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TAXTAKES

Perspectives on building a better tax system to benefit everyone in the UK

Edited by Will Snell

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About this publication

Tax Takes sets out some initial ideas about ways in which the UK tax system could be reformed to make it work better for the whole of the population, by making it both more progressive and more effective.

This pamphlet is made up of a series of short opinion pieces, each of which represents the opinions of its author, and none of which should be interpreted as an official statement of policy on behalf of Tax Justice UK.

In 2018, we plan to publish detailed information and analysis on all UK taxes, as well as an annual research report looking at the design and impacts of the UK tax system as a whole.

About Tax Justice UK

Tax Justice UK is a campaigning and advocacy organisation that works to promote the role of tax, to advocate for a more progressive tax system, and to campaign against tax avoidance.

We are not-for-profit and politically non-aligned. We aim to engage with a broad spectrum of people and organisations from across the UK, including Scotland, Wales and Northern Ireland.

We work with a range of partners in pursuit of our objectives, including charities and other not-for-profit organisations, church groups, think tanks, trade unions, parliamentarians and business associations.

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MAKING THE TAX SYSTEM BETTER **UNDERSTOOD**

Taxation builds a civilised society, healthy economy, secure country and decent public services.

Championing the role of tax in building a civilised and fair society

Will Snell | Director, Tax Justice UK

The UK aspires to Scandinavian levels of public services with American levels of taxation. Public spending (40% of GDP) is average for the developed world, but tax receipts (33% of GDP) are well below average (Germany: 37%, Netherlands: 38%, France: 46%, Denmark: 47%). The problem is not that we spend too much money, but that we raise too little money. Spending cuts starve public services (while demand increases every year). And taxes are not spread fairly across society: the richest 10% pay just 34% of their income in taxes, but the poorest 10% pay 42% of their income.

Let us look at corporate taxes (the subject of our *Fair Share* campaign, taxjustice.uk/fairshare) as an example. The UK has the lowest corporation tax rate in the G7, and recent rate reductions have cost the exchequer £16.5 billion per year, according to the IFS. Many multinational companies pay less than the 'headline' rate through tax avoidance, costing the exchequer many billions of pounds every year. And tax reliefs for large companies cost billions of pounds every year, yet the government does not monitor their exact costs or attempt to analyse their benefits; many are likely to be unnecessary at best, if not actively harmful to the wider economy.

Why has this situation come about? Party politics play a role, but the underlying dynamics have not changed significantly in decades. The UK economy is overly dependent on – and geared to the interests of – its finance sector. Politicians routinely equate the interests of the City of London with those of the country of the whole, but many policies that protect the interests of the financial sector harm the living standards of many people in the UK and jeopardise the success of other areas of the economy. The UK's model of capitalism and underpinning ideological assumptions support an uncritical adoption of harmful notions such as the need for nation states to 'compete' in a race to the bottom on tax, regulation and the size and remit of the state in the interests of 'capturing' mobile global capital and business, when in fact it is global capital that has arguably 'captured' the state.

The majority of the UK media supports and amplifies the dominant economic narrative, despite the fact that public opinion seems to be less aligned with this worldview than has generally been assumed. While the media debate around taxes in the UK is dominated by the idea of tax as a burden, research suggests that most people understand why taxes are needed, and are happy to pay them:

- Research by the Fabian Society in 2015 (www.fabians.org.uk/publications/the-tax-detox) found that people "feel a strong sense of solidarity, citizenship and obligation with respect to the payment of taxes", and are "proud of the UK's public services, and proud to contribute to them".

- The 2017 British Social Attitudes Survey (http://bsa.natcen.ac.uk/latest-report/british-social-attitudes-34) found that 48% of the UK public want *higher* taxes, with only 4% wanting them lower.

We strongly believe that there is a void in the debate around tax in the UK, which is crying out to be filled: championing the role of tax in building a civilised and fair society, with strong public services and a dynamic and inclusive economy. We fully intend to fill that void.

www.taxjustice.uk

MAKING THE TAX SYSTEM MORE **PROGRESSIVE**

The costs of contributing to tax revenues should be shared fairly, taking into account ability to pay.

Stopping 'competition' for corporate investment through tax cuts and giveaways

Sol Picciotto | Emeritus Professor, Lancaster University Law School

Tax justice requires fair taxation of profits as between companies and non-incorporated business, and between national and international business. These principles are too often undermined by business lobbying for tax breaks, and by exploitation by multinational enterprises (MNEs) of the opportunities for international tax avoidance resulting from weak coordination between states.

Governments have often been ambivalent in their policies, to the point of hypocrisy. While declaring its support for international efforts at coordination, the UK government has introduced incentives supposed to make the UK 'competitive' by attracting investment by MNEs. These are short-term and beggar-thy-neighbour measures, since such tax competition encourages other countries to follow suit, resulting in a race to the bottom which damages all. Tax breaks for MNEs disadvantage local companies and so fail to encourage growth and new employment.

The idea that the UK should have a 'competitive' tax system goes back to the 1980s, but it was made explicit as the policy of the Coalition government in 2010[1]. This resulted in three major new policies for corporate taxation in effect from 2012:

- to progressively reduce the corporate tax rate from 28% in 2010 to 24%, and then by 1% annually – it is now 19%, and due to reach 17% by 2020[2]
- to exempt UK resident companies in most cases from tax on their foreign profits, so encouraging MNEs to avoid taxes and undermining other countries' tax bases
- to introduce a 'patent box' providing a 10% tax rate on profits from products using a patent or similar IP mechanism

These gave the UK tax system some features of a tax haven: the low tax rate aiming to match Ireland's 12.5% rate, the foreign profits exemption emulating countries such as Luxembourg and Switzerland, and the patent box copying similar schemes in Belgium and other countries. Instead of taking a lead in trying to end such tax breaks, the UK joined the countries facilitating tax dodging.

