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ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We support our 131,500 members and 362,000 students throughout their careers, providing services through a network of 80 offices and centres. Our focus is on professional values, ethics, and governance, and we deliver value-added services through 50 global accountancy partnerships, working closely with multinational and small entities to promote global standards and support.

We use our expertise and experience to work with governments, donor agencies and professional bodies to develop the global accountancy profession and to advance the public interest.

CONTACT

For further information please contact:

Chas Roy-Chowdhury, head of taxation, ACCA
+ 44 (0) 20 7059 5976

Dr Steve Priddy, director of technical policy and research, ACCA
+44 (0) 20 7099 5971

Ian Welch, head of policy, ACCA
+44 (0) 20 7099 5729

Helen Thompson, head of media relations, ACCA
+44 (0) 20 7059 5759

www.accaglobal.com
Tax is becoming one of the key strategic issues of the age. Barack Obama made promises to act against tax havens one of the key elements of his successful election campaign and, following his inauguration in early 2009, there was a sudden flurry of concessions issued by private wealth centres before the April G20 summit, caused by immense political pressure over the issue. Switzerland, Hong Kong, Singapore, Luxembourg, Austria, Liechtenstein and others agreed to adopt the tax transparency standards and information exchanges of the Organisation for Economic Cooperation and Development (OECD). This had followed a decade-long campaign by the OECD, slowly building up pressure for reform.

These concessions were welcomed by G20 governments, which have long accused tax havens of allowing individuals and companies to thwart their own countries' tax laws by hiding wealth in these private wealth centres. The moves did not go far enough for some critics, who point out that tax authorities will still need to provide a challenging degree of evidence before they are able to extract information from such havens.

ACCA strongly believes in transparency and the right of governments to pursue suspected tax evaders. It could also be said that some offshore centres have not helped themselves by pursuing the letter, rather than the spirit, of internationally agreed rules that are intended to increase transparency. Nonetheless, given that the development of tax havens has been accelerated by the rapid growth of offshore banking carried out by large Western banks, these centres could reasonably point to the serious financial regulatory failures of the leading countries, as revealed by the global economic crisis. It is also true that many leading nations offer similar concessions to those of tax havens, such as bank accounts that pay gross interest and provision of tax-friendly regimes for rich non-domiciliaries, who bring wealth to their host nations while having their tax base in their countries of origin. Leading countries can be legitimately accused of double-standards for aiming their firepower at offshore financial centres, while ignoring locations and practices closer to home.

There is a political desire, among the large industrialised countries, for greater national and international financial regulation in reaction to the global economic crisis, while falling tax yields in many economies have generated additional pressure on tax havens. This is partly because of declining levels of economic activity, but companies are also choosing to use their mobility and relocate their headquarters if the tax regime is insufficiently attractive in the country where they are based. For example, a number of companies have changed their tax domicile from the UK in recent months, quoting the lower tax rates and friendlier systems in new domiciles.

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1. Barack Obama told a campaign rally in October 2008 ‘There is a building in the Cayman Islands that houses supposedly 12,000 US-based corporations. That’s either the biggest building in the world or the biggest tax scam in the world and we know which one it is.

2. The Sunday Telegraph on 15 March 2009 referred to Brit Insurance, United Business Media, WPP Group and Regus as having moved tax domiciles from the UK, and quoted a spokesman for Royal Sun Alliance who said that the insurer had established an Irish subsidiary to write insurance in the UK but take advantage of Ireland’s lower tax rate.
Analysis

Given these high-profile issues, which have seen tax move up the political agenda, ACCA believes that a clear exposition of what makes an efficient and just tax system in the 21st century is timely.

When examining tax principles, it is worth starting with a review of the famous four canons of taxation put down by Adam Smith, who is generally considered (certainly in the English-speaking world) to be the father of modern political economy. In *The Wealth of Nations* (1776) he argued that, ‘the evident justice and utility of these maxims have recommended them more or less to the attention of all nations’.

I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. (EQUITY)

II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. (CERTAINTY)

III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. (CONVENIENCE)

IV. Every tax ought to be contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state. (EFFICIENCY)

Translated to the modern era, the first maxim is in some ways the most contentious, as it appears to argue for progressive taxation, where tax is levied according to the ability to pay. On fairness grounds it is hard to argue against this and most modern tax systems follow this principle, but whereas the huge inequalities of wealth in Smith’s day made such a position necessary, it is arguable that it is now a political position rather than a statement of fact.

