House of Commons

Committee of Public Accounts

Tax avoidance: the role of large accountancy firms (follow–up)

Thirty-eighth Report of Session 2014–15

Report, together with the formal minutes relating to the report

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Committee of Public Accounts

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Summary

Large accountancy firms advise multinational companies on complex strategies and contrived structures which do not reflect the substance of their businesses and are instead designed to avoid tax. In light of the publication of leaked documents detailing some of the tax advice it has given to its multinational clients, we took evidence from PriceWaterhouseCoopers (PwC). PwC did not convince us that its widespread promotion of schemes to numerous clients, based on artificially diverting profits to Luxembourg through intra-company loans, constituted anything other than the promotion of tax avoidance on an industrial scale. The fact that PwC's promotion of these schemes is permitted by its own code of conduct is clear evidence that Government needs to take a more active role in regulating the tax industry, as it evidently cannot be trusted to regulate itself. In particular, HM Revenue & Customs (HMRC) needs to do more to challenge the nature of the advice being given by accountancy firms to their clients, ensure that tax liabilities reflect the substance of where companies conduct their business, and introduce a new code of conduct for all tax advisers. Unless HMRC takes urgent action, this irresponsible activity will go unchecked, causing harm to both the public finances and the reputations of the companies involved.

Introduction

We have reported previously our long-standing concerns about multinational companies avoiding tax, the role played by tax advisers in promoting company structures designed to avoid tax, and the effectiveness of HMRC and HM Treasury in tackling these problems. We have published relevant reports in December 2012, April 2013 and June 2013. In evidence used for our April 2013 report, the Head of Tax at PwC had told us that "we are not in the business of selling schemes". In November 2014 the International Consortium of Investigative Journalists (ICIJ) published documents showing that PwC negotiated advance tax rulings for many hundreds of companies with the Luxembourg tax authorities. Media attention focussed on the complex financial strategies employed by a small number of companies on the advice of PwC. The published documents appeared inconsistent with PwC's previous evidence to us, as they suggested PwC had been promoting complex structures that are similar in nature to numerous clients. We therefore invited PWC's Head of Tax to give further evidence, alongside the Director of Tax at Shire Pharmaceuticals, one of the firms on which media attention had focussed. Many other major firms were named in the Luxembourg tax rulings published by the ICIJ and our concerns go wider than the behaviour of PwC and Shire alone. Our conclusions and recommendations are therefore relevant to the tax advisory industry and its clients as a whole.

Conclusions and Recommendations

1. **The tax arrangements PwC promoted in Luxembourg bear all the characteristics of a mass-marketed tax avoidance scheme.** We consider that the evidence that PwC provided to us in January 2013 was misleading, in particular its assertions that "we are not in the business of selling schemes" and "we do not mass-market tax products, we do not produce tax products, we do not promote tax products". In November 2014, journalists disclosed 548 letters between PwC and the Luxembourg tax authorities, relating to 343 of PwC's multinational clients. The number of cases involved plainly demonstrates that PwC is effectively selling variations on a scheme to a large number of its clients. The effect has been to reduce the amount of corporation tax that these multinational companies have to pay in the countries in which they are in fact operating. Whilst acknowledging that the schemes have common features, PwC tried to argue that they are in fact individual arrangements tailored to the needs of individual clients. In attempting to hide behind a definition of mass-marketed avoidance as being "all around secrecy, not wanting HMRC to know", the companies and their advisers are choosing to adopt a very narrow and self-serving interpretation. In our view these are marketed tax avoidance schemes and we are also sceptical that HMRC was kept fully informed of PwC's activities. We continue to believe there is no clarity about the boundary between acceptable tax planning and aggressive tax avoidance.