On the other hand, the government gave vocal support to initiatives to reform international tax rules, especially the project on base erosion and profit shifting (BEPS), begun in 2012 by the Organisation for Economic Cooperation and Development (OECD), and endorsed by the G8 and G20 world leaders in 2013. However, the Treasury paper issued in 2014 outlining the negotiation priorities made it clear that these included preserving the UK's 'competitive' tax system[3].

As a result, the UK officials acted as a brake on the negotiations, limiting many of the outcomes. They resisted in particular moves to stop profit shifting out of source countries by arguing for minimal changes to the rules defining taxable

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[1] *Corporation Tax Reform: Delivering a more competitive system*, 29 November 2010 (gov.uk/government/news/corporation-tax-reform-delivering-a-more-competitive-system)

[2] Policy Paper: *Corporation Tax to 17% in 2020*, 16 March 2016 (gov.uk/government/publications/corporation-tax-to-17-in-2020/corporation-tax-to-17-in-2020)

[3] Policy paper: *Tackling aggressive tax planning in the global economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting*, 19 March 2014 (gov.uk/government/publications/tackling-aggressive-tax-planning-in-the-global-economy-uk-priorities-for-the-g20-oecd-project-for-countering-base-erosion-and-profit-shifting)

presence (a permanent establishment - PE), and for weak recommendations on taxing foreign profits of subsidiaries of UK MNEs (controlled foreign corporations, or CFCs). They also strongly defended the patent box, so that only limited restrictions on such measures were agreed. Although the UK in June 2017 signed the multilateral convention to implement the treaty-related aspects of the BEPS project outcomes, it made many reservations, to exclude changes enabling taxation of companies at source, where activities actually take place. It is clear that, in practice, the UK's support for the BEPS project was only half-hearted, and its position on international tax reform hypocritical.

Although the main outputs from the BEPS process were delivered in October 2015, they did not resolve the central challenge in the mandate from the G20, to ensure that multinationals are taxed 'where economic activities occur and value is created'. Indeed, the methods for the allocation of profits are still under discussion. Further, the work on Action 1 on tax consequences of the digital economy was also incomplete: an interim report is being prepared for the G20 in 2018, with the final report due in 2020. This slow progress is due in no small part to the UK's failure to take a strong lead on a new multilateral approach to allocation of MNE profits.

Yet it is five years since the Public Accounts Committee (PAC) hearings in November 2012 drew attention to the ways in which multinationals with extensive activities in the UK, such as Amazon, Google, Facebook and Starbucks, pay very little or no tax. This public pressure led the government to introduce a Diverted Profits Tax, which took effect in April 2015. This unilateral measure was resented by participants in the BEPS project negotiations, and indicated that the UK did not expect or perhaps even support multilateral solutions. The Treasury recently estimated that the DPT raised £31m in 2015/16 and £281m in 2016/17[4]. This came from relatively few firms: HMRC said it was targeting 100 large MNEs, and it was reported in May 2017 that Diageo alone would pay £107m, although under protest.

Nevertheless, these are relatively low sums in relation to the enormous revenues generated by many foreign MNEs that have extensive activities in the UK. Indeed, a further report from the PAC in 2016 revealed that a six-year investigation by HMRC into Google had resulted in the payment of only £130m in extra tax for the period between 2005 and 2015, from a total corporation tax charge of £196.4m over those ten years[5]. Yet not only does Google generate 10% of its global revenues in the UK, it also has some 3,000 employees apparently dealing with marketing, and a further 1,000 engineers. Shortly after the revelation of the settlement with HMRC, Google announced that it would expand its UK headquarters and employment. As the Economist commented: 'The bill presented to the company looks from the outside like a sweetheart deal, but it is impossible to be sure because you cannot know how it was calculated'[6].

Yet it is illusory to think that tax breaks to MNEs create a net increase in jobs. Favouring these gigantic monopolies has helped turn the UK into a low-wage, low-productivity economy, despite our world-leading researchers and innovative entrepreneurs. Companies such as Apple, Google and Amazon have become bloated from their excess profits, much of which results from tax avoidance. This allows them to expand by either buying up smaller companies and start-ups, or driving them out. They are often not the

[4] *Diverted Profits Tax Yield: methodological note*, 13 September 2017 (gov.uk/government/publications/diverted-profits-tax-yield-methodological-note)

[5] Public Accounts Committee, *Corporate tax settlements*, 23 February 2016 (publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/78802.htm)

[6] Economist, Going after Google, 28 January 2016 (economist.com/news/leaders/21689546-britains-tax-men-struck-poor-deal-real-problem-lies-flawed-international)

sources of innovation but its appropriators, as pointed out by economists such as William Lazonick and Paul Krugman[7]. Google itself acquired the pioneering artificial intelligence company DeepMind for £400m in 2014, and these technicians are an important part of its expansion. Yet unless HMRC changes its approach, both Google's software business and its marketing subsidiary in the UK will be taxed on a cost-plus basis, as if they were sub-contractors, overlooking their significant contributions to Google's worldwide profits.

Recommended reforms

Withdraw the 'patent box' low tax rate

HMRC recently calculated the cost to the taxpayer of the low 10% rate due to the patent box as £651.9m in 2014-5. This will rise to close to £1bn a year if the measure is not withdrawn, as companies could claim only 70% of the relief in that year[8]. This is on top of the tax credit for research and development (R&D) that already generously subsidises innovation at a cost of £2.9bn in 2015-16[9].

Due mainly to the UK's defence of the patent box, the OECD's Forum on Harmful Tax Practices asked only for some modifications of existing schemes[10]. As a result, countries such as Ireland, Italy and Switzerland rushed to adopt their own schemes, and there have been business pressures for their introduction in Germany and the USA. Thus, the UK has contributed to a race to the bottom.

