Panama Papers: Tactical tax planning

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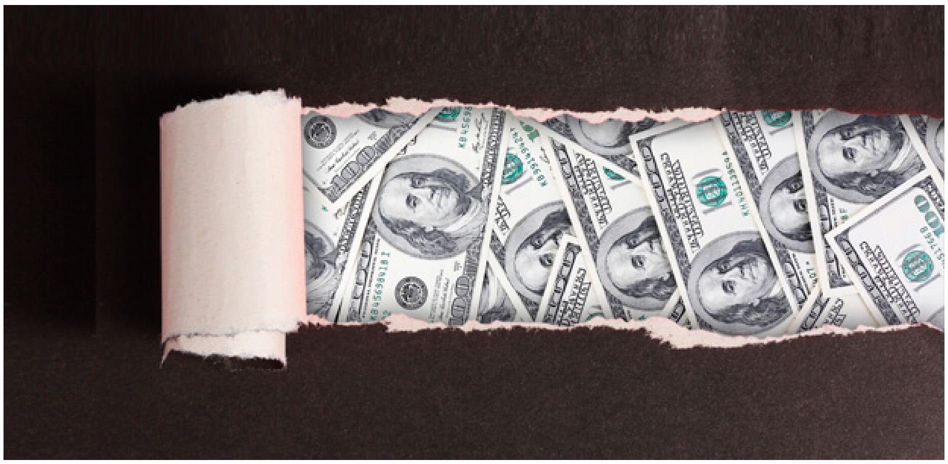

The Panama Papers have highlighted the need for international consensus on tax planning

Corporates, wealthy individuals and world leaders using the same offshore financial management vehicles as international drugs dealers and despots, should have rang alarm bells long before the publication of the Panama Papers.

Described by some tax experts as ‘the biggest wake-up call for the public around the world’, the 11.5 million leaked documents have put tax havens – or offshore financial centres – well and truly under the spotlight. This is precisely what the users of such vehicles had hoped to avoid. Secrecy, in addition to low or no taxes, is one of the principle ‘benefits’ of investing money offshore.

Legitimate purposes

‘Tax planning’ has always been accepted as a key component of good management. Governments offer a range of tools and mechanisms for tax planning purposes, such as reduced or zero rates, allowances, deductions, rebates and exemptions. Offshore tax jurisdictions can have legitimate purposes. They provide a tax-neutral jurisdiction for investors, creating a level playing field for joint venture partners based in different countries and subject to different tax regimes. Many have strong legal systems and can offer access to experienced financial and corporate governance professionals. They also enable firms to set up and or hold assets in a jurisdiction more stable than their own, protecting businesses and assets from volatile regimes. Advocates argue that they stimulate trade, investment and economic growth.

Aggressive avoidance

However, arbitraging between different regimes to obtain a tax advantage that the governments never intended is increasingly regarded as ethically questionable. This is not a new discussion but there is movement recently in the direction of the tax justice lobby. FTSE4Good said that it is considering excluding companies with overly aggressive tax reduction practices. A commitment to the open and transparent payment of taxes has long formed part of the GoodCorporation

Business Ethics Standard and in our experience companies are beginning to recognise that aggressive tax avoidance can damage corporate reputation.

Following on from the Panama Papers, Oxfam has published a report which claims that US corporations have $1.4 trillion hidden offshore in tax havens; a sum larger than the economic output of Russia, South Korea and Spain. However, this represents a fraction of the $20–30 trillion in estimated offshore financial assets. This means possible lost tax revenue of $280 billion. Not surprisingly many governments and international organisations had been calling for greater scrutiny and regulation of tax havens long before the leak from Mossack Fonseca.

International standards

A number of campaigns have been launched in recent years to tackle the secrecy surrounding tax payments. The OECD in conjunction with the G20 established the Global Forum on Transparency and Exchange of Information for Tax Purposes. The aim is to set international standards for tax transparency. There are now 133 members; 132 have committed to the exchange of information on request and 96 will introduce an automatic exchange of financial account information within the next two years. The OECD has also agreed a framework that would allow all interested countries and jurisdictions to join in efforts to update international tax rules for the 21st century, known as the Base Erosion and Profit Shifting Project (BEPS).

