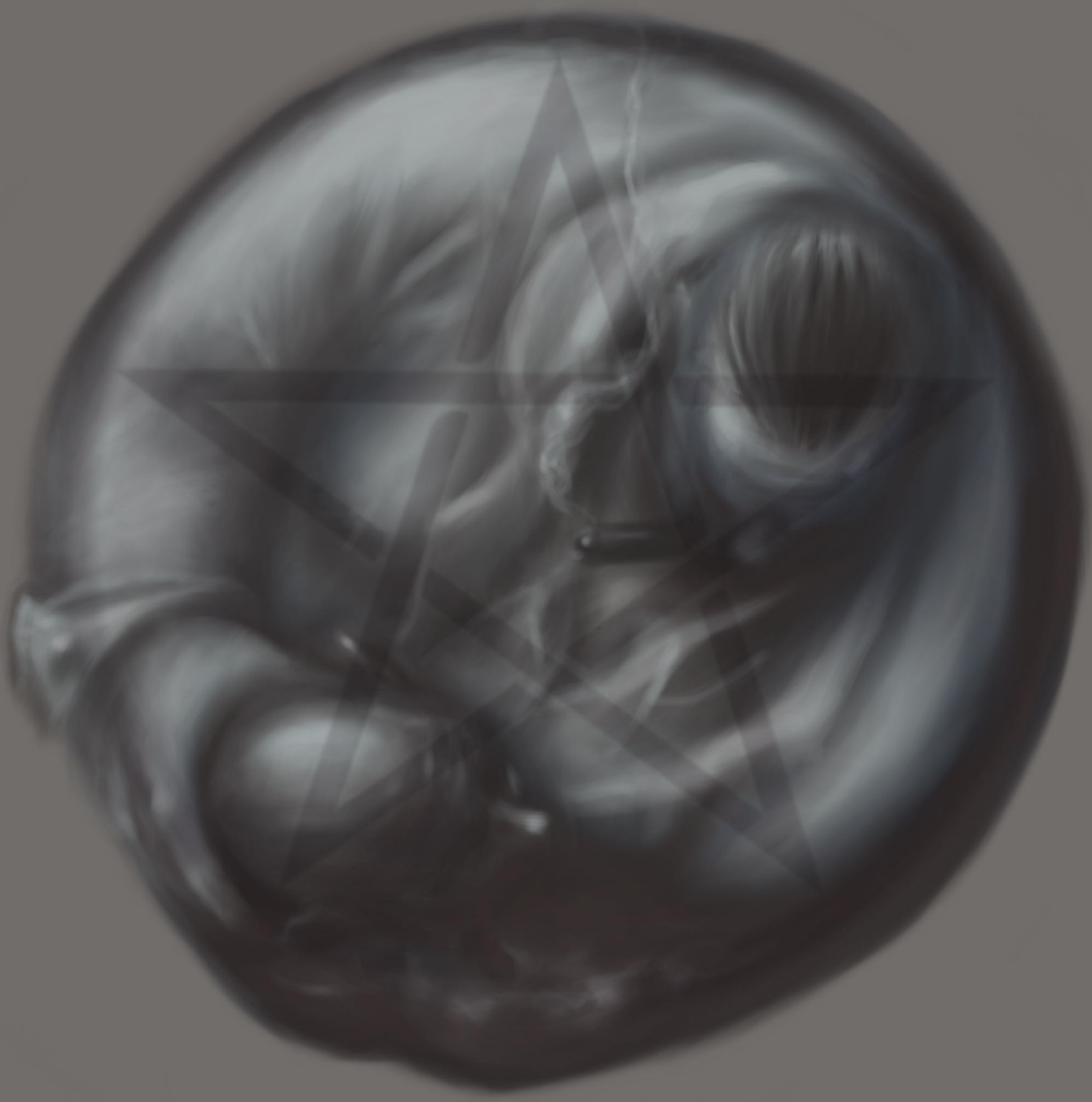
The Pentology

Volume 2

Big 4 Big Myth



GEORGE ROZVANY

BIG 4 BIG MYTH

An Ethical Audit Report of the Tax Practices of the Big 4 Accounting Firms

By

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Dedicated to:
Martin Luther King Junior
(1929-1968)
and
Coretta Scott King
(1927 – 2006)

Our lives begin to end the day we become silent about things that matter.

Martin Luther King Junior

For my own truly amazing Partner in life who inspired this work and the world's best daughter without whom it could never have been written. Thank you for just being the two of you!

Preface

My previous three works in the international tax area were either intended to be a detailed explanation of emerging areas in the taxation law or an examination of ethical tax issues facing the taxation industry.

Transfer Pricing: Regulation, Policy and Strategy for Australian Multinational Enterprises and *Transfer Pricing* were the foundation works for this area of the law in my home country Australia. Interestingly, almost 23 years after their publication no further major work has been completed in Australia on this major area of the international taxation law.

My following work, *Corporate Tax Ethics - A Journey for Mankind*, was the first volume in the planned five book series on tax ethics (the tax ethics series) and the foundation work which establishes the general principles for ethical taxation behaviour within a major company or multinational. The tax ethics series, once completed, will be a comprehensive analysis of what tax ethics means and how it should be considered by all stakeholders in the taxation arena including multinationals, the advisory firms, the Revenue, politicians and the judiciary.

This second volume of the tax ethics series explores the contemporary ethical taxation issues from the viewpoint of a tax ethicist confronting the *Big 4* accounting firms Ernst & Young (EY), Deloitte Touche Tohmatsu, PriceWaterhouseCoopers (PWC) and

KPMG in a fast changing world demanding transparency and much greater accountability following a series of seemingly endless international tax scandals including the Lux Leaks, Swiss Leaks, Panama Papers and the most recent Paradise Papers scandals to name just a few.

The role of the tax ethicist as with an external auditor to an organisation is to objectively examine the existing systems, in this case the taxation systems, and to provide views and suggest improvements on the overall integrity of those systems from both the viewpoint of the organisation and the viewpoint of the wider society. While this audit is written as a book, the objective is exactly the same as an external auditor to identify weaknesses and suggest improvements to stabilise and ensure integrity to those systems.

Over the past 34 years, I cannot recall a day in my professional tax life as a taxation lawyer and a Statutory Taxation Officer of a major multinational where I did not have contact with a Partner of one of the major accounting firms as a boss, as a mentor, as a colleague, as a comrade on a professional committee, as an adviser or as a lunch, tennis or ski buddy.

In this time, I have literally dealt with hundreds, if not thousands of Partners from the Big 4 accounting firms being male or female, from the richest families to the poorest and from a person of pure common decency to a person lacking any decency whatsoever on any front.

On the surface, there are seemingly no common characteristics of this group of Partners, but they do have one thing in common – they have all complained about something in their own firms! Given also the scale and frequency of major tax scandals, it is entirely appropriate to now ask the question and explore the issues as to why the the Big 4 accounting firms appear so dangerously dysfunctional to their own staff.

There are essentially three sources of information for this second volume on tax ethics.

The first source is the increasingly rich vein of publicly available information made so by the major tax scandals through the ground breaking work in recent years of the International Consortium of Investigative Journalists (the ICIJ), although this information is unlikely to be analysed and set out in quite this way before.

The second source is the Partners of the major accounting firms themselves, past or present, dead or alive. Importantly, no Partner is named in this book *unless* the Partner's actions or comments are a matter of *public* record. However, I must acknowledge that this work would not have been at all possible without the extensive contribution of these Partners who spoke freely and with veracity over the past 30 years, many in the belief that change was necessary but felt this was impossible to achieve as an individual Partner within the Firm.

The third source is my personal journey in three of what were the Big 5 accounting firms at various times over my tax career including Arthur Andersen & Co which I regard as the most eminent of the firms I worked for. Again, no Partners names will be mentioned or implied. However, the three different levels I worked at within the three firms did provide a rich base on which to build a deep understanding of the operation of the Big 4 accounting firms from the perspective of all stakeholders including those of the multinational clients, the Lawmakers, the Revenue and the media including the all important investigative journalists.

Although conspiracy books have their place in the literature, it is extremely important to recognise that this book is not one of them. All research conducted for this work was undertaken using the two trusted source rule whereby comments from trusted sources over 30 years have been independently verified with at least one other trusted source, if not many! It also important that these sources remain confidential, particularly from within the Big 4 accounting firms so that the discussion may continue in private.

The intention here is *neither* to cause a witch-hunt within the major international accounting and law firms *nor* to create th*e* setting for a post-apocalyptic version of John Grisham's best selling book *The Firm* although I must say that this sort of stuff does actually occur based on my research for this book. However, sensationalism is not an objective of this work and therefore such incidences should form the basis of another author’s work.

The simple rationale is that if in my experience over 34 years *the majority* of Partners in the major accounting and law firms either do not know themselves about the activities of the firm or question the ethics of the firm in relation to some or other operating aspects, then why wouldn’t the clients that they purport to serve or an increasingly savvy public with Internet capability *be doing exactly the same*?

One of the objectives of this book is *to encourage* the international firms themselves, whether they are of a legal or accounting discipline, to consider whether they are meeting the current and likely future expectations of the public in respect of transparency and ethical standards on contemporary taxation matters. The same questions are also asked of the Regulators and their political masters, the Lawmakers.

Although the first book in the series is focussed on the importance of ethical tax behaviours within the taxation industry generally as a clear expectation of the community at large, *actual* ethical behaviours by firms in all spheres in which they operate are clearly necessary if the firms are to ensure their longevity and their general respect within the community.

The Regulators and Lawmakers must also play a key role here in ensuring this standard is maintained by setting appropriate legal boundaries both domestically and internationally through cooperation and ensuring appropriate compliance standards are met through state of the art monitoring in all jurisdictions.

One of the most important principles of Arthur Andersen, the founder of Arthur Andersen & Co, was *ethical behaviour at all times*. This is a principle from within the profession itself that *must never be forgotten* and one I personally believe in.

In my humble opinion as a senior taxation lawyer operating in the international taxation field for over three decades, it is far more satisfying to deliver a risk free solution through intelligent engagement with the Revenue *prior to implementation* than to rely on the financially high risk approach of non-disclosure.

The role of the second volume of the tax ethics series is to also explore the issues that the clients of these firms, the general public and indeed the many Partners in the firms themselves are already asking with the same objective of ensuring integrity and ethical behaviours within the governing processes of the firms *albeit* in a way that the reader will hopefully enjoy, embrace and be inspired to both advocate and and ensure change for the betterment of the whole of the global society. In this regard, I am particularly targeting our current crop of leaders and the young as our future leaders.

It should be noted that there are some terms and parts of Chapters which are common to the first two volumes of the tax ethics series. This has been necessary to ensure a consistent message on tax ethics across both volumes, which are aimed at different audiences being the multinational conglomerates and the Lawmakers for Volume One and the general public for Volume Two.

It should also be recognised that one of the most important objectives of the tax ethics series is *to educate*. If one single salutary lesson is to be learnt at all, it is *that tax avoidance is not a victimless crime*! The real victims are many and are always those less fortunate in society: orphans in foreign countries, the sick, the elderly, abused women, the homeless, and the mentally challenged.

Therefore, one of the key outcomes sought by the International Society for the Promotion of Ethical Tax Behaviours is to establish or promote positive charitable works for the victims of international tax avoidance and those less fortunate in society to create both hope and empower them with opportunity to build a better future for themselves rather than despairing and abandoning themselves to ever more constrained welfare systems.

It is hoped that many of the multinationals involved in aggressive international tax avoidance behaviours, perhaps those involved in the Lux Leaks, Swiss Leaks, Panama Papers and the Paradise Papers tax scandals will reconsider their position and contribute to this fund.

For the reader, I hope it will bring you a greater insight in to the world of international tax avoidance

George Rozvany
February 2018

Chapter 1

The Mafia, the Yakuza, the Triads and other Secret Societies

Although now more than seventy years distant in human history, the words of the 32nd President of the United States of America, Franklin Delano Roosevelt, toll as ominously true today as when they were first delivered:

The liberty of a democracy is not safe if the people tolerate the growth of private power to a point where it becomes stronger than the democratic state itself.

It has been estimated that the aggressive taxation avoidance industry through its advisers organises and executes international transfer pricing arrangements (transfer of taxable profit) and other highly questionable international tax arrangements avoiding taxes, including tax shelters, in the order of US$1,000 billion *every year* and in my home country Australia's case somewhere between A$30 to A$50 billion. If the Lawmakers in the various Governments around the world ultimately deem this to be a head of taxation fraud, which it is at least on the border of, then it is a crime that in financial terms would be unprecedented in human history *every year*.

To understand the scale of these taxation avoidance behaviours, one should examine the economic output of the leading nations in the global economy. If the international tax avoidance industry was a sovereign nation at US$1,000 billion it would rank 26th in the world's economies between Pakistan and Malaysia. Of course, the scale of such aggressive taxation behaviours may be larger than that since *reporting* taxation avoidance activities tends not to be part of the disclosure requirements of the major companies that undertake such activities and certainly not by those firms promoting such activities.

Sadly, even less is said of the real victims of this crime. The total development foreign aid budget of the world's nations in 2016 was some US$142.6 billion or *no more* than about one seventh of the estimated *take* of the international tax avoidance industry.

Homeless women, uneducated youth and children dying of *curable* diseases in third world countries are but a few of the many victims resulting from the peddlers of greed within the taxation avoidance industry.

How often do politicians speak of the necessity for *restraint* or *austerity* and require budget cuts for the common working man as then and shortly thereafter former British Prime Minister David Cameron was scathingly criticised for following the Mossack Fonseca tax scandal on these perceived *soft targets* to meet falling revenue projections?

The same Lawmakers, however, will readily accept invitations from the Big 4 accounting firms to appear at tax conferences and other gala events as *keynote* *speakers*, watch major sporting events in luxurious corporate boxes or discuss the tax requirements of the *important people* in private dining rooms around the world. Seemingly, it becomes more important to give the billionaire a US$100 million tax cut for a new casino or to cut a corporate tax rate for highly profitable multinationals on *competition grounds* based on the most spurious of economic evidence than to provide the required benefits for the underprivileged, unlikely to be ever invited to these luxurious Big 4 accounting firm entertainment facilities. While not all politicians will be *gamed* by the Big 4 accounting firms for taxation advantages for their clients, *sadly the majority will!*

Politicians or indeed the wider society must never consider taxation *a game*! It is the duty of politicians to responsibly raise taxation from the revenue base and to appropriately allocate those funds back to society. In order to do this and meet their wider duties in a democratic system, the politicians should or ought to have *a deep understanding* of *both* the *responsible raising* and the *moral allocation* under the taxation process. Such a duty, of necessity, must be *independently* exercised to ensure integrity.

As the 2015 Panama Papers tax scandal involving aggressive Panamanian law firm Mossack Fonseca and the 2017 Paradise Papers tax scandal involving offshore magic circle law firm member Appleby disclosed by the International Consortium of Investigative Journalists (the ICIJ) has shown, the Big 4 accounting firms are not the only merchants of tax products *nor the most aggressive*. However, they are unquestionably the largest, the most sophisticated *and the most powerful*. Conceivably, they are also the most deceptive because if one walks in to any of the 30 offices of Mossack Fonseca around the global tax havens, one definitely knows that one has entered the doors of an aggressive taxation law firm. *This cannot be said about the taxation practices of the Big 4 accounting firms!*

In commercial terms, the estimated combined turnover in 2018 of KPMG, Ernst & Young, Deloitte Touche Tohmatsu and PricewaterhouseCoopers *the Big 4 accounting firms* will be in excess of US$140 billion and employing almost 1,000,000 staff including many former senior political figures. If the Big 4 accounting firms were a sovereign nation, at US$140 billion, it would rank 57th in the world's economies somewhere between Qatar and Indonesia.

Nevertheless, it would be a mistake to assume the commercial power of the Big 4 accounting firms is the equivalent of a Qatar or an Indonesia *or somewhere in between*. The reality is that the Big 4 accounting firms individually and collectively now have greater power and influence globally than any commercial institutions in history. Certainly, the Big 4 accounting firms shamelessly present themselves as *the guardians of international commerce*.

The real question is how do the Big 4 accounting firms exercise such enormous power in reality and are they transparent in their execution of it? And more importantly for the wider society and humanity generally, *who guards the guardians* to ensure appropriate integrity in the decision making and actions of these firms?

Surprisingly, not one of the Big 4 accounting firms has decided to follow the extremely lucrative financial route of publicly listing on one of the major bourses such as the London or New York Stock Exchanges. Given the growth and stability of earnings, such a Big 4 accounting firm stock would be considered a highly attractive proposition for conservative investors such as retirement funds and other institutional investors. Therefore, one would expect a stock price on an initial public offering of at least 15 to 20 times earnings and more depending on growth projections that conceivably could result in a US$150-200 billion float price or more for any of the Big 4 accounting firms.

This surely must be viewed as highly attractive for *any* retiring Partner of the firm or indeed any Partner of the firm. Nevertheless, no Big 4 accounting firm has listed and therefore is not subject to any of the strict listing requirements of the bourses including material disclosures that would affect the stock price.

Further, there are no global regulators so there is no central agency charged with the responsibility of monitoring the Big 4 accounting firms. Instead, this has been left to the prudential or financial regulators in individual countries, particularly the United States or by less formal means by organizations such as the

ICIJ which has been extraordinarily effective for an unfunded organisation of some 200 individuals *albeit* highly experienced investigative journalists.

The high water mark in regulatory action against the major international accounting firms occurred on 6 May 2002 when the United States financial regulator, the Securities and Exchange Commission (the SEC) charged the United States partnership, Arthur Andersen LLP (*Limited Liability Partnership*) of the former Big 5 accounting firm, Arthur Andersen & Co, with the felony crime of obstruction of justice. Arthur Andersen LLP senior figures allegedly directed staff to destroy evidence relating to a pending investigation by the SEC of one its largest clients Enron Corporation.