A number of criticisms can be made of the patent box:

- it provides a much-reduced tax rate (10%) for the profits from any products incorporating a qualifying patent or similar right, likely to cost taxpayers over £900m per year
- its provisions are highly complex,[11] making it hard for small firms to comply
- unsurprisingly, 305 'large' companies (over 250 employees) took 95% of the benefits in 2014-5; in contrast, under the R&D tax credit 83% of claims were under the SME scheme, amounting to 45% of the £2.9bn benefits in 2015-6
- it does not encourage new R&D, but gives a tax break for the use of patent rights which already ensure monopoly profits; as Mariana Mazzucato has argued, R&D tax credits and other measures are much better targeted at stimulating innovation[12]
- it is selective in rewarding only patents and not other kinds of know-how and intellectual property

Phasing out the patent box would save over £900m a year for taxpayers.

Reverse recent cuts in the rate of corporation tax

The UK should reverse the cuts in the corporate tax rate and move towards a rate of 25%, on which other major countries are converging.

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7 See hbr.org/2014/09/profits-without-prosperity and krugman.blogs.nytimes.com/2017/08/31/monopoly-rents-and-corporate-taxation-wonkish respectively

8 The phase-in is to 80% in 15-16, 90% in 16-17, 100% in 17-18; see *Overview of Tax Legislation and Rates* (March 2017), note 28 (gov.uk/government/uploads/system/uploads/attachment_data/file/600228/OOTLAR_pdf3.pdf).

9 *Corporate tax: Research and Development Tax Credit*, 14 September 2016, updated 14 September 2017 (gov.uk/government/statistics/corporate-tax-research-and-development-tax-credit)

10 OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, Action 5 - 2015 Final Report, 5 October 2015 (oecd.org/ctp/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report-9789264241190-en.htm)

11 It was enacted in Schedule 2 of the Finance Act 2012, which takes up 40 pages, while the revisions in Finance Act 2016 amounted to 28 pages, all in highly complex legislative language.

12 See marianamazzucato.com/blog/creating-a-more-symbiotic-medical-innovation-eco-system/

Fully support international tax reform efforts

As outlined above, the UK has failed to provide genuine support for initiatives such as the BEPS project, and in many ways it has undermined them. This is a short-sighted policy, which has increased conflicts with other countries, and results in undermining corporate taxation everywhere. Unilateral measures such as the DPT are only palliatives; the UK should take a lead in global reform efforts.

The UK should:

- conduct a public review of its tax treaty policies, especially in relation to developing countries, as recommended by the G20 leaders, and as has been done by other OECD countries such as Ireland and the Netherlands; strengthening the tax base of developing countries would make them less dependent on aid, and stimulate their growth
- ratify the Multilateral Convention on BEPS, withdrawing the unnecessary reservations that the UK made on signature, which inhibit taxation at source, where business activities take place[13]

Further, the UK should support a shift of international tax rules away from the separate entity principle, which treats the parts of a MNE according to the legal fiction that they operate independently from each other. This is the fundamental flaw, which encourages MNEs to adopt complex structures involving often hundreds of affiliates, many in tax havens. The solution is to move towards international tax rules that treat MNEs in accordance with the economic reality that they operate as unitary firms with centralised control and management.

To facilitate this the UK should:

- conduct a public review of its policies on definition of a PE (taxable presence) and on transfer pricing
- support revisions of international transfer pricing guidelines towards clearer and simpler methods of allocation of profits according to where real economic activities take place, by strengthening the profit split method
- contribute constructively to the discussions taking place in the EU on the proposal for a Common Consolidated Corporate Tax Base (CCCTB), including the amendments suggested by the European Parliament to adapt it to take account of the digitalised economy, and to prevent profit-shifting outside the EU
- put forward proposals to the G20/OECD Task Force on the Digital Economy for reforms of international tax rules which would apportion MNE profits according to where economic activities take place
- support moves in the EU and elsewhere to introduce public country-by-country reporting by MNEs

www.bepsmonitoringgroup.wordpress.com

[13] See oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm

How should we tax the new economy?

Jolyon Maugham | Tax Barrister, Devereux Chambers

There is always room to tackle avoidance and evasion. And there are always powerful arguments for changing rates and thresholds. But no one watching, as technology changes the shape of our economy, could rationally conclude that the response lies in tinkering around the edges.

The challenges come from the growing mobility and concentrations of wealth. If you think you have the answer, ask how it squares up to them. We must start not with, 'what do we tax' but 'how can we tax'? If an idea is to spring from the pages of academic treatises and take fiscal form it must be practical and deliverable.

On corporation tax, ignoring that capital is mobile, that our tax system is built on the old world of bricks and mortar, that the tax systems of different countries dovetail together poorly, all of this is a kind of wilful blindness. Steep rises in corporation tax rates without addressing these structural issues won't end well.

The best solution is international co-operation – where states club together to tax corporations and to share out the fruits. Fill the joins between systems, close the gaps into which income leaks away untaxed, and avoidance becomes much more difficult. It is only then that higher rates will translate directly into higher receipts.

The EU is embarked on exactly such a project: a "common consolidated corporate tax base". But if we choose to absent ourselves from the best systemic solution we will need to become more imaginative.

A very substantial source of avoidance – practised by the usual suspects, Google, Facebook, Airbnb and others – involves selling into the UK from tax havens abroad. We should tackle this with a Foreign Sales Levy on large companies who engage in that practice. Base yourself here and you can pay corporation tax – but if you choose to game the system by selling to UK customers from tax havens you will pay a substitute for the corporation tax you are dodging.

Of course, a tax on corporate turnover throws up unfairnesses but – a universal answer to those who complain about measures that combat tax dodging, this – those unfairnesses are the consequences of choices made by taxpayers. If you don't like the turnover tax, operate from within the jurisdiction.

Higher taxes on income are – by and large – another triumph of political rhetoric over reality. The evidence in the UK that raising rates will produce meaningful additional receipts is slim. But quite aside from this it hard to understand why our tax system should prefer the wealthy to higher earners. The trend should be to cut taxes on income and increase taxes on wealth. We must respond to the tendency of wealth inequalities to outpace income inequalities.

Some improvements to the way in which we tax wealth are relatively straightforward to introduce.