The other maxims are less contentious. Canon II forms our point 5. A society’s tax system must be known and understood by all its adult members; otherwise, they cannot play their part to the full. Maxim III is hard to argue against though is not always adhered to in practice. Maxim IV forms our point 7 – though it could be argued this is the area where Smith’s theory is furthest from modern reality, given the costs of the state’s taxation apparatus and the subsequent cost of advisers to represent taxpayers.

So it can be seen that, given the complexity of modern economies and societies, it is a challenge to apply the tenets of even the greatest thinkers to contemporary tax systems. Unlike Smith, ACCA does not offer the following points as universal truths, but believes that if followed by governments these 12 policies would represent the basis of effective tax systems around the world.
ACCA's 12 key tenets of taxation

1. AVOIDANCE/EVASION

Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands: Taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant. Honourable Learned Hand, US Appeals Court Judge, Helvering v. Gregory, 69 F.2d 809 (1934).

There is a clear division between tax avoidance (or planning, or mitigation), which is legal, and tax evasion, which is not. The former is the legal exploitation of the tax regime to one’s advantage, to attempt to reduce the amount of tax that is payable by means that are within the law while making a full disclosure of the material information to the tax authorities. In contrast, tax evasion works outside the rules, where the taxpayer tries to frustrate legal obligations by hiding income through nondisclosure, or improperly taking deductions to which he or she is not entitled.

Governments increasingly try to blur the distinction between the two, however, by using phrases such as ‘unacceptable tax avoidance’, which is not helpful. Tax law must be clear and certain (see points 3 and 5 below) and it should be remembered that businesses will try to minimise tax impact as a part of their normal commercial activity. Tax is a business cost like any other and company directors have a fiduciary duty to run the business in the most cost-effective manner.

As the case above reminds us, it is not unethical to minimise one’s taxes. While most businesses try only to comply with the law, there have nonetheless been many cases of convoluted tax planning schemes that are designed not for any proper business purpose but to exploit loopholes in the law and avoid its spirit. ACCA does not support this artificial activity, which could be considered the equivalent of the creation of some of the extremely complex financial products, designed to get round banking regulations, which have had such a disastrous effect on banks. Such actions, which may generate short-term financial advantage at the cost of long-term value, cannot be supported.

2. TAX AS A PERCENTAGE OF GDP

ACCA accepts that the current unprecedented economic turmoil may require special measures from governments. Notwithstanding current conditions, we believe that levels of taxation should be clearly stated as a percentage of Gross Domestic Product, as far as possible.

In countries such as the UK and US, in the years just before the current economic conditions developed, the trend was for tax revenues to rise. In other countries, increasing the ratio of tax receipts to GDP by tightening the tax compliance system has been a higher priority for authorities such as the International Monetary Fund.

ACCA does not seek to enter the political debate about the appropriate level of tax and public spending. Nonetheless, substantial tax increases represent a significant burden on businesses and individuals and should be subject to an impact assessment before being introduced. These impact assessments should be used to challenge the need for new regulations and to establish an accurate and updated estimate of costs. Once new measures are put in place there should be a means of measuring and evaluating their impact in terms of their proclaimed public policy objectives.

Government should rationalise and set a target of taxation as a percentage of GDP as part of its economic management, and then be held to account via objective measurement and variance analysis.

3. In his landmark report on regulation, Lord Turner, chairman of the UK City watchdog, the Financial Services Authority, referred to this as ‘adventures in risky proprietary trading activities of little social value’.


3. TAX SIMPLIFICATION AND STABILITY

ACCA believes that tax legislation and operations should be as simple and straightforward to understand and to comply with as possible. Research shows that, globally, companies spend almost two months per year complying with tax regulations – 15 days for corporate income taxes, 21 days for labour taxes and contributions and 21 days for consumption taxes.6

It is also essential that the volume of legislation is kept to a minimum. Much of the increase in tax law and administration in recent years7 is due to the number of new anti-avoidance measures introduced by tax authorities. Small businesses in particular have no time to engage in esoteric tax planning and are simply trying to cope with the volume of laws. Changes in tax law – particularly those that reverse previous tax breaks or incentives that have formed the basis of business planning – should be kept to an absolute minimum.

