Plc.”

Source: Jason Drummond and Commissioners for HM Revenue and Customs, Case Number CH/2007/APP/0461, 23 July 2008.

The scheme also involved an independent financial adviser EFG Private Bank and the judge said (paragraph 70 of the judgement) that “EFG Private Bank and its employees who “advised” Ms Sedgley and Mr Drummond were, in my view, acting out a charade for which EFG Private Bank were

paid a single fee of £5,000”. The judge disallowed the £1.9 million loss because the “scheme was artificial and had not been set up for a genuine commercial purpose³⁷”. The case subsequently went to Court of Appeal³⁸, but tax relief on the loss was denied. Similar schemes were stopped by the Finance Act 2003 and the above case.

Another mass marketed KPMG scheme enabled companies and their employees to avoid National Insurance Contributions (NIC) and income tax³⁹ by paying their directors with the debts of the company instead of cash⁴⁰. KPMG spoke to a number of clients, including Spectrum. Kirkstall were introduced to KPMG by their accountants who heard that KPMG were marketing a method for avoiding NIC on bonus payments to directors. Clients had to sign up to a duty of confidentiality about the scheme. Subsequently, KPMG explained how the avoidance schemes would work. The tax authorities disallowed the reliefs claimed by the schemes and the case was referred to a tax tribunal which upheld the position of the tax authorities. The subsequent appeal was referred to Special Commissioners and they stated that “Our decision on PAYE in Spectrum is that the assignment of book debts constituted a payment, but that they did not constitute trading arrangements ... Our decision in principle in the Kirkstall appeals is that the assignment of the book debts was not a payment in kind for National Insurance Contributions purposes; that it constituted a payment for PAYE; but that they did not constitute trading arrangements”.

Another KPMG scheme⁴¹ used the offshore fiction to attack VAT revenues in the UK. The normal position is that traders charge VAT to customers and collect what is known as “output” tax. Thus a sale of £100 is accompanied by VAT at the current rate of 20% and the trader collects £100 plus VAT of £20, i.e. a total of £120 from the customer. The trader needs to buy products and services to be in businesses and pays VAT on eligible purchases. This is known as “input” tax. So if the trader bought the item for say £40, and the VAT rate was 20%, he would incur “input” tax of

³⁷ Accountancy Age, 26 July 2007.

³⁸ Jason Drummond and Commissioners for HM Revenue and Customs, 2009, Case No: A3/2008/2148

³⁹ Spectrum Computer Supplies Ltd v Revenue and Customs Commissioners; Kirkstall Timber Ltd v Revenue and Customs Commissioners [2006] STC (SCD) 668.

⁴⁰ Accountancy Age, KPMG scheme advised paying directors with debt, 21 September 2006.

⁴¹ RAL (Channel Islands) Ltd v Customs & Excise Commissioners (2002), VAT Decision 1791.

£8 and pay a sum of £48 to its supplier. Periodically, traders pay the difference between “input” and “output” to the tax authorities. For the above example, the trader would need to pay £12 (£20 - £8) over to the tax authorities. Now suppose, an accountancy firm concocts a scheme under which the trader would somehow not be liable to the VAT regime. Strictly speaking the trader would not collect output tax on sales though he might still sell the product for £120. If so, he does not have to account for £20 to the tax authorities. If the trader’s business is not subject to VAT then he is entitled to a refund of the input tax (£8 above) from the tax authorities. The upshot is that the trader’s profits improve. This was the basic logic of the VAT avoidance scheme marketed by KPMG.

The scheme applied to gaming machines operated in the UK by companies in the RAL Holdings Ltd group. Under the scheme gaming machines in 127 amusement arcades in the UK were leased to a newly formed Channel Islands subsidiary company, which was granted licences by a group company in the UK to use the arcades. Another UK subsidiary contracted with the Channel Islands company to provide the staff at the arcades. The basis of the scheme was that the place of supply of gaming machine services to customers would be in Guernsey and that the Channel Islands company would be entitled to repayment of input tax on supplies made to it without being liable to any output tax. Such a view was based on interpretation of the European Union’s Thirteenth VAT Directive which enables businesses not established in the EU to recover VAT on business expenditure incurred in member states. Before the KPMG scheme, a single UK subsidiary made the supplies and output tax was paid. RAL owned or leased the arcades and employed staff. Output tax was paid out to the tax authorities. After the KPMG scheme there was no change to trade or economic essence of the business. Slot machines remained where they were, but their ownership was now assigned to a Channel Islands company.

The scheme was not developed in response to any request from the company. KPMG cold-called on companies. Its presentations were subject to a confidentiality undertaking being given. The visual presentations referred to the scheme as "KPMG's VAT Mitigation Proposals for Gaming and Amusement Machines". A 16 page report said that by using a Channel Islands companies RAL’s profits could improve by £4.2 million. KPMG would charge £75,000 plus VAT for an evaluation report and counsel's opinion and a fee of 25 per cent of the first year's VAT savings, 15 per cent of the second and 5 per cent of the next three year's savings. KPMG felt that the UK tax authorities will regard the scheme as 'unacceptable tax avoidance' and will challenge the arrangements, but still sold it. It sought to reassure clients by stating that

“... a similar concept for telecommunications ran for nearly four years in most Member States of the EU before the UK, French and German Governments secured the unanimous agreement of all 15 Member States to amend the primary legislation and stop the concept. Since at the moment we are not aware of any widespread use of these planning arrangements, and the fact (*sic*) that some EU Member States do not charge VAT on gaming machine income, unanimous agreement to amend the EC legislation could be difficult to achieve.”

Source: RAL (Channel Islands) Ltd v Customs & Excise Commissioners (2002), VAT Decision 17914.

KPMG listed over 80 steps that the company had to undertake with almost military precision to make the scheme work. These included attention to control of companies and appointment of skeletal staff in the Channel Islands to satisfy the letter of the law about control and ownership of companies. The UK authorities challenged the scheme. A Tax Tribunal decided that there was no real change to the substance of the business and that the Channel Islands company, trading in the UK was liable to output tax on the Gaming Supplies and consequently liable to register for VAT. It decided that RAL was not entitled to VAT refunds. The case subsequently went to the High Court⁴², which sought guidance from the European Court of Justice (ECJ). The ECJ stated that the economic activity took place in the UK – the contract arose at the moment at which the customer placed a coin in the slot machine. The slot machines were physically in the UK and therefore the contracts were performed entirely within the UK. Thus another KPMG scheme was halted. It didn't deter them.

KPMG has been on the radar of US authorities for some time. In 2002, the US Justice Department, filed a suit compelling the firm to disclose information about tax avoidance schemes marketed by it since 1998. KPMG grudgingly complied, but withheld a substantial number of documents. This lack of co-operation persuaded the US Senate Permanent Subcommittee on Investigations to investigate KPMG and expose its organisational culture⁴³. The Senate Committee scrutinised just four of the firm's 500 “active tax products”. Three schemes manufactured paper losses to enable clients to reduce their income tax. The fourth used a “charitable

⁴². RAL (Channel Islands) Limited and others v Commissioners of Customs and Excise (Case C- 452/03), 12 May 2005.

⁴³ US Senate Permanent Subcommittee on Investigations, (2003). US Tax Shelter Industry: The Role of Accountants, Lawyers, And Financial Professionals - Four KPMG Case Studies: FLIP, OPIS, BLIPS and SC2, Washington DC: USGPO.

contribution strategy” to reduce the tax bills of companies. KPMG received around \$124 million in fees.

The Senate investigation found that KPMG had an extensive organisational structure for developing and marketing tax avoidance schemes. It had a “Tax Innovation Center” with income generating targets and its sole function was to generate new schemes. It maintained a “Tax Services Idea Bank” and staff were encouraged to submit ideas for new schemes. The firm had a market research department, a Sales Opportunity Centre that worked on “marketing strategies” and telemarketing centre staffed with people trained to make cold calls and find buyers. Staff were coached in sales patter. Thousands of corporations and individuals were contacted to sell the products. Enormous pressure was put on accountants and lawyers working in the firm’s tax unit to sell avoidance schemes and meet revenue generating targets. The staff were encouraged to make misleading statements to potential buyers, such as claiming that a scheme was no longer available for sale, even though it was, apparently hoping that reverse psychology would persuade the client to buy the product. In folklore, accountancy firms claim that they operate “Chinese Walls” that somehow avoid conflicts of interest – for example by separating the consultancy and audit arms. But KPMG tax professionals were directed to contact existing clients about the product, including KPMG’s own audit clients. Sceptical buyers were told that the schemes had been examined by leading law firms and that they could buy insurance to protect themselves.

In fear of regulatory backlash and possible loss of competitive advantage presentations to potential clients were made on chalkboards and erasable whiteboards. Written materials were retrieved from clients before the salesman left meetings. Potential clients had to sign “non-disclosure” agreements. Staff were advised to not to keep revealing documentation in their files and clean out their files, to limit detection of the firm’s activities. Major banks, including Deutsche Bank, HVB, UBS, and NatWest provided loans for millions of dollars essential to the orchestrated transactions. Sceptical clients were reassured through opinion letters by friendly lawyers. The Senate Committee found that KPMG had drafted its own prototype tax opinion letter supporting the product and used this prototype as a template for the letters it actually sent to its clients. In addition, KPMG collaborated with an outside law firm to ensure that it would supply a favourable opinion letter. In many cases, the law firm issued its letter without ever speaking with the client to whom the tax advice was directed. KPMG did not disclose the existence of any of its 500 schemes to the IRS. Senior personnel were aware of its legal obligations but chose to flout them. The following extracts from internal correspondence provide an indication of the firm’s culture.

First, the financial exposure to the Firm is minimal. Based upon our analysis of the applicable penalty sections, we conclude that the penalties would be no greater than \$14,000 per \$100,000 in KPMG fees. ... For example, our average deal would result in KPMG fees of \$360,000 with a maximum penalty exposure of only \$31,000.

This further assumes that KPMG would bear 100 percent of the penalty. In fact ... the penalty is *joint and several* with respect to anyone involved in the product who was required to register. Given that ... our share of the penalties could be viewed as being only one-half of the amounts noted above. If other OPIS participants ... were also found to be promoters subject to the registration requirements, KPMG's exposure would be further minimized. Finally, any ultimate exposure to the penalties are abatable if it can be shown that we had reasonable cause. ...

To my knowledge, the Firm has never registered a product under section 6111

Third, the tax community at large continues to avoid registration of all products. Based upon my knowledge, ... *there are no tax products marketed to individuals by our competitors which are registered.* This includes income conversion strategies, loss generation techniques, and other related strategies.

Should KPMG decide to begin to register its tax products, I believe that it will position us with a severe competitive disadvantage in light of industry norms to such degree that we will not be able to compete in the tax advantaged products market.

Fourth, there has been (and, apparently, continues to be) a lack of enthusiasm on the part of the Service to enforce section 6111. In speaking with KPMG individuals who were at the Service ... the Service has apparently *purposefully* ignored enforcement efforts related to section 6111. In informal discussions with individuals currently at the Service, ... confirmed that there are not many registration applications submitted and they do not have the resources to dedicate to this area.

Finally, the guidance from Congress, the Treasury, and the Service is minimal, unclear, and extremely difficult to interpret when attempting to apply it to 'tax planning products. ...

I believe the rewards of a successful marketing of the OPIS product ... far exceed the financial exposure to penalties that may arise”.

Source: US Senate Permanent Subcommittee on Investigations, (2003), op cit, p. 60.

The Senate Committee investigation was followed by criminal charges. The US Department of Justice made the following announcement

“KPMG LLP (KPMG) has admitted to criminal wrongdoing and agreed to pay \$456 million in fines, restitution, and penalties as part of an agreement to defer prosecution of the firm ... nine individuals-including six former KPMG partners and the former deputy chairman of the firm-are being criminally prosecuted in relation to the multi-billion dollar criminal tax fraud conspiracy.

In the largest criminal tax case ever filed, KPMG has admitted that it engaged in a fraud that generated at least \$11 billion dollars in phony tax losses ... cost the United States at least \$2.5 billion dollars in evaded taxes.

... KPMG also admitted that its personnel took specific deliberate steps to conceal the existence of the shelters from the IRS by, among other things, failing to register the shelters with the IRS as required by law; fraudulently concealing the shelter losses and income on tax returns; and attempting to hide the shelters using sham attorney-client privilege claims

The agreement provides that prosecution of the criminal charge against KPMG will be deferred until December 31, 2006 if specified conditions-including payment of the \$456 million in fines, restitution, and penalties-are met.

KPMG admitted that the opinion letters issued for the FLIP, OPIS, BLIPS and SOS shelters were false and fraudulent in numerous respects ...”

Source: US Department of Justice, press release, 29 August 2005.

The terms of settlement insisted that the fine could not be paid with insurance money. KPMG also had to agree to supervision for good behaviour by an independent monitor for a period of 3 years.

In October 2005, 19 individuals associated with KPMG schemes were the subject of a criminal indictment by the Justice Department⁴⁴. Inevitably, there were legal wranglings about prosecutions. The US prosecutors insisted that senior KPMG personnel should not be able to get financial help from the firm to fight their cases. This restriction was considered to be a violation of their constitutional rights and in July 2007, a US court⁴⁵ dismissed charges against 13 KPMG personnel because the restriction had prevented them from presenting their defence. Despite this a number of

⁴⁴ US Department of Justice, press release, 17 October 2005 (http://www.justice.gov/opa/pr/2005/October/05_tax_547.html).

⁴⁵ The court judgement is available at <http://www1.nysd.uscourts.gov/cases/show.php?db=special&id=56>

individuals were sent to prison. In April 2006, a former KPMG tax partner told a court,

“I willfully aided and abetted the evasion of taxes” and that the avoidance schemes were designed “to help wealthy taxpayers significantly and illegally reduce their tax liability to the U.S. Internal Revenue Service so that they could keep the money for themselves instead of paying the taxes they owed, and also so that KPMG and other entities could earn significant fees ... [schemes] were “designed and approved by senior partners and leaders at KPMG and other entities to allow wealthy taxpayers to claim phony losses on their tax returns through a series of complicated transactions”.

Source: San Diego Union-Tribune, Plea by KPMG's Rivkin should aid prosecutors, 9 April 2006.

In January 2007, a former KPMG tax consultant pleaded guilty to fraud and tax evasion. He said⁴⁶ that a former partner in KPMG’s Los Angeles office paid him \$600,000 to pose as a private hedge fund owner and manager of several entities that were used to advance the tax shelter known as short options strategy. According to the Department of Justice press release⁴⁷ he stated that “clients were provided with opinion letters containing false statements including the claim that the tax shelter losses were "more likely than not" to survive IRS challenge. ... opinion letters also falsely represented that certain entities were established, owned and operated as private hedge funds by [him] and described him as a private hedge fund manager with experience investing in foreign currency options. ... [He] had no experience investing in currency options, was not a hedge fund manager, did not select or manage any of the currency options, did not own the entities, and acted only as a nominee with respect to those entities. ... [He] together with ... and others, created fraudulent documents, including back-dated documents ...”.

In April 2009, a former KPMG senior manager and a former partner were convicted of fraud⁴⁸. They were given 121 months in prison and a \$6

⁴⁶ US Department of Justice, Tax Division, Enforcement Results April 2006 to April 2007;

<http://www.justice.gov/tax/TaxDiv2007ResultsAppx.pdf>

⁴⁷ US Department of Justice press release, 10 January 2007; available at <http://www.justice.gov/tax/usaopress/2007/txdv07acostapleapr.pdf>

⁴⁸ US Department of Justice press release, 2 April 2009; <http://www.justice.gov/usao/nys/pressreleases/April09/larsonetalsentencingpr.pdf>

million fine, and 97 months in prison and a \$3 million fine respectively. The presiding judge said that

“while BLIPS and the other shelters they were involved in all were dressed up as investment opportunities, that is not what they were all about. They were designed to create tax losses so that the super-rich people could avoid paying income taxes. . . there does come a time when a scheme is so raw, so brazen, and so outrageous that it crosses the line that separates bad or incompetent or unsuccessful tax planning from crime. . . these defendants were not prosecuted and they were not convicted for making mistakes in judgement on debatable questions in good faith . . . these defendants knew that they were on the wrong side of the line . . . [They] cooked up in significant portion this mass produced scheme to cheat the Government out of tax revenue for the purpose of enriching themselves. It's that simple.”

