NEW LABOUR: TAX DODGERS' FRIEND

by

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Due to organised tax avoidance Britain is losing between £97 billion and £150 billion of tax revenues each year, large enough to make a huge difference to spending on education, healthcare, pensions, public transport and reduction in poverty. The poorest fifth of the UK households pay nearly 10% of their income in direct taxes and another 28% in indirect taxes. Elsewhere the story is very different.

Companies have developed strategies that result in higher accounting profits but lower taxable profits. Reneging on pension commitments and tax avoidance are all part of the same strategy. Between 2003 and 2006, the FTSE100 companies doubled their profits. Their executives enjoy bumper profit related remuneration. Yet there is little inquiry about the quality of such profits.

FTSE100 companies have more than 15,000 subsidiaries, many of which rarely trade but enable companies to book profits in tax havens and avoid UK taxes. Many companies employ ingenious intrafirm pricing schemes to shift profits out of the UK and reduce tax bills. Rupert Murdoch's NewsCorp generates revenues through SKY television and its newspapers, but most of the profits are booked in tax havens. Since the late 1980s it has paid little or no corporation tax in the UK. Richard Branson's Virgin empire is controlled from tax havens and pays little in UK corporate taxes.

An Early Day Motion in the House of Commons pointed the tax avoidance finger at Alliance and Leicester, Allied Domecq, Amersham, Arcadia, Barclays, BAT, BOC Group, Compass Group, Dixons, GlaxoSmithKline, Honda, Kelda Group, Lloyds TSB, Merrill Lynch, NewsCorp, Nissan, Northern and Shell, Portland Enterprises, Prudential, Rolls Royce, Sage Group, Severn Trent, Shell, Tesco, Toyota, Virgin Atlantic, Virgin Trains, Vodafone and WPP. The government has shown little interest in plugging the leakage of tax revenues to tax havens.

Under the private finance initiative (PFI) taxpayers are already committed to paying at least £150 billion to companies. The same corporations are shrinking the tax base by not paying taxes. Innisfree is one of the largest providers of funds for hospitals and schools. Its directors have been enjoying bumper rewards of £10 million. However, the company's audited accounts for the financial years 2004 and 2005 show that it did not pay any corporation tax in the UK. Nearly one-third of the company's shares are held in Jersey by Coutts Bank for some faceless beneficiary. This party receives dividends, effectively paid by UK taxpayers, but pays no taxes.

In 2005, retail entrepreneur Philip Green's Arcadia Group, which owns Burtons, Topshop and Dorothy Perkins, declared a dividend of £1.299 billion. £1.2 billion went to Mrs. Green, but she did not have to pay income tax of nearly £300 million because she is resident in Monaco. Philip Green was knighted in 2006.

Britain is now the world’s first onshore tax haven. Millionaires can live here, enjoy all the benefits of social infrastructure but pay little or no personal tax. Last year Britain’s 54 billionaires had an estimated income of £126 billion. At the normal rates of income tax they should have paid nearly £50 billion in tax but are estimated to have paid only £14.7 million, an affective tax rate of only 0.14%.

The government’s insistence on light-touch regulation has created opportunities for private-equity firms. These firms enjoy capital gains tax concessions and also siphon-off profits through interest payments, often to tax havens. The siphoned off profits return to the UK as borrowings and the interest paid then qualifies for even more tax relief with the inevitable outcomes. Despite combined sales of more than £12 billion and operating profits of more than £400 million, five of the largest ten private-equity firms paid no corporation tax during 2006/2006. Most reduced their tax bills and four of the top ten firms received tax credits.

The Finance Act 2006 has created new tax avoidance opportunities. In January 2007, the UK government launched real-estate investment trusts (REITs). In essence, a REIT is a company that owns and manages income generating property. However, it comes with a huge tax perk. If most of its income is paid out as dividends to shareholders then the company is exempt from corporation tax. Yet little attention has been paid to the use of REITs for tax avoidance.

In the US, following advice from Ernst & Young, Wal-Mart has used REITs to avoid paying taxes. Brief details of the schemes are that one or more Wal-Mart subsidiaries pay rent for occupying properties to a REIT. This REIT is either wholly or substantially owned by another Wal-Mart subsidiary and it can pay out its dividends without paying any corporation tax. Wal-Mart is effectively paying rent to itself and all payments stay within the same group of companies. The scheme enables Wal-Mart to claim tax relief on its rental cost and avoid corporate taxes on the income. In one four-year period, the REITs strategy enabled Wal-Mart to avoid paying $350 million in taxes. In the UK setting, investors receiving the dividends are also exempt from higher rate income tax (40%) on their dividend income. Even worse, these investors could be located in tax havens (see above) and would pay no income tax on their dividends.

In the US, Senate Committees led by Senator Carl Levin have targeted the tax evasion industry. Its hearings targeted major accountancy firms and led to KPMG being charged with the largest ever criminal tax case. The firm was fined US$456 million and a number of its partners are facing prosecutions. One of its partners subsequently told a US court, “I willfully aided and abetted the evasion of taxes”. Here KPMG’s global chairman Michael Rake received knighthood and his firm has close links with the Treasury. The Treasury Select Committee has shown no interest in investigating the tax avoidance industry.

Under New Labour poor are subsidising the rich. The tax system discriminates against British citizens by giving privileges to non-citizens. The UK tax base is being eroded and will not enable any government to make the required investment in social infrastructure or redistribute wealth. The government has shown little imagination and determination in checking the tax avoidance industry.