On 15 June 2002, just six weeks later, Judge Michael Chertoff in the United States District Court found Arthur Anderson LLP guilty. Under US Federal Law, a person or an organization found guilty of a felony is forbidden from undertaking an audit of a public company. As an immediate result of the conviction, the US audit practice of Arthur Anderson LLP had its audit licence withdrawn and ceased its US audit practice on 31 August 2002 triggering an effective and then *shocking* worldwide collapse of the firm.

While the decision was affirmed on appeal to a higher Court, on 31 May 2015 the United States Supreme Court in a unanimous finding reversed the original decision in favour of Arthur Andersen LLP. While in theory Arthur Andersen LLP could have continued to practice, the lucrative accounting business was long gone as was the potential for a rich initial public offering which occurred in the case of its prodigal fraternal twin Accenture. The formerly great Arthur Andersen LLP by that time had been essentially reduced to a holder of various investment assets for retired Partners of the firm.

In what must be one of the more important epilogues in the history of commerce, the firm has resurrected itself since in a somewhat phoenix like performance as a taxation and legal adviser and now operates through some 26 offices in 16 countries with far more aggressive growth targets than any of the Big 4 accounting firms.

It is well possible that if the resurrected Arthur Andersen & Co stays true to its founding principle of *ethical behaviour at all times* and avoids the obvious mistakes of its Big 4 accounting firm rivals which are only partly outlined in this book, it could well be the No 1 tax and legal advisory firm in the world and the most respected amongst major multinationals seeking to appropriately manage taxation risk. However, the new Arthur Andersen & Co will clearly need to differentiate itself in *practice* which may prove challenging culturally if the firm remains an association of independently affiliated firms *but by no means impossible.*

I must say this was a firm I was proud to work for as a young man as being closest to my ethical position and possibly as an old man. Overall, I believe that the stated objectives of Arthur Andersen & Co would be best served by way of a full merger of the independently affiliated firms followed by a listing on a major bourse in the same style as Accenture. *Only time will tell!*

There have been other spectacular forays by Regulators in to the world of Big 4 accounting firm impropriety. On 29 August 2005, KPMG admitted to and accepted a settlement with the United States Justice Department in what was then the largest tax fraud case ever filed. The tax fraud involved the generation of more than US$11 billion in falsified tax losses by KPMG resulting in tax evasion of in excess US$2.5 billion. In addition, nine individuals including a former Deputy Chairman and two former Heads of Tax of KPMG were charged with conspiring to defraud the Inland Revenue Service by concocting taxation shelter transactions, together with false and fraudulent factual scenarios to support them and then filing tax returns that claimed the US$11 billion in tax losses.

The taxation shelters were targeted at individuals requiring a minimum of US$10 million in tax losses with a view to claiming those losses against other sources of taxable income. A percentage of the desired tax loss would be paid to KPMG as a fee, certain law firms, and others instead of paying billions of dollars in taxes owed to the Government. To further the scheme, KPMG, the individual defendants, and their co-conspirators allegedly filed and caused to be filed false and fraudulent taxation returns that claimed the falsified tax losses. KPMG agreed to pay US$456 million in fines, restitution and penalties as part of an agreement to defer prosecution of the firm. Not the best August day at KPMG, but potentially not the worst either! This case is discussed in more detail in Chapter 4.

Despite the best of intentions of a regulator, the ultimate outcome may not be as planned. While certainly not great for the retired Arthur Andersen partners and their formerly very healthy firm paid retirement pensions, the demise of Arthur Andersen & Co's then audit practice created *the Big 4* and an extremely limited choice in international accounting service providers for the global multinationals. This only resulted in a significant strengthening in the position of the Big 4 accounting firms at the top end of world commerce and an imbalance in power between the Big 4 accounting firms and the multinational clients they serve.

This lack of choice is illustrated in the following example. If a multinational has an emerging conflict, perhaps through a merger or another transaction, or is simply dissatisfied with the service provided by its current Big 4 accounting firm then there are just three remaining service providers from the Big 4. If there is a conflict or dissatisfaction position with one of these firms or more than one conflict situation with two or more firms, then there is simply no effective choice in service provider.

This has essentially resulted in what must reasonably be viewed as *cartel-like* behaviour (which is arguably *illegal in* most parts of the world) where charge out rates have grown well in excess of inflation and are now reaching the princely sum of US$1,500 for one hour of a Tax Partner's time or US$25 per minute. Experience has shown that when one firm increases its charge out rates the other firms will follow that lead. Despite the problems caused by the near demise of Arthur Andersen & Co, the KPMG action was more successful from a regulatory viewpoint and did result in generally improved tax behaviours by that firm. However, it must be asked of every Big 4 accounting firm what happens when the regulator with limited staff and resources averts his or her eyes in seeking to address other issues!

Since the time of these events, there have been many other major lawsuits and investigations against Big 4 accounting firms including matters in respect of Lehmann Brothers, J P Morgan Securities, Adelphia Communications Corporation, Tyco International Ltd, the World Bank, Worldcom, Hewlett Packard, Freddie Mac and AIG to name just a few.

Unlike the Big 4 accounting firms offering a range of professional *financial* services to multinationals, the Mafia, the Yakuza and the Triads are involved in different areas of *professional service* but follow similar business models including specific *operating Divisions*. Generally, all three are involved to various degrees in the manufacturing and distribution of illicit drugs, have interests in both legal and illegal gambling establishments, various forms of extortion including protection rackets, predatory loan arrangements (loan sharking), various forms of white collar crime including embezzlement, legal and illegal brothels and various internet based schemes including theft identity and internet fraud. While there is no official reporting of financial information by the various crime families, by all other informal accounts, like the Big 4 accounting firms, business is booming.

Common to the Big 4 accounting firms, tax evasion issues have been a thorn in the side of the crime families. The most celebrated case of taxation and crime families was that of Mafia boss Alphonse Gabriel Capone commonly known as Al Capone. Born in 1899, Capone left school in sixth grade and immediately joined the street gang of Johnny Torrio in Brooklyn, New York. In 1920, Capone joined Torrio in Chicago who had risen in the ranks of the Colosimo mob gang. With Colosimo's execution and retirement of Torrio to Brooklyn following an assassination attempt, Capone became Mob Boss. With business opportunities aplenty for alcohol related activities during the Prohibition era, Capone was all-powerful and untouchable and leading the rich life in Chicago having developed an impressive network of beneficial relationships with a range of public officials and the unions.

The party came to an end for Capone when he was sentenced on 24 November 1931 to 11 years in a United States Federal Penitentiary required to pay some US$215,000 in back taxes, US$50,000 in fines and US$7,692 in court costs. It is tempting to ask who were Capone's tax advisors at the time and did they receive any jail time? The answer is not the fellow inhabitant of Chicago at that time, Mr. Arthur Andersen, who held the highest of personal ethics in his professional conduct.

At the time of the Capone trials his personal motto was *Think straight, talk straight* - a great example to any young accountant or indeed any professional! But the Capone conviction is actually relevant today on the question of appropriate penalties for tax avoidance by Lawmakers – Capone was the top guy and the conviction sent a powerful message to the community. If Steve Jobs had ended his days in jail for the perceived aggressive tax strategies of Apple, how would have the business community reacted today in terms of its approach to these aggressive taxation practices?

Based on the sheer scale of the KPMG tax fraud (or indeed the Lux Leaks scandal), Capone must be viewed as a little unlucky. Although there were some lengthy jail sentences for three persons from other firms associated with the KPMG tax fraud, the charges against the 13 KPMG staff indicted and tried were dismissed after the judge hearing the case found that prosecutors had violated their legal rights to counsel by placing undue pressure on KPMG not to pay the defendant's legal costs. This resulted in no jail time being served for any member of staff from KPMG involved in the US$11 billion tax fraud. Not the most exemplary of sentences for the Big 4 accounting firms in what was then the largest *detected* tax fraud in history!

As for the Mafia, in what may be considered the birth of the international tax avoidance industry, operations began to move to Cuba in 1933 as a result of discussions between Mafia *Chief Financial Officer* Meyer Lansky and military strongman and future Cuban President Colonel Batista under the watchful eye of then Mafia Boss Charles *Lucky* Luciano, the father of the modern mafia. Under the supportive Batista regime, Mafia business thrived until their Cuban operations came to a sudden end in 1959 when Fidel Castro seized power. Notwithstanding the loss of key Mafia assets as a result of the Cuban revolution, the Mafia has remained married to the tax havens ever since with all major cash flows disappearing in to a labyrinth of undisclosed entities within the tax haven network. *The lessen was well learnt from the Capone tax conviction!*

There is little doubt that the Yakuza and the Chinese triads are also extensively involved in tax evasion. An interesting emerging case is that of *alleged* Yakuza crime boss Kenichi Shinoda who heads up the 23,000 strong Yamaguchi-gumi, the largest Yakuza crime gang in Japan. In early 2015, some ten per cent of the gang allegedly split off to form a separate Yakuza gang. Speaking at the prestigious Foreign Correspondents' Club of Japan freelance journalist and Yakuza expert Atsushi Mizoguchi citing a recent arrest of a head of another rival Yakuza group on tax evasion charges based on memos showing cash transfers, speculated that the new rival gang would be in a position to leak similar information to police leading to the arrest and conviction of Shinoda. It is a long way from speculation to conviction, but the evidence necessary to convict would provide an interesting insight in to the world of the Yakuza.

Despite many headline grabbing arrests and busts around the world, Police action has barely slowed the advance of organized crime in to everyday life. As the crime gangs have grown larger and more sophisticated in their operations, detection of their crimes has grown more difficult. Similarly, the Big 4 accounting firms have grown so large and influential that they have largely risen above international regulatory control of which the Lux Leaks scandal is a prime example.

Nevertheless, major lawsuits and settlements do occur on a regular basis for each of the Big 4 accounting firms, which suggests that clients and stakeholders have now become one of the quasi-regulators of the Big 4 accounting firms along with the investigative journalists of the ICIJ. *But this is not an easy road either!*

As previously stated in the first volume of tax ethics series *albeit* to a different intended audience, aggressive taxation behaviours may be viewed by some as little more than a game of chance in the casino of life. Such behaviours only seek to financially benefit the individuals who seek to play *the game* to the detriment of the wider society.

The question for the Big 4 accounting firms is:

Should they be playing this game at all from an ethical viewpoint?

The founders of these firms including the late great Arthur Andersen espoused the highest of ethical standards in building the accounting profession and indeed these actions were based on the very solid laws introduced in the mid nineteenth century under the *English* Joint Stock Companies Act, which led the world in this regard. Certainly, many of the actions of the Big 4 accounting firms described in this book would hardly be described as *professional* then or now in the accounting profession or any other profession. Nevertheless, the Mafia, the Yakuza and the Triads may well consider some of the actions of the Big 4 accounting firms to be highly impressive to them, perhaps the passing off of tax avoidance work in the tax havens as bona fide international tax planning, but this is a matter for them to discuss in examining their own international tax planning arrangements. *The Mafia may well be much better!*

In Francis Ford Coppola's 1974 blockbuster *The Godfather Part II*, Kay Corleone played by Diane Keaton pleads to Michael Corleone played be Al Pacino, her Godfather husband:

Kay Corleone: “*It made me think of what you once told me: "In five years the Corleone family will be completely legitimate." That was seven years ago*”

Michael Corleone *“I know. I'm trying, darling”.*

Michael Corleone in the end, despite his initial best of intentions, was simply too drawn to the money and the power to ever turn the family business *legitimate*.

The Big 4 accounting firms may well ask themselves whether they are now in the same position that Michael Corleone found himself in. Ultimately, it is a straight question of choice going forward for each of the Big 4 accounting firms. *Given the scale of the tax frauds discussed in this book, there is certainly not unlimited time for this choice!*

Chapter 2

History and the Curse of the Ancient Structures

Despite the various taxation, accounting and other service line scandals that have engulfed the Big 4 accounting firms in recent years, there is little doubt that the overwhelming majority of Partners in the Big 4 accounting firms *do* act ethically and *d*o give appropriate high quality advice in relation to the commercial transactions in respect of which they are called to advise.

This is of course in complete contrast to the members of the various crime gangs, who in all likelihood *do not* go about business in quite the same way in their operations on a day to day basis. Notwithstanding, it is the sheer scale of the wrongdoing such as the 2008 US$50 billion deception in the case of Lehmann Brothers resulting in its collapse, the then largest in corporate history, or the *industrial scale tax avoidance* in the 2014 Lux Leaks tax scandal as it was then described in the UK Parliament that brings the activities of the Partners of the Big 4 accounting firms in to such sharp relief.

An analysis of the major Big 4 tax and accounting scandals indicates that they *generally* have occurred as a result of the unauthorised action or behaviour by one or a small number of Partners within their wide and largely unsupervised mandate as Partners. Accordingly, it is reasonable to conclude that such Partner or Partners are indeed *rogue* in the same way that derivatives broker Nick Leeson was, as the original *rogue trader*, in incurring a US$1.3 billion trading loss which led to the 1995 collapse of Barings Bank or indeed Jerome Kerviel was is in incurring a US$6.9 billion loss in 2008 for Societe Generale through trading in European stock index futures. Given the scale of the Lux Leaks scandal and the subsequent actions purportedly taken by the Big 4 accounting firms and Revenue Luxembourg discussed in Chapter 4, an argument may well be put that the era of *the rogue firm* is now upon us.

Nevertheless, such scandals as was with Baring Brothers or Societe Generale are immensely costly to the Big 4 accounting firms not only in terms of loss of reputation with clients, the regulators and the general public, but also in terms of the huge financial cost of *just getting it wrong* through lawsuits and stiff regulatory penalties. It is also self evident that scandals involving the Big 4 accounting firms occur on a far more frequent basis and a far greater scale than their corporate cousins.

The ultimate regulatory sanction of shutting down the business of a Big 4 accounting firm suffered by Arthur Andersen & Co has now been arguably removed as this would result in the creation of an improbable *Big 3*. As such, this would be simply unworkable for market dominance reasons under the corporation's law in most jurisdictions around the world as not allowing for sufficient competition between the remaining firms. This would certainly be the case in relation to multinational company audits where the

Big 4 accounting firms dominate. Indeed, it was surprising that the Regulators allowed just four firms to remain after the collapse of Arthur Andersen & Co's audit practice and suggests a lack of understanding about the forces within this rarefied market.

The more appropriate regulatory response and undoubtedly the most sensible would be to split a Big 4 accounting firm or indeed to split *all* of the Big 4 firms to re-create a Big 8 and as a result return the entire market to a much more favourable open market competitive position.

This would set an entirely appropriate and base level of competition amongst the international accounting firms rather than the current environment of potential connivance and cartel-like behaviours including joint *self* insurance arrangements which may carry considerable risk in terms of the financial stability of the Big 4 accounting firms and have only arisen through the rise of private power of only four firms and little or no regulation. As will be appreciated, licenced entities such as banks and insurers also have strict requirements in terms of capital to protect clients in adverse circumstances. The Big 4 accounting have no capital requirements whatsoever!

It should also be noted and it is emphasised that splitting does not mean a reduction in the total number of service professionals. It will simply mean that the same number of service professionals will operate in a greater number of tax and accounting firms *albeit* with greater regulatory scrutiny. These matters are discussed further in Chapter 10.

The question nevertheless remains as to how and why *rogue* Partners actually emerge in a Big 4 accounting firm environment and can wreak such havoc on the firm, the clients they are supposed to legally and ethically serve and the general public to which they represent as maintaining the highest of ethical standards? In reality, there is a disconcerting cocktail of circumstances that makes this outcome *virtually certain* on a regular basis for each of the Big 4 accounting firms.

The biggest issue remains the Partnership structure itself, an archaic and entirely inappropriate form of operating structure in today's modern world of risk management. Each of the Big 4 accounting firms is essentially a Federation of National Partnerships with locally appointed Partners joined by various service, fee or cost sharing arrangements turning over around US$33 billion per annum on average. For organizations this size, the international norm is a company structure so it may be noted that the Big 4 accounting firms while purporting to advise major global companies on their operations are not structured in the same way as the multinational companies they seek to ethically advise.

In this regard, it is interesting to observe the separate paths of Arthur Andersen & Co and Andersen Consulting, a provider of management consulting and technology services, since their demerger in 1989 under their then holding entity Andersen Worldwide Societe Cooperative. Not long after the demerger in what was always an unstable commercial arrangement, a conflict arose over the contractual requirement that Andersen Consulting, the more profitable of the two businesses, pay Arthur Andersen & Co some 15% of its profits. In 1998 under a settlement agreement, the two organizations separated permanently.

In 2001, the then renamed Andersen Consulting, *Accenture,* became a public company floating on the New York Stock Exchange. Today, Accenture PLC employs more than 425,000 staff globally more than any of the Big 4 accounting firms with earnings in excess of US$34.9 billion. As noted previously in Chapter 1, in 2002 under what must at least be considered in the realm of rogue Partner actions, Arthur Andersen & Co effectively collapsed under the weight of the Enron scandal. There is little doubt as to which organization has become the more successful of the two and under what structure.

Before considering the weaknesses associated with the Partnership structure in what should properly be considered the more problematical and clearly riskier of the two structures, let us consider the typical workings of a publicly listed company in terms of mitigating risk under normal risk management practices.

Publicly listed companies are composed of the owners of the company *as shareholders*, a Governing Board, a Chief Executive Officer or Managing Director, various senior executives and the operational staff beneath them. Unlike the Big 4 accounting firm partnership structures, there is a definite and direct line of reporting with the owner shareholders electing and monitoring a Governing Board, a Governing Board appointing and monitoring a Chief Executive Officer, a Chief Executive Officer monitoring the various senior executives and so forth down the structure of the organization. Importantly, every position within a corporation is accountable to the shareholders under this process and is subject to *immediate dismissal* for certain wrongdoing including fraud or gross incompetency under most employment arrangements.