Source: US Department of Justice press release, 2 April 2009.

In March 2010, a former KPMG partner already serving a 97-month prison sentence was given another 57 months concurrent sentence⁴⁹. He had pleaded guilty to concealing millions of dollars of fee income from tax shelter transactions from the IRS and conspiring to defraud a company by sharing tax shelter fee income with officers of that company. In June 2011, the US Supreme Court rejected an appeal⁵⁰ from three individuals, including two former KPMG executives, to question their conviction.

What of KPMG’s own taxes? The firm allegedly used “one of its own mass-marketed corporate-tax strategies to record a \$34 million deduction on its 2001 tax return, just months before the Internal Revenue Service listed the strategy as an abusive tax-avoidance transaction⁵¹”. The Australian press reported⁵² that KPMG partners “were hit with a claim for up to \$100 million in unpaid taxes and penalties for allegedly breaching . . . anti-avoidance tax laws. [Australian Taxation Office] claimed that KPMG partners had channelled such a high proportion of their income through the trusts that the sole or dominant purpose of the trusts must have been to avoid paying tax”. KPMG is thought to have settled the matter with a payment of A\$7 million to the tax authorities.

⁴⁹ US Department of Justice press release, 3 March 2010.

⁵⁰ Bloomberg, Ex-KPMG Officials Rejected by Top U.S. Court on Tax Convictions, 27 June 2011

⁵¹ Wall street Journal, KPMG used its own tax shelter, 14 October 2005.

⁵² Sydney Morning Herald, KPMG hit with penalty tax bill, 17 May 2004; Sydney Morning Herald, Second big firm hit in tax sweep, 18 May 2004.

KPMG' predatory culture came under the spotlight because of determined action by US Senators and regulators. The same culture operates in the UK too, but only comes to light when occasionally, after years of expensive litigation, the schemes are struck down by the courts. One cannot tell how much remains undetected. KPMG is not alone in being intoxicated with the smell of money. The next section provides a glimpse of the practices of Ernst & Young, another key player in the global tax avoidance industry.

ERNST & YOUNG AND ITS WORLD OF TAX AVOIDANCE

Ernst & Young has a history of crafting ingenious tax avoidance schemes. One enabled directors of Phones 4u (part of the Dextra Group of Companies) to pay themselves in gold bars, fine wine, and platinum sponge⁵³ and avoid National Insurance Contributions (NIC). No sooner had the legislation killed off that scheme, Ernst & Young devised another. This enabled higher paid employees and directors of Phones 4U (and other companies) to avoid NIC and income taxes by securing payments through an offshore employee benefit trust⁵⁴ (EBT) in Jersey. The gist of these schemes was that companies paid money into the trusts which then 'lent' it to the employees. As long as the transaction looked like a loan, for example by carrying interest, tax is avoided by the company and the employee. The transactions for the scheme were set up with the involvement of Regent Capital Trust Corporation Limited (Regent), a Jersey company, which in turn was owned by the partners of a Jersey law firm, Bedell & Cristin.

An HMRC bulletin⁵⁵ explained that Dextra Accessories Ltd and five other companies made contributions to an EBT. They deducted these contributions in computing their taxable profits. The trust deed gave the trustee wide discretion to pay money and other benefits to beneficiaries and a power to lend them money. The potential beneficiaries of the trust included past, present and future employees and officers of the participating companies in the Dextra group, and their close relatives and dependants. The trustee did not make payments of emoluments out of the funds in the EBT during the periods concerned, instead the trustee made loans to various individuals who were beneficiaries under the terms of the EBT. The legal point was whether the companies' contributions to the EBT were "emoluments" and thus liable to income and tax and NIC. The House of Lords held⁵⁶ that the contributions by the companies to the EBT were potential emoluments and hence liable to income tax and NIC.

⁵³ Mail on Sunday, £6m tax threat to Phones4U founder, 15 February 2004.

⁵⁴ For details, see http://www.taxbar.com/documents/dextra_sp.pdf.

⁵⁵ <http://www.hmrc.gov.uk/practitioners/macdonald-v-dextra.htm>

⁵⁶ MacDonal v. Dextra Accessories Ltd & Others [2005] STC 1111

The Ernst & Young factory manufactured another novel avoidance scheme codenamed "Project Pita" or "Pain in The Arse". The scheme would enable Debenhams and 90 major high street retailers to avoid VAT and increase their profits. Brief details of the scheme are as follows:

“Until 1 October 2000 DR, a 100% subsidiary of Debenhams Plc, used to sell goods whose price tag showed, for example, £100 ("the ticket price"). Where the customer used a credit card, a debit card or a store card to pay, DR then paid the credit or debit card handling company, or the company behind the store card arrangements, an amount of, say, £1.00 for its exempt card-handling supply. The result was a supply by DR of the goods for £100; and because the amount paid by DR to the card-handling company (the £1.00) was in return for an exempt supply, no VAT relief was obtained for that expenditure.

From 1 October 2000 onwards an arrangement was put in place. The arrangement was designed to change the terms on which "the Debenhams Group accepts credit cards in order to produce a position whereby less VAT is paid than was paid previously and for no other reason". Those words are taken from a letter dated 17 March 2003 written by Ernst & Young (E&Y), the architects of the scheme who have represented Debenhams in the hearing before this Tribunal. The changed arrangements were designed to make the card-paying customer enter into two purported contracts at the point of sale. One was with DR for the sale of the goods (ticket price £100) for £97.50. The other was with another company called Debenhams Card Handling Services Ltd ("DCHS"). DCHS is a wholly owned subsidiary of DR, but is not a member of the same VAT group as DR. Under the latter purported contract 2.5% of the total ticket price was said to be payable to DCHS for exempt card-handling services. The arrangement, if successful, results in DR making a supply of the goods for a consideration of £97.50, i.e. 97.5% of the ticket price.”

Source: Debenhams Retail PLC v Customs and Excise [2003] UKVAT V18169 (03 June 2003).

The outward sign of the above scheme was a statement printed on the customers' credit card receipt. It read "I agree that 2.5% of the above value is payable to DCHS for card handling services. The total amount I pay remains the same." Of course, the price paid by the credit card customer was the same as for a cash sale. As financial services were exempt from VAT Debenhams claimed that 2.5% of the proceeds were not subject to VAT and therefore the output tax payable to the Treasury would be less. Ernst & Young correspondence seen by the court referred to the £4 million VAT saving for Debenhams as "a very lucrative tax planning opportunity

... an ongoing opportunity “unless legislated against by Customs” ... counteracting measures would take “a number of years” to enact. ... “Due to the level of potential profit opportunity available there is a desire to introduce the scheme as quickly as possible”. Ernst & Young informed Debenhams of a strong “counsels opinion that Customs would need a legislative change to stop this⁵⁷”.

The Tribunal rejected the scheme by concluding that it was “carried out solely for the purpose of avoiding tax. Other than tax avoidance there were no commercial or economic reasons for introducing DCHS into the supply chain”. Of course, Ernst & Young were not going to give up lucrative fee earning opportunities. So the case went to the High Court⁵⁸ which ruled in Debenhams’ favour and subsequently to the Court of Appeal⁵⁹ which finally killed off the scheme and the presiding judge referred to the scheme as “Tweedledum in Alice in Wonderland: I know what you're thinking about, but it isn't so, nohow”. Through this one avoidance scheme alone the participating retailers hoped to increase their profits by some £300 million to £500 million a year. A relieved Treasury spokesperson said, “This was one of the most blatantly abusive avoidance scams of recent years, and the court's decision to quash it is very welcome⁶⁰.”

Another Ernst & Young scheme called Tax-Efficient Off-Market Swaps (or TOMS) was marketed by Ernst & Young as a “tax planning opportunity using the hedging method”; “a 'one-off' as it relies on an asymmetry between the foreign exchange and financial instruments regimes⁶¹”. It was one-off because the government was going to introduce anti-avoidance legislation to block it. The key idea of the scheme was to construct complex hedging transactions, with the help of Royal Bank of Scotland (RBS) and Goldman Sachs. A Deloitte partner explained that the scheme involved “Prudential entering into an off-market currency swap with a bank, on terms that a very significant initial payment was made to the bank.

⁵⁷ See *Debenhams Retail PLC v Customs and Excise* [2003] UKVAT V18169 (03 June 2003); available at

<http://www.bailii.org/uk/cases/UKVAT/2003/V18169.html>

⁵⁸ *Debenhams Retail Plc v Commissioners of Customs and Excise* (2004) EWHC 1540 (Ch)

⁵⁹ *Debenhams Retail Plc* [2005] EWCA Civ 892 (18 July 2005); available at <http://www.bailii.org/ew/cases/EWCA/Civ/2005/892.html>

⁶⁰ The Daily Telegraph, *Debenhams lose VAT case* 19 July 2005.

⁶¹ As per *Prudential Plc v Revenue & Customs* [2007] UKSPC SPC00636 (11 September 2007);

<http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j3463/Spc00636.doc>

The idea was that the payment was deductible for tax purposes in the period in which it was made. Prudential actually entered into two of these arrangements: the first involved a payment of £65m to RBS for a €500m swap, and the second a payment of £40m to Goldman Sachs for a \$250m swap. If all had gone well, a tax deduction would have been claimed for £105m, saving corporation tax of £35m⁶²”. The scheme was sold to Prudential and around 30 other companies and if successful could have resulted in loss of tax revenues of more than £1 billion. The Special Commissioners rejected the scheme and stated that

“Hedging was not a main purpose of the short-term swap agreement. ... Prudential Group had no need of €500,000,000 on 19 June 2002; and a full-term swap agreement of the same date as the short-term swap agreement could, we infer, have been given the same effective date as the short-term swap agreement. The remaining candidate as a "main purpose" was the investment opportunity presented by the front end payment. Mr Foley had £65,000,000 of what he called "idle" cash which, again to use his words, could be invested "on commercially acceptable arm's length terms ... Did the Prudential's decision to deploy the £65,000,000 of idle cash as the front end payment under the admittedly tax driven Ernst & Young Opportunity rank as a main purpose for which it entered into the RBS short-term swap contract? Prudential argue that it did. We find the evidence in support to be unconvincing”.

“We are not persuaded that the main purpose or indeed one of the main purposes of the GSI swap arrangements was to provide Prudential with the opportunity of investing the £40,000,000 of idle money. The purposes for structuring the GSI agreement such that a £40,000,000 front end payment was to be made and for Prudential entering into it were, we think, together a tax avoidance purpose which was a main purpose if not the main purpose”.

Source: Prudential Plc v Revenue & Customs [2007] UKSPC SPC00636 (11 September 2007).

Prudential's appeal against the judgment was rejected⁶³.

Successive UK governments have failed to investigate or fine the firm, or prosecute its partners for peddling these dubious schemes. The firm's

⁶² Dodwell, B., (2007). TOMS: The Special Commissioners' Verdict, Tax Adviser, October, p. 7.

⁶³ Prudential Plc v HM Revenue & Customs [2008] EWHC 1839 (Ch) (31 July 2008)

persistence with its predatory practices finally pushed the US authorities to take action. A report by the US Senate Permanent Subcommittee on Investigations concluded that Ernst & Young sold “abusive or illegal tax shelters”, marketed a number of questionable tax products to multiple clients⁶⁴. Some of the abusive tax avoidance schemes were never registered with the tax authorities. The documents examined by the Senate Committee provide a glimpse of the firm’s organisational culture.

“An internal E&Y email ... recites seven tax products then under development and closes with the statement: “As you can see, we have a great inventory of ideas. Let’s keep up the R&D to stay ahead of legislation and IRS movements.” An E&Y email ... promises the imminent completion of a particular tax product and states: “We will have until 10/31 to market the strategy. ... Once we roll this product out, I will travel to each area to help you present this strategy to your clients. ... Let’s have fun with this new strategy and kick some KPMG, PWC and AA??? ... another E&Y email ... sets a nationwide sales goal for one of the firm’s tax products, asking its tax professionals to work to generate “\$1 billion of loss.”

Source: US Senate Permanent Subcommittee on Investigations, (2005). The Role of Professional Firms in the US Tax Shelter Industry, USGPO: Washington DC p. 83.

Banks, law firms and financial advisers were enrolled to complete the financial manoeuvres necessary for the avoidance schemes. For a fee of \$550,000 (\$250,000 for Ernst & Young, \$250,000 for financial advisers and \$50,000 for the law firm) a tax loss of \$20 million could be generated for willing clients. In some cases, the firm’s fees was calculated as 1.25% of the tax loss generated through avoidance scheme. Some schemes were marketed even though some tax professionals were concerned not only about the scheme’s technical validity, but also about the firm’s failure to disclose the risks associated with the product. In July, 2003, Ernst & Young paid \$15 million to the US tax authorities for failures to register tax avoidance schemes and maintain proper lists of people purchasing them. The firm also agreed to institute a number of organisational and procedural changes to curb its trade in questionable avoidance schemes, but was soon under the spotlight again.

⁶⁴ US Senate Permanent Subcommittee on Investigations, (2005). The Role of Professional Firms in the US Tax Shelter Industry, USGPO: Washington DC p. 6 and 82
(http://www.quatloos.com/Tax_Shelter_Industry_Firms.pdf).

In May 2004, the US Attorney for the Southern District of New York began an investigation into the firm's sale of avoidance schemes to corporations and wealthy individuals. In May 2007, four current and former partners of Ernst & Young were charged⁶⁵ with eight separate counts, including conspiracy to defraud the IRS, tax evasion, making false statements to the IRS, and impeding and impairing the lawful functioning of the IRS. The accompanying 72 page indictment sheet⁶⁶ explained that the firm had elaborate organisational structures for designing and marketing tax avoidance schemes, which through a series of complex transactions either eliminated, or deferred taxes. Many had no meaningful business purpose. The schemes were mass-marketed and sceptical clients were reassured by "false and fraudulent opinion letters" from leading law firms (paragraphs 15 and 62 of the indictment sheet). The defendants allegedly took active steps to prevent the tax authorities from becoming aware of the nature of the schemes by directing "destruction of documents which would reveal the true facts surrounding the design, marketing and implementation" (para 29). Internal emails said that there "should be no materials in the clients' hands - or even in their memory ... a fax of the materials to certain people in the ... government would have calamitous results ... Please take us seriously when we instruct that you not leave ... materials behind at your presentations. ... If these slides ever made their way to the IRS . . . the entire business purpose argument that gives us the ability to distinguish this from COBRA [acronym for a scheme] would be out the window ..." (para 39 and 46).

In June 2007, a former Ernst & Young employee pleaded guilty to conspiracy to commit tax fraud and admitted that "she and others deliberately concealed information from the IRS, and submitted false and fraudulent documentation to the IRS. ... She knew that in order for these tax shelters to succeed in generating the intended tax benefits, it was necessary for the clients to have non-tax business motivations for entering into them, and for carrying out the various steps that generated the tax benefits ... that she and her co-conspirators also took steps to disguise the fact that all the steps of the transactions were all pre-planned from the beginning, and that they did so because they knew that fact would harm the clients' tax positions⁶⁷".