Sharing information

Britain has joined France, Germany, Spain and Italy in announcing a crackdown on tax payments. These countries have agreed to share information on ownership, which will reduce the ability to hide behind anonymity to avoid tax. Meanwhile, the US Treasury Department has announced its intention to issue a long-delayed rule forcing banks to seek the identities of people behind shell-company account holders, although critics, including the International Monetary Fund, have argued that the beneficial ownership portion of the rule is too broad and easy to circumnavigate.

Transparency International (TI) is calling for a global, public register of beneficial ownership, arguing that this will not only reduce tax avoidance but also minimise the criminal activity often concealed by anonymous offshore entities. Although beneficial ownership is likely to be on the agenda at the UK anti-corruption summit in May, there is currently no plan to mandate UK dependencies operating as financial centres to hold public registers of ownership, despite the fact that a central register will be introduced in the UK in June.

Social responsibility

The point we have arrived at seems straightforward, but below the surface it is quite the opposite. Public opinion and civil society increasingly regard the tax affairs of major corporations as a package of fiddles, as the vast bulk of citizens are taxed at source and have nowhere to hide from the tax authorities. 'Offshore' has become synonymous with scams and engenders deeper scepticism about the sincerity of codes of ethics and the notion of a corporates being socially responsible. Most take the view that tax should be paid where the economic activity takes place, in proportion to where the value is added in making a product or providing a service.

Corporations on the other hand are confused about where they can draw the line. Management is mandated to act in the interests of shareholders, so how should it distinguish between paying the minimum tax possible and voluntarily paying more to avoid accusations of tax injustice? Value added per jurisdiction is a lot easier to apply in theory than it is in practice. Besides, countries like Ireland have established tax incentives to attract investment and supra-national authorities like the EU have not blinked an eye. There used to be a common acceptance of the line between tax avoidance (legal and also done by most citizens in one way or another) and tax evasion (illegal). We now have a new ill-defined category of 'aggressive tax avoidance', recognised by centre-right political parties, as much as the left, as being unacceptable.

Defining unacceptable

There needs to be more transparency and TI's call for registers of beneficial ownership must be a key part of this.

Companies need to follow suit and set out publicly how they manage their international tax affairs. They should focus on the structures they have set up explicitly for tax saving. Some have started to do this. It is a struggle to make such reports readily intelligible to a lay reader but they should cover enough to allow scrutiny by those equipped to do so on behalf of the rest.

Tax planning consistent with the objectives of government tax incentives, which have been accepted internationally, should be regarded as reasonable, as when used by individuals to save and provide pension funds.

Governments must also clarify where the acceptable practice stops by defining what they consider to be aggressive tax avoidance and re-classifying it as evasion. Manoeuvres that deliberately obfuscate flows of money through labyrinthine legal structures, and bear little resemblance to real economic activities and trade flows, should be put on the other side of the line.

Pressure for reform should be put on jurisdictions with tax regimes that are designed to encourage the creation of opaque corporate structures, which capture other jurisdiction's tax take without moving the underlying economic activity.

An ethical direction

In the long term, governments should focus on aligning economic activity and tax payment. This move is fraught with complexity, but this starts the right conversation and moves us in an ethical direction. It will take time because a consensus on the lines to draw, although wider than it was just a few years ago, is far from complete. It also involves great international cooperation at a time when there are other priorities, from security and migration to the environment. Most importantly, for tax havens to give up economic benefits of current structures, alternative sources of funding must be available. For UK crown dependencies, this may mean a reconsideration of rights to live in the UK and a move back to grant aid to fund small and vulnerable economies. What is clear however is that this problem is not going away.

The debate of the last few years in corporate ethics circles on whether tax justice belongs to social responsibility is over for good.

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