Of great significance, in a company structure there is also a clear separation between ownership and the operations of the organisation which allows wrongdoing to be independently monitored and assessed with appropriate follow up action untainted by internal bias from the operations.

Further, there are a number of specific roles that provide *substantial* integrity to a company structure including (together with a brief description of the function):

Chief Risk Officer – Responsible for identifying risks to the organization and advising the Governing Board and developing appropriate risk policies and risk management procedures for *key risks* specified by the Board.

Head of Internal Audit – Responsible for monitoring all company procedures including financial and operational procedures, identifying weaknesses and improvements to these procedures and making appropriate recommendations to the Board.

Chief Legal Officer – Responsible for all legal matters relating to the organization including compliance (although usually not taxation) and advising the organization and the Board accordingly.

Chief Taxation Officer – Responsible for all taxation matters within the organization and signing off from a statutory viewpoint after appropriate consultation with the Board.

Chief Financial Officer – Responsible for statutory accounting, management accounting, financial analysis, budgetary reporting and treasury operations (although other functions may be added or subtracted depending on the overall experience of the Chief Financial Officer).

It should be noted that each of the above risk management roles relate to the *whole of the company* with strict accountability, targets and the capacity to be removed by the Governing Board at any time for inappropriate behaviours. Overall, this is an extremely robust risk management model for any company if undertaken with proper discipline.

In contrast, the present ownership and operational structure of the Big 4 accounting firm is one largely of historical accident rather than a modern organization established on contemporary risk management principles and practices.

All Big 4 accounting firms have grown from initial one or two Partner accounting firms. The oldest Big 4 accounting firm in terms of its antecedent practices is Deloitte Touche Tohmatsu having been founded by William Welch Deloitte in London in 1845. Ernst & Young and PricewaterhouseCoopers were both founded in 1849 also in England as Harding & Pullein and Samuel Lowell Price (London) respectively. KPMG was the late arrival in 1870 having also been founded in London as Barclay Peat & Co.

The fact that all of the antecedent firms of the Big 4 accounting firms commenced in England in the middle of the nineteenth century was not altogether a co-incidence. The industrial revolution in England had been in full swing since the mid-eighteenth century before spreading to the rest of the world. As the former agricultural based economy with smaller concerns was converting to a factory based system, businesses grew in both size and complexity.

As such, there were much greater capital requirements for these new industrial behemoths. Such capital requirements were typically well beyond the capacity of a single individual and required many investors. While it was possible to *incorporate* by way of Royal Charter or an Act of the British Parliament, the majority of large businesses operated through unincorporated associations with varying numbers of individual members.

The English law, which has led the world in developing legal concepts for commerce, addressed this challenge through the passing of two ground breaking Acts. The first, in 1844, was the *Joint Stock Companies Act*, which allowed a group of individuals owning a business or other enterprise to incorporate by choice for the first time. The second in 1855, was the *Limited Liability Act*, which restricted any liability for shareholders, for companies with more than 25 shareholders, to the extent of the paid up capital.

This was a radical change from the Partnership structure in which the Partners were joint and severally liable, that is, if some Partners could not pay their share of the liability then the remaining Partners had to do so. In 1856, the Joint Stock Companies Act was amended to include the requirement that *external auditors* be appointed by the company to audit the profit and loss statement and the balance sheet. These measures effectively introduced the current system for external audits of companies by independent accounting firms and created a fertile environment for the enormous growth of the accounting profession *and also the problems that lay ahead.*

Over the years, the various antecedents of the Big 4 accounting firms grew in size and consolidated to create *the Big 8* accounting firms in the 1970's. As a result of further consolidations in the 1990’s and 2000’s together with the demise of Arthur Andersen & Co in 2002, the current Big 4 accounting firms came into existence. One of the most delicious mooted mergers during this latter period was that of the then Price Waterhouse and Deloitte Haskins & Sells. The merger unfortunately fell through leaving the much-anticipated *Greatest accounting firm name in history* in the dustbin. Alas, *Price Sells* never came to fruition!

While it has been noted before that the modern Big 4 accounting firm is a Federation of individual National firms, there are also clear parallels with a franchise arrangement. In a franchise, the franchisor or owner of the business grants or licenses the franchisee the rights to carry out certain commercial activities as defined under the franchise agreement.

In this sense, the Big 4 accounting firm member firms are not dissimilar to a McDonalds franchise. Typically, the franchisee will own the store and the National Partnership will own the local operations. In both arrangements, there are certain service obligations of the franchisor (and the Big 4 accounting firm head office) to service the need of the local operations and correspondingly the local operations are required to meet various standards in terms of the product delivered. In both arrangements, the brand name carries considerable cache in the market place and will draw customers. The difference is that at McDonalds the customer will get a perfect burger each and every time while at the Big 4 accounting firm the Worldcom, AIG and Lehmann Brothers burgers may cause some lasting gastric and financial discomfort

A curious question arises as to the uplift in charge out rates that the Big 4 accounting firm moniker gives to a local firm once admitted as a member firm. There are no empirical studies as such and the uplift will no doubt vary from country to country, but it is reasonable to assume that the base charge out rates will generally double at all levels of the firm once the Big 4 accounting firm name has been introduced.

What bang does one get for one's additional bucks? Initially, probably not too much! Apart from the carefully crafted illusion of the value behind a Big 4 accounting firm name, it is still the same staff sitting in the same offices providing the same advice except at double the price. Commonly, a Big 4 accounting firm will initially parachute an experienced practitioner from an established practice, particularly in emerging countries often with the lure of a full equity Partnership.

The idea is to establish connections with the more established practices and develop new service lines and products. However, this will take time particularly in relation to the service requirements of a major multinational, which the local firm may not be familiar with. Experience suggests that the normal integration of a new member firm takes about five years depending on the complexity, size and services offered by that firm.

A related question is how is the uplift in fees addressed from the viewpoint of the transfer pricing law which requires that international related party transactions be charged on the same basis as those of independent parties. Based on the publicly made representations of the Big 4 accounting firms, one would expect that the member firms are indeed *one firm*. However, are they actually related for transfer pricing purposes, which typically requires an equity participation, that is, a degree of actual ownership, to trigger the rules locally?

Depending on the actual structure of the local member firms, this may not be the case. Global branding suggests strength and power, but is this just the Big 4 accounting firm creating a well forged myth? From a transfer pricing viewpoint, it is one for the Revenue Authorities and the Big 4 accounting firms to resolve on a taxation audit. From a multinational client viewpoint, it may be wise from a risk management viewpoint to discuss the structure of the international operations of one's Big 4 accounting firm from one's Big 4 accounting firm Partner. From the viewpoint of the rest of the world and to maintain integrity in the system, no less than full disclosure is required.

The road to Partnership in a Big 4 accounting firm is unquestionably a very tough one and on the small chance that it will be successful will be one taking fifteen years or more. There is little doubt that the prestige of the firms attracts the best and the brightest from the leading universities of the world.

But what is life really like in the Big 4 accounting firm?

Generally, for the new arrivals to the firm there will be an initial honeymoon period through the induction process where the values and the perceived importance of the firm first introduced during the recruitment process will be reinforced through various training sessions and firm social events. Such firm events may include a cocktail party, a luncheon for the new graduates or a similar social function attended by a number of the more senior and charismatic Partners of the firm.

Building the link between Partnership and a career of desirable commercial success is a particularly important and ongoing doctrine to be delivered to the young graduates as part of the firm culture. Meeting the Partners in a social setting and seeing them as highly respected and likeable professionals on presumably large incomes begins to create the seductive allure which keeps staff slaving away in the backrooms of the Big 4 accounting firms for years in the hope that they will be anointed one day *as a Partner*.

The early years in the firm may be best described as *slaughter of the lambs*. Junior staff are generally expected to work long hours in all locations while also undertaking further professional or academic studies such as the Professional Year or Master of Tax programs or both. The combination of work and study hours is extreme as the young staff members seek to outdo each other in fierce competition for promotion through the firm. Work hours and fees charged are often published to further encourage this competition. Clearly, no junior staff member would aspire to be at the bottom of *the list* as this is generally perceived as being the death knell to one's career in the firm as simply not putting in *the hard yards* required.

Unfortunately, the system may also encourage forms of *gaming* by junior staff to improve relative performance to one's peers such as falsely charging or *dumping* of time on client charge codes. If not discovered, dishonesty becomes its own reward and becomes the early training ground for measured risk taking behaviour to improve the junior staff members own position but at the cost of increased risk to the firm.

During this period, burn out rates are very high and many junior staff opt out in the early years to take up positions on the typically more lucrative salaries in commerce. There is little doubt that for most junior staff members leaving a Big 4 accounting firm, there will be an uplift in salary due to both the prestigious name of the firm and the strong early training received, although perhaps less now than in earlier times. Nevertheless, this does leave most of the successful risk takers aspiring to Partnership within the firm structure itself and the early *also rans* out of the firm.

If the first five years are *slaughter of the lambs*, the last five years are definitely *dog eat dog* and most likely of the *Pit Bull Terrier kind*. The now business savvy and hardened accounting professionals with ten or more years of experience have set their aim at winning a Partnership. With three, four or five of these senior professionals vying for the one partnership, a ready comparison may be made with similar internal struggles within the Mafia or the Yakuza.

The need for a powerful partnership business case to support promotion to Partner before the firm's hierarchy, the requirement to effectively eliminate one's rivals for Partnership and the huge financial reward from being promoted to a Partner typically results in much more aggressive behaviours than a similar corporate struggle where quality staff tend to be retained rather than eliminated. Unquestionably, a Partner is the equivalent of the *made-man* in the Mafia or a Yakuza crime boss being largely untouchable within the firm structure. While functionally not more than a unit manager in terms of a corporate structure, as part owner of the business a Partner carries disproportionate power and earnings relative to his or her corporate equivalent.

Another key difference in terms of risk borne by a firm compared with a corporate structure is that a Senior Partner will typically have considerable political sway and influence to limit the effectiveness of the internal risk and compliance functions of the firm in relation to his or her own matters. Some

Partners will no doubt dismiss these functions entirely as being relevant to *staff only.* Such an outcome typically cannot occur in a corporation as it is only the Board that can override findings from the risk and compliance areas and not unit managers. This is not to say that every Partner in a Big 4 accounting firm is aggressive or dismisses these key control functions but these differences do support the conclusion that additional risk is borne in the Partnership structure that produces the *rogue* Partners with such catastrophic results for the Big 4 accounting firms.

While there are some successful examples around the world of accounting and law firms electing *to go public* and listing on a stock exchange, such instances are rare and so far is yet to occur in respect of a firm operating globally, let alone in the context of a firm with the scale of operations of one of the Big 4 accounting firms.

From a financial viewpoint, this is thought-provoking given the difference in multiples of earnings paid on private trade sales which are generally much lower than their publicly listed equivalents. It is not uncommon for a company once publicly listed to double, triple or even quadruple in value within a short period of time even without the occasional share market exuberance experienced during market booms, which may take a company's value to extremes as was evidenced by the two *tech booms* of the last 100 years in 1920's (radio) and 2000's (internet).

This is particularly the case when one is contemplating a public offering with the growth, stability of earnings and quality of brand name of a Big 4 accounting firm which as previously mentioned could conceivably be valued at US150-200 billion on fairly conservative multiples in an initial public offering or IPO. This immediate uplift in value combined with the ability to choose one's exit time during a market high would be very appealing, if not compelling, for senior partners contemplating retirement, rather than merely selling equity back to the firm.

While no information has been publicly released on whether a Big 4 accounting firm or indeed any of its member firms has contemplated an initial public offering there are a number of issues which need to be considered and potential reasons as to why this may not have occurred.

Firstly, the Big 4 accounting firm would have to consolidate all member firms' interests in to a single entity capable of being listed on a stock exchange from the existing position of independent ownership and the various commercial arrangements between the member firms. By way of agreement between the member firms, this is by no means insurmountable and in fact would follow a similar model adopted around the world albeit on a smaller scale where a number of accounting or law practices are first consolidated then made available to a stock exchange. There are specialist financiers who undertake this type of work although probably more generally in the context of merging accounting or legal firms but also in preparation for an initial public offering if required.

Secondly, a Big 4 accounting firm would become subject to the strict listing requirements of one of the major bourses presumably either the London or New York Stock Exchanges or perhaps both in the case of a dual listing. This would then require the listed Big 4 accounting firm to make appropriate disclosures in accordance with those rules on price sensitive matters including pending lawsuits and the outcomes of existing lawsuits against the firm. Depending on the disclosure requirements, this may be a considerable challenge for a Big 4 accounting firm seeking to optimally manage its downside reputation risk in the event of an adverse Court finding. Nevertheless, the alternate argument is that the Big 4 accounting firm would merely be subject to the same disclosure requirements as most of its clients. The better view is that this would be a desirable outcome for a Big 4 accounting firm, its clients and the general public.

Thirdly, a publicly listed entity of this scale similar to the licensed insurers and banks would require an appropriately disciplined regulator to ensure that the Big 4 accounting firm would comply with appropriate regulatory standards. Again, a centralised regulatory control would be seen has highly attractive within the investment community in setting strict standards, mitigating risk and applying appropriate sanctions to inappropriate commercial behaviour by Partners, rogue or otherwise.

Fourthly, a Big 4 accounting firm would need to introduce the roles appropriate to a publicly listed entity for risk mitigation with the same or very similar accountability and sanctions for underperformance including dismissal as discussed earlier in this Chapter. This would lead to far greater accountability for risk taking behaviour and likely reduce the frequency of such behaviours. An ounce of prevention is worth a pound of cure! There is little doubt that the investment community would perceive the introduction of a robust risk management system as an attractive feature.

Fifthly, a special mention needs to be made of perceived *opportunistic plays* by Partners on their personal account including transactions with parties associated with the Partner in some way. For example, this may include the sale of an asset on a favourable valuation to a family member of the Partner’s wife. There are transactions that may fall within the bounds of the law and also within the firm’s conflict rules, but nevertheless delivers a clear benefit to the Partner or a party associated with the Partner. The question then arises as to whether such rules need to be modified in the generally stricter environs of a corporate culture.

Finally, the reward structure within a conventional firm where an equity Partner may earn four to ten times the income of a salaried Partner or other senior staff would be clearly inappropriate within a conventional corporate structure. In reality, this probably represents the single greatest obstacle for a

Partner. There is little doubt that the more conservative Partners would welcome reduced risk to the firm, but the question remains whether the overall return would be matched through salary, returns on equity and reduced risk. The Accenture story discussed earlier in this Chapter may provide useful guidance in this regard.

Each of the above issues would no doubt require appropriate consideration for a Big 4 accounting firm contemplating an initial public offering, yet it is the above characteristics that would attract the leading multinational companies from a Governance viewpoint to such a listed Big 4 accounting firm as their service provider. For the Partners of the firm, the question is ultimately one of balancing risk and reward.

In the meantime, the Big 4 accounting firms must live with their archaic partnership structure and the curse of the risks it presents for them. Based on my numerous discussions with Partners over the years, there is little doubt that many Partners in the Big 4 accounting firms are asking themselves the same questions as I am in this second volume of the tax ethics series.

While they may not necessarily accept my views, fully or partly, they are nevertheless asking themselves the question of whether there is a better way of running their businesses from a commercial, risk management and reputational viewpoint. I would strongly suggest that there is in all of the Big 4 accounting firm's client bases. *All they need to do is look!*

Chapter 3

Reputation and the Fine Art of Illusion

Ensuring a Big 4 accounting firm's reputation as a superior provider of services is critical to its continuing commercial success. No firm can charge US$1,500 an hour (or more) or indeed $US150 million (US$200 million inflation adjusted) over seven years as was the case with Ernst & Young leading up to the 2008 failure of Lehmann Brothers without keeping the confidence of its client base. During a gentler and perhaps nobler time in history, Benjamin Franklin observed:

It takes many good deeds to build a good reputation and only one bad one to lose it.

As wise and impressive a man as Benjamin Franklin was, these are simply vastly different times. The Lehmann Brothers, the Lux Leaks scandal, the KPMG tax frauds and the WorldCom and Tyco accounting scandals appear to have been only mere *temporary* setbacks in what appears to be the inevitable advance and stature of the Big 4 accounting firms which now audit some 98% of companies turning over in excess of US$1 billion and earn as previously mentioned over $140 billion in fees. This level of penetration *by just four players* in a global market with the scale of the Big 4 accounting firms is quite exceptional in commercial history, *if not unique*. *This simply does not happen by accident, but by creative design!*

Although there are certainly acts of aggression in defending the reputation of a Big 4 accounting firm, which are discussed in some detail in Chapters 7 and 8, this would be a complete and utter *under estimation* of the overall sophistication of a Big 4 accounting firm's strategy in protecting and enhancing its business reputation. Like the business plans of the crime gangs, a full business and marketing strategy of a Big 4 firm is *unlikely* to be externally published to allow a study of its key elements.

While not quite as simple as looking at the top of an iceberg and concluding that there is probably ice underneath as well, an experienced observer may examine what appears outside these accounting behemoths and draw reasonable conclusions as to what may occur within its bastions in terms of its strategy for optimizing its reputation.

As with the *made men* of the Mafia and the crime bosses of the Yakuza and the Triads, it is important that a Partner of a Big 4 accounting firm be perceived as *all powerful and infallible* in terms of his or her conduct. As Partners may be quite young and dealing with senior commercial figures potentially *double* their age, an appropriately rigid supporting structure is necessary to maintain and support the illusion of commercial strength justifying their extreme charge out rates.

In 1963, Joe Valachi a 40 year veteran of the Mafia became the first insider to testify in a long standing investigation on organized crime and gambling before Senator John McClellan's Permanent Subcommittee on Investigations of the U.S. Senate Committee on Government Operations, the US Senate's chief investigative and oversight committee. Valachi not only confirmed that the Mafia actually existed, bringing the term *Cosa Nostro* into common usage, he also outlined in great detail the structure and operations of the Mafia with a specific focus on the five New York crime “families”.