In September 2008, partner of a law firm associated with Ernst & Young schemes pleaded guilty to criminal tax fraud. He acknowledged that over a

⁶⁵ United States Attorney Southern District of New York, 30 May 2007 (<http://www.justice.gov/usao/nys/pressreleases/May07/eyindictmentpr.pdf>)

⁶⁶ See <http://visar.csustan.edu/aaba/Ernst&Young2007taxindictment.pdf>

⁶⁷ US Department of Justice press release, 14 June 2007.

period of several years, “he and others, including individuals at E&Y, participated in developing the PICO [acronym for the tax avoidance scheme] shelter and creating a legal opinion that would be used to support it. ... admitted he and his co-conspirators knew that the IRS would not allow PICO’s tax benefit if the IRS was told that PICO was designed primarily to allow the client to avoid paying taxes and otherwise did not have economic substance⁶⁸” (US Department of Justice press release, 11 September 2008). In May 2009, following a 10-week jury trial, the four partners were found guilty on all counts⁶⁹. Subsequently, in January 2010, the four were given prison sentences ranging from 20 months to 26 months⁷⁰. A steady stream of individuals connected with design, marketing and implementation of the tax avoidance schemes has continued to receive fines, probation or prison sentences⁷¹

The firm was soon in the spotlight again. This time for tax avoidance schemes crafted for US supermarket giant Wal-Mart, which also owns ASDA supermarket chain in the UK. Wal-Mart has a history of avoiding taxes through complex avoidance schemes⁷². Ernst & Young, Walmart’s external auditors, have devised a number of schemes⁷³ for Walmart and one of these related to the use of Reinvestment Trusts (REITs). The scheme was also aimed at banks as they too operate through branches. The REITs were introduced by the US government to encourage small investors to invest in a diversified portfolio of commercial property and spread their risks⁷⁴. The US legislation exempted REITs from corporate taxes as long as they paid out 90% of the profits to shareholders. REITs need at least 100 shareholders. To meet the 100-shareholder threshold Walmart distributed a minimal amount of nonvoting stock, to approximately 114 of its employees. Walmart transferred a number of its properties to a specially created subsidiary and turned it into a REIT. These properties were then leased back and the stores continued their trade in the normal way. Under the arrangements, the subsidiary occupying the property paid rent, which was a tax deductible expense and hence reduced its tax liability in the relevant tax jurisdiction. In fact, Walmart was paying rent to itself and the benefit was that the subsidiary receiving the income would be exempt from

⁶⁸US Department of Justice press release, 11 September 2009.

⁶⁹ US Department of Justice press release, 7 May 2009.

⁷⁰ US Department of Justice press releases, 21 and 22 January 2010.

⁷¹ For example see Bloomberg, 30 March 2010, 13 April 2010;

⁷² Wall Street Journal, Wal-Mart Cuts Taxes By Paying Rent to Itself
1 February 2007.

⁷³ http://online.wsj.com/public/resources/documents/wsj071023-walmart-tax_reduction.pdf.

⁷⁴ They were subsequently also introduced in the UK.

tax because of the special concessions available to REITs. Over a four-year period, the REIT strategy may have reduced Walmart's tax obligations by around \$230 million⁷⁵.

Amongst other US states Walmart's tax avoidance scheme was challenged by the North Carolina tax authority and it blocked the \$33.5 million tax relief claimed by the company⁷⁶. In 2005, a court ruled against Walmart. The company unsuccessfully appealed against the judgement. The judge rejected Walmart's claim that it had incurred rental costs. The judge concluded⁷⁷ that the

“rental arrangement allowed plaintiffs [Walmart] to funnel substantial amount of their gross income through respective REITs and property companies only to have the “rent” return to them in a non-taxable form, prior to the eventual transfer of the funds to the parent Wal-Mart Stores, Inc. There is no evidence in this record of any economic impact (apart from the obvious state tax savings) of the transaction to plaintiffs, particularly as plaintiffs were rendered no poorer in a material sense by their “payment of “rent” ... there is no evidence that the rent transaction, taken as a whole, has any real economic substance ...”

Source: Wal-Mart Stores East v Reginald S. Hinton, Case No 06-CVS-3928, 31 December 2007, North Carolina Wake County, Superior Court Division.

Walmart could not persuade the Court of Appeals to overturn the judgment⁷⁸. The company fought unsuccessfully to prevent public disclosure of court documents. One of these contained a letter⁷⁹, dated 30 April 1996, from Ernst & Young to Walmart and stated that the

⁷⁵ Wall Street Journal, Inside Wal-Mart's Bid To Slash State Taxes, 23 October 2007.

⁷⁶ Bloomberg, Wal-Mart May Appeal \$33.5 Million North Carolina Court Decision, 6 January 2008.

⁷⁷ Wal-Mart Stores East v Reginald S. Hinton, Case No 06-CVS-3928, 31 December 2007, North Carolina Wake County, Superior Court Division (<http://online.wsj.com/public/resources/documents/wmttaxruling1.pdf>); also see Wall street Journal, Judge Rules Against Wal-Mart Over Its **Tax-Shelter** Dispute, 5 January 2008.

⁷⁸ Wall street Journal, In Tax Case, Wal-Mart Still Singing Carolina Blues, 19 May 2009.

⁷⁹ http://online.wsj.com/public/resources/documents/wsj071023-walmart-tax_project.pdf.

“successful operation of this project will result in substantial state income tax savings to Wal-Mart. While the strategies being implemented are totally within the law, we see no useful purpose being served in broadcasting these changes. Rather we see only potential downside from any external publicity from these changes. We don’t think there is much the state taxing authorities can do to mitigate these savings to Wal-Mart, however, some states might attempt something if they had advance notification. We think the best course of action is to keep the project relatively quiet. All our team members of course need to know what we are doing and why. It does not need to be treated as a secret. On the other hand, if a broader group of people are knowledgeable about these strategies, there just seem to be too many opportunities for it to get out to the press or financial community and we all know they are difficult to control, particularly when we are dealing with a client as well-known as Wal-Mart. As a result, we have concluded that the project’s long-term success will be enhanced by being discreet in how and where we discuss the project”.

In another document⁸⁰, Ernst & Young considered hypothetical questions and then provided answers – “Q: What if the press gets wind of this and portrays us as a ‘tax cheat’? A: That’s a possibility ... If you are concerned about possible negative publicity, you can counter it by reinvesting the savings in the community⁸¹”. Seemingly, Ernst & Young thought of everything except the negative impact its predatory practices on communities.

PRICEWATERHOUSECOOPERS AND ITS WORLD OF TAX AVOIDANCE

SABMiller is the world’s second largest beer company, with interests across the world. It has over 200 beer brands, including Pilsner Urquell, Peroni Nastro Azzurro, Miller Genuine Draft, Grolsch, Aguila, Castle, Miller Lite and Tyskie. Its 65 tax haven subsidiaries exceed the number of breweries and bottling plants in Africa. Its accounts for the year to 31 March 2011 show sales revenues of US\$19408 million (2010 \$18,020 million), pre-tax profits of US\$3,626 million (2010 \$2,929 million) and tax-paid US \$885 million (\$620 million), which approximates an effective tax rate of 24% (2010 21%). The company is audited by PricewaterhouseCoopers, which continues to give it a clean bill of health.

⁸⁰ For further documents see http://walmartwatch.com/wp-content/blogs.dir/2/files/pdf/state_tax_avoidance.pdf

⁸¹ Wall Street Journal, 1 February 2007; http://online.wsj.com/public/article/SB117027500505994065-WAv3Z4GcXNsXgv1Bi_Xlvadhgpk_20070322.html?mod=msn_free

In 2011, PwC picked up fees of \$20 million, including \$3 million for advice on taxation and another \$5 million for “other services”.

A 2010 report by Action-Aid⁸² alleged that SABMiller may be avoiding around £20 million in taxes each year in India and Africa through complex financial transactions, transfer pricing techniques and shuffling profits to subsidiaries in tax havens. The report notes that SABMiller’s brewery in Ghana, Accra Brewery, has sales of £29 million, but in the last two years declared a loss and has paid local corporation tax in only one of the four years from 2007-2010. The report shows that one woman selling beer outside SABMiller’s brewery in Ghana paid more income tax last year than the multi-million pound brewery.

Action-Aid report shows that SABMiller companies in India and Africa pay some £47 million a year in management services fees to Swiss subsidiaries of the Group. These fees count as expenses for the Indian and African operations and deprive the local governments of some £9.5 million of tax revenues. SABMiller denies the allegations and claimed that

“SABMiller companies pay a significant level of tax. In the year ended 31 March 2010, the group reported US\$2,929 million in pre-tax profit and group revenue of US\$26,350 million. During the same period our total tax contribution remitted to governments, including corporate tax, excise tax, VAT and employee taxes, was just under US\$7,000 million. Seven times that paid to shareholders. This amount is split between developed countries (23%) and developing countries (77%). In both Colombia and South Africa, we contributed over US\$1,000 million in taxation to each respective government's revenues.”

Source: SABMiller press release, 26 November 2010.

The absurdity of the above claim is noteworthy. The company had a profit of \$2,929 million but made tax payments of \$7,000 million! The fantasy figures are manufactured by PwC, all for a fee of course. PwC sells what it calls “Total Tax Contribution” (TTC). The purpose of this calculation is to enable “corporations to pretend their tax bills are bigger than they really are, by counting not just their actual taxes, but also taxes they don’t pay, such as those paid by their customers, workers, suppliers, and so forth⁸³”.

⁸² Action-Aid, (2010). Calling Time: Why SABMiller should stop dodging taxes in Africa, London: Acton-Aid (http://www.actionaid.org.uk/doc_lib/calling_time_on_tax_avoidance.pdf).

⁸³ McIntyre, R.S. (2006). Transparently Dishonest, The American Prospect, 30 August.

PwC's spin-machine says that TTC helps "companies measure and communicate all the different taxes and contributions that they pay to governments. ...The framework looks at all the taxes that companies pay and not just corporate income tax, which is usually the only tax separately disclosed in the financial statements. It makes a distinction between taxes borne and taxes collected. Taxes borne are the company's own cost and will impact their results, e.g. property taxes will form part of the property costs. Taxes collected are those that the company administers on behalf of government and collects from others, e.g. employee income taxes deducted through the payroll. Taxes collected will have an administrative cost for the company and will also have an impact on the company's business, e.g. employment taxes impact the cost of labour⁸⁴". PwC propaganda attributes all taxes to corporations, including those not borne by the company at all. For example, employees pay income tax and National Insurance Contributions (NIC). These are deducted at source by companies and then remitted to the tax authorities. Similarly consumers pay VAT and fuel duty on purchases. This is collected by companies and then at set intervals, after deduction of VAT on their purchases, is paid over to tax authorities. PwC's 'total tax contribution' lumps corporate taxes, if any, paid by the company together with income tax, VAT, NIC and excise duties.

Companies are buying up PwC's propaganda. In the US, ExxonMobil with profits of \$36 billion claims to have paid taxes of \$99 billion⁸⁵. In the UK, government reports show that major companies are avoiding taxes⁸⁶ and others say that in 2009 only 33.6% of the UK companies actually paid corporate tax⁸⁷. In contrast, a PwC report claimed that in 2010 UK's largest 100 companies made a total tax contribution of £56.8bn, which is 11.9% of government receipts from all taxes. PwC spin includes £39.2 billion which is not borne by companies. In fact, as income tax, VAT, NIC and fuel duty is remitted in arrears to government, companies are getting a huge interest-free loan from the taxpayer even though they pass on the cost of acting as tax collectors to the consumer through prices.

A PwC report prepared for the US Business Roundtable⁸⁸ claims that major US corporations have an effective tax rate of 27.7%. Floyd Norris, a

⁸⁴ PricewaterhouseCoopers, (2010). Tax transparency: Communicating the tax companies pay, London: PwC, p. 14.

⁸⁵ McIntyre (2006), op cit.

⁸⁶ National Audit Office, 2007; op cit.

⁸⁷ Murphy, R. (2011). 500,000 missing people: £16 billion of lost tax- How the UK mismanages its companies, Downham Market: Tax Research LLP.

⁸⁸ US Business Roundtable, (2011). Global Effective Tax Rates, Washington DC: BRT

veteran journalist at New York Times put a number of questions to Andrew Lyon, the author of the report, a former assistant Treasury secretary under George W. Bush. These included⁸⁹: “how much do these companies actually pay in taxes to Uncle Sam? How much do they actually pay to state and local authorities? How much do they actually pay to foreign governments? We have not looked at that data,” he replied”. Norris noted that in the 1960s, corporate taxes amounted to about 22 percent of overall tax receipts, and averaged 3.9 percent of gross domestic product. In the most recent decade, the figures are about 12 percent of total taxes and 2.2 percent of G.D.P. In other words, the corporate tax burden is roughly half what it was. In the US corporate tax payments as a percentage of pre-tax income are lower than at any time since World War II. Norris concluded that the PwC report was “blatantly misleading”. PwC spin appropriates the vocabulary of transparency, but provides no information about its own role in tax avoidance, the schemes that it manufactures and the amount of tax that major corporations should have paid, or even the fees that the firm charges for its spin and whitewash.

PwC is no stranger to controversy and spin. For years it promoted patent donations as a tax avoidance strategy⁹⁰ in the US. The idea of patent donations began in the mid-1990s. It was designed to encourage US corporations to donate unusable and defunct patents to universities, hospitals and not-for-profit organisations so that these organisations could use them in their own research programmes and thus generate income for the welfare of the community. The donating companies got a tax deduction. It was not long before dubious values began to be assigned to spurious patents to enable companies to claim high deductions from their tax bills. An IBM executive is credited with saying that “97% of all U.S. patents have no economic value because majority of patents are not licensed because the technology they embody is not really useful, not feasible to commercialize, or simply not marketable⁹¹”.

PwC became bold in its marketing of tax avoidance schemes and its wings had to be clipped. A 2005 report published by the US Senate Permanent Subcommittee on Investigations concluded that

⁸⁹ New York Times, A misleading view of corporate taxes, 14 April 2011.

⁹⁰ Forbes, Washington Blocks Patent Tax Breaks, 7 January 2004.

⁹¹ Cited in US Department of Treasury Internal Revenue Service Office of Tax Shelter Analysis, (2003). Patent Donations, p. 3 (http://www.m-cam.com/downloads/20030108_donation-whitepaper.pdf).

“PricewaterhouseCoopers sold general tax products to multiple clients, despite evidence that some, such as FLIP, CDS, and BOSS, were abusive or potentially illegal tax shelters ... Each of these tax products has been identified by the IRS as an abusive tax shelter. ... PwC’s handling of the FLIP tax product demonstrates the firm’s flawed process for developing, marketing, and implementing potentially abusive or illegal tax shelters. ... PwC issued opinion letters to its clients, stating that it was “more likely than not” that FLIP would be upheld, if challenged by the IRS. PwC apparently continued to issue these favorable opinion letters even after learning that the FLIP transactions was the subject of federal legislation ... PwC failed to register FLIP with the IRS as a tax shelter ...”

Source: US Senate Permanent Subcommittee on Investigations (2005), *The Role of Professional Firms in the US Tax Shelter Industry*, Washington DC: USGPO.

Some PwC schemes generated tax losses for clients through a series of complex financial transactions. These were sold to clients even though the firm knew that they are dubious and would probably not withstand a challenge from the tax authorities. One of the tax avoidance schemes known as Foreign Leveraged Investment Program (FLIP) apparently migrated from KPMG to PwC after a KPMG partner joined the firm and brought the scheme with him. Banks and law firms were enrolled to enable the firm to sell its products. The Senate report drew attention to the collusive and dependent relationship with banks. For example, the Senate Committee noted that PwC entered into a client referral arrangement with First Union National Bank (subsequently became part of Wachovia National Bank). Under this arrangement, First Union referred banking customers to PwC for presentation of schemes.