Recommendation: ***HMRC should set out how it plans to take a more active role in challenging the advice being given by accountancy firms to their multinational clients, with a particular view to the mass marketing of schemes designed to avoid tax.***

2. **Multinational companies do not need to conduct any business of substance in the countries where they shift profits to in order to avoid tax**. Shire Pharmaceuticals has arranged its affairs so that interest payments on intra-company loans reduce significantly its overall tax liabilities. While Shire has external borrowings of around £800 million, it makes interest payments on intra-company loans worth £10 billion to a company it has established in Luxembourg. The effect is to shift profits from other countries, where tax rates are higher, to Luxembourg. The "substance" of Shire's business in Luxembourg, used to justify these arrangements, consists of two people out of the 5,600 staff the company employs globally. One of Shire's two Luxembourg based staff also holds 41 directorships of other companies. Neither PwC nor Shire could demonstrate that the company's presence in Luxembourg was designed to do anything other than avoid tax. We note that Shire paid tax of only 0.0156% on its profits to the Luxembourg tax authority.

Recommendation: ***In contributing to the OECD's discussions aimed at reforming international tax law, HMRC should push for a more rigorous and meaningful definition of what substance means.***

3. **The tax industry has demonstrated very clearly that it cannot be trusted to regulate itself.** Like the other big four accountancy firms, PwC provides tax advice to its clients in line with an internal Code of Conduct. PwC's Code does little more than shroud the way PwC exploits flaws in international tax law to devise and offer aggressive tax avoidance schemes to its clients. PwC requires only one of three conditions in its Code of Conduct to apply for tax advice to be compliant. This means that a scheme set up solely for tax avoidance, and with no other commercial purpose, can still comply with PwC's Code provided one of the two other conditions in the code is met. The code does nothing to prevent PwC's staff from selling schemes which are designed to create artificial company structures to avoid tax, deprive the Exchequer of money, and damage PwC's reputation. That the Shire arrangement can still meet the conditions of PwC's Code of Conduct is indisputable evidence that the code is not fit for purpose.

Recommendation: ***We believe strongly that the Government must act by introducing a code of conduct for all tax advisers, as we recommended in our April 2013 report. We further recommend that it should consult on how it should regulate the industry and enforce such a code, including through financial sanctions that could be imposed in the event of non-compliance.***

1 Tax avoidance: the role of large accountancy firms

1. We have long-standing concerns about the way in which some multinational companies pay little corporation tax despite doing a large amount of business in the UK. We published reports in December 2012 and June 2013 on the amount of corporation tax paid by multinational companies, and in April 2013 on the role played by large accountancy firms in designing ways for companies to avoid tax.[1] We held evidence sessions with HMRC and HM Treasury, the big four accountancy firms, as well as representatives from Google, Amazon and Starbucks, to examine these issues. At the session with the accountancy firms in January 2013, the Head of Tax at PWC had told us that "we are not in the business of selling schemes".[2]

2. In November 2014, the International Consortium of Investigative Journalists (ICIJ) published correspondence between PwC and the Luxembourg Inland Revenue.[3] The so-called "Luxembourg leaks" consist of 548 letters and appear to show that PwC secured deals with the Luxembourg tax authorities for 343 multinational companies between 2002 and 2010. Many of the companies who received advice from PwC—Amazon, IKEA, Burberry, Accenture, Coca-Cola and Vodafone—are household names and at least 80 have UK headquarters.[4]

3. These deals appeared to contradict the evidence which PwC had given us in 2013. PwC had told us that it does not sell schemes, but the Luxembourg leaks suggest that PwC had advised many multi-national firms to adopt similar complex financial structures for the purposes of avoiding tax. We therefore invited Kevin Nicholson, PwC's Head of Tax, to return and give further evidence in December 2014. Alongside PwC we also took evidence from Fearghas Carruthers, Director of Tax at Shire Pharmaceuticals, one of the companies that received advice from PwC on its company structure and operations in Luxembourg.