Valachi named the five families based on their bosses at the time being, Joseph Bonanno, Carlo Gambino, Vito Genovese, Tommy Lucchese and Joseph Profaci, hence the Bonanno, Gambino, Genovese, Lucchese and Profaci families whose names remain in usage today. The families operate on agreed territory or *turf* in New York, Florida, the West Coast, the mid-West and other parts of the United States and Canada.

The five families were formed in 1931 by Salvatore Maranzano the then *Capo di Tutti Capi* or the boss of all bosses after a short and bloody gang warfare known as the Castellammarese War which resulted in the murder of Giuseppe Masseria his predecessor. With Maranzano’s murder shortly thereafter the five families met and agreed to form what has become known as *the Commission* made up of the bosses of the 5 New York families and Al Capone’s Chicago Outfit.

The role of the Commission was to resolve matters in dispute between the families and to approve new bosses or *made men*. Believed to be in existence today although of lower profile because of obvious law enforcement interest and activity, it must be nevertheless observed that the top structure of the five families has remained extremely stable and indeed workable *amongst crime families* for 85 years. Compare this to Corporate America or indeed what were the antecedent firms of the Big 4 accounting firms over 85 years and the differences are quite remarkable. In this regard, such preservation of structure and existence may simply be the product of concealed and brutally efficient criminal behaviours. This is probably entirely justified in the context of criminal gang and no doubt meets society's expectations in this regards, however, it is not exactly befitting for a Big 4 accounting firm and the ideals they purport to maintain.

Maranzano was also responsible for establishing the Mafia hierarchy of Boss *or Capofamiglia*, Underboss *or Sotto Capo*, Advisor *or Consigliere*, Captain *or Caporegime* and Soldier *or Soldato* being some six levels in the hierarchy with some variations. Interestingly, the modern Big 4 operates around a similar six level hierarchy being Partner, Director, Senior Manager, Manager, Senior Associate and Associate and again with some variations.

In a crime family, one may readily understand why six levels of hierarchy are necessary to distance the revenue generating and presumably illegal activities from the top levels of the crime family. In any advisory firm, six levels are very unusual, particularly, when one compares similar work undertaken by the international law firms with two, three or four levels in the provision of major advice or services essentially because it is difficult to control risk with so many levels in a professional hierarchy.

So why six levels in a Big 4 firm? One must presume that at least one of the reasons is to build the reputation of the Partner by having large teams underneath him and to protect him in meetings on technical issues. It must be recognized that with so many mouths to feed the primary role of the Partner is to *generate fees and not to provide technical advice*. This is often over-looked by clients. Therefore, it is very important for the Partner to maintain the illusion of a deep technical knowledge which he or she may not actually have to keep the confidence of the client. This should be compared with the international law firms, which tend to have smaller professional staff to Partner ratios and a much more hands on role by the Partners in respect of the provision of advice in respect of technical taxation issues.

The concept of *respect* for both Big 4 accounting firm Partners and crime bosses alike is critical to their survival. Any perceived slight by a staff member towards a Partner in a meeting, even as part of correcting wrong advice provided by that Partner, may result in a harsh career end with the firm for that staff member. In the Yakuza, the junior members can make up minor indiscretion in the eyes of their bosses by lopping off part of a finger. No doubt many a senior practitioner in the Big 4 accounting firms on the cusp of partnership but who failed to make it for such an indiscretion would have preferred the loss of a digit or two or even three to losing out on a lucrative appointment as Partner.

Setting aside the moral questions rightly or wrongly, it is necessary for both the Big 4 Tax Partners and crime bosses to maintain that respect to control staff members and crime members alike and to ensure that clients and crime victims do not take adverse action against them.

Respect for the Big 4 Tax Partners has also been maintained by a number of *myths* perpetrated by the Big 4 firms over the decades. One of these myths promoted by the more aggressive Tax Partners is that a company should never speak directly to a Revenue Authority or other Regulator on the basis that it is somehow *very risky or dangerous* to do so.

This is clearly over-played by such Tax Partners and contrary to any sensible tax risk management or commercial behaviour. The real risk arises in NOT speaking to the relevant Revenue Authority or other Regulator on a matter where there is uncertainty and acting without guidance from the Revenue Authority or Regulator. As such, this is an uncontrolled risk, a pariah in the world of risk management.

The analogy of a normal arm's length commercial transaction will be useful here in illustrating this risk. When a commercial contract is agreed with a third party, would one merely work with one's own Lawyers in drafting the contract and hope that the counter-party agrees with everything in the unseen contract post execution? The answer is that this would be *completely foolish* from a commercial viewpoint, so why not agree what is effectively *a contract* with the Revenue Authority or other Regulator prior to execution. The arrangement will anyway be subject to a review by the Revenue Authority or Regulator at a later date. Such a risk free approach makes perfect sense from both a risk and commercial viewpoint.

One important further aspect of a Regulator is that they are bound by strict laws with respect to confidentiality and cannot disclose any aspect of a matter before them to third parties. The same cannot be said for Big 4 accounting firms where a client only has contractual protection at best under a service agreement.

Of course, the Mafia have a similar issue regarding members speaking to *their regulatory authority* the Law Enforcement Agencies, however, possible death sentences and lengthy prison terms does represent a very serious problem for them.

Another myth is the *image of self* that each of the Big 4 accounting firms will project. Each of the firms will purport or to be *the best* both internally to staff and externally to customers. It is part of the *tribal ethos* that every Big 4 accounting firm believes this to be the case. However, unless a Big 4 accounting firm can establish objectively as to why *it is the best* with comparative data from the performance of other firms to support that conclusion, the comment by and large is *completely vacuous* and, in fact, may do more damage to the Big 4 accounting firm's case than can assist it. Further, no Big 4 accounting firm can realistically purport to be the best in all areas given the partnership structure and the variation in performance of individual equity Partners.

In a similar vein in past times, it was not unusual to have a Big 4 accounting firm Tax Partner to *smugly chortle* that we are *highly professional*. This seems to be the war cry mostly of the older generation of Partners trapped at the top of the Big 4 accounting firms with inadequate and outdated skill sets for the role. The expression seems to have its origins during the high water mark of the the tax avoidance industry era in the 1980's and early 1990's when aggressive tax schemes were heavily sold to unsuspecting high net worth individuals and professionals as *tax planning opportunities* by the (antecedent) Big 4 accounting firms.

The *highly professional* stance was essentially used to provide the *appearance* of legitimacy to these highly aggressive and contrived tax schemes while in reality such schemes often ended up with a highly negative financial outcome for the overly trusting client. If a dentist, doctor, pharmacist, engineer or any other professional *guffawed* about *how professional* he or she was, it would most likely be greeted with a feeling of distinct uneasiness by their client. The real question is can accurate advice be provided in a clear manner in accordance with the Board Tax Mandate or client instructions, *not whether the tax adviser is highly professional or not in his presentation!*

One certain differentiating point about the criminal gangs is that the true professionals in those gangs will *never guffaw* how professional they are. They will simply and very effectively act in total silence!

There is little doubt that both the five New York families of the Mafia and the Chicago outfit have over their history extensively used corrupt Government officials to further their criminal activities including *labour racketeering,* which the FBI defines as the domination, manipulation, and control of a labor movement in order to affect related businesses and industries. This can lead to the denial of workers' rights and inflicts an economic loss on the workers, business, industry, insurer, or consumer.

An example of this was the infiltration of the Teamsters Union by the Mafia in the 1970's and 1980's prior to US Prosecutor (later New York Mayor) Rudolph Giuliani's 1989 crackdown on the Mafia. Nevertheless, the high water mark of the Mafia's was during the Capone era in Chicago when a perfect storm of a rapidly growing city, a wave of immigrants desperate for work and a stretched bureaucracy led to a city wide culture of corruption and the ideal positioning for the growth of criminal organizations.

Outright bribery and corruption would be extremely unusual in the context of a Big 4 accounting firm. Nevertheless, it may exist in developing economies where the local Big 4 accounting member firms may well have lesser controls placed on them by the Big 4 accounting firm hierarchy or there are simply weaknesses present in the local tax or other regulatory law which may encourage inappropriate behaviours by officials. The more usual approach is the *seduction of politicians* from all Western economies in terms of influencing policy through private dining rooms, sports events and invitations to speak at gala events and possibly by the use former Government Ministers recruited by the firm of which the Big 4 accounting firms have recruited six in the United Kingdom in the past few years.

However, the impact of this may well be limited and be over-represented by the firms as *privileged access not available to others*. This is largely a myth. Although some advantage may be gained on policy, it will generally not apply to regulatory decision making unless, of course, such activity occurs in a tax haven such as Luxembourg.

While it is true that most firms will be aware of the appropriate regulatory contacts on a particular issue, any regulator providing a privileged outcome to a particular firm will in most jurisdictions be guilty of a criminal offence, *but not all jurisdictions!*

The reality is that most major corporations desiring to act ethically from a tax viewpoint will have or should develop their own regulatory contacts. This is not difficult to do – it is merely a question of picking up the telephone and initiating discussions.

As *loyalty* is critical within the parts of a criminal venture for its success, so is the success of a Big 4 accounting firm's reputation dependent on loyalty between its operating Divisions. There is little doubt that the Audit Divisions of the Big 4 accounting firms do understand in great detail the structure of commercial transactions. In turn, that knowledge is passed on to the Tax Division as part of the tax planning process. At this point, this is totally acceptable. However, a problem arises when the Tax Division as part of maintaining the reputation of the firm puts pressure on the Audit Division to sign off on the tax provisions relating to aggressive tax arrangements resulting in the legendary *scorched carpet* between the Taxation and Audit Divisions in every Big 4 accounting firm.

Given the scale of the tax scandals involving the Big 4 accounting firms, it would be farcical for the firms to say that this does not occur. Of course this occurs, which is one the strongest reasons why Regulators should step in and split the Audit and Tax Divisions of the Big 4 accounting firms. If I was an Audit Partner in a Big 4 accounting firm, I would want the Tax Division out of the firm and I know many of them agree with me because they have told me so including a retired and highly respected Australian Big 4 Audit Head on a long haul flight between Sydney, Australia and

Denpaser, Bali who described dealing with the tax division *as the absolute worst aspect of his career*.

One area where the Big 4 accounting firms certainly outdo all criminal gangs is *branding*. It is hard to be in any major city these days without seeing all of the Big 4 accounting firm names lighting up the night sky. Airports all around the world are adorned with commercially highly insightful comments from lead Partners from the Big 4 accounting firms carefully chosen to appropriately reflect both gender and racial diversity. Strategically placed advertisements in the print media are now extremely common. It must be acknowledged that the placement of the Big 4 accounting firm names in these ways is extremely effective in presenting an image of institutional solidarity and a genuine sense of belonging to clients, employees and even former employees like myself.

An interesting point of differentiation between the Big 4 accounting firms is the use of *catchwords*. KPMG, Deloitte and PricewaterhouseCoopers have clearly chosen not to adorn their brand names with any form of additional wording opting instead to rely purely on promoting the strength of the brand name itself. Ernst & Young is the only Big 4 accounting firm to go down the path of adding further wording to its brand name.

This strategy seems to have been tested internally at the top end of the firm. In 2013 with the ascension of Mark Weinberger to Global Chairman and CEO, Ernst & Young adopted “EY” as its global brand name and launched a new slogan *Building a Better Working World* replacing *Quality in Everything We Do.*

At first observation the new slogan appeared more suited to a heavy engineering and construction firm rather than an accounting behemoth (unless of course the firm is building tax shelters), but the underlying message is far more sophisticated than that.

Mark Weinberger described the new catch cry in very strong terms:

"*At EY, building a better working world has always been our purpose and we are now capturing that in an explicit and concise way. We know that building a better working world is an ambitious objective but it is an incredibly important aspiration and will be front and center of everything we do as an organization. In a better working world trust increases, so capital flows smoothly and investors make informed decisions. Businesses grow sustainably, employment rises, consumers spend and businesses invest in their communities. More than just growth, a better working world harnesses and develops talent in all its forms and encourages collaboration. We understand our obligation to look beyond our self-interest and engage with the world. We use our global reach and our relationships with clients, governments and other stakeholders to create positive change. We do this through who we are and what we stand for and most importantly we back it up by how we act. We help our clients, our people and our communities - one project at a time. We solve the problem in front of us and move* *on to the next. Over time, the whole working world works better."*

This is unquestionably a highly laudable objective and, if achieved, highly impressive, but spin and conjecture must translate into outcomes. The international community is becoming increasingly more intolerant of aggressive tax practices and is now demanding action. Whether this is successfully achieved, only time will tell!

There is little doubt that the Big 4 accounting firms collectively and individually have an incredible capacity to manage and control their reputation based on a disturbing level of *increasing* private power. Whether these firms will continue to survive in their current forms and with their current practices will depend on whether the myths and the illusions can be maintained successfully. It is also possible that the rise of a new firm or the return of an old firm such as Arthur Andersen & Co with a superior practice model may simply force change in the Big 4 accounting firms.

If history is a guide, every edifice set up by man eventually collapses. Like the Nazi Swastika which once tragically adorned most of Europe as a monument to man's inhumanity to man or the aquila of the Roman Empire symbolizing the power of a Roman legion, the names of the Big 4 accounting firms will one day fall from the skylines of the major cities of the world. The question is what will cause this*? In my view, the Big 4 accounting firms may well have already sown the seeds of their own destruction!*

Chapter 4

The Scandals – The Dark Mistress Leaves Her Perfumed Calling Card

Of the wide range of generally meritorious commercial services provided by the Big 4 accounting firms, international taxation must surely be the cruellest of mistresses for the Big 4 firm accounting chiefs as they lay their heads on their pillows at night next to their wives. Alluring, mysterious, captivating, all consuming, part passion, part obsession and potentially so risky and so expensive that each of the Big 4 accounting firms has had its existence threatened by a seemingly endless stream of increasingly more outrageous and extreme taxation scandals caused by this dark mistress.

If history is any guide, cruel, alluring and dark mistresses tend generally not to be promotive of happy family life and the family of global service heads in the Big 4 accounting firms must surely be asking themselves as each taxation scandal unfolds, is this bewitching lady really worth it? The considered and objective answer is probably a resounding *no,* but taxation services have become so inextricably bound in the current range of services offered by the Big 4 accounting firms that it would be commercially difficult to voluntarily remove even though it may prove necessary to do so.

There is no doubt that many audit Partners in the Big 4 accounting firms would welcome regulatory change to either prevent Big 4 accounting firms acting as both auditors and tax advisers for the same client or simply to split out the tax advisory practice in to a separate firm. Many would no doubt wish that the consulting arms such as Accenture were retained as they have proven to be immensely profitable with far less risk than the provision of taxation services and arguably a far better fit culturally with audit services. The better view is that regulatory change should be considered and arguably at the request of the Big 4 accounting firms themselves, that is, if social responsibility and professional ethics still mean something to them.

The primary defence of PWC in the Lux Leaks scandal discussed below is essentially that the actions of the firm were entirely legal and indeed were the subject of private binding rulings under the taxation laws of the Grand Duchy of Luxembourg. On a superficial observation, this may appear to be aligned to the principles of the ethical tax regime discussed in Chapter 11 as there has been disclosure and confirmation by way of a Revenue Authority. However, this is not correct as the principles of ethical taxation behaviour require *full* disclosure to *all relevant* Revenue Authorities particularly where a tax haven is involved and then properly explained in its commercial context.

The question of legality is not as straightforward as one might imagine. The Big 4 accounting firms are so commercially powerful today that it is well conceivable that they can cause taxation laws to be changed in some jurisdictions with the promise of additional revenue. There is little doubt that the Lawmakers of many small nations would be attracted by the prospect of a few extra billion dollars in unexpected Revenue flowing in to their coffers. There is no definitive evidence to suggest that this has yet occurred. Like conflict, this is a question of perception. Notwithstanding, the prospect of such an outcome should be of the gravest of concerns for the international community and one it must guard against by way of requiring appropriate transparency and other regulatory requirements.

It is important to recognise that aggressive planning tax structures of which the following are but a few examples are typically *developed and sold* by the Big 4 accounting firms and not developed *in-house* by the multinationals they serve. From a risk management viewpoint, it is important that multinational companies have the capacity to properly test such structures from a commercial viewpoint *in the context of their operations* and not merely accept the representations of the Big 4 accounting firms. If such testing had occurred, the following structures would likely have not been implemented at all.

Finally, the Directors on the Boards of the multinationals themselves must recognise that aggressive taxation practices are not victimless crimes and the public and their customers are well aware of this. Tax scandals do damage the reputation of multinationals with a clear and negative commercial outcome. The victims of the peddlers of greed are many and has been stressed throughout the Tax ethics series are usually those who are the least privileged in society *who do need* their Government programs and *who do suffer* when these programs are cut because of Government budgetary problems.

The following tax scandals are merely representative of the many ethical taxation issues and questions currently facing the Big 4 accounting firms.

PWC – Luxembourg "LuxLeaks" Scandal

In November 2014, following the disclosures of whistleblower Antoine Deltour, whose case is discussed in detail in Chapter 6, the International Consortium of Investigative Journalists (the ICIJ) published a list of multinational companies who purportedly had received highly favorable private tax rulings from the Government of Luxembourg. It is understood that these tax deals may have *saved* tens of billions of dollars or more in taxation, but is a contemporary and unfolding tax scandal and much, much more is likely to be be revealed over time.

The ICIJ published list only relates to PWC's clients with Luxembourg and not the other three Big 4 accounting firms or the other 21 European Union countries which *may* have issued private rulings but on a much lesser scale. Nevertheless, it is important to understand how large the Big 4 / Luxembourg challenge is for the more responsible global economies. The 310 companies named by the ICIJ are attached in Appendix I at the end of this book.