Faced with possibility of retribution, the firm explained its predatory culture by stating that “In the 1990’s there was increasing pressure in the marketplace for firms to develop aggressive tax shelters that could be marketed to large numbers of taxpayers. This had not been a traditional part of our tax practice, but regrettably our firm became involved in three types of these transactions. ...” (p. 94). For an organisation that audits mega corporations, PricewaterhouseCoopers argued that the sale of abusive tax avoidance schemes was facilitated by “a lack of a centralized review process with proper authority, accountability, and oversight”. PwC did not explain the reasons for embracing predatory culture and the persistence of oversights. At the Senate hearings PricewaterhouseCoopers personnel argued that the firm has learnt from its past mistakes and has turned a new leaf. It settled the cases with the US tax authorities by making a \$10 million

payment and handing over certain client lists to the IRS. It also permitted the IRS to review the firm's quality control procedures and examine 130 tax planning strategies intended for sale to multiple clients. However, PwC still did not restrain its trade.

Secrecy is a key ingredient for the tax avoidance industry. The UK tax legislation requires taxpayers (or third parties) to provide a tax inspector documents which the inspector may consider to be relevant to determining the tax liability of a taxpayer. In response, professional advisers can often claim "legal professional privilege" (LPP) and may thus fail to provide the relevant documents. Such issues came to a head as a result of a complex scheme sold by PricewaterhouseCoopers to Prudential Plc and its subsidiaries. Special Commissioners rejected the tax avoidance schemes and ordered Prudential to disclose advice given by PricewaterhouseCoopers. Traditionally, lawyers have claimed LPP but a key issue was whether advice given to Prudential by PricewaterhouseCoopers, i.e. accountants rather than lawyers, is also covered by LPP. The extension of LPP to accountants, the major players in the tax avoidance industry, would have created additional problems in combating organised tax avoidance. The High Court decided⁹² that LPP applies only to advice given by lawyers and not to legal advice given by accountants. Subsequently, Prudential appealed to the Court of Appeal. Rather than arguing for openness to check the tax avoidance industry, the ICAEW intervened in the Court of Appeal hearing to argue for LPP for accountants. The Law Society also joined the fray. Their interventions were motivated by turf battles and profits for their members rather than any conception of social justice. The Court of Appeal unanimously rejected Prudential's appeal⁹³. Prudential has been granted leave to appeal to the Supreme Court and the ICAEW is continues to show its anti-social credentials by pursuing secrecy and related privileges for accountants through courts and by lobbying of parliament to get the law changed.

Another PricewaterhouseCoopers scheme was thrown out by the US Court of Appeals for the Fifth Circuit with the following conclusion:

⁹² Prudential Plc & Anor, R (on the application of) v Special Commissioner of Income Tax & Anor [2009] EWHC 2494 (Admin) (14 October 2009); <http://www.bailii.org/ew/cases/EWHC/Admin/2009/2494.html>

⁹³ Prudential Plc & Anor, R (on the application of) v Special Commissioner of Income Tax & Ors [2010] EWCA Civ 1094 (13 October 2010); <http://www.bailii.org/ew/cases/EWCA/Civ/2010/1094.html>

“The uncontroverted evidence supports the district court’s conclusion that this was a sham conduit transaction ... the transaction was designed solely for the purpose of avoiding taxes, taxes, and Midcoast has offered no adequate non-tax reasons for using a conduit entity ... the uncontroverted evidence shows that the arrangement at issue in this case had the sole purpose of avoiding federal income tax.”

Source: US Court of Appeals for the Fifth Circuit, *Enbridge Energy Co. and Enbridge Midcoast Energy LP v United States*, 10 November 2009.

The case was brought by Enbridge Energy Company, Inc. and Enbridge Midcoast Energy, L.P. (collectively, “Midcoast”) against the US IRS for a refund of \$5.4 million assessed in taxes and penalties. The taxes arose from a series of transactions. In 1999, Midcoast acquired the control of the Bishop Group (Dennis Langley was its sole shareholder) which operated various energy-related pipelines. The change of control took the form of a conduit transaction, whereby Bishop’s sole shareholder sold his stock to a third-party intermediary (the K-Pipe Merger Corporation), which then immediately sold the formerly Bishop assets to Midcoast. The IRS applying the “substance over form” doctrine disregarded the use of the conduit in the transaction, treating the transaction as a direct stock sale for tax purposes -- resulting in less favourable tax treatment for Midcoast. After paying due taxes and penalties under protest, Midcoast brought the instant suit claiming the IRS erroneously treated the transaction as a direct stock sale and erroneously assessed a 20% penalty. The district court granted summary judgment to the IRS on both claims. Thus the case went to the Court of Appeal which upheld the previous decision.

Midcoast was advised by PwC and the firm suggested that idea of using a “midco transaction,” in which Langley would sell his Bishop stock to a third party, and the third party would in turn sell the Bishop assets to Midcoast. This arrangement, PwC advised, would provide tax benefits for both Midcoast and Langley. The financial manoeuvres for the tax avoidance scheme were facilitated by Fortrend International, an investment bank. Fortrend created an entity, K-Pipe, specifically for the transaction. K-Pipe had no assets of its own, nor had it conducted any prior business. Thomas J. Palmisano, then a senior manager with PwC, testified that his firm contacted Fortrend to facilitate the Midco transaction specifically so that “Midcoast [would] receive a stepped-up basis in the [Bishop] assets. And by doing so, it would give [Midcoast] an ability to increase the amount of consideration for the assets.” Recognizing the benefits of the Fortrend-facilitated midco transaction, Midcoast agreed because, as Midcoast’s CFO

testified, “this was the only thing that we felt could close” the gap between Langley’s requested price and Midcoast’s offer.

The US case of Canal Corporation and Subsidiaries, formerly Chesapeake Corporation and Subsidiaries v Commissioner of Internal Revenue, 135 T.C. 9, Docket No. 14090-06 (2010) exposed conflicts inherent in PwC’s tax avoidance business, namely when auditors draft tax avoidance schemes for clients⁹⁴. In this case the judge considered the firm’s opinion to be tainted. Briefly, Chesapeake (previous name of Canal Corp.) was a leading player in the paper tissue products through its subsidiary, Wisconsin Tissue Mills Inc (WISCO). The industry is capital intensive and due to consolidation in the industry WISCO faced considerable disadvantages. Chesapeake was keen to exit the industry. One option was to sell WISCO, but felt that due to its tax status the after-tax proceeds would be low compared to the pre-tax proceeds. This tax differential caused Chesapeake to decide a direct sale of WISCO would not be advantageous. Chesapeake hired Salomon Smith Barney and PricewaterhouseCoopers to explore strategic alternatives for the tissue business. PWC had served as Chesapeake’s auditor and tax preparer for many years.

Salomon recommended that the best alternative would be to form a leveraged partnership structure, or a limited liability company (LLC), with Georgia Pacific (GP). PwC advised and assisted Canal in structuring the leveraged partnership transactions. In particular, PWC determined that the transaction should be treated as a sale for accounting purposes, but the tax aspects were to be significantly different. A PwC partner, Mr. Miller, helped structure the partnership agreement. Under this, WISCO and GP transferred all of their respective tissue business assets to a new partnership which, in turn, borrowed \$755.2 million from a third party that was immediately distributed to Canal as a "special distribution." WISCO guaranteed this third-party debt and executed an indemnity agreement with Georgia Pacific. After these transactions, WISCO ended up with a small minority interest in the partnership. The tax authorities construed the transaction as a disguised sale of the transferred assets. Therefore, Chesapeake had to include an additional \$524 million of income on its tax return. The IRS also imposed a \$36.7 million penalty on the company for substantial understatement of income tax. This was upheld by the Tax Court.

The company contested the penalty by saying that it acted in good faith by seeking advice from a competent tax adviser. “Good faith” could mean that the advice was provided by an independent party. However, in this case, for

⁹⁴ <http://www.ustaxcourt.gov/InOpHistoric/chesapeakecanal.TC.WPD.pdf>

a fixed fee of \$800,000 PwC gave an opinion saying that the transaction would not constitute a disguised sale. As PwC was closely involved with the scheme could it really objectively assess the risks? The court felt, not.

“PwC crossed over the line from trusted adviser for prior accounting purposes to advocate for a position with no authority that was based on an opinion with a high price tag—\$800,000 ... Any advice Chesapeake received was tainted by an inherent conflict of interest. We would be hard pressed to identify which of his hats Mr. Miller was wearing in rendering that tax opinion. There were too many. Mr. Miller not only researched and drafted the tax opinion, but he also “audited” WISCO’s and the LLC’s assets to make the assumptions in the tax opinion. He made legal assumptions separate from the tax assumptions in the opinion. He reviewed State law to make sure the assumptions were valid regarding whether a partnership was formed. In addition, he was intricately involved in drafting the joint venture agreement, the operating agreement and the indemnity agreement. In essence, Mr. Miller issued an opinion on a transaction he helped plan without the normal give-and-take in negotiating terms with an outside party. ... Considering all the facts and circumstances, PwC’s opinion looks more like a quid pro quo arrangement than a true tax advisory opinion. If we were to bless the closeness of the relationship, we would be providing carte blanche to promoters to provide a tax opinion as part and parcel of a promotion. Independence of advisers is sacrosanct to good faith reliance. We find that PwC lacked the independence necessary for Chesapeake to establish good faith reliance. ... Chesapeake did not act with reasonable cause or in good faith in relying on PwC’s opinion.”

Source: Canal Corporation and Subsidiaries, formerly Chesapeake Corporation and Subsidiaries v Commissioner of Internal Revenue, 135 T.C. 9, Docket No. 14090-06 (2010).

The judge upheld the \$36.7 million penalty and struck another blow against the conflicts of interests rampant in the tax avoidance industry. Canal is expected to appeal against the court decision.

PwC’s tax avoidance manoeuvres are not constrained by any geographical boundaries. In 2009, the New Zealand High Court upheld a total tax assessment of NZ\$961 million by rejecting an avoidance scheme used by Westpac Banking Corporation⁹⁵. The assessment consisted of tax of NZ\$586m with another NZ\$375 million in interest payments. The bank used a series of structured finance transactions to reduce its tax liability.

⁹⁵ Westpac Banking Corporation v The Commissioner of Inland Revenue, CIV 2005-404-2843, 7 October 2009.

The tax authorities characterised these transactions as a “sham” and the court decided that they were tax avoidance arrangements entered into for a purpose of avoiding tax. PwC’s role was identified in parliament by Dr. Russel Norman, co-leader of the New Zealand Greens.

“According to the judge, not only were the arrangements unlawful but the four transactions tested in the case were “tax avoidance arrangements entered into for a purpose of avoiding tax;”. Anyone who has followed this case will be amazed at the extent Westpac went to in order to have this series of structured finance arrangements—very, very complicated structured finance arrangements—in order to, in Justice Harrison’s words, simply “avoid paying tax”. That was the only purpose of those arrangements.

It is also quite sad that one of the people involved—in fact, he was one of the key advisers to Westpac in this case—was no less than John Shewan, who is now chairman of PricewaterhouseCoopers, one of our most important accounting and advisory firms. John Shewan, according to the judgment, advised Westpac to make tax payments as low as 6 percent—most taxpayers would be surprised by such advice—but no lower. That is in the context of New Zealand’s company tax rate being 30 percent. Westpac was advised by one of the most senior tax lawyers in our country to have a tax rate of 6 percent, but no lower. Justice Harrison wrote in his judgment: “The bank”—that is, Westpac—“was anxious not to reduce it unduly because of its reputational effect; it wanted to appear as a good corporate citizen paying a responsible level of tax. For that reason, Westpac’s chief executive officer imposed a minimum ETR for the Westpac group of 25% in 1997. All these transactions took that factor into account. However, management progressively allowed the ETR to fall, first to around 20% in about May 2000 and then to the ‘high teens’.” The Government’s banker is organising its tax affairs in order to reduce its corporate tax rate to under 20 percent. It is an extraordinary turn of events. What is even more extraordinary is that one of Westpac’s key advisers, John Shewan from PricewaterhouseCoopers, is now on the Government’s Tax Working Group.”

Source: Hansard, Daily debates, 14 October 2009. Vol. 658, p. 6993.

Major accountancy firms have close relationship with the state officials all over the world. In July 2008, PricewaterhouseCoopers partner Eric Crawford, also a past president of the Institute of Chartered Accountants of

Jamaica, submitted a report to the Jamaican government⁹⁶ listing the steps it needs to take to become a tax haven.

Firms helping their wealthy clients to shave their tax bills are also capable of doing the same to their own and their partners; tax bills. In 2006, it was reported that PwC has been the subject of a special audit by the United States tax authorities⁹⁷. The audit examined the timing of tax deductions, the group's pension plan and how the firm moved profits between international units. Edward Nusbaum, chief executive officer of Chicago-based Grant Thornton LLP, the sixth-largest accounting firm, said he was unaware of previous IRS audits of accounting firms. "In general, accounting firms don't get audited," he said. "I know we have not been audited⁹⁸". The annual reports published by PwC do not provide any information about the inception or the outcome of this audit.

DELOITTE & TOUCHE AND ITS WORLD OF TAX AVOIDANCE

In November 2010, the US Securities and Exchange Commission (SEC) charged⁹⁹ a former Deloitte Tax LLP partner and his wife with repeatedly leaking confidential merger and acquisition information to family members overseas in a multi-million dollar insider trading scheme. The SEC alleged that husband and wife provided advance notice of at least seven confidential acquisitions planned by Deloitte's clients to relatives in London. As part of the same case, the UK's Financial Services Authority (FSA) laid charges¹⁰⁰ against the two relatives.

Deloitte & Touche is under the spotlight for its links with the Royal Bank of Scotland (RBS). RBS, bailed out by the UK taxpayer, is accused of avoiding £500 million of taxes through complex avoidance schemes¹⁰¹. The schemes were designed during the time of its chairman Sir Fred Goodwin and involved the movement of large amounts of cash, often through offshore places like the Cayman Islands. Deloitte have been auditors and advisers to RBS for many years. John Connolly, former chairman of Deloitte, mentored Goodwin and promoted him to partner status in the

⁹⁶Jamaica Gleaner, Offshore centre won't cave to market turmoil, 3 October 2008.

⁹⁷The Daily Telegraph, IRS carrying out special audit of PwC, 28 August 2006.

⁹⁸ Bloomberg, PricewaterhouseCoopers, Biggest Accountant, Faces IRS Audit, 25 August 2006.

⁹⁹ SEC press release, 30 November 2010.

¹⁰⁰ FSA press release, 30 November 2010.

¹⁰¹ The Guardian, RBS avoided £500m of tax in global deals, 13 March 2009.

firm¹⁰². Goodwin also handled the lucrative liquidation of the Bank of Credit and Commerce International (BCCI), the fraud-ridden bank that was closed in July 1991. In 2000, when Deloitte were first brought to RBS, the firm took £9 million in fees, including £4 million in consultancy fees. By 2008, just before the state-backed Deloitte collected £38.6 million in audit and £20.1 million for other fees. RBS received its customary clean bill of health from auditors and there is no mention of any tax avoidance scheme.

Bankers have destroyed economies with their reckless gambling and risk-taking, but have been bailed-out by taxpayers. They are still collecting mega salaries and bonuses. Hard-pressed governments are hoping to collect taxes from these remuneration packages, but Deloitte have drawn up schemes to thwart that. In 2004, the firm designed a scheme for the London office of Deutsche Bank (DB), advising the government on the sell-off of Northern Rock, to enable it to avoid income tax and National Insurance Contributions (NIC) on bonuses adding up to £92 million. More than 300 bankers participated in the scheme which operated through a Cayman Islands-registered investment vehicle called Dark Blue Investment (DBI), managed by Investec. The key idea was summed by a Tax Tribunal.