Why are taxes on earned income considerably higher than taxes on the income fruits of wealth? Bring the latter up to the level of the former – not at all difficult to do – and we would generate very substantial additional tax receipts and in a rational and progressive fashion.

But other improvements will require more radical action.

We do have a wealth tax – when income is passed between generations – but state sponsored loopholes for particular classes of assets render it insignificant as a revenue earner. What it does instead is create false markets in those asset classes – their value is inflated by their use as tokens to pass wealth tax free between generations. This is bad tax - and bad economics. Their value is decoupled from and no longer dependent on their efficient economic use and, as tokens, they change hands frequently.

We must be radical.

We should halve the rate of inheritance tax – the current 40% rate is confiscatory – but reduce the threshold so it is paid by the top half of estates and applies to substantially all transfers of capital above £100,000. And we should remove the exemptions for special asset classes and special trusts. These measures will be hugely cash generative – and fairer by far than the current system.

And we must begin work on untangling the fiscal Gordian knot. We must look afresh at an annual wealth tax. The march of technology has two inevitable consequences. One is huge and growing concentrations of wealth. And another is disruptions in the labour market. The former must be used to ameliorate the latter. If society is to cohere into the future there is no alternative.

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An income tax system supporting social spending to reduce gender inequality

Sue Himmelweit | Professor of Economics, Open University

The UK government reformed the tax treatment of married couples in 1990 by introducing 'independent taxation'. This was a great victory for women, ensuring that everyone's income tax was based on their own income alone, unlike 'joint taxation', where a couple's incomes are aggregated and both partners pay the same tax rate. In a progressive income tax system, joint taxation results in lower-earning spouses paying more income tax, and higher-earning spouses paying less, than if they were taxed independently or than each would pay if they were single. Within couples, joint taxation therefore favours the higher earner, in practice usually the man, and magnifies any income inequality between spouses.

Independent taxation is also more egalitarian because in principle everyone gains in the same way from entering employment, through having their own personal allowance on which they do not pay income tax, and then starting to pay tax at its lowest rate. Under joint taxation, the couple gets a tax-free allowance, which one partner may use up entirely. This renders employment less worthwhile for a second earner, who gets no personal allowance and has to pay tax at the same marginal rate as their partner. Although in theory this applies to second earners of either sex, in practice, despite rising levels of women's and mothers' employment, couples are still more likely to question the value of a woman's employment and to see childcare costs as deductions from the mother's income. This is the other reason why achieving independent taxation was so important to women.

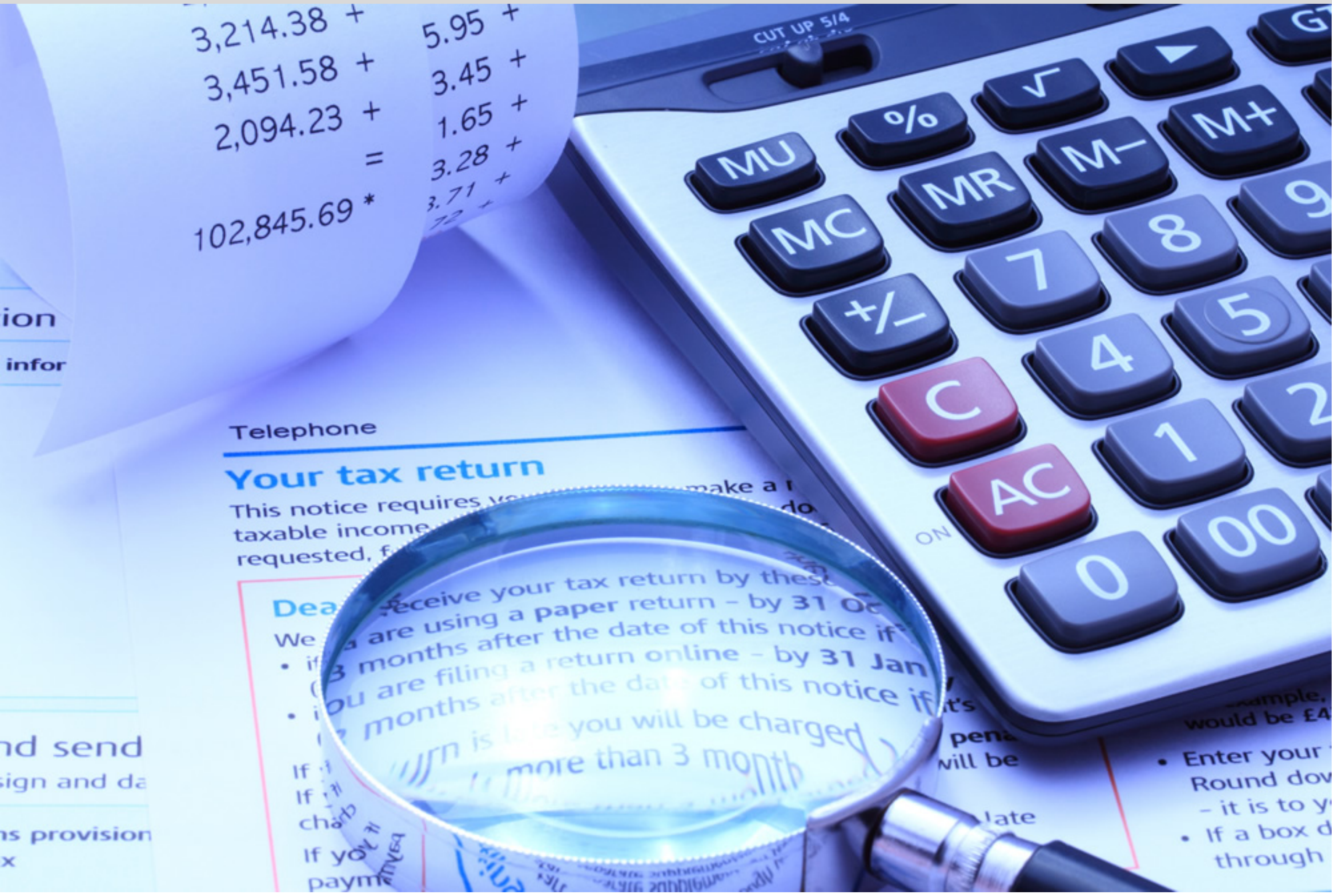
However, independent taxation has been eroded in various ways in recent years. The coalition government introduced transferable tax allowances (TTAs) for some married couples and civil partners, which allow an unused proportion of one partner's personal allowance to be set against the higher earning partner's tax liability. TTAs have similar employment disincentive effects to joint taxation. When a woman takes employment, the net gain to her household will be less if her partner had previously made use of some of her tax allowance. She may consider, before taking a job, that her partner will end up paying more tax as a result. Further, TTAs increases income inequality between partners, since it is the higher earner who gains from it.