There have been many observations in respect of the Lux Leaks scandal some of which reflect a far greater understanding of what the true position is than others. In 2013, British Prime Minister, David Cameron, delivered the keynote address at the World Economic Forum in Davos, Switzerland observing:

It's a world where some companies navigate their way around legitimate tax systems – and even low tax rates – with an army of clever accountants. We can be the generation that eradicates extreme poverty in our world, but we need to tackle the causes, not just the symptoms. We need to lay down the rules of the game, and we need to be prepared to enforce them. Proper companies, proper taxes, proper rules.

Cameron's speech was strong but he could have been stronger by referring to President Roosevelt's concerns about the growth of private power threatening mainstream global policies of democratically elected nations. An outright proposal for regulatory reforms together with appropriate prosecutions to curb the rise and rise of the Big 4 accounting firms which develop and sell such structures as those used in Luxembourg would have been impressive.

Cameron's observation regarding *clever accountants* is quite frankly a little overly complimentary and inaccurate to those firms involved in setting up the Luxembourg tax schemes. As has been previously noted, the foundations of the modern accounting profession courtesy of the *English* Joint Stock

Companies Act were based on *accuracy and transparenc*y in financial reporting for the benefit of investors *and not secrecy and deception of foreign Revenue Authorities*. Clever may be, but more likely in a way that a successful confidence trickster would be clever in identifying and playing unwitting targets for financial gains rather than solidly based financial work ethically based on the law and in accordance with strong Board policies aligned to community expectations.

As the ICIJ observed, in many cases the companies' presence in Luxembourg was only symbolic pointing out that 1,600 companies were registered at one address in Luxembourg (5, rue Guillaume Kroll). Any competent transfer pricing specialist will attribute a relatively accurate arm's length or market price in respect of the international related party activities conducted in a particular jurisdiction by a multinational company.

Such a value will be based on the actual functions performed in that jurisdiction, the assets employed in generating the revenue and the commercial risks undertaken. A letterbox presence in a particular jurisdiction for a major multinational group does not add any material value whatsoever and would be recognized as such under the transfer pricing laws of the over-whelming majority of nations around the world, unless, of course, the letterbox is located in Luxembourg!

Distinguished Harvard Law School Professor in International Tax, Stephen E Shay correctly observed:

A Luxembourg structure is a way of stripping income from whatever country it comes from (which) combines enormous flexibility to set up tax reduction schemes, along with binding tax rulings that are unique. It's like a magical fairyland.

And so it is with the ICIJ reporting that in 2012 US corporations with Luxembourg operations paid tax of just US$1.04 billion on US$95 billion of net profits a rate of a 1.1 per cent. It may be fairly observed that the major investment banks would charge a similar percentage on a successful transaction of this scale. Given Luxembourg's reputation as a creative financial center, there is a reasonable argument to suggest that the so-called tax charged is just a fee for the use of the Luxembourg financial system to reduce taxes for multinationals.

As Professor Shay observed, there are a number of variants to the Lux Leaks schemes, but essentially they all involve the movement of income from a high tax or higher tax jurisdiction to the low or no tax jurisdiction of Luxembourg by way of transactions largely based on *commercial illusion* rather than reality to create the *magical fairyland.* It is emphasized that it is not difficult for an experienced transfer pricing specialist to create a reasonably persuasive argument to support a commercial illusion before a Revenue that is only too keen for these structures to succeed under a tax avoidance friendly local law.

One should also properly and carefully consider the potential between aggressive tax avoidance behaviours, money laundering, organized crime and terrorism of which the Brussels attacks this year were a powerful local reminder within the Benelux nations.

The question for Luxembourg is, are you really collecting enough revenue to responsibly filter the organizations that pass through your nation? Antoine Deltour is not your enemy Luxembourg!!

Chapter 5 explains how the transfer pricing law operates around the world and provides examples of aggressive transfer pricing behaviour in respect of service arrangements, technology transfers including royalty arrangements relating to both patented intellectual property and marketing intangibles, loan arrangements and transfer of goods.

Of the many potential *aggressive* transfer pricing structures, loan arrangements are the oldest and easiest to establish and maintain with little or no supporting transfer pricing documentation. It is also an easy structure for compliant Revenue officers to quickly and consistently approve. Accordingly, it is not surprising that this was the predominant transfer pricing weapon of choice in Luxembourg.

Under the tax scheme, a multinational established an in-house finance company in Luxembourg usually by way of low interest debt which then on-lent money at high interest rates to various operating entities within the group. Luxembourg has a very favourable taxation regime in respect of these in-house finance companies taxing the interest earned at very low rates moving taxable income from high tax jurisdictions to lowly taxed Luxembourg thus slashing the tax bill of corporations.

The ICIJ provided a number of examples of how this scheme worked in relation to the operations of some well known global house-hold names. Two of these ICIJ cases are quoted below.

Pepsi Bottling Group Inc

A New York-based unit of PepsiCo used subsidiaries in Luxembourg to arrange a series of loans among sister companies that allowed the bottler to reduce its tax rate on its $1.4 billion purchase of a controlling interest in JSC Lebedyansky, Russia's largest juice maker. At least $750 million of the money involved in the Russian deal traveled through a Luxembourg subsidiary named Tanglewood, before landing in a Pepsi subsidiary in Bermuda. Luxembourg acted as a tax-reducing conduit as the profits moved from Russia to Bermuda.

IKEA

IKEA has used Luxembourg as part of a tax-savings strategy almost as complicated as the retail chain's ready-to-assemble furniture. IKEA operates through *two independent groups of companies: IKEA Group, which controls most of the 364 iconic IKEA big-box stores and Inter IKEA Group, which oversees franchise operations. Inter IKEA's structure includes a Luxembourg holding company, a Luxembourg finance company, a Liechtenstein foundation and a Swiss finance arm. Leaked documents show IKEA's Luxembourg operations opened the Swiss subsidiary in 2009 to outsource part of their financing operations to yet another low-tax jurisdiction, allowing the company to save taxes both in Luxembourg and in Switzerland.*

The indicative response of the European Commission has been to develop full disclosure requirements for multinational corporations in respect of their European tax arrangements including tax payable in each European jurisdiction. However, this should be properly viewed as a mere starting point to the international tax problem and not relied upon as the panacea. Much work is still to be done to address this issue.

There have persistent rumors around the corporate world that with the looming requirement to disclose private ruling requests, Revenue Luxumbourg in March 2015 called the Big 4 accounting firms together who at the time had some 5,000 outstanding ruling requests before them. Purportedly, an offer was put on the table that if the ruling requests were withdrawn Revenue Luxumbourg in substance be honored without formal agreement thus reducing or avoiding the new EU reporting requirements. Of course, this may be just mischievous scuttlebutt.

Nevertheless, if this is true it would carry some profoundly serious implications for both the Big 4 accounting firms and Luxembourg. For the first time, it would mean that evidence has arisen of a sovereign state and purported major financial center conspiring with all all four of the guardians of commerce to openly mislead and arguably defraud the major economies of the world. However, the matter can be easily resolved by direct enquiry and a transparent response with the alleged five parties involved by way of regulatory enquiry.

The best analogy of the present circumstances of the European Commission may be that of Heracles from Greek mythology and his challenge to slay the multi – headed Hydra. Like Heracles, the European Commission may cut off the Luxembourg tax avoidance head but it must also ensure that the Big 4 accounting firms do not re-grow that head in another jurisdiction willing to prostitute its taxation laws for mere financial gain. Like Heracles, the slaughter of the Hydra may only be achieved by cutting off the immortal heads of the Big 4 accounting firms by way of the European Commission leading an international charge to either break up the Big 4 accounting firms or at least curb their immense and largely uncontrolled private power in some other way.

KPMG - 0ffshore Tax Shelters

Compared to PWC's Lux Leaks, the major tax avoidance cases of the three remaining Big 4 accounting firms on which there is publicly available information are *still very large* and of great concern but *not* on the same scale as Lux Leaks. This does not mean that each of the other Big 4 accounting firms does not have a scandal brewing on the scale of Lux Leaks as it may simply be that these scandals are yet to emerge from other jurisdictions or indeed possibly they will emerge in Luxembourg itself as Lux Leaks II, III and IV. Time will tell!

It is interesting to note that in KPMG's case, they have an office in Luxembourg designed for 1,600 people in a country of 550,000. On a proportional basis, this would be the equivalent of an office of *over one million* in the United States. Curious, but not enough to condemn!

Nevertheless, for the purpose of advocating change, it is important to recognise that each of remaining Big 4 accounting firms are not exactly free from the challenge of aggressive tax avoidance behaviour either. Further, it should also be recognised by the Big 4 accounting firms that admission of past mistakes does create an environment for positive change and will operate to redeem them in the public eye, but it needs a willing partricipant.

As discussed in the opening Chapter, KPMG did admit to and accepted a settlement with the United States Justice Department in what was then the largest tax fraud case ever filed. The tax fraud involved the generation of more than US$11 billion in falsified tax losses by KPMG resulting in tax evasion in excess of US$2.5 billion. It should be recognised that these figures are in 2005 dollars so this figure would be likely closer to US$15-18 billion in today's dollars.

The tax losses were generated through fraudulent tax shelters which carried entirely credible commercial names to financially inexperienced investors such as bond linked issue premium structure, foreign leveraged investment program, offshore portfolio investment strategy and short option strategies. Although KPMG purportedly advised the investors that these structures carried tax risk, they carried more than just some tax risk as the United States Inland Revenue Service considered all four of these these structures completely invalid for tax purposes.

The tax shelters were targeted at individuals requiring a minimum of US$10 million in tax losses (let us say US$13-15 million today). One will of course recognize that these are the *minimum amounts* and are certainly not in the domain of the average working Joe (or Joelene) and the underprivileged of society. However, this does not matter in the tax shelter business as the objective is fee generation. Certainly, the method used by KPMG in charging its clients under the tax shelter arrangements is of immense concern. The fee was essentially a commission arrangement understood to be in the range of 8-10 per cent to basically deliver a successful tax fraud based on extremely high levels of deception before multiple regulators. It bears all the hallmarks of the worst characteristics of tax avoidance including blatant greed and dishonesty.

As has been emphasized several times in this book, the foundations of the accounting profession were based on ensuring integrity in relation to company financial reporting. However, this was the complete opposite but in the benign cloak of that original integrity of the accounting profession, a complete betrayal to all stakeholders.

The Regulatory outcome was not entirely satisfactory either. There is little doubt that KPMG was brought to the edge of extinction by the tax shelter scandal, but unlike Arthur Andersen just managed to survive perhaps only through the good fortune of timing. Although the KPMG tax shelters were well underway at the time when the Enron scandal was unfolding for Arthur Andersen, they were not detected as yet and, therefore could not be the subject of regulatory action.

It is an interesting question that if the Arthur Anderson Enron scandal, the KPMG tax shelters scandal and PWC Lux Leaks scandals were all detected at exactly the same time, how would have the Regulators reacted? Given the relative level of culpability between the three firms, the Regulators may not have decided to effectively shut down Arthur Andersen through the withdrawal of its audit license. This would have been the correct decision given that the US Supreme Court ultimately found the regulatory action to be wrong. Unfortunately, this was a Pyrrhic victory for Arthur Andersen whose business was already long dead when the decision was made.

There is an argument that any one or all of the firms should have been shut down by the regulators for their inappropriate professional behaviour but this would have been a mistake. The concept of the rise of private power by the Big 4 accounting firms has been discussed with concern throughout this book. If King Solomon was called to the table on this issue, he may well have cut all three babies in two to create six firms *because only the accounting firms true to their original purpose will survive.* It is certainly strongly arguable that break up of the accounting firms is the appropriate regulatory response to maintain integrity and credibility before the public as is occurring within the banking system.

But how exactly would have King Solomon split these troublesome babies in two. Apologies to King Solomon if the following is not the case, but I believe he would have considered the best solution would have been to split the audit and tax businesses on the basis that a firm cannot be both *gamekeeper* as an auditor and *fox* as a tax adviser.

One of the most effective of the *foxes turned gamekeepers* was the first Chairman of the Securities and Exchange Commission, Joseph (Joe) Kennedy Snr, who was also President Kennedy's father. There is little doubt that Joe Kennedy was an extremely astute and opportunistic businessman who became one of the world's richest men through stock and commodity trading, the entertainment industry and alcohol distribution agreements. But at a time when Wall Street needed to be brought in to line in terms of its practices, Joe Kennedy's personal understanding of the flaws in the capital markets made him an outstanding regulator of those markets. There are other successful examples of fox turned gamekeeper which have brought enormous benefits to their communities. But it is quite another matter, if the purported gamekeeper turns fox *but still pretends to be a gamekeeper*. This is the problem with the Big 4 accounting firms.

Eventually, KPMG agreed to pay a relatively modest US$456 million given the sheer scale of the fraud in fines, restitution and penalties as part of an agreement to defer prosecution of the firm.

Although a number of Partners and staff members faced charges in relation to the tax fraud, none were prosecuted. KPMG had sought to finance the legal defense for its staff and was quite right in doing this as it was a major matter threatening the reputation and the possible existence of the firm. However, the Department of Justice threatened KPMG with indictment if it did so.

On 27 June 2006, Judge Kaplan dismissed all charges against the KPMG Partners and staff on the basis that the action of the Department of Justice breached their constitutional rights. In my view, the decision of Judge Kaplan was *legally* correct but it was unfortunate from a regulatory viewpoint that this was the outcome in such an important case. What would have been desirable and in line with community expectations would have been a strong message that the tax fraud perpetrated by individuals within the firm was unacceptable and those individuals should have been punished accordingly.

For what was then the biggest tax fraud case prosecuted in history, no individual from KPMG was criminally punished. While KPMG was fined US$456 million, this was arguably a mere expense of running a large tax business and nothing more. Al Capone was no doubt rolling in his grave at the decision.

Mossack Fonseca – Panama Papers Tax Scandal

The Mossack Fonseca Panama papers tax scandal is a fascinating case and not just only because of the extreme taxation avoidance techniques used to avoid tens of billions of dollars of tax payments each year.

In what has been one of the largest hackings in history, some 11.5 million documents were downloaded from the Mossack Fonseca website *without detection*. The hackers exploited a plugin code which is a piece of code written by third party companies, people or contributors that does something for the website. For example, a contact form on a website is a plugin. In Mossack Fonseca's case, the problem plugin was a piece of code that displayed a welcome image on the home page of its website.

Plugin codes sometime become vulnerable to certain attacks because of their imperfection. Like a loop hole in laws where criminals find ways to avoid jail, a weakened plugin code inadvertently allows malicious users entry to something they would not otherwise have had access to. Mossack Fonseca didn't pay attention to this and did not update the plugin with a refreshed piece of code to close these holes. As a result, an attacker used this to gain access to the website. One this entry point was gained, a lack of security architecture lead to an easy access to the rest of the customer information sitting on the network.

Once downloaded, the 11.5 million documents were delivered through the German newspaper *Süddeutsche Zeitung* to the ICIJ headquarters in Washington where the documents were examined by a large team of investigative journalists. In one sense, the findings of the ICIJ were not entirely surprising for an international tax specialist in that Mossack Fonseca had developed a highly efficient system for placing large amounts of money into offshore entities including companies, trusts, funds and foundations located in 21 tax havens such as the British Virgin Islands which today number in excess of 200,000. The ICIJ published the full list of these entities on 9 May 2016. Basically, these entities which are typically established by engaging *Directors for hire* are used to set up bank accounts into which money is transferred. The money can’t really be traced unless nefarious tactics are used such as hacking of IT systems (which now famously occurred in this case).

It would appear that Mossack Fonseca does not conduct specific due diligence in relation to whom they work for provided they have the capacity to meet their fee obligations. As the released ICIJ documents disclosed, the advisory activities of Mossack Fonseca heavily leaned towards high net worth individuals desiring to hide their wealth by sham corporate structures undetectable by the Revenue.

Nevertheless, there were also a very large of major corporations involved in these structures which were audited by major international accounting firms and received an audit clearance from them. As part of the audit process, it is necessary to sign off on what is known as the *tax provision* which is essentially a statement of the tax liability of the company from the viewpoint of the auditors. Such a sign off would at least require a cursory examination and satisfaction that such structures would not result in an unexpected tax liability. If as a result of the Mossack Fonseca disclosures, a large adverse tax liability does arise at the hands of a Revenue Authority, there may well be large lawsuits relating to these sign offs. Once again, this will test the integrity of the audit processes of the major accounting firms in relation to tax matters.

Where large deposits and flows of money remain completely unchecked and unaccountable. the danger to global society is extreme. If the origins and purpose of such money is simply unknown, it can be used for any purpose open to the imagination of the controlling person from corruption, to terrorist acts killing hundreds, if not thousands of honest, decent people, to funding civil wars which kill tens or hundreds of thousands of people, all of which the world is becoming all to familiar with. Indeed, it is arguable that these structures represent the major financial sewer of humanity

The political fallout from the Panama Papers scandal was immediate. Iceland's previously well liked Prime Minister Sigmundur David Gunnlaugsson was the first to fall. During a recorded interview with Sven Bergman of Swedish television station SVT he stated:

Society is seen as a big project that everybody needs to take part in. So when somebody is cheating the rest of society, it is taken very seriously in Iceland.

Briefed by the ICIJ, details were then released of a secret company that the Prime Minister and his wife owned, which had been the subject of payments from Icelandic banks bailed out during the Global Financial Crisis. Gunnlaugsson resigned shortly thereafter more in embarrassment than anything else and without really acknowledging the dangers of secret money stashes. This undoubtedly would have correct in the circumstances and would have meant a more graceful departure (if indeed this was possible). What would have happened if his accounts had been hacked and misappropriated for a terrorist Act?