“DB arranged for certain bonus sums that were to be payable to identified individual DB employees to be paid into the vehicle created for the Scheme and not directly to any employee. Those sums were used to purchase shares in DBI which were allocated to individual employees. DB employees were given rights to sell their shares and withdraw sums from the Scheme over a period, up to the amount of the individual bonus of the employee subject to any fluctuation in the value of the shares during the period. If this right was used the employee received a cash sum. The Scheme was wound up at the end of a specified period, and sums paid to employees who had not previously received sums from the Scheme”.

Source: Deutsche Bank Group Services (UK) Ltd v Revenue & Customs [2011] UKFTT 66 (TC) (19 January 2011)

Deutsche Bank argued that the employees received nothing taxable when the sums were paid into the Scheme. They received shares, but no income tax or NIC contribution liability arose in respect of the receipt of those shares because they were “restricted securities” exempted from liability by section 425 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). Employees disposed of their shares by sale at various times, but there was no income tax liability or NIC contribution liability by reason of the sale.

¹⁰² The Sunday Times, Auditors: In the palm of the banks?, 25 January 2009.

The Tribunal judge concluded that the avoidance scheme was put together by Deloitte on the basis of a more general proposal initially put to Deutsche Bank. Deloitte continued throughout to play a central role in designing and delivering the Scheme. The firm developed a draft timetable and action plan for the Scheme. An email assured clients that “each time an action changes in time, delay or advancement, Deloitte will review the whole process to ensure any knock on effect are dealt with effectively. The timetable will be published to all involved every 2/3 days, including an early Monday morning edition focussing on action for the week in strict order”.

The Tribunal rejected the scheme and the judge said that “DBI, the company in which the restricted securities were held, was therefore in reality purely a vehicle for the Scheme ...the Scheme as a whole, and each aspect of it, was created and coordinated purely for tax avoidance purposes”. To save its Treasury contracts Deutsche said that “This was a one-off arrangement from seven years ago and hasn’t been repeated¹⁰³”. It did not say what other avoidance schemes it is using. Deloitte are also silent on the number of other schemes that it has marketed.

Deloitte is also the tax adviser to London-based Vodafone, the world’s largest mobile telecommunications company. Vodafone came on the UK tax authorities’ radar for its acquisition of German telecoms operator Mannesmann in the year 2000. The acquisition was financed by a €35bn debt parked in Vodafone’s Luxembourg subsidiary, VIL Sarl. Under the deal Mannesmann paid interest on debt to VIL Sarl and thus reduced its taxable profits and tax bill in Germany. The interest received by VIL Sarl avoided tax. The transactions fell foul of the UK Controlled Foreign Companies legislation and the tax authorities argued that the financing deal was “wholly artificial”. Some estimated that the UK authorities were trying to collect £6 billion of tax though the details are unknown. Vodafone’s accounts audited by Deloitte contained a provision of £2.2 billion to meet the expected tax liability. Deloitte showered hospitality upon HMRC boss Dave Hartnett¹⁰⁴. Private-Eye reported (21 June 2011) that since 2006 Dave Hartnett had no less than 48 meetings with Deloitte UK chairman David Cruickshank. Magically, Vodafone’s tax liability shrank. The company may have been willing to settle for £2.2 billion, but the actual settlement was a lump sum of £800,000 and a further £450,000 spread over five years.

¹⁰³ The Daily Telegraph, Deutsche Bank fights tax ruling on £92m bonus pool, 2 April 2011.

¹⁰⁴ Daily Mail, Revenue boss entertained by Vodafone accountants weeks before £6bn tax deal, 27 March 2011.

Deloitte was tax adviser to MG Rover Group, a UK car manufacturer which collapsed in April 2005 with debts of £1,289 million and the loss of 6,500 jobs. A government inquiry¹⁰⁵ drew attention to large scale tax avoidance, using leasing, loans and offshore entities in Guernsey. The report noted that for 2000-2005 Deloitte received £30.7 million in fees from the MG Rover Group and £28.8 million of this was for “other services”, including advice on taxes. In May 2011, four former MG Rover directors were disqualified by the UK government, but no action has been taken against Deloitte even though the tax authorities thwarted some of MG Rover’s tax schemes. On 17 August 2005, the Accountancy Investigation and Discipline Board (AIDB), an offshoot of the UK accountancy regulator the Financial Reporting Council (FRC) announced that it is to “investigate the conduct of Deloitte & Touche LLP as auditors and advisers to the MG Rover Group. Initially, the investigation will focus on the audits of the 2003 accounts of MG Rover Group Limited and its ultimate parent company, Phoenix Venture Holdings Limited and certain non-audit services provided by Deloitte & Touche to the Group”. In November 2009, it further announced that in the light of the government report it is still looking at the issues¹⁰⁶. The FRC has carefully avoided any direct mention of scrutiny of the role of Deloitte in crafting tax avoidance schemes and no report on Deloitte has as yet materialised.

In May 2011, Switzerland based commodity trader Glencore International, with subsidiaries in Bermuda, Luxembourg, Jersey and the British Virgin Islands, was floated on to the London stock market and made instant billionaires of its directors. The flotation fees of some \$435 million were shared by various underwriters, bankers, lawyers and accountants. Deloitte and Touche provided accountancy services for an unspecified amount. For the year to 31 December 2010, the company reported sales revenues of US\$145 billion and pre-tax profits of US\$4,340 million. The total worldwide tax-paid was just \$323 million, an effective rate of 7.44%. The company does not say how much it paid to each country. Deloitte audited the Group’s accounts for the year to 31 December 2010 and gave them a clean bill of health.

Glencore’s stock market debut was marred by allegations of tax avoidance by the Zambian government. These were based upon a report

¹⁰⁵ Department of Business Innovation and Skills, (2009). Report on the affairs of Phoenix Venture Holdings Limited, MG Rover Group Limited and 33 other companies, London: TSO.

¹⁰⁶<http://www.frc.org.uk/images/uploaded/documents/ROVER%20PROGR%20REPORT%20-%20PUBLISHED.pdf>

commissioned by the government that examined Glencore's trading relationship with its Zambian subsidiary Mopani Copper Mines Plc. The report¹⁰⁷ was prepared by Grant Thornton, another accountancy firm, and alleges that an accounting technique known as transfer pricing enabled the company to shift profits from Zambia. The report says that Mopani may be selling Zambia's copper to Glencore at less than the prevailing market prices so as to reduce the profits booked in Zambia and deny the government about £100 million in lost taxes. Glencore denies the allegations¹⁰⁸ and as part of its defence wheeled out a statement from Deloitte, Mopani's auditors, which claimed that Grant Thornton's report was flawed¹⁰⁹. The Zambian government has asked the OECD to intervene.

Poor countries offer economic incentives to attract foreign investment and stimulate their economies. Accounting firms are adept at exploiting this. Thailand has offered corporate-tax holiday period of up to 8 years to foreign investors. The tax holidays create possibilities for shifting profits to these low-tax jurisdictions and thus avoid tax elsewhere. In relation to tax-holiday in Thailand, a tax partner of Deloitte advised that

“By engaging in transfer-pricing planning on day one as opposed to waiting until the tax holiday ends, the Thai company and its multinational group may be able to take advantage of the tax holiday to shift a supportable level of profit to the Thailand company to reduce the multinational group's worldwide tax cost, whilst also planning ahead for the day when the tax holiday ends”.

Source¹¹⁰: Bangkok Post, Transfer pricing and BOI Tax Holidays: Is It Really an Issue? 23 May 2007, p. B10.

Of course poor countries rarely have the financial and political resources to challenge giant multinational corporations or accounting firms.

Deloitte was a key player in enabling Enron, the US energy company, to avoid taxes. In late 2001 Enron collapsed and a 2003 US Senate report¹¹¹

¹⁰⁷ http://www.amisdelaterre.org/IMG/pdf/report_audit_mopani-2.pdf

¹⁰⁸ The Guardian, 7 June 2011.

¹⁰⁹ http://www.glencore.com/documents/Letter_From_Mopanis_%20Auditors.pdf

¹¹⁰ Also see Deloitte & Touche (2007). Global Transfer Pricing: Arms' length standard, June/July newsletter, p. 14.

¹¹¹ US Senate Joint Committee on Taxation, (2003). Volume 1: Report of the Investigation of Enron Corporation and Related Entities regarding

noted that “One aspect of Enron’s business, however, did raise persistent and significant transfer pricing issues. These issues involved the treatment of services performed by Enron for the benefit of related foreign entities in connection with the foreign infrastructure development business. At a very early stage in the project development process, the project typically was handed off to a local project entity that was owned by Enron (often jointly with a third-party co-venturer), with Enron’ interest in the project entity typically held in two or more Cayman Island holding companies” (p. 383). Such corporate structures enabled Enron to book profits in tax havens and avoid taxes elsewhere. Enron’s profits of US\$1.785 billion for the years 1996 to 2000 attracted no taxes. It also avoided taxes in developing countries such as India and Hungary. Deloitte & Touche was a key adviser to Enron and was one of the promoters behind exotic schemes known as Condor, Valhalla and Tammy. The structure of these schemes resembles a complex wiring diagram. The Condor and Tammy I schemes generated fees of \$8.325 million and \$8 million for the firm. US Senator Charles Grassley said that Enron’s tax avoidance schemes read “like a conspiracy novel, with some of the nation’s finest banks, accounting firms and attorneys working together to prop up the biggest corporate farce of this century¹¹².” The US Senate reports providing an introduction to Enron’s tax avoidance schemes run to some 2,300 pages and the Senate Committee estimated that it will take more than a decade to examine them.

Deloitte brought a case against the UK government for refund of £10 million VAT on behalf of WHA. The case related to a UK insurance company which entered into a series of complex transactions with Gibraltar based companies to enable it to reclaim VAT on motor breakdown insurance sold to UK motorists. Gibraltar is part of the EU for some purposes but for VAT purposes it is treated as a non-EU jurisdiction. As the services were supplied in Gibraltar, the company argued that the VAT on its supplies is exempt from VAT. This case began in 2002 and in 2003 the Special Commissioners ruled in favour of the company. In 2004, HMRC appealed to the Court Appeal¹¹³, which in turn sought guidance from the European Court of Justice. Finally, on 17 July 2007 the Court of Appeal ruled in favour of the tax authorities¹¹⁴. The main reason was that the arrangements were mainly designed for tax avoidance. The court

Federal Tax and Compensation Issues, and Policy Recommendations, Washington DC: US Government Printing Office.

¹¹² The Guardian, Scandal of crashed company’s tax evasion, 14 February 2003.

¹¹³ WHA Ltd & Anor v Customs & Excise [2004] EWCA Civ 559.

¹¹⁴ WHA v HM Revenue & Customs [2007] EWCA Civ 728.

judgment came as Deloitte was threatening¹¹⁵ to launch litigation to demand VAT refunds of £400 million if the government did agree to VAT refunds dating back to the 1970s. The automotive industry was getting ready to demand repayments of up to £2 billion.

Deloitte designed a VAT avoidance scheme to enable a building partnership in Ireland to avoid VAT on the sale of holiday homes. In order to reduce their VAT liability, which would arise by virtue of such a sale, the partners entered into a twenty year and one month lease “with a connected company”, Shamrock Estates Ltd. The property was then leased back immediately to the partners by Shamrock Estates for two years. Then the lease and the leaseback were extinguished by a mutual surrender. The judge said that crucial to the issue of payment of VAT on the sale of the holiday homes is whether there was any reality to the scheme of lease and leaseback that the partnership claimed had preceded it. The partners and their advisers cited the EU Sixth Council Directive 77/388/EEC of 17th May 1977 to support their position. The High Court held that the lease was ineffective for the purpose of VAT because of the absence of prior written consent of the mortgagee, ACC Bank. The judge added that

“neither the lease nor the leaseback had any commercial reality: There was no evidence of intention to sell the property by way of lease to any third party; in effect the partners were simply leasing to themselves, and surrendering back to themselves, for the purpose of reducing VAT. In the circumstances, I was of the view that the lease and leaseback arrangement constitute an abusive practice, contrary to the purpose of the Directive, and accordingly the Respondent is correct in saying that the Applicants should be subjected to VAT upon the freehold sales of the houses to third parties.

Source: Cussens & Ors -v- Brosnan [2008] IEHC 169.

The High Court judgement has implication for a number of other developers as well and the Irish revenue may be able to collect nearly €50 million in back taxes¹¹⁶ to enable the government to combat the deepening recession.

¹¹⁵ The Daily Telegraph, Deloitte threatens £400m excess VAT suit, 8 July 2007.

¹¹⁶ The Sunday Business Post, Revenue to demand €50 million from developers, 22 June 2008

SUMMARY AND DISCUSSION

This chapter has provided a brief glimpse of the predatory practices of the Big Four accountancy firms. Behind a wall of secrecy they operate tax avoidance factories. No school or university ever teaches graduates to circumvent laws, but major accountancy firms train thousands of graduates to circumvent laws. No social value is created, but accountancy firms make millions on fees. The schemes promoted by accountancy firms are often artificial and lack any economic substance. Their sole purpose is to thwart elected governments and enable wealthy clients and corporations to avoid taxes, which in turn forces ordinary folks to either forego hard won social rights or pay disproportionately higher taxes. The loss of tax revenues increases government borrowing and debts, leading to austerity measures, loss of jobs and economic crisis.

No government or country is safe from the practices of the major accountancy firms. They camouflage their practices by claims of ethical codes and publication of glossy corporate social responsibility reports, but are busy devising ingenious schemes to attack direct and indirect tax revenues. The firms claim to be advising on 'tax planning' which is a euphemism for tax avoidance and evasion. All schemes examined in this monograph masqueraded as 'tax avoidance', but when challenged in the courts they turned out to be tax evasion and unlawful. We can only wonder how many others would have been declared unlawful if more had been challenged by governments. If the schemes pay off, the firms rake in vast amounts in fees and the public purse is robbed. If thwarted they invent another, leaving taxpayers to pick up the enormous legal and administrative costs of fighting them. The firms are not deterred by fines and prison sentences for their partners. Many poor countries lack the resources to challenge the firms and are deprived of much needed revenues for economic and social development.

Accountancy firms have developed elaborate organisational structures to manufacture tax avoidance/evasion schemes. Tax departments function as profit centres and are assigned revenue generating targets. The schemes are not only manufactured to meet requests from clients, but the firms produce off the shelf schemes, which are mass marketed. Staff are trained in the sales talk and encouraged to be persistent. The successful ones are rewarded. There are numerous incidences of where the senior people within the firms have known that their activities are dubious and will be challenged by the tax authorities, but the firms take chances because they know that tax authorities lack the financial and administrative resources to challenge them. In some cases, the firms even performed cold cost-benefit analysis and decided that they will make more money from illegal activities

even after paying financial penalties. So they knowingly went ahead and engaged in tax dodges.

Any individual fiddling taxes faces the wrath of the tax authorities. In contrast, little happens to accountancy firms. KPMG admitted “criminal wrongdoing” and should have been closed down as an example to others. Instead, the firm used its political and financial resources to negotiate a fine of \$456 million and survive. Other firms have also paid fines and their partners have been sent to prison. Their promises to mend their ways are cynical ploys to manage public opinion and they are all active as ever before in devising tax dodging schemes. The message is loud and clear: the firms can continue to engage in criminal activity and then can be let-off the hook as long as they have enough resources to pay the occasional fine, assuming that the regulators and the legal processes can catch-up with them.