Another coalition government policy, to 'withdraw' child benefit from higher-earning parents, has eroded independent taxation at higher income levels. It is meant to work by collecting an amount equal to the child benefit, which is paid to the mother by default, in extra tax from a parent with annual income above £50,000. Among couple parents, that high earner is more likely to be a man, who is thereby taxed on income that is not his own. To avoid this situation, some women have stopped claiming child benefit, with deleterious effects on their eligibility for the national insurance credits for caring on which their pension rights may depend. This policy also discourages parents, but not others, from increasing their income and becoming subject to these additional taxes.

The benefit of independent taxation is also reduced by the means-testing of benefits and access to some public services. Like joint taxation, means-testing, which is always calculated on joint income, makes the net gains from employment of one partner depend on the other's income. Means-testing similarly discourages paid work, especially for second earners on low earnings or with childcare costs (since childcare subsidies in the social security system do not cover all costs). Not only does that increase poverty levels, since dual earning is increasingly necessary to keep families out of poverty, but it works against gender equality. Despite rising levels of women's employment, there remains a substantial gap between men's and women's employment rates, and a much larger one between the employment rates of fathers and mothers. Interruptions in employment render women economically dependent (which is undesirable for both them and their relationships) and harm their future employment prospects, making them less likely to get well-paid jobs and increasing the gender pay gap. Finally, we need to remember that a large proportion of relationships do not last. Women who have given up employment or taken a poorly paid part-time job during a relationship are in a particularly vulnerable position if they have to manage on their own – and so, of course, are their children.

The solution to these dilemmas is to have a social security system and social services that rely less on means-testing and more on a progressive tax system that raises more revenue to pay for them. However, policy in recent years has gone in the opposite direction, with the means-testing of benefits and access to public services being ramped up in order to reduce costs, while revenue from income tax has been cut. Successive increases in the personal tax allowance and higher rate threshold since 2010 have eroded the tax base, with most of the gains going to men; the 43% of adults who earn below the personal allowance, two-thirds of them women, have gained nothing from these give-aways. A more progressive tax system - bringing more people into income tax, initially at very low rates, with higher rates at the top end than we have currently - would not only generate much-needed revenue, but might also increase understanding among taxpayers of the importance of universal benefits and social services.

www.open.ac.uk/people/sfh2



MAKING THE TAX SYSTEM MORE **EFFECTIVE**

All taxpayers, including companies and individuals alike, should pay all of the tax that they owe.

Social justice, tax justice and transparency

Krishen Mehta | Former Partner, PwC & Board Member, Tax Justice Network

Tax justice is one of the pathways to social justice. Just as the movement for women's rights and labour rights, or the right to health care and education are an important element of our social fabric, so is the movement for tax justice. Ultimately, we want to build a just society that serves, protects, and promotes participation of the most vulnerable. Pope Francis began his speech to the UN in 2015 by talking about the need for a foundational imperative of a just economic system for all mankind.

What does this mean in the context of tax and financial transparency? I believe that it needs to have the following components:

- Can large multinational companies be obliged to pay their fair share of taxes in countries where their economic activity actually occurs? This can best happen if they are taxed as single entities, rather than as a group of separate entities.
- Can we stem the abuse of shell companies and tax havens that enable companies and the financial elite to move their profits away from where their profits occur? Can we expect more from the lawyers and accountants who help make that possible?
- Can country-by-country reporting be a required public disclosure for all publicly held companies, so that the public itself can be a judge of the ethics and values of the companies in which they invest?
- Can automatic exchange of information be a matter of normal practice among all jurisdictions, so that tax abuse can be stemmed with simplicity and ease?
- Can the beneficial ownership of companies, trusts, and foundations be a matter of public record, so that society can exercise its fiduciary obligation to hold each person or entity accountable to the highest standard?
- Can there be a World Tax Authority that can arbitrate tax disputes between nations, so that developing countries, that are often more vulnerable, are not left at the mercy of the richer multinational companies and of pressure from their countries of residence?
- Can there be a harmonisation of predicate offenses, so that a crime in one jurisdiction can be considered a crime in another, and funds from the proceeds of such crime cannot easily be transferred from one jurisdiction to another?

When we address the issues above with care and diligence, we will have the resources and the fortitude to take on some of society's more pressing challenges. As an example, we could better ensure that banks and other financial institutions, subject to complete disclosure of their activities, do not take advantage of people suffering or recovering from a financial crisis. We can work towards trade agreements that can ensure that people with limited financial means can have access to lifesaving medicines. We can prevent austerity measures (that have inequality at their core) from closing schools and hospitals and other public services that are important for society. By taking these steps, we would essentially move from having profit as the primary motivation for our companies (which benefits just a few) to making society the primary beneficiary of a company's success and wellbeing. Tax and financial transparency therefore has its origin in our natural desire for a just and fair economic system. As we move towards such a system, we respond to the challenge asked of us by Blaise Pascal, when he said that "justice and power must be brought together, so that whatever is just may be powerful, and whatever is powerful may be just."