In what was unquestionably not a good month for the top end of Icelandic politics, the Panama Papers tax scandal linked the wife of President Olafur Grimsson to offshore accounts in tax havens. First Lady Dorrit Moussaieff was listed in the documents released by the ICIJ as a beneficiary of five companies and trusts that have held Swiss banks accounts. While no wrongdoing was proven on the part of President Grimsson at the time of the release of this book, it does raise some delicious issues. Should a First Lady resign from office in such circumstances and is tax avoidance of your spouse grounds for divorce in Iceland? If we have a Madame President Clinton she may be wise to check out husband Bill's tax affairs to avoid another fracas in the White House.

British Prime Minister David Cameron unexpectedl*y* found himself caught out by Panama Papers disclosures relating to payments received from his father's aggressive offshore tax shelter arrangements. Unlike Gunnlaugsson, Cameron has steadfastly refused to resign.

Again, it matters not that these offshore tax shelters *were legal or not*. David Cameron is the leader a major economy in a country that has a proud history of financial and social integrity and is charged with responsibility of ensuring that such financial and social integrity continues in the United Kingdom and around the globe as a leading lawmaker and economy.

The office of the Prime Minister is a lofty one with the highest standards of ethical behaviour required *as a minimum standard*. Offshore aggressive taxation practices are not exactly Robinson Crusoe material and as a Prime Minister he should have made proper enquiry as to these earnings fully anticipating a question from any of the stakeholders within the British legal or political systems.

It would have been a strong and impressive statement for a Prime Minister to come forth prior to its detection, voluntarily disclose the arrangement, state the breadth of the problem and then proceed down his agenda of accountability for companies that Cameron proposed.

Rather than welcoming the new policies, his Parliamentary Opposition attacked the tax scheme questioning the reason why the United Kingdom had to go *through six years of austerity*. If Cameron had done his job as Chief Lawmaker crafting laws that were effective against international tax avoidance, then the need for such austerity may not have been necessary at all or would have been far less painful than it was.

Defending such arrangements as Cameron did as *aspiration and wealth creation* looked weak for a world leader now dealing with the peddlers of greed and the wider implications of the Mossack Fonseca tax scandal. Tax evasion, as this clearly was intended to be, is *not* aspiration and wealth creation, *it is tax evasion*. To argue anything else somewhat lacks credibility before his voting constituents even if one is arguably one of the best Lawmakers in the World.

As Joe Kennedy demonstrated, a fox turned gamekeeper is a powerful agent for change, but not if the fox is an elected gamekeeper at the same time.

Arguably, Cameron made the same mistake that President Richard Nixon did following the Watergate scandal – the cover up was far worse than the crime which is why one should study history. Cameron could have considered offering his resignation to restore public faith in his otherwise solid tax avoidance initiatives. However, timing was poor as Britain was considering the EU question at the time. Whether the voting constituents demand he revisits the question, only time will tell!

There were many other world leaders and other leaders in positions of great responsibility also caught up in the Panama papers tax scandal. At one time or another, all these leaders had the choice to go down the subversive path of international tax avoidance or not. As Gunnlaugsson correctly observed, it is *cheating society*. If everyone cheats society, there is no framework to support it and society will collapse into chaos.

The immortal words of U.S. Supreme Court Justice Oliver Wendell Holmes Junior ominously ring through the eons:

Taxes are what we pay for civilized society

Chapter 5

The World of Aggressive Transfer Pricing Practices

Despite growing holes in the Revenue base of all Western economies resulting in unacceptable reductions in the all important budgets of health, education, welfare and foreign aid, the lawmakers of our Governments seem totally incapable of constructing and implementing the manifestly obvious changes to the taxation law and regulatory structure that would largely prevent aggressive taxation practices from thriving.

Such inaction and misplaced action by Governments has placed considerable pressure on otherwise ethical businesses to follow the practices of the aggressive taxpayers and, as a result, have become tainted by them. For example, almost a third of the US Fortune 500 companies with foreign subsidiaries channelled all or part of their profits through the Lux Leaks structures discussed in Chapter 4 with a resultant vast loss of taxation revenue. If the Lawmakers of the world had acted earlier and more decisively this would not have occurred.

The role of the elected Lawmakers in Governments around the world is to internationally co-ordinate such efforts against aggressive tax practices. This process is vital in ensuring that taxation laws are drafted in such a way so as to avoid these confronting ethical questions for major international corporates from arising in practice. Given the Lux Leaks scandal, the Lawmakers have generally failed to meet this goal and need to raise their game considerably to meet community expectations. No individual director or a senior executive of a major corporation or indeed any organization should be placed in a position where they are effectively required to *pursue* aggressive tax practices *merely to compete on a level playing field*. If this is allowed to continue resulting in a similar size tax scandal to Lux Leaks in the future without any intervention by Lawmakers, this should be regarded as a shameful dereliction of duty by the Lawmakers of the world. As such, the Panama Papers and Paradise Papers tax scandals *do not* fall in to this category.

Notwithstanding, it is the strong belief of the author that the majority of politicians and Lawmakers enter the public arena to improve society despite the many and obvious political scandals around the globe. However, the question of competency of the Lawmakers to appropriately and independently address these complex issues is quite another question. As discussed in Chapter 10, the solutions to international tax avoidance are not necessarily difficult *it just takes political will.*

One of the great difficulties of public life is that career terms in office for politicians, Lawmakers and their typically young staff advisers tend to be *much shorter* than career taxation specialists in the major companies and advisory firms around the world. Thus, it is extremely difficult for Lawmakers to generally gain a necessary and deep understanding of taxation matters, let alone tax reform matters on the international stage.

Short political careers and even shorter periods in office tends to encourage conservatism by politicians for fear that they might fall outside what are perceived to be the parameters of international competitiveness when it comes to strong action on aggressive tax practices internationally or simply appear uninformed before their constituents. For younger or less experienced players, it is not unreasonable to be uninformed but it is manifestly wrong to *pretend* to be informed and endanger or prevent international progress in this area.

Despite their clear expertise, the focus of the international firms is firmly centred on the perceived financial interests *of their clients* and *their own* profit motives so it is difficult to rely on the *independence* of the Big 4 accounting firms to address ethical questions including *no risk tax positions*. Further, law reform commissions and academics tend to have less real world knowledge to provide consistently effective advice on such a complex subject matter.

Given the Lux Leaks scandal, there is little doubt that effectively addressing aggressive tax practices should be the number one international tax issue for Governments generally, but considered, sustained, knowledgeable and co-ordinated action is required. There is a clear need for ethical or no risk tax practices to gain ascendancy internationally. The need for the ethical taxation practitioner to take centre stage has never been more important. The concepts of tax ethics generally are discussed further in Chapter 9.

As has been often stated, international related party transactions make up *more than half* of all international trade. Applying this figure to the World Trade Organization estimated global exports of around US$50,000 billion in 2017 suggests that international related party transactions are now in excess of US$30,000 billion per annum.

Assuming that just 5 to 10 per cent of these transactions are the subject of aggressive transfer pricing practices (which may be low considering Lux Leaks), the amount of tax in dispute in any one year from a tax avoidance viewpoint is simply vast. When multiple years are taken into account and potential penalties and penalty interest considered in relation to these years, the total amount *in play* is simply extraordinary and certainly in the trillions of dollars. While the exact amount is extremely difficult to quantify due to the many veils of tax secrecy involved (and I believe more than the usual and alluring seven veils have been employed here), let us quantify this figure at US$10 trillion *or US$10,000 billion for the traditionalists!*

When this figure is compared to the global foreign development aid budget in 2016 of US$142.6 billion, the extent of the tax avoidance problem strongly emerges and should or ought to be recognised by the Governments of all major economies. For the purpose of realising just how big the problem is, let us define a new unit of wealth being the MBGU. So one MBGU is the combined wealth of Melinda and Bill Gates, the second wealthiest couple on the planet worth some US$95.4 Billion at last check and a very likeable couple indeed due to their outstanding charity work, a strong move away from the House of Entitlement.

As such, the Foreign Aid budget of the World is about 1.49 MGBU, the annual figure for international tax avoidance at some 10.48 MBGU and the total tax in play within the international tax empire some 104.8 MBGU. (And Melinda and Bill, I am happy to fly anywhere in the World at my expense to go through these issues with you if you are interested in funding the work of the Society).

There will no doubt be critics of foreign aid programs (but not Melinda and Bill) and legitimate arguments as to how such programs could work more effectively, but no amount of validly critical points in respect of foreign aid programs can ever justify US$1,000 billion *every year* of international tax avoidance and US$10,000 billion in play through illegal transfer pricing practices, other tax shelter arrangements and the dropping of the corporate tax rate for capital importing nations in first World economies. Just for the record, the total wealth of the world's billionaires is some US$6,000 billion or a mere 62.89 MBGU.

Irrespective of the MGBU count, the scale of the international tax avoidance industry is a crushing indictment on the Lawmakers of the major economies and the firms that promote such practices. Such matters should be dealt with the highest of priorities and the toughest of outlooks. The promotion of such activities is more than arguably tantamount to tax fraud (or is just simple tax fraud) and should be viewed as such. As discussed in Chapter 4, it is important to recognise that such transfer pricing structures are typically *sold* by the firms *not bought* or developed by the multinationals. There are no doubt subtle seduction techniques employed here!

By way of technical introduction to this issue, transfer pricing is the mechanism by which a Multinational Enterprise trades internationally within itself on *an arm's length* or *market basis* as required by the taxation law.

From the perspective of a Revenue Authority, a Multinational Enterprise *mus*t allocate its total profit among the jurisdictions in which it operates on the said arm's length basis.

The arm's length principle is the key driving principle under the transfer pricing law. The principle essentially requires that the various members of a Multinational Enterprise conduct their international related party transactions *on the same basis as would cindependent parties*.

Further, the arm's length principle is designed as an *integrity measure* to ensure that there is *no profit shifting* out of a jurisdiction causing a reduction in taxation takings in that jurisdiction (and one should be mindful of Lux Leaks in this regards).

In the context of a particular jurisdiction (including Luxembourg), profit shifting will occur from that jurisdiction where the local operation of a Multinational Enterprise;

1. Pays *in excess* of the arm's length consideration for what is acquired from the offshore related entity;

2. Sells *for less* than the arm's length consideration what is supplied to the offshore related entity; or

3. Has been allocated an *excessive* share of global, headquarters or other group expenses.

Such profit shifting may occur in relation to a number of international related party transactions including:

1. All forms of service arrangement including marketing, logistics, human resources, legal, actuarial, taxation, intellectual property, mergers and acquisitions and financing;

2. Technology transfers including royalty arrangements relating to both patented intellectual property and marketing intangibles;

3. All forms of loan arrangements and associated activities including financial derivative arrangements; and

4. Transfer of goods including raw and processed materials, semi finished products and finished manufactured products including mass produced goods and custom made goods.

The taxation procedures of a company or organization set down the detailed tax processes by which the company or organization conducts all its tax affairs.

Whether such a company or organization is conventional or ethical, if it has international related party transactions, then the Board must *set clear transfer pricing policies* and procedures to appropriately govern these transactions and manage tax risk .

If the taxpayer is a conventional taxpayer, a *clear transfer pricing policy* should be drafted aligned to the relevant transfer pricing law of the various jurisdictions in which the multinational corporation operates and should clearly state the various international related party transactions undertaken by that multinational corporation and the methodologies used to establish the arm's length price for these transactions. The transfer pricing procedures should also include the various controls, the testing of those controls and the reporting obligations that will be used to *ensure* integrity under the transfer pricing policy and procedures.

The ethical or no risk taxpayer will have a similar transfer pricing policy and procedures, but will *add* the requirement that all transfer pricing methodologies in respect of the various international related party transactions will be agreed prior to implementation.

Some jurisdictions have highly developed regimes for agreeing transfer pricing methodologies with a Revenue Authority prior to implementation. These are typically referred to as *Advance Pricing Agreements*. Unfortunately, some jurisdictions place extreme requirements under these procedures that have placed considerable pressure on their effectiveness. If available in a particular jurisdiction, a shorter form but still substantive procedure such as acceptable operating ranges would be more desirable from an efficiency viewpoint.

After many years of consideration, one of the most burning questions faced by the Revenue Authorities, the Lawmakers and the major corporates remains what is or what should be considered *acceptable* in terms of *price* from the viewpoint of the transfer pricing laws.

The problem is *not* with the actual transfer pricing law itself, which is essentially robust in terms of basic principles and is entirely workable *at law.* In most countries, there is a strong argument for retention *albei*t with some obvious improvements. Accordingly, one must question many of the current initiatives of the OECD that seek to replace or rewrite the transfer pricing law *without long term substantive practical experience* (please respectfully note Mousier Pascal

Saint-Amans of the OECD). It is my personal view that this will only create confusion and greater opportunity for aggressive tax practices to emerge by replacing a fundamentally sound position with an uncertain and untested one.

The real issue is how the major corporates address such issues in terms of their Board Mandates, working with their internal tax teams and external tax advisers and their position on an ethical tax approach.

There is unquestionably an *economically correct* price for each international related party transaction based on what jurisdictions the major corporate has located its functions, assets and commercial risks. What is clearly being misunderstood is that the transfer price or indeed an acceptable range for that transfer price is determined by this location process and this is *entirely unrelated to any tax question.* It is then a question of establishing a transfer price based on normal commercial principles.

This is where *the choice* of the Board guided by senior management and the external advisers becomes critical in the overall tax risk management of its international related party transactions.

If the Board forms the view guided by its senior executives that it should locate the company's functions, assets and risks in various jurisdictions for sound commercial reasons, then this approach is entirely acceptable from a transfer pricing viewpoint provided there are no other legal issues or impediments presented. Such an approach can also be easily managed *without any tax risk whatsoever* through the ethical tax approach which is discussed in Chapter 9.

If the Board forms the view guided by its senior executives that it intends to lower the company tax through *artificial means* by way of arguments provided by external advisers, then the Board has made a *conscious decision* to step away from ethical tax practices to an *aggressive tax approach*. By implication, and in fact, the Board has made a clear decision before the relevant Revenue Authority to break the law and subject itself to any penalties under the law as a result of the inevitable tax audit. Generally, it is the strong view of the author that this is an extremely poor decision from a competency, tax risk management and Governance position.

There is little point during an audit for Boards to point to their advisers and their advisers pointing back blaming the other and arguing that communication was inadequate or indeed that the excessive value attributed to functions was somehow reasonable.

Both the Boards and the external advisers have an *independent obligation* to manage tax risk in accordance with the transfer pricing law on behalf of the organization and should make proper enquiry on such matters. A competent Revenue Authority is not foolish and any attempt to justify absurd positions before them will only result in a far worse outcome by way of damage to reputation and tax risk rating.

The Board, however, is *ultimately in control* of the process and must undertake its own due diligence and make sound tax decisions in relation to such matters. This is not difficult to do by any means.

Notwithstanding, some guidance is provided in this work below as to what should be considered ethical or aggressive from a tax viewpoint in respect of the normal range of international related party transactions.

As Multinational Enterprises have grown in both size and complexity, it has become usual to concentrate teams of service specialists either at the head office level or in service hubs across the globe. The role of such teams is to provide dedicated *in-house* or *on-call* services to the various business units of the organization as and when required. It is not uncommon for such teams to be located in special purpose companies or other special purpose entities.

The question from the viewpoint of the transfer pricing law is how should these specialist teams charge such services to the various business units.

The primary rule under the transfer pricing law of most countries is that such services should provide a *real or tangible benefit* to the recipient of the services *or* at least at the time the services were requested were intended by the service provider to provide a real or tangible benefit, even if the anticipated benefits did not arise.

Once the benefit is established, it is usually then a question of allocating the expense under management accounting principles on a fully absorbed (that is including all indirect expenses) plus a small mark-up of 5-10% on the service component, *but not on third party expenses.* This will be acceptable to virtually all Revenue Authorities and is relatively straightforward and uncontroversial.

The objective of the aggressive tax approach in relation to the charging of in-house or on call services is to charge as high a price as possible for such services from a low taxing jurisdiction to a high taxing jurisdiction. In this way, profits are shifted and taxes lowered *albeit illegally* and in all likelihood temporarily.

The basic strategy is to either argue with the Revenue Authority that the pricing of the service arrangements is acceptable from a transfer pricing viewpoint or to simply avoid any examination from the relevant Revenue Authority at all through blocking or other subversive tactics. One suspects that the latter is the more common approach. Nevertheless, both these strategies seem to be still around well past their use by dates against all common commercial logic and sense of risk. There is a range of methods that are generally employed in pursuing such an aggressive tax approach in relation to internal services.

The most common method used by the aggressive taxpayer is to compare the in-house services with those available in the market from third party service providers and then align the internal prices to the external prices identified as *comparable transactions.* Given that most external service providers will charge out their services at several times cost to generate profit for the equity owners of the firm, there is a *clear distortion* caused by using this method.

Despite the possible similarity in the services provided, the operation of an internal service function is quite different to that of a consulting firm. The primary commercial reason for a firm's existence is to provide advice and make profits for its owners. As noted previously, these firms rely on extensive support functions including large teams of marketing and sales professionals to further the objectives of their organization. The major corporates in which the in-house service teams reside typically run businesses *unrelated* to the provision of such services. There is no imperative for profit other than to charge out the cost of providing the service. More importantly, the companies and their advisers who argue the third party service provider case *well know this.* It is a deliberate misrepresentation and should be looked at in no other way by Directors and senior management.

The other approaches used to shift profits under purported service arrangements tend be a little more covert in their style. One such method is to inflate the cost base of the services provided from a low tax jurisdiction beyond what is normally justifiable and then charge a specific high tax jurisdiction for those services, thus shifting profits to the low tax jurisdiction.

Another approach is to simply charge for a service from head office that does not actually provide any real benefit to the subsidiary and should not be charged for at all, such as a head office *think tank*. Think tanks are more in the nature of a non-chargeable shareholder activity to do with the strategic direction of the parent company rather than providing any direct or indirect benefit to the subsidiary. Accordingly, it is not appropriate to charge for such activities.