The UK is conspicuous by its failure to take any effective action against accountancy firms. Courts often brand tax avoidance schemes as “evasion” and unlawful and lacking any economic substance. Despite the introduction of the “Disclosure of Tax Avoidance Schemes” (DOTAS) tax avoidance is rampant. The Big Four accounting firms are behind most of the schemes. Rather than challenging accountancy firms, successive governments have shifted taxes on to labour consumption and savings and eroded ordinary people’s purchasing power. Unsurprisingly, the UK is in deep economic crisis.

Successive UK governments have neither sought to recover the legal and administrative costs of fighting the firms nor investigated their predatory practices of major firms. In 2004, the UK Chancellor called in¹¹⁷ senior partners from Deloitte and Touche, Ernst and Young, KPMG and PricewaterhouseCoopers to warn them that the Government was concerned about the “rising scale, seriousness and aggression” of tax avoidance marketing. He told them was wrong for firms to market loopholes when they knew the Revenue would close them down as soon as they could. Such appeals clearly do not work with money hungry accountancy firms and ordinary people are showing their anger with the tax avoidance industry. Action group UKUncut has taken to the streets to draw attention the damage done to social fabric by big accountancy firms, but such is their hold on the officials of the state that they continue to act as advisers to government department and receive government contracts, all paid by the taxpayers.

¹¹⁷ The Times, Brown hits at 'aggressive' tax avoidance advice, 12 March 2004.

CHAPTER 3 CARTELS AND COLLUSION

The Big Four accountancy firms dominate the UK audit market. They audit 99 of the FTSE100 listed companies. A House of Lords report¹¹⁸ noted the lack of competition and choice in the audit market and pointed out that despite collecting millions of pounds in fees the auditing oligopoly failed to provide any warning that banks were in trouble. The public face is competition, but the private fact is collusion to hold governments and consumers to ransom.

There are numerous opportunities for accountancy firm partners to get together through their membership of the councils of accountancy bodies, at standard setting bodies, at government sponsored and social events. They gather to advance their common interests. It is hard to think of any steps taken by the firms to enhance their own accountability, but protection of niches is very close to their hearts. In November 2005, France introduced legislation restricting firms from sell non-auditing services to audit clients. It imposed a ban on offering an audit if the client has received other services from the audit firm in the previous two years. This had the potential to enhance auditor independence, but could possibly reduce firm income and was therefore not welcome. So the Big Four firms and Grant Thornton formed an alliance to contest the law with the complaint that “They’ve taken the rules on auditor independence in the Eighth Directive too far¹¹⁹”. The firms jointly fought the French government on the grounds that French law is incompatible with European Union directives and threatened¹²⁰ to take the matter to the European Court of Justice.

The insolvency industry is full of rip-off practices¹²¹, robbing creditors, employees, small businesses and causing loss of thousands of jobs. The entire industry consists of around 1,733 licensed practitioners, of which around 1,300 are active. It is dominated by the Big Four accounting firms. The 2011 report by the Insolvency Service notes that there are more

¹¹⁸House of Lords Select Committee on Economic Affairs, (2011). *Auditors: Market concentration and their role*, London: TSO.

¹¹⁹ Accountancy Age, Big Six press Europe to block French law, 20 September 2007.

¹²⁰ The Times, Top accountancy firms fail to halt French restraints, 28 March 2006; Accountancy Age, ECJ challenge looms for French conduct rules, 4 April 2006.

¹²¹ Cousins, J., Mitchell, A., Sikka, P., Cooper, C. and Arnold, P. (2000). *Insolvent Abuse: Regulating the Insolvency Industry*, Basildon: Association for Accountancy & Business Affairs.

complaints against insolvency practitioners than any other licensed practitioner group¹²². Following an investigation the government began considering some reforms, most notably independent investigation of fees and complaints¹²³. Rather than competing to end abuses Ernst & Young, Deloitte, KPMG and PricewaterhouseCoopers joined forces to demand a meeting with Ministers and oppose the reforms¹²⁴.

Auditing firms are adept at ethical charades. The principle is very simple: auditors should act exclusively as auditors and that means no consultancy services for any audit clients. Auditors enjoy a public monopoly and should be accountable to the public, but the ethical standards do not demand that. They do not prevent auditors from selling lucrative services, such as tax avoidance, to audit clients. These ethical standards are drafted by the Auditing Practices Board (APB), part of the Financial Reporting Council (FRC). The APB¹²⁵ is populated by personnel from the Big Four firms. MPs are, quite rightly, not permitted to make their own rules for ethical conduct, but the auditing industry makes its own and firms involved in headline scandals control the process. After the banking crash, a working party consisting exclusively of partners of the Big Four firms rehashed the 2010 ethical standards. Unsurprisingly, they did not address the issues arising from audit failures. Auditors still do not owe a 'duty of care' to any individual stakeholder and will not come clean about any dodgy accounting or tax avoidance schemes sold to corporations.

Each of the Big Four accounting firms provides US\$1.5 million each year to the International Accounting Standards Board (IASB), a private company based in London but controlled by a secretive Foundation in Delaware. Rather than parliament the IASB makes accounting rules for corporations. The IASB is populated by individuals from the big four firms. They in collusion with their corporate clients manufacture accounting standards and then claim to independently audit the companies applying them. The IASB facilitated dodgy accounting practices, including so-called 'fair value' accounting, which enabled banks to inflate their profits and balance sheets. The big firms collected huge amounts of fees from banks. None found any fault with the accounts published by banks.

¹²² Insolvency Service, (2011). Annual Review of Insolvency Practitioner Regulation March 2011, London: BIS.

¹²³ Insolvency Service, (2011). Consultation on Reforms to the Regulation of Insolvency Practitioners February 2011, London: BIS

¹²⁴ Accountancy Age, Insolvency reform will cost businesses say Big Four and R3, 26 May 2011.

¹²⁵ See <http://www.frc.org.uk/apb/> for further details.

The Big Four firms also dominate the setting of international auditing standards through the International Auditing and Assurance Standards Board (IAASB), an offshoot of the International Federation of Accountants (IFAC). Its standards are silent on the accountability, performance and value for money provided by auditing firms. Accounting firms are not required to open their files to stakeholders, publish meaningful accounts or owe a ‘duty of care’ to any individual stakeholder.

Accountancy firms have used their resources to hold elected governments to ransom. They routinely demand lax auditor liability laws to shield themselves from the consequences of their own failures and shortcomings. When the UK government was not responsive, Ernst & Young and PricewaterhouseCoopers spent £1 million to hire lawyers to draft a Limited Liability Partnership (LLP) law. Naturally, they gave themselves protection from liability lawsuits with no public accountability and rights for the long-suffering public. They then hired legislators in Jersey to enact their private law¹²⁶. The government of Jersey was happy to sell its sovereignty and duly obliged. Armed with this purchase, accountancy firms threatened to cause economic chaos by relocating their UK business empire in the poorly regulated offshore tax haven of Jersey¹²⁷. Eventually, the UK government capitulated and enacted the Limited Liability Partnership Act 2000. Rather than feeling any shame at holding elected governments to ransom, an Ernst & Young senior partner boasted:

“It was the work that Ernst & Young and Price Waterhouse undertook with the Jersey government ... that concentrated the mind of UK ministers on the structure of professional partnerships. ...The idea that two of the biggest accountancy firms plus, conceivably, legal, architectural and engineering and other partnerships, might take flight and register offshore looked like a real threat ... I have no doubt whatsoever that ourselves and Price Waterhouse drove it onto the government’s agenda because of the Jersey idea”

Source: Accountancy Age, 29 March 2001, p. 22.

¹²⁶ Cousins, J., Mitchell, A. and Sikka, P., (2004). Race to the Bottom: The Case of the Accountancy Firms, Basildon: Association for Accountancy and Business Affairs.

¹²⁷ These were empty threats as the firms were hardly going to give up their lucrative monopolies in the UK, but the threats were amplified by the media to portray the government as unfriendly to big business (for a discussion see Sikka, P. Auditors’ rocky road to Jersey. The Times, 4 July 1996, p. 30.

Behind a wall of secrecy, major firms have organised their own accountability off the political agenda. The same firms also crafted secret cartels and price-fixing agreements. In the late 1990s, Consob, the Italian Competition Authority fined Arthur Andersen [now defunct], Coopers & Lybrand [now part of PricewaterhouseCoopers], Deloitte & Touche, KPMG, Price Waterhouse [now part of PricewaterhouseCoopers], Reconta Ernst & Young, the then Big-Six accounting firms, for operating a cartel. The Italian regulator explained that the firms had

“agreements to substantially restrict competition on the auditing services market in Italy ... covered virtually every aspect of competition ... the agreements set the fees for auditing ... rules to be followed when acquiring new clients in order to protect the market positions of each firm. In particular these rules prohibited any form of competition in relation to each audit firm's "client portfolio". By applying these rules, the auditing firms were able to agree, for example, on how to respond to requests for discounts from client companies, and to establish in advance the firm that would be awarded auditing contracts, in many cases making competitive tendering a mere formality. Other agreements were also designed to ensure anti-competitive behaviour by the auditing firms for public tenders and when establishing agreements with the authorities. ...”.

In competitive markets, producers often poach their competitors' clients and personnel, especially if the competitor is under distress. Accountancy firms frequently poach key staff from each other, but this policy was suspended whilst KPMG was under scrutiny in the US for facilitating tax evasion. Since late 2003, KPMG had been under this US regulatory scrutiny and was fined \$456 million. This could have persuaded other firms to poach staff and clients or engage in competitive practices to win new clients, but the three largest accounting firms, apparently all independent of each other, “ordered their partners not to poach clients or personnel from KPMG while it remains under investigation¹²⁸”. This policy was driven by their self-interest as the demise of KPMG may have persuaded regulators to break-up the remaining Big three firms to enhance competition.

Accountancy firm partners frequently earn fees by acting as expert witnesses in court cases. The same expertise could also be used to advance cases of negligence and fraud brought against major firms. The New Zealand case of *Wilson Neill v Deloitte* - High Court, Auckland, CP 585/97, 13 November 1998 revealed that “The major accounting firms have in place a protocol agreement promising that none will give evidence

¹²⁸ Daily Telegraph, Poaching ban gives KPMG elbow room, 24 August 2005.

criticising the professional competence of other Chartered Accountants” (reported in the (New Zealand) Chartered Accountants’ Journal, April 1999, p. 70). The case against Deloitte was dismissed because of insufficient evidence of negligence.

SUMMARY AND DISCUSSION

The UK Office of Fair Trading (OFT) and the House of Lords¹²⁹ have at long last woken up to the lack of competition in the auditing industry. The OFT says¹³⁰ that “there are competition problems in the audit market ... the market for external audit services to large firms in the UK is highly concentrated, with substantial barriers to entry and switching”. In July 2011 the OFT referred the matter to the Competition Commission, but little reform is expected. In 2002, after Enron and the demise of Arthur Andersen, the OFT had the opportunity to enhance competition, but under the lobbying and political power of big firms it backed-off¹³¹.

Besides, the whole approach to tackling competition is misguided. There will be no responsible competition until the influence of the big firms on regulatory and professional bodies is ended. Otherwise the firms will continue to craft ethical codes and auditing standards to suit their own narrow interests. Neither can any competition be enhanced without public accountability. Firms have been able to reach secret agreements to operate cartels and challenge governments. They should be subjected to freedom of information laws. They enjoy the state guaranteed markets to earn monopoly rents. In return, the public and regulators should be entitled to see secret documents that carve-up markets, hike prices and pick our pockets. Firms need to owe a ‘duty of care’ to the general public. That is no more than what producers of toffees and potato crisps have to do.

¹²⁹ House of Lords Select Committee on Economic Affairs (2011), op cit.

¹³⁰ Press release, dated 17 May 2011.

¹³¹ Office of Fair Trading, (2002). Competition in audit and accountancy services, London: OFT.

CHAPTER 4

BRIBERY AND CORRUPTION

Bribery and corruption are running at over \$1 trillion each year¹³² as kick-backs, secret commissions and cheating have become common ways of gaining commercial advantage, boosting profits and personal wealth. The UK Bribery Act 2010 creates new fee earning opportunities for accountants as businesses need to establish internal control and systems to ensure compliance with the law. This presupposes that accountancy firms are vigilant and will not be swayed by fee dependency on clients. Not much chance of that as the history of accountancy firms is replete with examples of conflicts of interests and the firms have always chosen to fill their own coffers rather than do anything public spirited. Major firms have been strangely quiet about corruption and bribery at their major corporate clients and have also themselves indulged in corrupt practices.

SEE NO EVIL, HEAR NO EVIL AND SPEAK NO EVIL

In December 2008, Siemens AG, a German manufacturing conglomerate, and three of its subsidiaries pleaded guilty in a US federal court to violating the Foreign Corrupt Practices Act by engaging in a systematic practice of paying bribes to foreign government officials to obtain business. The US Securities and Exchange Commission (SEC) reported¹³³ that Siemens paid bribes to secure business on the design and construction of metro transit lines in Venezuela, power plants in Israel, refineries in Mexico, mobile telephone networks in Bangladesh, national identity cards in Argentina, and medical devices in Vietnam, China, and Russia. Siemens paid kickbacks to Iraqi ministries in connection with sales of power stations and equipment to Iraq under the United Nations Oil for Food Program. Siemens earned more than \$1.1 billion in profits on these and several other transactions. Siemens is estimated to have made at least 4,283 payments, totalling approximately \$1.4 billion, to bribe government officials in return for business around the world. In addition, the company made approximately 1,185 separate payments to third parties totalling approximately \$391 million, which were not properly controlled and were used, at least in part, for such illicit purposes as commercial bribery and embezzlement.

The US Justice Department reported¹³⁴ that since the mid-1990s Siemens had been engaged in systematic efforts to falsify its corporate books and

¹³² The Guardian, Bribery costs \$1 trillion a year - World Bank, 11 July 2007.

¹³³ Press release, 15 December 2008.

¹³⁴ Press release, 15 December 2008.

records. Companies in Hong Kong, British Virgin Islands and other places were used to make clandestine payments to companies in Switzerland and Liechtenstein. Siemens agreed to pay \$350 million in disgorgement to settle the SEC's charges, and a \$450 million fine to the US Department of Justice to settle criminal charges. Siemens also paid a fine of approximately \$569 million to the Office of the Prosecutor General in Munich, to whom the company previously paid an approximately \$285 million fine in October 2007.

The extent of corruption raised questions about Siemens' auditors, the people who have unrestricted power to interrogate records, files, directors and advisers to the company. So attention focused on KPMG. A spokesman for the company's supervisory board said¹³⁵ that the executive board, the auditors and subsidiaries did not report any information which demonstrated the full extent of the scandal. Investigators hired by Siemens told the company that KPMG Germany didn't do enough to flag improprieties in recent years¹³⁶. In November 2008, KPMG were dropped as Siemens auditors and replaced with Ernst & Young.

Another KPMG client BAE Systems (BAES) has been under scrutiny for allegedly paying bribes to secure defence contracts¹³⁷. On 1st March 2010 BAE Systems pleaded guilty to knowingly and willfully making false statements to US government agencies¹³⁸. BAES admitted it regularly retained what it referred to as "marketing advisors" to assist in securing sales of defense items without scrutinizing those relationships. The company took steps to conceal its relationships with some of these advisors and its undisclosed payments to them. For example, after May 2001, BAES contracted with and paid certain advisors through various offshore shell companies beneficially owned by BAES. BAES also encouraged certain advisors to establish their own offshore shell companies to receive payments from BAES while disguising the origins and recipients of these payments. BAES admitted that it established one company in the British Virgin Islands (BVI) to conceal its marketing advisor relationships, including who the advisor was and how much it was paid; to create obstacles for investigating authorities to penetrate the arrangements; to circumvent laws in countries that did not allow such relationships; and to assist advisors in avoiding tax liability for payments from BAES. Through

¹³⁵ The Independent, Bribe scandal highlights KPMG auditing role, 23 September 2007.