4. OPENNESS, TRANSPARENCY AND ACCOUNTABILITY

Tax policies should be transparent and non-discriminatory unless part of a declared discriminatory policy, such as one intended to encourage new enterprise. There is a wider political question about the extent to which it is appropriate to use taxation as an instrument of social policy (eg penalising smoking by heavy duties, or environmental taxes to mitigate climate change). ACCA’s view is that this use of tax by elected governments is legitimate but such taxes should then meet the other principles such as being transparent, simple and effective. Governments should be wary of increasing the complexity of the tax system by too much tinkering to ‘reward’ certain groups of taxpayers.

Too often, consultation processes on tax policy are flawed exercises where government policy has already been decided, and are carried out largely for appearances’ sake. On major issues of tax policy, there should be clear consultation where the different options are specified at the start, and properly considered with an audit trail including unambiguous minutes and written responses.

There should also be openness on the application of tax policy. So-called ‘stealth taxes’, such as the quiet reduction of tax exemptions, and the phenomenon of ‘fiscal drag’, whereby personal tax thresholds are not increased in line with rising prices and incomes, thus bringing more individuals into higher-rate tax bands, cannot be justified. Tax rises should be made openly and subject to debate.

6. World Bank (2008), Paying Taxes. Time recorded is in hours per year.
5. CERTAINTY

The tax systems in many jurisdictions can be criticised for the lack of certainty in outcomes or operations. The UK and US authorities do not explicitly ban certain types of tax planning that are within the law, but nonetheless take a negative view of them. (In the US these are sometimes referred to as ‘abusive transactions’.) Companies using these legitimate tax planning techniques may find themselves having to report to the authorities or becoming the subject of onerous tax enquiries. Often these artificial ‘blocks’ are used by the tax authorities as a way of ‘fine-tuning’ the legislation when it is unclear where the boundaries of acceptable tax planning are drawn.

This is unacceptable for companies trying to plan their business activities and who need certainty. It should always be possible for different taxpayers who look at legislation to come to the same interpretation of the law. And it should not be possible for authorities to overturn long-established practice, which businesses are accustomed to, and then seek to challenge them on an obscure point of law, as happened in the UK in the landmark Arctic Systems ‘husband and wife’ case.8 Taxpayers must have certainty over Revenue authorities’ interpretations. Authorities should establish a proper and efficient clearing mechanism for complex anti-avoidance provisions.

6. TAX COMPETITIVENESS

The globalisation of business means that each country should ensure its tax rates are competitive and its regime user-friendly. Tax is a key factor in ensuring the overall attractiveness of a location to mobile capital (businesses and individuals). It is important to look at the underlying tax base of a country and not just focus on the rate. For instance, the headline corporate tax rate could be cut but if other aspects of business tax such as capital allowances are consequently abolished then the net effect can be an increase in tax.

The danger with competition, however, can lie in very low tax rates, where offshore tax havens or flat tax systems can lead to ‘beggar my neighbour’ approaches, in which inward investment can be lured from one country to another and which may undermine agreed international financial regulation initiatives. They can also have regressive rather than progressive tax outcomes and so entrench wealth inequality.

ACCA supports the principle that nations are free to determine their tax affairs within the context of a global competitive environment, but governments must be wary of causing retaliatory action and trade wars by drastic business tax cuts.

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7. EFFICIENCY

Tax systems should be efficient for governments in terms of their ability to secure the revenue due and to prevent tax leakage and the development of a black economy. It should, however, also be efficient for taxpayers in terms of their ability to comply with its requirements. It should not be forgotten that small businesses represent the bulk of economic activity in most countries and regulation can have a disproportionate effect on small firms, as the smaller the business the heavier the compliance cost. Research has shown that the smallest companies incur five times the administrative burden per employee than larger firms and so every effort must be made to increase efficiency of the system. Test questions might include the following.

- Can related companies be treated as single entities for VAT and other tax purposes and so be able to make only a single tax filing?
- Do multiple enquiries of the same taxpayer by different parts of the tax authority take place?
- Are the size of tax returns and the numbers of new or revised forms that need to be completed reasonable?
- Can the taxpayer have flexibility between completing a paper return or an electronic return?