4. We sought to understand the nature of the deals arranged by PwC on behalf of its clients. The arrangements have a number of common features; the companies all set up subsidiaries in Luxembourg, and were protected by advance tax rulings from the Luxembourg tax authorities. Most employed a complex system of intra-company loans from their Luxembourg subsidiaries to subsidiaries located elsewhere.[5] The interest on these loans was deductible against profits in other countries, while the interest paid to Luxembourg was taxed at a very low rate as a result of the agreement negotiated with the

1 Committee of Public Accounts, *HM Revenue & Customs: Annual Report and Accounts 2011–12*, Nineteenth Report of Session 2012-13, HC 716, December 2012; Committee of Public Accounts, *Tax avoidance: the role of large accountancy firms*, Forty-fourth Report of Session 2012–13, HC 870, April 2013; Committee of Public Accounts, *Tax Avoidance – Google*, Ninth Report of Session 2013-14, HC 112, June 2013

2 Q 2; Committee of Public Accounts, Tax avoidance: the role of large accountancy firms, Forty-fourth Report of Session 2012–13, HC 870, April 2013 (Ev 5, Q39)

3 http://www.icij.org/project/luxembourg-leaks

4 Qq 5 and 250

5 Qq 7 and 12

tax authorities. The schemes thereby reduced the amount of corporation tax that multinational companies have to pay in the countries in which they are truly operating.[6]

5. In January 2013 PwC had told us "we do not mass-market tax products, we do not produce tax products, we do not promote tax products" and "we are not just producing a clever idea and distributing it out".[7] The number of letters subsequently disclosed under the "Luxembourg leaks", all on PwC headed paper, clearly cast doubt on those statements. When we asked PwC to explain these statements in light of the Luxembourg leaks, it argued that rather than mass-marketed schemes, these are in fact individual arrangements, each tailored to the needs of individual clients. PwC referred to HMRC's definition of mass-marketing under DOTAS, which it defined as being "all around secrecy, not wanting HMRC to know".[8] We accept that the circumstances and business models of each company may be different, but PwC could not demonstrate that these are anything other than schemes which are effectively mass-marketed to different clients and then tailored accordingly.[9]

6. We asked PwC whether it devised the arrangements put in place by Shire and other companies. PwC would not be drawn on whether this was the case for all companies, as they may have their own in-house tax specialists; however the leaked documents to the Luxembourg tax authorities were all on PwC-headed paper.[10] We were frustrated at the evidence session by PwC's unwillingness to assist us by explaining the leaked diagrams, again on PwC headed paper, depicting Shire's company structure before and after it restructured its financing activities through Luxembourg.[11] PwC did provide us with further information after the session, but that did not convince us that the new structure was anything other than an artificial arrangement of high-value intra-company loans with no commercial purpose other than to avoid tax.[12]

7. We asked Shire about its company structure following the advice provided by PwC. Shire is a global pharmaceutical company, incorporated in Jersey but domiciled in Ireland for tax purposes. It has around 5,600 staff worldwide, of which the majority are based in the USA. It has around 300 staff in the UK, 100 in Ireland, and none in Jersey where it is incorporated.[13] We were particularly interested in the role of the two employees that Shire has in Luxembourg and Shire's seven companies that are located there.[14] In evidence provided by Shire after the evidence session, we were told that one of these full-time members of staff was paid €135,000, with the other paid an additional sum through a service company. Between them they are responsible for managing intra-company loans of about $10 billion. As well as having eight Shire group company directorships between

6 Qq 84-89

7 Q 2; Committee of Public Accounts, *Tax avoidance: the role of large accountancy firms*, Forty-fourth Report of Session 2012–13, HC 870, April 2013 (Ev 4, Q36)

8 Qq 15-16, 20-22

9 Qq 42-45

10 Qq 38-39

11 Qq 117, 181, 189

12 Written evidence from PwC to the Committee of Public Accounts dated 16 December 2014 (pages 3-4)

13 Qq 137-139

14 Qq 304-308

them, they each also hold directorships at other companies, with one holding three and the other holding 41 external directorships.[15]

8. We asked Shire to demonstrate that their business in Luxembourg had substance. Having only two employees, who also hold so many positions of authority in companies outside of Shire, calls into question whether they could possibly be responsible for taking decisions on a loan book of that scale.[16] Shire maintained that decisions are taken in Luxembourg, and that other directors based elsewhere support the two employees.[17] The Director of Tax, for example, visited 5-10 times per year. PwC told us it is about having the "right amount of substance" for the activities taking place and told us that the latest guidance from HM Treasury and HMRC says that "not much substance is required if all you have is a finance company".[18]