¹³⁶ Wall Street Journal, Auditor faulted in Siemens probe, 4 May 2007.

¹³⁷ The Guardian, BAE accused of secretly paying £1bn to Saudi prince, 7 June 2007.

¹³⁸ US Department of Justice press release, 1 March 2010.

this BVI entity, from May 2001 onward, BAES made payments totaling more than £135 million plus more than \$14 million, even though in certain situations BAES was aware there was a high probability that part of the payments would be used to ensure that BAES was favored in foreign government decisions regarding the purchase of defense articles. According to the US court documents, in many instances, BAES possessed no adequate evidence that its advisors performed any legitimate activities in justification of the substantial payments. BAE Systems agreed to pay a \$400 million fine for its criminal conduct, one of the largest criminal fines ever levied in the US against a company, to settle the charges.

As part of its settlement with the UK authorities, it was announced¹³⁹ that BAES will plead guilty to an offence under section 221 of the Companies Act 1985 of failing to keep reasonably accurate accounting records in relation to its activities in Tanzania. The company will pay £30 million comprising a financial order to be determined by a Crown Court judge with the balance paid as an ex gratia payment for the benefit of the people of Tanzania. This was followed with a fine of £500,000 in December 2010 as the company admitted that it failed to keep adequate accounting records in relation to a defence contract for the supply of an air traffic control system to the Government of Tanzania¹⁴⁰. The company made secret payments to secure a US \$39.97 million contract in Tanzania.

The above episodes raise questions about what KPMG knew or should have known. How did the firm manage to complete its audits when by BAES's own admission it failed to keep reasonably accurate accounting records? Was the firm ever put upon inquiry? BAES always received a clean bill of health from KPMG even though allegations of bribery and corruption appeared in the press, most notably The Guardian, since 2003. KPMG has been BAES auditor, consultant and adviser on tax and other matters for many years and in 2009 and 2010, it collected fees of £11.5 million and £14.5 million respectively. On October 2010, the Accountancy and Actuarial Discipline Board (AADB), an offshoot of the Financial Reporting Council (FRC) announced¹⁴¹ that it is investigating "the audits of British Aerospace/BAE Systems Group plc and any of its subsidiaries by KPMG from 1997-2007 in relation to the commissions paid by BAE through any route to subsidiaries, agents and any connected companies. Also any other professional advice, consultancy or tax work provided to BAE by KPMG between those dates in respect of (i) commission payments paid by BAE and (ii) the status, operation or disclosability of Red Diamond

¹³⁹ Serious Fraud Office press release, 5 February 2010,

¹⁴⁰ Serious Fraud Office press release, 21 December 2010.

¹⁴¹ FRC press release, 25 October 2010.

Trading Ltd., Poseidon Trading Investments Ltd. and Novelmight Ltd.”. Previously, BAES finance director had acted as an adviser¹⁴² to the FRC. FRC’s record and capture by giant accounting firms does not inspire any confidence. We can sense puny fines and bucket loads of whitewash.

SNOUTS IN THE TROUGH

The regulatory inertia has emboldened firms and as previous chapters have shown they are not averse to dubious practices to boost their profits. Whilst the UK government departments and regulators act as cheerleaders for the Big Four, regulators in other countries are losing their patience and occasionally warn the firms. Following evidence provided by a whistleblower in September 2004, the US authorities charged PricewaterhouseCoopers for paying kickbacks to secure government contracts. In August 2007, the US Justice Department announced that

“IBM Corporation and PriceWaterhouseCoopers have both agreed to pay the United States more than \$5.2 million to settle allegations that the companies solicited and provided improper payments and other things of value on technology contracts with government agencies, the Justice Department announced today. IBM has agreed to pay \$2,972,038.50, while PWC will pay \$2,316,662.

IBM and PWC knowingly solicited and/or made payments of money and other things of value, known as alliance benefits, to a number of companies with whom they had global alliance relationships. The government intervened in the actions because the alleged alliance relationships and resulting alliance benefits amount to kickbacks, as well as undisclosed conflict of interest relationships in violation of contractual provisions and the applicable provisions of the federal acquisition regulations”

Source: US Department of Justice press release, 16 August 2007.

This has not been the only warning to PwC. In 2001, a lawsuit by the US shopping mall operator Warmack-Muskogee Limited Partnership accused PwC of fraudulently overbilling clients by hundreds of millions of dollars for travel-related expenses by allegedly failing to disclose the existence of large, year-end rebates paid to the firm by airlines, hotel chains and other companies. The documents presented to the court included the firm’s email and other internal documents. One partner said, “we have changed our way of pricing airline tickets to effectively get our discount at the back end in the form of a retroactive rebate. This means our clients get charged a gross

¹⁴² FRC press release, 20 September 2002.

ticket price and we collect and benefit from any discount. I find this practice potentially dishonest to our clients and possibly in violation of engagement contracts ...” and another described the firm’s practices as “greedy¹⁴³” An Arkansas judge fined PwC \$50,000 for engaging in a “systematic course of conduct intended to obstruct the discovery process¹⁴⁴”. The judge subsequently remarked that “some documents will have inevitably been destroyed or deleted because of the failure of defendant to comply with the protective order”. PwC denied fraud allegations but in December 2003 settled the lawsuit with a payment of \$54.5 million¹⁴⁵.

The private lawsuit and the documents presented to the court persuaded the US Department of Justice to launch an investigation. In July 2005, the firm paid the US government \$41.9 million to resolve allegations of that it defrauded government agencies over a 13-year period, from 1990 to 2003.

“Without admitting wrongdoing, PwC paid the settlement ... to resolve fraud claims in a “whistleblower” lawsuit that accused the company of overbilling for travel expenses.

The lawsuit, which was filed in United States District Court in Los Angeles in late 2000 by a former PwC partner, alleged that the firm knowingly overbilled many federal agencies that had contracted with PwC for auditing and consulting services. The federal agencies involved included the Department of Defense, the Department of Justice, the Environmental Protection Agency, the Securities and Exchange Commission, the Peace Corps, the Department of Education and the Department of Veteran Affairs.

The complaint specifically alleged that PwC charged the government agencies substantially more for travel expenses and credit card purchases than the firm actually spent. An investigation by the government following the filing of the lawsuit determined that PwC overbilled the government because its bills failed to take into account commissions, rebates and incentives given to PwC by travel companies and charge card issuers.

The lawsuit alleged that PwC management had been made aware of the problem through internal complaints by several partners, but it made no effort to refund the overpayments to the government.

Source: US Department of Justice press release, 11 July 2005.

¹⁴³ Wall Street Journal, PricewaterhouseCoopers Partners Criticized the Firm's Travel Billing, 30 September 2003.

¹⁴⁴ Wall street Journal, Arkansas Rulings May Hurt Reputation of Pricewaterhouse. 18 September 2003.

¹⁴⁵ Wall street Journal, Pricewaterhouse Settles Billing Case, 22 December 2003.

PwC was not alone in the overbilling controversy. The same lawsuit also accused KPMG and Ernst & Young for retaining rebates from mass buying and overbilling clients. Ernst & Young settled the suit with a payment of \$18 million and its consultancy arm Capgemini paid \$2 million. KPMG and its former consultancy arm Bearingpoint settled with a payment of \$34 million¹⁴⁶.

The US government was also hot on the heels of these firms. On 3 January 2006, the Department of Justice announced that

“Bearingpoint, Inc.; Booz Allen Hamilton, Inc.; Ernst & Young, LLP; and KPMG, LLP have each settled lawsuits concerning false claims allegedly submitted to various agencies of the United States in connection with travel reimbursement.

Bearingpoint has agreed to pay \$15 million to settle the matter, Booz Allen has agreed to pay \$3,365,664, E&Y has agreed to pay \$4,471,980 and KPMG has agreed to pay \$2,770,000.

In relation to work performed for the government, all four firms received rebates on travel expenses from credit card companies, airlines, hotels, rental car agencies and travel service providers. The companies did not consistently disclose the existence of these travel rebates to the United States and did not reduce travel reimbursement claims by the amounts of the rebates. The lawsuits alleged that Bearingpoint, Booz Allen, Ernst & Young and KPMG each knowingly presented claims for payment to the United States for amounts greater than the travel expenses actually incurred, in violation of contractual provisions and the applicable provisions of the Federal Acquisition Regulations.”

Source: US Department of Justice press release, 3 January 2006.

With lax regulations, secrecy and poor enforcement, offshore tax havens are a magnet for criminal and corrupt activity. Major accountancy firms are present in force in most tax havens, even those that do not levy taxes or require companies holed up there to publish accounts. What do they do there? An example is provided by Robert Morgenthau, former (1974-2009) District Attorney of New York County. In 2001 in evidence to the US Senate Permanent Subcommittee on Investigations he told the story of bribery of US bank officials. He went on to say

¹⁴⁶ Accounting Today, E&Y, Cap Gemini Settle Travel-Billing Lawsuit for \$20M, 20 September 2004

“... my office concluded a case involving the bribery of bank officers in U.S. and foreign banks in connection with sales of emerging markets debt, transactions which earned millions for the corrupt bankers and their co-conspirators. In this case, a private debt trader in Westchester County, New York, formerly a vice president of a major U.S. bank, set up shell companies in Antigua with the help of one of the "big five" accounting firms; employees of the accounting firm served as nominee managers and directors.

The payments arranged by the accounting firm on behalf of the crooked debt trader included bribes paid to a New York banker in the name of a British Virgin Islands company, into a Swiss bank account; bribes to two bankers in Florida in the name of another British Virgin Islands corporation; and bribes to a banker in Amsterdam into a numbered Swiss account. Because nearly all the profits in this scheme were realized in the name of the off-shore corporations or off-shore accounts, almost no taxes were paid.”

Source: Robert Morgenthau testimony to the US Senate Permanent Subcommittee on Investigations, 18 July 2001.

Further details were provided by New York Daily News, which also carried an interview with Morgenthau¹⁴⁷. “The shell company in the above case went under the name of Merlin Overseas Limited. There was no actual physical business in Antigua, named Merlin. It consisted of little more than a fax machine in a Caribbean office of Price Waterhouse. Thanks to that fax machine and the sterling reputation of Price Waterhouse a thief in Westchester was able to turn paper into gold, to wash millions of dollars in stolen money through the island of Antigua, and to hide the wealth from American tax collectors. Merlin Overseas was nothing more than a mirage created for the Westchester thief by Price Waterhouse”.

The District Attorney’s office asked Price Waterhouse in Manhattan for help in reaching the people behind Merlin, but the help was not forthcoming. They were told that the Price Waterhouse in Antigua is not the same legal creature as the one in New York. Robert Morgenthau and his colleagues stated that

¹⁴⁷ New York Daily News, City Paying Price For Merlin Mess, 10 January 1999.

“The accounting firm set up Merlin Overseas at its offices in Antigua, one of the tiny island states where money vanishes like lizards under rocks. Once the money was booked in the name of Merlin Overseas, it could ricochet around the globe to secret bank accounts held by the players in the scheme.

...Merlin was nothing but a shell provided by Price Waterhouse to these guys ... There was no actual physical business in Antigua named Merlin the entire thing was chartered and set up within the walls of the Price Waterhouse office. This accounting company was complicit ... They facilitated hiding of bribes that were paid to bank officers, and they provided the officers and directors for those phoney companies. ... If you changed the name Price Waterhouse to Gotti or Gambino, the stunts in Antigua would bar them from towing cars or picking up trash, much less auditing sensitive financial transactions worth billions of dollars”

Source: New York Daily News, City Paying Price For Merlin Mess, 10 January 1999.

SUMMARY AND DISCUSSION

Countries spend vast amounts on economic surveillance and accounting firms make lots of money by assuring the public that businesses are not corrupt. Yet under pressure from stock markets to deliver higher earnings companies are engaging in bribery and corruption to win contracts. Accountancy firms pretend to be auditors but are at the same time consultants to companies and their directors. Huge fees and income dependency buys their silence. It is difficult to think of any instance where auditors have drawn attention to the corrupt practices of companies. Newspapers reported alleged bribery by BAES for a number of years, but auditors just pretended to be Trappist monks. Auditors managed to complete audits even when the company admitted that it did not keep reasonably accurate accounting records. At Siemens bribes ran into billions of dollars but auditors did not notice anything and gave their customary clean bill of health.

This chapter provided examples to show that major firms are directly involved in corrupt practice themselves. They paid millions of dollars to settle allegation of false billing. They are also a party to sham structures that facilitate bribery and corruption. No country will ever be able to combat bribery and corruption by placing reliance on major accounting firms.

CHAPTER 5

CRIMES AGAINST THE PEOPLE

ACCOUNTANCY MAFIA HEAPS MISERY AND DEATH

In 1997, a UK government report on frauds at Guinness Plc concluded that major businesses have “. . . cynical disregard of laws and regulations . . . contempt for truth and common honesty¹⁴⁸”. This conclusion applies to major accountancy firms. Outwardly the firms masquerade as professionals deeply committed to ethical conduct and serving the public interest, but money and private profits are their sole priorities. They are committed to making money at almost any cost and routinely undermine the state, social justice and democracy. Fines and prison sentences do not seem to deter their partners’ lust for even more money. Organised tax avoidance is a key reason for the current economic crisis. The tax dodging schemes designed by major accounting firms are eroding the tax base and damaging the citizens’ right to mandate social change through redistribution of wealth or provision of public goods and services. In democracies, ordinary people have the right to determine the size of the state, its operation and the level of redistribution that it undertakes to alleviate poverty, reduce inequalities and exclusion and make provision for public goods. That right is under threat by the tax dodging trade of accountancy firms. This trade produces telephone number salaries for accountancy firm partners and business executives, but condemns millions to misery, hardship, even early death.

In developing countries, over a billion people do not have access to safe drinking water. About 1.9 million people die every year from diarrheal diseases. Around 1.5 million (or 5,000 a day) of the fatalities are children under the age of five¹⁴⁹. Out of an estimated world total of 2.2 billion children, over 1 billion live in poverty¹⁵⁰. An estimated 640 million lack basic shelter, 500 million do not have adequate sanitation facilities, 400 million lack access to safe water, 270 million have no access to healthcare, 140 million have never been to school and 90 million face daily starvation. An estimated 774 million adults lack basic literacy skills¹⁵¹. Due to loss of tax revenues, 34 out of 84 countries have decreased the share of gross

¹⁴⁸ UK Department of Trade and Industry, (1997), Guinness PLC, The Stationery Office, London, p. 309.

¹⁴⁹Water Aid, (2007). The State of the World’s Toilet 2007, London: Water Aid.

¹⁵⁰ UNICEF, (2004). The State of the World’s Children 2005:Children Under Threat, New York: UNICEF

¹⁵¹United Nations Educational, Scientific and Cultural Organization, (2007). Education for All by 2015: Will we make it? Paris: UNESCO.

national product (GNP) devoted to education since 1999. Around 1.6 billion people do not have access to electricity and another two billion people have limited access to it¹⁵². In the absence of safe energy sources, more than 3 billion people use wood, dung, coal, and other traditional fuels inside their homes to meet cooking and heating needs. The resulting pollution kills 1.5 million each year - mostly young children and mothers. Through the United Nations all nation states have committed themselves to achieving eight Millennium Development Goals (MDGs) and improve the quality of life of millions of people¹⁵³. These include making significant progress by 2015 towards eradication of extreme poverty and hunger, achieve universal primary education, promote gender equality and empower women, reduce child mortality, improve maternal health, combat diseases, promote environmental sustainability and develop a global partnership for development. None of above can be achieved without closing the tax dodging trade promoted by the Big Four accountancy firms.