Such approaches in respect of internal services are not difficult to do for a major corporate but may be extremely difficult for the relevant Revenue Authority to detect in practice even on a full audit. This is particularly the case where an acceptable or indeed no mark up is charged. This tends to throw a less experienced auditor from the relevant Revenue Authority off the scent of tax avoidance.

Notwithstanding that it may be possible to make such arrangements difficult to audit with the possibility of not being identified by the relevant Revenue Authority, such behaviours are clearly not ethical and must be avoided as part of an ethical or conventional tax policy by Directors and the senior management of the company.

It is beyond question that at one time or another just as an independent business will require some form of external funding, so will the discrete functions of a major corporate or multinational in the jurisdictions in which it operates whether through a branch or subsidiary operation.

In the context of a major corporate's or multinational's financial affairs, loan arrangements will be generally more common than equity raisings, given that the formal requirements for loan funding are typically much simpler and such organizations typically raise money centrally through their in-house finance companies or centralised treasury operations such as in the Lux Leaks transactions.

The issue that immediately arises in respect of such intra-group loans when considering the impact of the transfer pricing rules is the establishment of an arm's length interest rate for the loan arrangement.

Generally, the transfer pricing rules for calculating arm's length interest rates on intra-group loans are basically *the same* as for third party loans. The principal factors include the nature and purpose of the loan, the market conditions at the time the loan was granted, the amount, duration and terms of the loan, the currency in which the loan is provided and the currency in which the repayment has to be made, the security offered by the borrower, guarantees involved in the loan, the credit standing of the borrower, the location of the borrower and lender and the prevailing interest rates for comparable loans. Therefore, the approach for a “vanilla” type loan arrangement is relatively clear.

A challenge has been presented by the emergence in international commerce of a considerable number of financial instruments including those promoted by the large number of emerging investment banks. These include hybrid instruments that have blurred the distinction between loans and equity contributions. While some countries have adopted *debt / equity* rules to characterise such arrangements at law, many countries have not. This has created opportunities for the aggressive tax advisers to peddle their wares to unsuspecting treasuries of major corporates.

As a general rule in the absence of such rules, the following factors may be used as a guide for distinguishing a loan agreement from a contribution of equity. These factors include the legal effect of the transaction, repayment of principal, purpose of the contribution, debt-equity ratio, factors affecting the form of the investment in a particular country, written loan agreement and the ability to obtain finance from an unrelated third party. Such matters including the attaching tax risks should be carefully considered before contemplating such arrangements.

As part of this general discussion on the transfer pricing rules around loan agreements, there are two further areas of special interest.

The first area of special interest is with respect to trade credits between related companies. The general rule is that it is usual for Revenue Authorities to impute interest on intercompany indebtedness arising from non-payment of accounts for periods *in excess* of that allowed for third parties under normal trade credit arrangements. Commercial practice in respect of trade credit arrangements does vary between countries, however, there is unlikely to be any dispute with any Revenue Authority if outstanding credit balances are cleared well within commercially acceptable periods of time.

The second area of special interest is with respect to a related company in financial difficulties either during its start-up phase or at a later point in time when the operation is well established, but due to an adverse change in trading circumstances and additional finance is required.

With regards to intra-group loans during the *start-up phase*, the general rule of most Revenue Authorities is not to accept an interest free intra-group loan merely because the related company is in its start-up phase. The general view is that interest should always be charged unless a third party lender would not have charged interest in similar circumstances. There are generally no circumstances under which this would occur between an arm's length lender and borrower.

With regards to intra-group loans to an established related company *in financial difficulties* due to adverse trading circumstances, some jurisdictions are more sympathetic to waiving or deferring interest in respect of either emergency or outstanding loans where a third party lender would have similarly acted. Notwithstanding, it would be prudent to engage with the relevant Revenue Authority prior to executing such loan arrangements.

The next question for consideration is how charges for internal loan arrangements would be typically undertaken to minimise tax risk.

Once it has been decided to fund a subsidiary by way of a loan arrangement, rather than an injection of equity, it is then a question of calculating an arm's length interest rate. This can be done by way of engaging with the company's relationship banker or bankers recognising the above-mentioned factors set down by the Revenue Authorities for establishing an appropriate arm's length interest rate and any other factors that the bankers believe are relevant to the transaction. The opinion of the bankers on the interest rate calculation should be confirmed in writing and the terms of the loan arrangement recorded in a *draft* agreement for discussion with the relevant Revenue Authority.

The final step to obtaining tax certainty and a no risk tax position is to agree the draft loan agreement *before execution* with the relevant Revenue Authority in each of jurisdictions in which the loan arrangement will apply. Again, if there is any issue from the relevant Revenue Authority's perspective, it is important that the matter be identified and discussed prior to the arrangement being implemented to avoid a potential tax exposure.

All other financing arrangements will be more complex than the vanilla loan arrangement described above and should from a tax risk viewpoint be the subject of confirmation with the relevant Revenue Authority to ensure a no tax risk outcome.

An aggressive tax approach in respect of debt servicing on loan arrangements should be considered of particularly high tax risk given its "traditional" link with profit shifting either from subsidiary to the parent or vice versa depending on whether the lender charges an excessive rate of interest or the borrower pays less than normal interest.

Such simple arrangements for profit shifting still occur such as in the Lux Leaks cases but they are more overt and are relatively easy to identify for an experienced auditor. Even the more sophisticated structures such as hybrid structures are well under attack by Revenues around the world and are likely to be ineffective as tax based financing instruments within the foreseeable future provided the Lawmakers are diligent.

The following financing arrangement is one that may test the boundaries between what may be considered ethical from a tax viewpoint and one that may be considered aggressive and therefore is interesting to examine from a theoretical perspective. It would make commercial sense to discuss the financing arrangement with all relevant Revenue Authorities before execution to eliminate or reduce risk.

As mentioned earlier, it is the usual practice of a major corporate or multinational to centrally manage the finances of its operations. This may be done by way of capital raisings or borrowings that may be then used to fund subsidiary operations by way of capital injections or borrowings. Equally, it is not unreasonable to repatriate capital from the subsidiaries to the parent operation for group financing purposes.

Let us assume that a parent company elects to run its subsidiaries with the minimum possible capital and chooses debt over equity as its own primary source of funding. The reason for choosing debt over equity is that it can source debt cheaply using its strong parent company balance sheet in its home jurisdiction and the obligations of debt are considerably less than for equity in terms of required return on capital hurdles for shareholders.

The parent company then decides to charge its subsidiaries with an arm's length interest rate commensurate with the poor credit rating of its subsidiaries that have little in the way of equity and no parent company guarantee. The interest rate is backed by an opinion from the parent company's relationship banker and is much higher than the interest rate charged through the external funding arrangement.

The parent company also resides in a much lower tax jurisdiction than any of its subsidiaries but was legitimately founded with publicly raised capital in that jurisdiction. The Board of the parent company has formed the view that this is an entirely reasonable arrangement for repatriating profits to the low tax home jurisdiction and has deliberately *bled the subsidiaries dry* of capital to achieve this result.

The question arises for the Lawmakers as to whether such an arrangement should be considered a legitimate use of the taxation rules of the various jurisdictions in which the company operates or a tax avoidance scheme when looked at in totality. I will deliberately leave this as an open question for the reader although the fact circumstances are very similar to a case recently decided in Australia relating to the Chevron Corporation.

The increase in importance of intangibles in international commerce has matched the rise and rise of the multinational conglomerates. The development, use and protection of intangibles relating both to technology and the more nebulous marketing intangibles are now critical factors in the commercial success of virtually every company in this increasingly internet based world.

The diverse nature of an intangible is also an aspect that has lent itself to opportunistic and aggressive transfer pricing behaviours and arguably represents the most difficult area in transfer pricing both for the Revenue Authorities and international companies.

By way of brief explanation, a *patent* may be defined as giving a legally protected monopoly right to an invention Normally, this is for a legally restricted period of time, but this may be the subject of a *patent extension* case to extend the period to recover costs or make profits from the relevant discovery. For example, an ethical pharmaceutical company running a full research and development program will need to recover the cost not only of the *successful* discoveries but also the *unsuccessful* programs.

The term *know-how* is more difficult to define and is a broader concept but for practical purposes should be considered to be knowledge and experience of a technical, commercial, administrative, financial or other nature that is practically applicable in the operation of an enterprise or the practice of a profession.

There are three main methods for making patents or know-how available to a related party:

1. Payments by the various members of the international company for patents or know-how once developed by one member of the group (licensing arrangements);

2. Payments by the various members of the international company that contributes to the cost of research and development undertaken by one

member of the group (research and development cost contribution agreements); and

3. Payments by one member of the international company to another member of the international company to carry out specific research and development services on its behalf.

The transfer pricing rules in most jurisdictions in respect of related party licensing arrangements, involve three considerations being:

1. The justification of benefits;

2. The requirement for arm's length pricing; and

3. The form and the amount of the consideration.

In broad terms, the transfer pricing rules operating across most jurisdictions are in respect of these three considerations are:

1. Tax deductibility of payments under intra-group licensing arrangements may only be expected where a real benefit has been conferred or could reasonably be expected to be conferred on the licensee at the time the relevant agreement is concluded. The term *real benefit* should be read as a *real commercial benefit* for practical and economic valuation purposes;

2. The licensing agreement should be reduced to writing describing the nature of the intangible

property employed and the benefit sought in order to provide a basis for assessing the benefit conferred. The form of the agreement should be on the same or similar basis to an arm's length agreement of intellectual property between unrelated parties;

3. Supporting evidence should be available to tax authorities in order to demonstrate the benefit sought had in fact been conferred on the licensee;

4. The evidentiary requirements justifying the benefits sought under the licensing agreement should not be confused with the separate matter of what is the appropriate rate of payment to be made for the benefit conferred;

5. While the form used will depend on the particular circumstance of the transaction the following forms of payment are generally acceptable:

- A recurrent payment based on the user's output, sales or, in some circumstances, profits (a royalty payment);

- A lump sum payment, sometimes combined with a recurrent payment;

- Reciprocal licensing arrangements (although individually recognised); and

- Including the compensation for the use of intangibles in the price charged for the sale of goods.

6. In terms of the methodology to be employed in determining the amount of the arm's length consideration in relation to royalty or similar payments, the standard to be applied is the amount that would have been paid by an unrelated party for the same intangible property under the same circumstances. There are a number of methodologies by which an arm's length consideration may be obtained including:

- Using evidence provided by comparable third party or unrelated transactions;

- Comparing intangible property provided by the same developer to unrelated parties. These are referred as *internal comparable transactions*;

- Comparing profits earned by the developer against profits earned by unrelated parties in the same or similar circumstances; and

- The cost plus method whereby a mark-up is added to the cost of developing the intangible property.

Trademarks or trade names are a category of intellectual property worth special discussion in a transfer pricing context. Trademarks are essentially marketing intangibles that confer on their owners the right to use them as distinctive signs to identify specific products or services of a particular manufacturer or dealer and to prohibit the use by other parties for similar uses. Examples include the well known McDonald Hamburgers *Golden Arches* trademark and Apple Computers famous *Apple* logo.

From a Revenue Authority viewpoint, international related party transactions involving trademarks are of particular concern due to the risk that a Multinational Enterprise will over-value the trademark and then shift profits to a lower tax jurisdiction. As such profit shifting in relation to arrangements involving the use of trademarks will occur out of the local jurisdiction of a Multinational Enterprise where:

1. The local operation pays in excess of the relevant arm's length transfer price for the use of the trademark owned by an offshore related entity; or

2. Charges an offshore related entity less than an arm's length price for the use of a trademark owned by the local operation.

In general terms, the following principles apply to the transfer pricing arrangements of trademarks:

1. The value of a trademark or any changes to the value of the trademark will depend on how effectively the trademark is promoted in the relevant market;

2. The share of the obligations and the expenditure necessary for the effective use of the trademark between licensor and licensee in an arm's length situation will mainly be influenced by the relative benefit expected between the parties;

3. The arm's length price for the right to license a trademark may be established by using what is referred to as Comparable Uncontrolled Price Method (the CFUP Method) if a trademark or trademarks with similar effects is licensed to unrelated parties in the market;

4. The costs incurred in developing a trademark will not be as useful in establishing the arm's length price, rather an examination of the costs of maintaining the value of the trademark should be used; and

5. Guidance in establishing the arm's length price may be found by comparing the volume of sales and the prices chargeable and profits realised for trademarked goods with those for similar goods that do not carry the trademark.

Generally, it should be recognised that the establishment of an arm's length valuation in respect of international related party transactions for the use of technology and trademarks is a highly complex discipline. Accordingly, it must be undertaken with the greatest of care.

Further, Revenue Authorities typically have considerable concern about how such transactions are valued for transfer pricing purposes, particularly where the transaction has a connection with a low tax jurisdiction or a tax haven or a jurisdiction with an extremely favourable tax regime for the tax deductibility of intellectual property.

Given this background, the approach of the multinational must be both measured and conservative. The valuation of the relevant intellectual property should be undertaken with an appropriately qualified independent valuation firm specialising in intellectual property. All instructions to the independent valuation firm should be framed in accordance with the Board Tax Mandate

Once the independent valuation has been completed and internally approved by the ethical taxpayer, the next stage is to approach the relevant Revenue Authority to discuss the proposed implementation of the arrangement. The Revenue Authority should have full access to the independent valuation and, if necessary, the valuation firm to allow all matters raised by the Revenue Authority to be appropriately addressed.

It should be remembered at all times that the objective of the ethical taxpayer is for the Revenue Authority to sign off on the arrangement to ensure a no risk tax outcome.

The objective of the aggressive taxpayer in respect of internal technology transfers is to shift profits to a low tax jurisdiction, a tax haven or a jurisdiction with an extremely favourable tax regime for the tax deductibility of intellectual property.

In circumstances where a Revenue Authority in a particular jurisdiction is not strong on examination of internal technology transfers, an opportunity for the aggressive taxpayer may well exist. Apart from the all important ethical tax considerations, it is relatively easy to construct an apparently legitimate intellectual property transfer supported by a purportedly favourable valuation. This may be by way of an excessive charge for the use of intellectual property or for the use of a trade name. gn w

From the perspective of a Revenue Authority, large payments for intellectual property transfers to international related parties combined with a low taxable income or indeed tax losses should draw appropriate concern. This is particularly the case where the low taxable income or losses extend for a number of years.

Another approach is to sell the relevant intellectual property to a favourable tax jurisdiction and to licence the intellectual property back to the original jurisdiction. This may be particularly attractive where there is no capital gains tax in the original jurisdiction and a tax deduction is obtained for the licence fee for using the technology. General anti-avoidance provisions in most jurisdictions would typically prevent such an arrangement from succeeding for tax purposes but may work in some jurisdictions. A similar arrangement could be argued in respect of a trade name although it would be questionable whether a trade name could be transferred in isolation of the underlying goodwill of the business.

A relatively unsophisticated approach to profit shifting in respect of goods is simply for one member of a Multinational Enterprise in a low tax jurisdiction to sell its goods to a member in a high tax jurisdiction at above an arm's length or market price.

An alternate to this approach is to charge the correct amount for goods but then to add either excessive charges for marketing intangibles or services to reduce profit in the high tax jurisdiction. Such an approach may be used during the earlier stages of a Multinational Enterprise's presence in a particular high tax jurisdiction and argued as *market penetration expenditure*. Legitimate market penetration expenses may result in early losses but are not expected to continue beyond a reasonable period of time, which is framed by the particular market being entered.

A more sophisticated approach is to interpose a service entity in a low tax jurisdiction between the manufacturing member of a Multinational Enterprise and the distribution entity. This is done with a view to charging in excess of an arm's length price for the services provided with a view to reducing taxes in the other two jurisdictions thus reducing taxes overall.

There are many different ways open to the aggressive taxpayer *to attempt* to shift profits, but the resultant primary tax adjustments, penalties and penalty interest adjustments together with loss of reputation and increased tax risk ratings are inevitably present should the aggressive taxpayer be unsuccessful. It is unquestionably a matter of choice to pursue such practices.

Given the extent of tax avoided through the aggressive tax avoidance industry by way of international transfer pricing arrangements, Lawmakers are no doubt required to Act.

If the Lawmakers can encourage ethical tax practices through economic means, there will be far greater certainty in terms of the tax base, reduced costs of monitoring by Revenue Authorities as a result of less tax being *in play* and likely an improved quality of Government service through increased revenue. All these outcomes are laudable objectives for any Lawmaker in any jurisdiction. The introduction of ethical tax regimes or an ethical tax regime specifically relating to the transfer pricing question is one way to achieve this.

An alternative approach may be for the international community, perhaps through the OECD, to set a series of *safe harbour* (that is acceptable) transfer pricing rules in respect of the full spectrum of international related party transactions. This would essentially mean that all international related party transactions would be subject to a specific range of returns based on an internationally determined and agreed set of factors. Anything falling outside the range would, of necessity, be the subject of extensive Revenue

Authority investigation. This approach also has the important advantages of being simple in concept and straightforward in its application.

A further approach that would assist with the problem of the imposition of double taxation on the same transaction through the inconsistent treatment by Revenue Authorities in different countries would be the establishment of an International Court of Transfer Pricing Matters. Such a Court could be given the full authority to make binding decisions in respect of transfer pricing disputes between Governments. There are two clear advantages to the establishment of such a Court.

The first advantage to international commerce would be to ensure that large amounts of capital (or alternately large tax provisions) are not tied up for years through disagreement between Revenue Authorities.

The second advantage would be the establishment of a specialised team of jurists well versed in resolving transfer pricing disputes. One of the challenges faced by virtually all jurisdictions is the general inexperience of the judiciary in transfer pricing matters that can result in inconsistent and therefore unproductive decision making on transfer pricing disputes. Such issues would be eliminated through the establishment of the Court.

Finally, although more radical, would be for all Governments to simply cede their transfer pricing law making powers to one global authority with the mandate of governing all international related party transactions. While no doubt difficult to establish, this would largely eliminate the transfer pricing challenge for the Revenues.