9. We sought to understand the commercial reasons for a multinational company to operate out of Luxembourg, rather than another country.[19] PwC told us—as it had when it gave evidence to us in January 2013—that the global nature of companies' operations and transactions means that countries compete for tax revenues.[20] Luxembourg has therefore designed its tax systems to make it attractive to companies wishing to finance their operations overseas and hold investments. However, we note that Shire paid only 0.0156% tax on profits in Luxembourg.[21]

10. On its decision to locate its financing function in Luxembourg Shire told us that "It is not necessarily a question of comparative efficiency. We could have the lending in and lending out in all sorts of other jurisdictions. It is just a good location".[22] Shire has an intra-company loan balance of $10 billion, the equivalent of two years' sales. The amount of money Shire has borrowed externally is much less than this at $800 million. We asked if Shire's internal loans served as a genuine method of financing its business. Shire told us that the loans were "drawn down for sound business purposes to fund acquisitions and that the interest cost [on the loans] is deductible".[23]

11. Like the other big accountancy firms, PwC provides tax advice to its clients in line with an internal Code of Conduct. PwC's Code of Conduct has been in place since around 2005, and outlines three conditions which govern its provision of tax planning advice.[24] The first condition is that "the underlying business arrangements have some commercial purpose

15 Qq 71, 300; Written evidence from Shire Pharmaceuticals to the Committee of Public Accounts dated 16 December 2014 (pages 1-2)

16 Qq 76, 235-242

17 Q 75

18 Qq 235, 328

19 Qq 155-171

20 Q 4; Committee of Public Accounts, *Tax avoidance: the role of large accountancy firms*, Forty-fourth Report of Session 2012–13, HC 870, April 2013, paragraph 11

21 Qq 9-10, 85

22 Q 171

23 Qq 77-84

24 Committee of Public Accounts, *Tax avoidance: the role of large accountancy firms*, Forty-fourth Report of Session 2012–13, HC 870, April 2013; Q 34

other than the avoidance of tax".[25] However, we heard that of the three conditions set out in the code, only one needs to be met for the advice provided to be compliant. Therefore, whilst the code may prevent PwC tax advisers from acting outside of the law, it does not prevent them from devising and selling schemes that have no purpose other than the avoidance of tax.[26]

12. PwC told us several times that the arrangements discussed at our evidence session complied with its code of conduct.[27] The Head of Tax at PwC is accountable for ensuring that PwC remains compliant with its Code of Conduct. He told us that "if we were doing file reviews or talking to our partners about their performance, we would talk about whether they have complied with the code." We asked what would happen if people broke the code. We were told that PwC would "talk to them and try to ensure that that did not happen again."[28]

25 Qq 154-170, 201-220

26 Qq 203-207

27 Qq 153, 201-203, 217, and 292

28 Qq 215-217

Formal Minutes

Wednesday 28 January 2015

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon
Meg Hillier
Stewart Jackson
Dame Anne McGuire
Austin Mitchell
Stephen Phillips
John Pugh

Draft Report (Tax avoidance: the role of large accountancy firms (follow up)), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 12 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Thirty-eighth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 2 February at 3.00pm

Witnesses

Monday 8 December 2014

Page

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/pac.

Kevin Nicholson, Head of Tax, PricewaterhouseCoopers LLP (UK firm); and **Fearghas Carruthers**, Head of Tax, Shire Pharmaceuticals Q1-329

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/pac. tav numbers are generated by the evidence processing system and so may not be complete.

1 Pricewaterhousecoopers (tav0001)

2 Shire (tav0002)

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Thirty Third Report	Oversight of the Private Infrastructure Development Group	HC 675
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Thirty Fifth Report	Financial Sustainability of NHS Bodies	HC 736

Thirty Sixth Report	Implementing reforms to civil legal aid	HC 808
Thirty Seventh Report	Planning for the Better Care Fund	HC 807