8. ‘SUNSET CLAUSES’

Tax systems should have a review principle whereby tax legislation is periodically overhauled and consolidated to bring it up to date and make it easier to follow. Outdated laws should be removed.

There needs to be a positive prompt for justifying the existence of legislation. All anti-avoidance legislation should have sunset clauses attached to it. This will ensure that it is regularly reviewed and the need for it to remain in place is actively considered. Governments and tax authorities should devise clear metrics to gauge whether the tax system is being appropriately and sufficiently reviewed.

9. CLEAR LINK FROM TAX TO SPEND (HYPOTHECATION)

There is a lack of credibility with tax systems when taxpayers do not know why they are being taxed and where the revenue is being spent. It is of benefit to society, individuals and businesses if there is a clear link between tax take and its application. Issues such as ‘green taxes’ (see point 12 below) have fallen victim to cynicism as the public has not been convinced that the revenue raised has been spent on activities to help the environment. Although we are not convinced that such ‘hypothecation’ of particular taxes to specific areas of spending is practical, we do believe that there should be greater clarity in the public finances showing expenditure projections and how these are to be financed.

10. AVOIDANCE OF DOUBLE TAXATION

An essential principle of tax law must be that income should be subject to tax only once. This applies both to direct tax, where an individual or business should suffer tax once, and consumption taxes such as VAT, where input tax recovery should be available at each stage of the transaction chain and only the end user, in the form of a private individual, ultimately pays the tax.

In the case of direct taxes there needs to be an efficient and effective mechanism available in all countries to give relief to a company which has already paid tax in another jurisdiction, before subjecting that same income, in whole or in part, to taxation. In practice, too many countries do not consider it an important enough priority to seek to offer this full relief for tax suffered in another jurisdiction and this aspect of the global fiscal regime is an additional cost burden on multinational businesses.

The ‘arm’s length’ principle whereby tax authorities treat transactions between connected parties by reference to the amount of profit that would have arisen if the same transactions had been executed by unconnected parties is a sensible and long-established convention which should be the basis of international tax affairs.

Sales tax regimes are meant to tax only the end user but all too often governments place restrictions or long delays on full input-tax recovery and this again creates unfair costs for businesses. If full recovery is not facilitated then it is unjust to charge the full VAT rate to the end user and only adds to creating a less efficient business environment.
11. HUMAN RIGHTS

Taxpayers have rights as well as responsibilities. They are obliged to pay their tax due, in full and on time, as this is the only way governments can generate the funding to provide the public services everyone depends on, and in this sense tax is part of the social contract of any civilised society.

Nonetheless, the huge inequality in resources and power between governments and individual taxpayers places a responsibility on states not to impose their will in the field of taxation in an arbitrary or vexatious way. For instance, since 2 October 2000 the incorporation into UK law of the European Human Rights Act has empowered tax payers to challenge pernicious tax law in cases where it could be argued there is fundamental uncertainty or unjustified additional cost of operating in one particular business vehicle rather than another.

A similar approach throughout tax jurisdictions should become the norm.

12. ‘TAX SHIFTING’ – GREEN TAXES

We have said in point 4 above that elected governments have the right to use taxation in certain circumstances in pursuance of agreed social policies. ACCA believes one of the most important examples is to change behaviour that can damage the environment. Accountants should play an active part in efforts to reduce global carbon dioxide emissions, and the concept of ‘tax shifting’ by increasing carbon taxes on the use of fossil fuels but reducing them for payroll, income or corporate taxes should be promoted.

Governments must use tax policy as an instrument of positive change by providing incentives for investment in new cleaner technologies across a wide range of industries. When combined with tax reductions, green taxes should be seen as a positive step rather than a threat to taxpayers. Governments across the world are beginning to take significant steps to creating a low-carbon economy and accountants should help to identify the emerging fiscal incentives that will be a crucial part of that.

CONCLUSION

ACCA believes that taxation is a dynamic economic and social tool and must inevitably change in nature as national economies and business sectors develop. Green taxes, for example, were unheard of 20 years ago. Yet there are also some enduring maxims from Smith’s day whose relevance is still undiminished. ACCA would be pleased to discuss the points raised in this paper with policymakers and other stakeholders.