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Resourcing and refocusing HMRC

Cathy Cross | Parliamentary Officer, PCS & Board Member, Tax Justice Network

Her Majesty's Revenue and Customs (HMRC) was created in 2005 by the merger of the Inland Revenue and Her Majesty's Customs and Excise. The newly formed HMRC had around 104,000 staff. In 2017 the headcount in HMRC stands at approximately 58,000, but under proposals ironically titled "Building Our Future" they intend to cut thousands more jobs by 2021.

The Building Our Future programme also plans to close almost the whole HMRC estate of over 170 offices and move to a regional "hub system" of just 13 offices with five specialist centres. Huge areas of the UK will be left without a "tax compliance" presence.

HMRC say that this is designed to save money, but in reality the closures are linked entirely to the 2021 end date of the disastrous Mapeley contract by which the HMRC estate was handed over to an offshore company in 2001, only to be leased back to HMRC. Experience to date shows that cutting jobs and offices not only results in poorer services to the public but also loses tax yield by making it easier to avoid and evade tax.

A member of staff in the compliance business stream of HMRC brings in on average over £900,000 a year on a £30,000 salary. Yet HMRC continues to cut the jobs of compliance staff.

HMRC is a crucial government department, assessing, enforcing and collecting taxes that pay for all public services. Common sense screams that it should be adequately and appropriately resourced and well managed, with a strategic direction to perform its statutory functions and to stand it in good stead for any future challenges, in particular as the UK leaves the European Union.

But it isn't. HMRC's budget after years of systematic cuts was 40% less in 2016 than in 2000.

For more than a decade HMRC has faced year on year cuts to funding at the same time as ongoing internal re-organisations. Together these have led to a situation where HMRC has been variously described as a government department in "crisis" and "not fit for purpose".

Staff morale is so low that even in areas where HMRC is not seeking to cut jobs, experienced staff are leaving in droves, worn down by years of pointless "change management" and relocations that never lead to better efficiencies, either cost-wise or service-wise. This is set against a backdrop of a tax code of more than 16,000 pages, a tax gap of approximately £119bn (see below) and a complete dismantling of face-to-face services to the public.

HMRC is also seen as being soft on the perpetrators of tax avoidance. It has devoted disproportionate senior management time to negotiating "sweetheart deals" with big companies like Vodafone, rather than strengthening its services to ordinary members of the public or to the accountancy profession.

Stronger anti-avoidance legislation is needed to tackle abuse of the system by big business and rich individuals and to ensure that taxes due are collected, but this legislation cannot be implemented without the necessary staff and resources; and this requires political will.

No one argues that there is a linear relationship between the actual number of staff employed in HMRC and tax collected. It is clear, however, that depriving HMRC of resources has not resulted in a more efficient tax authority. No other tax authority in Europe save Greece has cut its staffing more than the UK in percentage terms, and lessons need to be learnt from that.

We believe that the tax gap, which is made up of avoided, evaded and uncollected tax, stands at closer to £119bn per year than the £36bn figure quoted by the government. Added to this, the equivalent of £120bn of income is waived every year in the form of tax reliefs, often to rich companies and individuals who are thus subsidised by the taxes paid by ordinary workers.

It is impossible to collect these missing billions without properly resourcing HMRC and changing the ideology that presides at the heart of government and in the senior levels of HMRC. Mismanagement of the department has been commented on in select committee reports. The Public Accounts Committee has published findings critical of the practices of HMRC. Figures in the accounting industry, companies with ethical tax arrangements, a growing number of individuals and organisations in civil society and the CBI have all agreed with workers in HMRC that the department should be adequately resourced and refocused to make it a department fit for the 21st century.

These resources and reforms would enable the government to collect many billions more in tax revenue, every year.

www.pcs.org.uk

Requiring companies to calculate and submit figures on deliberately created tax risk

David Quentin | Tax Barrister

Tax risk – by which we mean the risk of owing more tax than you say you owe when you file your tax return – is an inevitable consequence of doing business. This is because, however clear and certain tax law is, it cannot anticipate the infinite variety of real commercial situations. And where there is uncertainty, a taxpayer might take one view of how the law applies, and HMRC might take another view, and HMRC might be right.

There is nothing wrong with taking steps to mitigate such tax risk when it arises, for example by structuring a transaction differently so that the risk does not arise. That kind of behaviour is one of the two forms of 'legitimate tax planning' (i.e. tax planning that is not tax avoidance). The other kind of 'legitimate tax planning' is where you do something which Parliament intended should attract a tax relief.

Much tax planning, however, does not fall into either of these categories. What happens is that taxpayers deliberately create tax risk with the intention of making tax savings – this is tax planning which, for whatever reason, may or may not succeed – and then take steps to mitigate this 'deliberately created' tax risk in order to ensure that they have the best chance of obtaining the saving.

This behaviour is both institutionally and legally distinct from 'legitimate tax planning'. It is institutionally distinct, because the tax risk originates in tax planning and is therefore created by tax professionals rather than being encountered by them when they review commercial plans and operations, and it is legally distinct, because the steps taken to mitigate these sorts of tax risks are not steps which Parliament intended should attract a tax relief.

Amounts of deliberately created tax risk – in other words amounts of tax put at risk by tax planning irrespective of how effectively the risk is then mitigated – are broadly equivalent to amounts of tax 'avoided', but with one crucial difference. Tax avoidance is generally thought to be an indeterminate 'grey area', meaning that it would not be possible to determine how much tax is being avoided. On the other hand a corporate tax function should be able to (a) identify deliberate tax planning which introduces tax risk factors, and (b) put a reasonably precise figure on the amount of tax saved by such planning.

This is important. It means that it should be possible to obtain real hard data about a category of tax abuse which the tax industry claims is only capable of vague definition. Corporation tax law should therefore require companies to perform that computation in relation to all deliberately created tax risk, and include the resulting figure in their tax returns. It should also require them to be able to substantiate how the figure was derived, disclosing the relevant transactions where appropriate, upon HMRC request. In addition, a tax-geared penalty should apply where companies deliberately create tax risk and do not include the amount of the tax put at risk on their tax returns.