The consequences of the deadly trade of major accountancy firms are evident at home too. Due to lack of tax revenues local councils are unable to repair roads. The government has curtailed the building programme to replace crumbling schools and hospitals. Approximately 13.2 million people, including 2.8 million children and 2 million pensioners¹⁵⁴ are living in poverty. A European league table of young people's wellbeing places the UK 24th out of 29 countries¹⁵⁵. Nearly a third of all households with dependent children in England live in 'non-decent' homes that do not meet sufficient standards of upkeep, facilities, insulation and heating. Despite having one of the highest retirement ages in Europe, and rising, the UK state pension, as a percentage of average earnings, is the lowest in western Europe. A typical pensioner couple receives a weekly income of £207.15, but spends £207.24 on food, fuel, housing and transport, leaving nothing for emergencies and other things necessary for quality of life. A care home place costs around £30,000 a year, well beyond the reach of most pensioners. According to the OECD, the UK has just one carer per 100 pensioners compared to 12 in Sweden. The tax avoidance industry dominated by the Big Four accountancy firms is the author of social

¹⁵² World Bank, (2006). An Investment Framework for Clean Energy and Development: A Progress Report, Washington DC: World Bank

¹⁵³ United Nations, (2005). Investing in Development: A Practical Plan to Achieve the Millennium Development Goals. New York: UN.

¹⁵⁴ The Guardian, 2m pensioners live in poverty, says ONS, 27 January 2010.

¹⁵⁵ The Guardian, UK lags behind most of Europe in child wellbeing league, 21 April 2009.

miseries. The biggest crime of all is that the legal and political system allows the abuses to flourish.

CAPTURE OF THE STATE

How do the accountancy firms get away with it? Why is the UK government so timid in challenging the Big Four accountancy firms? The answer is that they have captured the state and its organs. This power is an ultimate in political and financial corruption. It is used to shield firms and their clients from control, regulation and retribution. They specialise in circumventing laws and inflicting social harm, but have been rewarded with the state guaranteed markets of external auditing and insolvency. The same firms are given consultancy contracts by government departments, funded by taxpayers. The firms play both sides of the street, advising companies and government departments on Private Finance Initiative (PFI) contracts. Despite clear conflicts of interests they rake in millions in fees¹⁵⁶. PFI is poor value for taxpayers but external advisers rake in fees of over £3 million per project or approximately 2.6 per cent of the capital value of the projects¹⁵⁷. Indeed, a large amount of corporate profits from the PFI projects are ending up in offshore tax havens¹⁵⁸. The firms undermine tax laws, but advise the Treasury on reforms. No other occupational group or organisation is rewarded for inflicting social misery.

The Big Four accountancy firms have a corrosive relationship with the state, enabling them to advance their financial interests. Before the 2010 general election, the Big Four firms gave £3.5 million to the Conservative Party and provided advisers and consultants to shape party policies. They got £100 million a year windfall as the incoming government promised to abolish the Audit Commission and pass the work to accountancy firms. The Big Four firms had also lubricated the Labour Party in previous elections.

KPMG is the accountancy industry's most prolific winner and diner of Britain's top civil servants¹⁵⁹, closely followed by PricewaterhouseCoopers, Deloitte and Ernst & Young. It's doubtful that these meetings are designed to curb predatory practices, or advance democracy. Rather they help to colonise the state and dividends are high. In 2007, soon after KPMG admitted "criminal wrongdoing" for tax dodging and paid the highest fine

¹⁵⁶ Unison, (2003). *Stitched Up: How the Big Four accountancy firms have PFI under their thumbs*, London: UNISON.

¹⁵⁷ House of Commons Treasury Committee, (2011). *Private Finance Initiative – Volume 1*, London: TSO.

¹⁵⁸ *The Guardian*, 4 March 2008; *BBC News*, 12 April 2011.

¹⁵⁹ *Accountancy Age*, 13 February 2009.

ever levied by the US government, the UK government did not investigate the firm. Instead it gave a knighthood to KPMG International chairman (2002 to 2007) Michael Rake for services to the accountancy profession. In October 2010, Sir Michael Rake became an advisor to Prime Minister David Cameron. In 1999, KPMG chairman Colin Sharman was elevated to the House of Lords by Liberal Democrats and is now known as Baron Sharman of Redlynch. Another KPMG partner and former ICAEW president Sheila Masters became a life peer in 2000 and Conservative Party's Treasury spokesperson. She is now known as Baroness Noakes of Goudhurst.

Former PricewaterhouseCoopers staffer Mark Hoban is the current Treasury Minister responsible for oversight of tax laws. PFI is a huge money spinner for accountancy firms. PwC partner Richard Abadie has been the head of PFI policy at the UK Treasury and has been accompanied by 10 or more colleagues¹⁶⁰. In June 2009, former PwC partner Amyas Morse was appointed UK Comptroller and Auditor General and became responsible for directing the National Audit Office (NAO). There he is accompanied by another former PwC partner, Dame Mary Keegan, who previously was chairperson of the ineffective UK Accounting Standards Board and subsequently an adviser to the UK Treasury. In 2008, PwC tax partner John Whiting and architect of the "Total Tax Contribution" whitewash was awarded an OBE for public service. In June 2011, he became the Director of the newly established Office of Tax Simplification (OTS), advising the government on simplification of tax laws. Caroline Turnbull-Hall, another PwC tax manager is on the OTS and thus two of three people (re)designing the UK tax system come from PwC. Chris Tailby, one time tax partner at PricewaterhouseCoopers became Head (until 2009) of Anti-Avoidance at HMRC. In September 2004, Sir Nicholas Montagu, the former chairman of the Inland Revenue became an advisor to PricewaterhouseCoopers. In July 2010, partners from KPMG, Ernst & Young, Grant Thornton and BDO became members of the government appointed Tax Professionals Forum¹⁶¹ and shape the UK tax law, a classic case of foxes guarding the henhouse.

In 2007, following disquiet about loss of personal data of UK taxpayers, the Prime Minister turned to £3 million a year PricewaterhouseCoopers partner Kieran Poynter to write a report. In January 2008, UK Prime Minister Gordon Brown's visit to China was not accompanied by any campaigners on tax avoidance or human rights, by the western world's biggest growth industry – tax avoidance. At taxpayer expense he was

¹⁶⁰ House of Commons Treasury Committee (2011). Op cit.

¹⁶¹ See http://www.hm-treasury.gov.uk/tax_forums_tax_professionals.htm

accompanied by Ernst & Young chief Mark Otty, KPMG chairman John Griffith Jones, and £5.1 million a year Deloitte senior partner John Connolly¹⁶². Many senior politicians have already snuggled up to major accountancy firms. Prior to the 1997 general election, Sir Stuart Bell MP was Labour's spokesperson on trade and industry where he became a strong advocate of liability concessions for auditing firms. After the general election victory he failed to secure a cabinet position and soon became an adviser to Ernst & Young. Former Labour Business Secretary Lord Peter Mandelson resigned from government in 1998, but was soon hired by Ernst & Young. He subsequently returned for two more stints as Business Secretary and Labour quietly dropped its 1997 business manifesto commitment to have independent regulation of the world of accountancy.

Since 1999, former Conservative Minister Sir Malcolm Rifkind has been an adviser to PricewaterhouseCoopers. In June 2011, former Labour Home Secretary Jacqui Smith became a consultant for KPMG, the firm that advises Libyan dictator Colonel Qaddafi on managing his wealth¹⁶³. In an earlier incarnation as a trade minister she piloted auditor liability 'cap' through parliament, all without demanding any quid pro quo from accountancy firms. For five years to 2010, the NHS paid out £487 million to external advisers and consultants, paying £1,000 a day to personnel from the likes of PricewaterhouseCoopers, Ernst & Young and Deloitte. Then in July 2009 former Labour Health Minister Lord Norman Warner of Brockley became a strategic adviser to Deloitte's public sector practice. In June 2007, Deloitte & Touche adviser Sir (later Lord) Digby Jones became a minister (resigned October 2008) at the Department for Business, Enterprise and Regulatory Reform. No doubt, all are honourable individuals desperate to serve the public interest, but their conception of 'public interest' is inevitably influenced by their wealth and business interests.

The Institute of Chartered Accountants in England & Wales (ICAEW) has long been a cheerleader for the tax avoidance industry. It is the lobbying front for the Big Four accountancy firms who second staff to its working parties, committees and provide many of the officeholders. Partners from big firms can sit on its council even though they are not elected by the membership. Rather than forcing firms to end their anti-social practices, the ICAEW is campaigning to extend legal professional privilege to the tax

¹⁶² The Guardian, 7 February 2009;

<http://www.guardian.co.uk/business/2009/feb/07/tax-gap-avoidance-schemes>

¹⁶³ New York Times, Qaddafi Reportedly Stashes Billions in Western Institutions, 26 May 2011.

avoidance industry¹⁶⁴. This would enable the tax advisers to hide their identity and make it even harder for tax authorities to challenge them.

After the taxpayer-funded bailout of Northern Rock, the House of Commons Treasury Committee advocated a ban on the sale of consultancy services, which would include tax dodges, by auditors to their audit clients¹⁶⁵. The accountancy regulator the Financial Reporting Council (FRC) complied with the wishes of the major firms and opposed the recommendation. This is hardly surprising. The FRC is dominated by the Big Four accountancy firms.

Big Four accountancy firms have colonised international structures too. They hire lobbyists for the EU and are present in force at the OECD and other meetings. They thwart development of accounting standards that can expose corporate tax avoidance. A good example of this is the country-by-country approach, which would force corporations to public information showing their assets, liability, profits, losses, sales, costs, staff, etc. in each country. This would show that companies have vast trade in the UK but pay virtually no corporate taxes. The Big Four firms are opposed to that. So is the International Accounting Standards Board (IASB), a private London-based limited company that issues international accounting standards dealing with disclosures by corporations. It does not ask companies to publish anything about profit shifting through transfer pricing and other accounting practices. The Big Four firms fund the IASB and their personnel dominate its proceedings. The same mafia also controls the creation of auditing standards at home through the Financial Reporting Council and globally through the International Federation of Accountants (IFAC), an organisation funded and dominated by the Big Four firms. Despite thousands of pages of auditing standards, not one line is devoted to accounting firm accountability, responsibility or even asking firms to come clean about how they help companies to dodge taxes. Rather than coming clean, firms invest in impression management gimmicks. For example, in April 2011 PricewaterhouseCoopers appointed its first-ever head of reputation¹⁶⁶.

The capture of the state inevitably leads to regulatory inertia, enabling accountancy firms to continue their predatory business unchecked. Despite

¹⁶⁴ Accountancy Age, ICAEW mulls another foray into legal privilege battle, 19 April 2011.

¹⁶⁵ House of Commons Treasury Committee, (2008). *The Run on the Rock*, London: TSO.

¹⁶⁶ The Daily Telegraph, PricewaterhouseCoopers creates new role to boost its public image, 23 April 2011.

losses of billions of pounds of tax revenues, the UK government has failed to investigate the tax avoidance industry, or prosecute any of its key players. The anti-social practices of accountancy firms are routinely camouflaged by claims to professionalism, ethical conduct and anything else that disarms journalists, legislators and critics.

WHAT'S TO BE DONE?

There is nothing inevitable about the tax dodging industry. It flourishes because governments permit it to. The following steps would help to check the predatory practices of major accountancy firms

1. Citizens can and should boycott the services of the firms peddling tax avoidance schemes.
2. Accountancy firms selling tax avoidance schemes should not get any public contracts for consultancies with local and central government departments.
3. Firms convicted of predatory practices should not be able to hire out staff to any government department.
4. The hiring of former ministers or legislators by accounting firms should be subject to security and consent by a parliamentary committee. All correspondence and contracts should be publicly available.
5. Firms should publish a complete list of their offshore business operations, ownership structures and profits in each country of their operations and from tax avoidance.
6. Fines levied upon the firms for selling tax dodges should not be tax deductible from the taxable profits of the firms or their partners.
7. Firms and their partners should be forbidden from paying fines from insurance cover.
8. Persistent offenders should be closed down.
9. There should be complete ban on the sale of tax avoidance schemes to audit clients.
10. Much tax avoidance revolves around artificial transactions. These should be challenged by enacting a General Anti-Avoidance Principle (GAAP). So the peddlers of tax avoidance will have to show that the transactions have some economic substance. Schemes designed mainly for the purpose of avoiding taxes should be declared unlawful.
11. Legislation should be enacted to encourage whistleblowers to blow the whistle on firms selling tax avoidance schemes. Upon successful prosecution they should get a share of the fines levied on the firms.
12. Accountancy firms losing the legal challenge mounted against their avoidance schemes should be forced to meet all the legal and

- administrative costs which are currently borne by the tax authorities, effectively the taxpayers.
13. Governments need to invest in HMRC, for example more tax inspectors, to ensure that the predatory powers of major firms are checked.
 14. The principle of legal professional privilege should not be extended to the tax avoidance industry as major accountancy firms have a history of lying and cheating.
 15. At company AGMs resolution should be tabled to ensure that firms engaged in robbing the public purse cannot become auditors.
 16. Secrecy breeds anti-social practices and should be eroded. Tax authorities should have unrestricted access to the files and working papers of the firms selling tax dodges. As the cost of tax dodges is ultimately borne by taxpayers, the public should be able to see the tax files of accountancy firms.
 17. All corporate tax returns should be publicly available. This information would enable citizens to become the eyes and ears of the tax authorities and alert them of unusual transactions.
 18. The Companies Act should be amended so that companies are required to disclose details of all tax avoidance schemes.
 19. The Companies Act should be amended to require companies to publish show sales, costs, profits, losses, assets, liabilities, employees and tax for each country of their operations.
 20. Companies should publish details of their transfer pricing practices.

All this will go some way towards ending the reign of the Pin Stripe Mafia and curb the predatory practices of major accounting firms, which are destroying societies. All reforms are clearly needed to reduce the power of these states within states whose power has increased, and is increasing, and must be diminished if we are to build a good society that enables all citizens to live fulfilling lives. Accountants and auditors will still have plenty of useful and well paid work to do but that work will be the legitimate and socially useful work of keeping businesses and social organisations accountable and productive rather than leading them astray into undesirable and sordid financial fiddling which may earn fat fees for a few but damages social fabric and denies citizens the right to determine the nature of the state and extent of social welfare rights.

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The Pin-Stripe Mafia: How Accountancy Firms Destroy Societies takes the lid off the anti-social practices of major accountancy firms. The firms are inflicting enormous social harm through direct engagement in tax avoidance, tax evasion, bribery, corruption and cartels. Their predatory practices are depriving elected governments of vital tax revenues to provide healthcare, jobs, pensions, education, security, transport and other public goods essential for quality of life. Accountancy firms employ thousands of people for the sole purpose of circumventing tax laws and devising dubious tax avoidance schemes which create nothing of social value but condemn millions of people to misery and hardship. Some of the firms have been fined and their personnel have been sent to prison for unlawful practices, but in pursuit of easy profits the firms still persist with anti-social practices. In democracies, ordinary people have the right to determine the size of the state, its operation and the level of redistribution that it undertakes to alleviate poverty, reduce inequalities and exclusion and make provision for public goods. That right is under threat by the tax dodging trade of accountancy firms. Major accountancy firms also collude to threaten states and disadvantage consumers. They have also engaged in bribery and corruption to inflate their profits. Tackling the predatory practices of major accountancy firms is a key requirement for invigorating democracy and social responsibility,

Austin Mitchell is Labour MP for Grimsby. He is a former spokesperson for Trade and Industry. He has written extensively on corporate governance, tax havens, accountancy and business matters in newspapers, magazines and international scholarly journals.

Prem Sikka is Professor of Accounting at the University of Essex. His research on accountancy, auditing, corporate governance, money laundering, insolvency and business affairs has been published in books, international scholarly journals, newspapers and magazines. He has also appeared on radio and television programmes to comment on accountancy and business matters.

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