To emphasise, the amounts that it is suggested should be disclosed would represent tax put at risk by the company's tax planning, irrespective of how well the risk is mitigated. This is because the purpose is to find out how much tax is being avoided, irrespective of whether the avoidance would turn out to be successful or unsuccessful upon forensic analysis.

What purpose would be served by such a figure? There would be at least three purposes. First, it would greatly assist HMRC in risk-assessing individual corporate taxpayers. Second, it would enable HMRC (upon investigation of taxpayers' disclosures) to better keep track of developing trends in corporate tax avoidance. And third, the figures could be aggregated across the corporate sector and published alongside somewhat vaguer 'tax gap' estimates as a precise and objective indicator of the scale of the problem of corporate tax avoidance.

The usual argument against suggestions like this is to do with the costs of compliance. Such complaints would be without merit in relation to this proposal: competent tax risk management requires that this kind of analysis be performed in any event. The additional compliance burden would be little more than putting the figure in the box on the return. And if that is too burdensome, companies always have the option of not deliberately creating tax risk at all.

www.dqtax.tumblr.com

The Tax Gap and what to do about it

Richard Murphy | Director, Tax Research UK and Professor, City University

A decade ago, almost no one discussed the UK tax gap. One of the impacts of the global financial crisis is that this issue is now on the public, media and political agenda. This is to be welcomed.

The tax gap is in two parts. The first and most discussed part is the difference between the amount of tax that should be paid in this country based on HM Revenue & Custom's reasonable interpretation of tax law and the sum actually paid.

Most of this part of the tax gap arises because of tax abuse. Whether that abuse is supposedly legal, when some call it tax avoidance, or may be illegal, when it is usually called tax evasion, does not matter: the net outcome in both cases is that someone has deliberately decided to abuse the law as it stands (and with which most people comply) to secure an unfair advantage. To be blunt, they've cheated.

This cheating has another component too: some people just refuse to pay what they owe in tax. Too often they get away with it because they trade through limited companies where the money has long gone before tax owing gets a look in, and is then lost forever. This is why company regulation matters for the tax gap.

The second, and maybe as important part of the tax gap is the amount of tax not paid because of either official policy or HMRC failure. Tax policy can, it must be stressed, be socially useful, for example by setting low rates of VAT on essential items. It can also be deeply divisive, for example with regard to low capital gains tax rates, low corporation tax and the refusal of HMRC to engage with tax abuse by the likes of Google, Amazon and Starbucks. This tax policy gap can also arise because there are just not enough staff employed at HMRC to enforce tax law. HMRC does, for example, currently plan to close all tax offices north of Glasgow, west of Bristol and throughout East Anglia. This is going to weaken tax enforcement.

How much these two issues cost is open to debate. HMRC say that the cost of tax abuse and tax bad debt is about £34 billion a year. Using very different approaches (including what I think is the quite reasonable assumption that if one tax, such as VAT, is not declared then other, related taxes, such as corporation tax might also be lost) I come up with the very much higher figure of £120 billion a year. Which is right is open to question and interpretation. What is beyond dispute is that the sums involved are huge and, as HMRC themselves admit, are simply unknown in some cases. This is also, rather embarrassingly for HMRC, also true of many issues relating to the tax policy gap, where the published data is very rough and ready, to be kind to them.

And this matters: when austerity remains a core government policy and the excuse is used that this is because of a shortage of tax revenue, it automatically follows that the tax gap has an enormous social cost for society at large. In that case the reasonable question has to be asked as to what might be done about it.

The official answer to this question is that HMRC's budget is to be cut significantly (see 'Resourcing and Refocusing HMRC'). It almost seems as though it is government policy not to collect tax that is owed.

What is required, then, is something significantly different. First, there has to be a commitment to more accurately assess the tax gap. HMRC cannot undertake this task because they are responsible for closing that gap: the risk of moral hazard in asking them to set their own target that this duality of tasks gives rise to is just too great for an issue of this significance. I suggest we need a new Office for Tax Responsibility to audit the tax gap and HMRC's successes and failures in tackling it for this reason.

Second, I suggest that this new Office for Tax Responsibility should also audit the rationale for all tax reliefs and allowances and then identify those that no longer serve any social purpose and which could, as a result, be abolished. We can no longer afford pointless tax giveaways.

Third, I suggest that HMRC be required to suggest how it could close the tax gap if given the resources to do so, and then be allocated the resources required to achieve as much of that goal as possible.

Fourth, I would expect as a result that HMRC will restore its past commitment to tax offices being found in each moderately sized town in the country. If tax is the consideration in the social contract between the state and those it governs, HMRC must be represented in the communities it serves, and be accessible to taxpayers face-to-face as well as online.

Fifth, it is time for the social purpose of tax to be reappraised as a critical part of macro-economic and social policy in its own right. Tax is not just a revenue-raising tool (if, indeed, it is even that when government can also pay for spending using borrowed funds), but is also a major tool for the delivery of social and economic policy. The time to appraise just how to meet these social and economic goals has arrived.

And for that reason, nothing less than a Ministry of Tax, with a cabinet minister separately responsible for the delivery of tax policy, is now required to transform the way tax is seen by the government, the Treasury, spending departments and most especially by the people of this country, who are as dependent on the public services that tax can provide as some are dedicated to not paying it.

www.taxresearch.org.uk

Abolishing non-domiciled status

Prem Sikka | Emeritus Professor of Accounting, University of Essex

A favourable taxation regime is available to non-domiciled individuals living in the UK, but who have a permanent home somewhere else. This policy is a relic of a bygone age; it is unfair, enables tax avoidance, and should be abolished.

Tax concessions for individuals not domiciled in the UK (popularly known as non-doms) were introduced by the government in 1799 and gradually refined in subsequent years[14]. The tax-raising policies of that time sought to replenish the coffers of the British state for the losses arising from wars with France, Spain and America and turmoil in Ireland. Inevitably, the question was which individuals and income would be taxed, as not all income arose in the UK and some wealthy individuals may have made British colonies their home. The concession given to non-doms was to exempt their foreign income, gains and profits from UK taxes. Over the years, various changes have been made to the tax rules, but the tax concessions remain.

A 'domicile' is defined as the country which a newly-born child's parents consider to be their permanent home. This can change as individuals can leave a country with no intention of returning. In principle, it is possible for someone to live in the UK but be domiciled elsewhere. There is no statutory definition of a non-dom, and the status depends on a variety of factors and circumstantial evidence. The case of *Gaines-Cooper v Revenue & Customs Rev 2 [2006] UKSPC SPC00568* shows that the rules are complex.

After the Finance Act 2017, the position is that all non-doms are required to pay income tax on their UK earnings, but avoid income tax and capital gains tax on assets held elsewhere as long as the amounts are not remitted to the UK. There are also valuable inheritance tax, business investment and other tax reliefs, which are not available to individuals domiciled in the UK. Rather than declaring their foreign income and gains to the UK tax authority, the non-doms can choose to pay what is known as the "remittance basis charge". The remittance basis charge is effectively a UK tax on unremitted foreign income/gain. £30,000 is payable by individuals resident in the UK for more than 7 out of the past 9 years. Before the seven-year period, individuals can still claim the non-dom status, but are not liable for the remittance charge. The charge rises to £60,000 for individuals resident in the UK for more than 12 years out of the past 14 years. Non-doms who have resided in the UK for more than 15 of the past 20 tax years are deemed UK-domiciled for income tax, capital gains tax and inheritance tax purposes, even if they maintain a domicile abroad.

Around 5 million people[15] living in the UK may be able to claim non-dom status, but most are unable to secure any tax advantage because their income and gains solely arise in the UK. Non-dom status is actually claimed by wealthy individuals, often advised by aggressive accountants and lawyers. According to Her Majesty's Revenue and Customs (HMRC), 121,300 individuals[16] claimed non-dom status for

[14] See John F Avery Jones, Taxing Foreign Income from Pitt to the Tax Law Rewrite—the Decline of the Remittance Basis, in John Tiley (ed.), Studies in the History of Tax Law, Volume 1, Oxford: Hart Publishing, 2004; William Phillips, The Real Objection to the Income Tax of 1799, British Tax Review, 1967: 177-186

[15] The Telegraph, *Non-dom status: do you qualify?*, 17 March 2010 (telegraph.co.uk/finance/personalfinance/expat-money/7465517/Non-dom-status-do-you-qualify.html)

[16] Her Majesty's Revenue and Customs, Statistics on Non-domiciled Taxpayers in the UK 2007-08 to 2014-15, August 2017: gov.uk/government/uploads/system/uploads/attachment_data/file/640897/Statistical_commentary_on_non-domiciled_taxpayers.pdf

tax purposes in 2014/15. There were 85,400 UK-resident taxpayers; the remaining 35,800 were non-UK resident. Famous residents claiming non-dom status include Mark Carney, the current governor of the Bank of England; Roman Abromavich, the billionaire owner of Chelsea Football Club; Steel magnate Lakshmi Mittal, media tycoon Viscount Rothermere and numerous footballers.

The UK government statistics for 2014-15 show that 54,600 non-doms opted to pay the remittance basis charge (see above), but only 5,100 individuals became liable to pay it. The statistics are silent on the actions of the other 49,500. The number of investigations of non-doms, if any, by HMRC is not known. The remittance basis charge raised £226 million. The government estimates that altogether non-doms contributed £9.3 billion in various taxes and National Insurance contributions to the UK Treasury. However, the statistics do not say what the non-doms would have paid if they were subject to the rules applicable to normal UK taxpayers.

Non-dom tax concessions are unfair and discriminatory. Non-doms enjoy all the benefits of UK infrastructure but are not liable to UK taxes on the same basis as the majority of people, even when they have lived in the UK for 14 years. Non-dom taxation hinders investigation of tax avoidance and evasion, as wealthy individuals do not have to provide any indication of wealth stashed elsewhere. The government claims that non-doms bring investment into the UK, but has failed to provide any details or to show any economic benefits. The paradox is that government policy fails in its own terms. By allowing non-doms to cap their tax liability at £30,000 or £60,000 in respect of unremitted income, the government is incentivising them to enjoy the benefits of UK residence whilst keeping their wealth offshore.

Non-dom status facilitates all kinds of economic distortions. For example, a large number of Premier League football players have non-dom status. They pay UK income tax on their wages. But their employment with a UK football club also leads to other streams of income, such as the income from image rights. Many have incorporated their image rights outside the UK, often through companies registered in low- or no-tax jurisdictions, and thus avoid UK tax on the income and probably also in their home countries too[17]. In contrast, British-domiciled players cannot easily ring-fence their income from image rights and may thus exert pressure for higher wages and signing-on fees. These distortions also extend to other sectors of the economy.

Non-dom status is a relic from the past and continues to enable wealthy elites to shelter their wealth from tax authorities, with significant economic consequences. It should be abolished altogether. The principle should be that if someone has lived in the UK for a 'reasonable period', they should be subjected to the same tax rules as anyone else. The 'reasonable period' can be fine-tuned to exempt temporary workers, and could possibly be aligned with citizenship rules, whereby individuals living in the UK for five years can generally apply for UK citizenship.

huffingtonpost.co.uk/author/prem-sikka

[17] The Guardian, *HMRC chief calls for tax crackdown on Premier League footballers*, 7 December 2016 (theguardian.com/business/2016/dec/07/hmrc-chief-calls-for-tax-crackdown-on-premier-league-footballers); The Telegraph, *Tax savings tactics with new Guernsey image rights laws*, 29 January 2013 (telegraph.co.uk/finance/personalfinance/expat-money/9826890/Tax-savings-tactics-with-new-Guernsey-image-rights-laws.html)