There are a number of ways of addressing the transfer pricing question for the global community and its loss of revenue to tax havens. Although solutions are succinctly put in Chapter 10, *the key is for a coordinated and consistent approach to be adopted by the major economies!*

Chapter 6

The Whistleblower - The Case of Antoine Deltour

Throughout history, the outcomes for whistleblowers even with the most robust of claims has tended not to be kindly even if a successful prosecution arises in relation to the whistleblower's claims. The essential problem is that the whistleblower is usually in the same industry as the subject company or organization of the claims and a successful, or even indeed an attempted prosecution, will be usually somewhat career limiting for the whistleblower seeking re-employment.

The whistleblower despite the purported transparency of most organizations will be seen as being a little too transparent and therefore a risk to the organization. In some industries, such as general insurance or indeed some countries under specified circumstances, whistleblowers are specifically protected by legislation. However, this does not guarantee re-employment within the industry. If anything, whistleblowing is an invitation to never be employed within an industry again.

It is important to recognize that whistleblowing involves the disclosure of criminal or other undesirable activity of organizations, which is not publicly available and may result in criminal prosecution of individuals within the organization or the organization itself.

This of course should be differentiated from the role of *the corporate tax ethicist*, which is to provide a thoughtful and interesting thesis with the objective of examining the entire system and providing insights in to improving its financial integrity and stability based on publicly available information while speaking to all the right people and sunning themselves by the pool at a personal cost of some US$1 million - *a completely different scenario!*

From the viewpoint of the Big 4 accounting firms, the question of whistleblowers has historically not been an easy one for them surprisingly being met with derision rather than support for what is an entirely legitimate integrity mechanism for raising regulatory issues of concern either on the accounting or on the taxation fronts.

The term surprisingly is used quite deliberately here. It will be recalled that the Joint Stock Companies Act of 1856, which effectively established the modern system for external audits of companies by independent accounting firms, was arguably the foundation integrity measure of the accounting profession by requiring an independent audit of the profit and loss statement and the balance sheet of companies.

These measures were introduced on the basis of public policy to ensure that investors and potential investors in those companies were correctly informed on the company's true financial position, rather than being exposed to financial misstatements resulting in potentially very large losses for those investors.

In a very real sense, these independent accounting firms were the original whistleblowers calling to account improper financial practices that were previously undisclosed to the public.

What has been changed in 160 years since the passing of the original legislation? From the viewpoint of the investors, absolutely nothing. Investors and potential investors still want to be informed about a company's true financial position and to make sound investment decisions based on this.

From the viewpoint of the lawmakers, again very little has changed as true financial disclosures are considered absolutely sacrosanct in all developed economies and there has only been an expansion of the law in this area. However, there has arguably been a significant shift in the approach of the Big 4 accounting firms as no firm would appear to have introduced its own whistleblowing procedures for inappropriate accounting behaviours instead pursuing whistleblowers where they can and making life difficult for them.

It may be fairly observed that each of the accounting and taxation scandals in this work may well have been prevented by early detection through a robust and effective whistleblower process within the Big 4 accounting firms. Certainly each and every other integrity measure within the Big 4 firms had failed to prevent the disastrous outcomes that had occurred in relation to these scandals including very real damage to professional reputation.

It is reasonable to envisage that all of the Big 4 firms would have preferred not to have dealt with this reputational fallout in circumstances which were largely indefensible. This remains an important ethical issue for the Big 4 accounting firms in an environment where the public increasingly wants truth in the financial reporting process.

The public attitude is reflected in the law in many countries including the United States where, for example, under Section 301 of the Sarbanes-Oxley Act 2002 companies are required to offer employees an option to anonymously report questionable auditing or accounting matters. In order to protect investors, the law could go further and create a positive duty on employees and others aware of inappropriate accounting behaviour to report such behaviours to regulators such as the US Securities & Exchange Commission (the SEC).

This is a matter for lawmakers, but the requirement for true and proper disclosure should not unreasonably override individual discretions, particularly where the financial losses as a result of falsified financial information being presented to investors can run in to the tens of billions of dollars.

The actual attitude of the Big 4 accounting firms with respect to whistle blowers is probably best evidenced in jurisdictions where there is not only no legislative protection for whistle blowers but legislative sanctions instead such as violation of secrecy laws.

The role of Antoine Deltour in relation to the Lux Leaks tax scandal provides an important contemporary example of the polarization of views between disclosure of tax avoidance in the public interest as against the perceived right of multinational companies to take advantage of tax havens that support tax avoidance practices structured by the Big 4 accounting firms. The LuxLeaks scandal is discussed in detail in Chapter 4 and does not need to be repeated here but the very challenging circumstances that Mr. Deltour found himself requires appropriate examination.

In 2008, the bright and unassuming 22 year old graduate from the École Supérieure de Commerce in Bordeaux, France, Antoine Deltour, joined the prestigious firm PWC in Luxembourg as a junior in the firm's auditing department. Following his resignation some two years later, Deltour made the decision to download some 28,000 documents contained in what appears to have been an open electronic database within the firm including a series of tax agreements between the Luxembourg Revenue Authority and a large number of multinationals.

There is little doubt that PWC and Deltour would have parted ways a lot less eventfully if PWC had a more robust documentation risk management system. It is not uncommon for departing junior staff to quietly copy documentation to refer back to in overstating their experience to future employers but far less common for the purpose of taking a moral position on the legality of structures which Deltour unquestionably certainly did when invited to do so by a journalist.

Further, it took some time for the LuxLeaks documents to emerge in the public domain and the sheer volume of documents at 28,000 should have been detected and followed up by the firm's internal audit department much earlier than it was. Preventing either access to juniors or monitoring and following up unusual document download patterns would have eliminated or largely eliminated these risks and their resultant reputational and financial damage to the firm and the clients they served.

PWC cannot blame Deltour exclusively for its woes and should consider re-examining its own internal processes! As a client, I would certainly be both very upset and very concerned that a junior in the audit practice was able to access sensitive documentation about a tax planning arrangement advised on and organized by the firm from an open firm data base and distributed to the public. Litigation regarding negligent communications would need to be considered in consultation with the company's legal team.

Nevertheless, it did take some time for the details of the confidential documentation to begin to emerge in to the public domain. After a chance encounter by way of an anonymous internet chat site discussion with the French journalist Edouard Perrin, Deltour released some of the confidential PWC documentation that became the basis for a documentary produced for French television by Perrin in 2012 entitled Tax Havens - the Little Secrets of the Big Companies. As a result of the documentary, PWC conducted its own internal investigation identifying Deltour as the source and filed a complaint with the Luxembourg Government.

Still it took another two years for the full force of Hurricane LuxLeaks to take a vice like hold on the international community from a political perspective and seal the fate of PWC's actions in Luxembourg when in November 2014 the International Consortium of Investigative Journalists (ICIJ) released a series of stories globally based on the documentation.

In the no doubt Luxembourger equivalent of William Shakespeare's classic line on human nature in Hamlet:

The lady doth protest too much, methinks;

the then Finance Minister of Luxembourg, Pierre Gramegna, described the scandal as the worst attack Luxembourg has experienced in its history. The fact that Luxembourg had benefitted from perhaps billions of dollars in ill gotten taxation gains to the much greater taxation expense of other countries appears to have been lost on the good Minister –

perhaps the Luxembourger equivalent of the culture of entitlement.

In reality, the real victims are not the wealthy Luxembourgers, but homeless women and HIV orphaned children in Africa who lost their Government programs as a result of tax scams. One may also note that some 2,000 Jewish citizens of Luxembourg were murdered by the Nazis during World War II. Mousier Gramegna's comments have deeply offended the Jewish community in a country that has had a relatively good record in terms of eliminating discriminatory behaviour and may well go down as one of the most insensitive in political history.

A mere six weeks after the ICIJ stories hit the global press, Deltour was charged with various offences under Luxembourg law including robbery, professional confidentiality violations, laundering and fraudulent access to a database. In what surely must be received as an affront to the freedom of the French press and no doubt the objectives of the ICIJ as well, Edouard Perrin was charged as an accomplice to Deltour's alleged crimes. Rather than PWC and the Luxembourg Government bowing to international pressure to sensibly drop all charges against Deltour and Perrin, a trial date was set by the Luxembourgers for 26 April 2016 which made little sense at all from a reputational viewpoint in all likelihood setting a mere witch hunt to be played out in the Courts over years.

Notwithstanding the legal action, the judgement of *the People's Court* on Deltour had already been strongly delivered by the rest of the world in favor of the boy from Epinal with his being declared *a hero* underlining the importance of robust laws to protect whistleblowers in similar circumstances.

In 2015, Deltour was awarded the European Parliament's European Citizen's Award for contributions to European cooperation and promotion of common values. Of far greater importance though than individual accolades, Deltour's actions caused a groundswell rethink on the nature of such arrangements and how they would be treated within Europe.

The European Parliament Special Committee on Tax Rulings and other Measures Similar in Nature or Effect (TAXE committee) was established with an impressively tough mandate to address such matters.

As was mentioned in Chapter 4, the indicative response of the European Commission was to develop full disclosure requirements for multinational corporations in respect of their European tax arrangements including tax payable in each European jurisdiction

The then and current European Commission President and former Prime Minister of Luxembourg from 1995 to 2013, Jean-Claude Juncker, was understood to be supportive of the measures. If I were in Mousier Juncker's shoes, *I would be too*.

Whether the support by Jean-Claude Juncker is real or merely political convenient, it is important that Lawmakers examine their personal ethics and the expectation of their constituents and maintain a legal environment that allows appropriate whistleblower protection. As the vestiges of PWC Lux Leaks fade in to history and even more aggressive structures such as Mossack Fonseca's use of nominee companies in the British Virgin Islands and other jurisdictions emerge, it is critical for whistleblowers to confidently come forth and present their disclosures for a balanced examination by regulators.

As for Antoine Deltour, the correct decision was finally handed down on 11 January 2018 by Luxembourg's highest court quashing the six month suspended jail sentence and Euro 1,500 monetary penalty imposed by the court of first instance ruling that Mr Deltour should have been recognized as a whistleblower.

On leaving the court, a beaming Antoine Deltour simply and modestly declared;

Today is a victory.

While this is no doubt the case in a personal and legal sense, it was simply wrong for Deltour to stand trial at all and one the Lawmakers of the world must surely guard against in building financial integrity in to a profoundly flawed global financial system. Whistle blowing should properly be viewed as an integrity measure and not one for persecution by powerful wrong doers.

It would be entirely appropriate for Luxembourg and PWC to issue a formal apology to Antoine Deltour or rightly suffer the severest of international sanctions in the emerging tsunami of resentment towards tax havens and their promotion of aggressive tax practices through the passing of favorable but socially irresponsible taxation laws.

While admittedly this is unlikely to occur, Deltour will undoubtedly remain a hero in the people's eyes – *in all likelihood history will not be so kind to Luxembourg and PWC. Let us hope that history does not forget!*

Chapter 7

Assassinations and Other Sly Manoeuvres

Sometime in the mid 1600's, the term soldier of fortune entered the English language. Although there are various definitions of the term, the common thread may be defined:

As one who will serve in any army or undertake risky tasks for personal gain.

In the mid 1600's, the fledgling accounting profession although generally required to service the book keeping practices of small medieval businesses had benefitted considerably from the double entry accounting system which had become vogue for the merchants and bankers of Renaissance Italy a little over a century before. Double entry accounting revolutionized and replaced what was called single entry book keeping and introduced much greater financial integrity to the accounting profession by requiring each accounting entry to have a corresponding entry to a different account (the so called debits and credits) and the all important requirement that the books balance, otherwise back to the books to find where the offending error or errors occurred and then fix them.

If the books balanced, then the financial reporting for the business was proven and the accountant's work was then done with no further pressure on either the client or the accountant to do anything more provided that the Tax Collector was paid the required taxes on the net profit of the business.

Today, the accounting profession is immeasurably larger and vastly more sophisticated than those medieval times and arguably with far less financial integrity. There is unquestionably intense pressure *from a business viewpoint* on many of the ever growing number of Big 4 accounting firm Partners to meet budget expectations. While not every Big 4 accounting firm Partner will go down the path of assassinations and other sly manoeuvres in aggressively generating fees to meet budget requirements, *many will!* In a very real sense, the accountant of fortune has not only been born, he is now an experienced and canny warrior.

For a number of decades now, it has been the practice of the Big 4 accounting firms to *recommend and place* senior staff desiring a career *in commerce* rather than *the profession* (or staff simply not regarded as partnership material) into their client or target client base. The idea here is relatively simple and blatantly self serving for the firm. The concept is basically one of *we will look after you* (if you refer all your external work to us), *if you look after us* (by referring that work).

There is little doubt that such arrangements do work well for both the firm and the former staff members, but not necessarily for the client organization themselves. The reasons for this are fairly obvious.

Firstly, executives in outsourcing roles should ensure the best commercial outcome for their company or organization based on risk management principles. This is normally done by selecting and choosing candidate firms for assignments based on certain specific criteria and objective standards typically agreed with the Board by way of a Board policy and supporting procedures from which the the best firm is chosen for the assignment.

Secondly, independence is critical from a Director's viewpoint and indeed it would considered a Director's duty to ensure that the best firm for the role is actually chosen for a particular assignment. In the event of a large unforeseen liability arising as a result of advice from the firm selected and potential legal action by shareholders, the Director's conduct will certainly be examined in detail before the courts and may present a sleepless night or two.

It is far more difficult to demonstrate objectivity or independence if the same firm, or predominantly the same firm, is chosen for all projects or assignments and there are other well established links with the same firm on other questionable bases.

The close relative of recommendation and placement into clients or target clients of senior Big 4 accounting firm staff is the *assassination of corporate executives* perceived to be in the way of the Big 4 accounting firm's interests, perhaps because they have chosen a properly structured and independent process in the selection of firms rather than selecting the one firm all the time.

As Michael Corleone said in the Godfather in reflecting with his family lawyer Tom Hagen:

I don't feel I have to wipe everybody out, Tom. Just my enemies.

The assassination process is not exactly ethical or in the best interests of the target executive's company or organization, but is disturbingly straightforward and efficient particularly where more senior executives are unaware that such forms of corporate assassination actually exist. In reality, with such subversive tactics, this is the rule rather than the exception and why these sly manoeuvres do typically work *extremely well!*

The most usual practice is to quietly undermine the reputation of the target executive to more senior executives in the organization either locally or at the international head office level by way of client visits by Big 4 accounting firm Partners. The undermining of reputation of the target executive does not have to be extreme and in most cases is usually very subtle. All that is required is to plant the seeds of doubt in the more senior executive's mind, particularly where the more senior executive is relatively new to the organization or the senior executive has recently gained his position through promotion and has a mandate and a budget *for change* and is keen to score goals.

Executive vanity does play a major psychological role here and the Big 4 accounting firm Partners work it very well. A statement along the lines of:

Old Joe has served your organization with great distinction, but what is required now is a fresh pair of eyes to take on the new challenges.

The hapless Joe will never really know why he was shown the door or perhaps may not be too fussed if there is decent severance package involved with the cost obviously being borne by the target client. Notwithstanding, the path is now free for the Big 4 accounting firm staff plant to enter the scene and direct fees to the firm without a cent in marketing costs or any other costs being incurred.

An interesting question arises if Old Joe also holds a statutory position and is required to independently consider matters and initiate appropriate action based on the law. As part of the assassination process, Joe may be placed in a position where an independent decision cannot be made as a result of comments or actions including threatening comments or other malevolent acts.

In such circumstances, Old Joe from a legal viewpoint should stand down, at least temporarily, draft a detailed report of the action and immediately submit the report to the Board of the company. If the Board does not take appropriate action, it may also be necessary for Old Joe to report the matter to the relevant regulatory authority. Otherwise, Old Joe may risk prosecution for potentially breaching a statutory duty if he otherwise proceeds.

But for Old Joe, this may be easier said than done and the easiest course of action in practice may be to express some concern and to negotiate a larger severance package reflecting the regulatory risks involved and agreeing to be bound by a tight confidentiality agreement, rather than take on the corporate empire and the Big 4 accounting firm which together are likely to be proven powerful enemies!

As Pat Conroy said:

Paranoia has a sharper taste if the danger is real.

Success fees in relation to tax planning matters such as the KPMG tax shelters discussed in Chapter 4 and other tax products remains a very challenging ethical issue for the Big 4 accounting firms, particularly when considered in light of the purportedly high ethical standards on which the accounting profession was founded. Notwithstanding, success fees are not unusual in other industries such as investment banking or commercial real estate where such fees can be indeed princely in sum running in to the tens of millions of dollars, but not the wider professions such as engineering, medicine or law (with the exception of contingency fees in the law).

Unlike engineering or medicine, the Big 4 accounting firm Partners do have exposure to these large fees through either accounting audits or taxation advice. There is little doubt that more than a modicum of professional avarice has occurred in relation to the scale of these fees somewhere along the line within the Big 4 accounting firms. One can just imagine a group of Partners asking: Why not us? Indeed, why not us!! And indeed it has become so.

The way that the success fee structure operates is firstly that the client is charged a base fee by the firm for setting up a tax structure. If the tax structure survives without adjustment from the relevant Revenue Authority or Revenue Authorities for an agreed period of time, usually the current audit cycle, then a further additional fee being the success fee is charged by the firm.

The success fee would normally be payable even if the relevant Revenue Authority did not examine the tax structure relying on non disclosure and the so-called muddying of the waters, historically two of the most favoured techniques of the international tax avoidance industry.

In recent years, there has been a strong trend of the Big 4 accounting to argue for reduced accounting requirements (special purpose accounts) for subsidiaries in foreign jurisdictions even though turnover of those subsidiaries may be in the billions or tens of billions of dollars. If less is disclosed in the financial statements in a particular jurisdiction, it is harder for the local Revenue Authority to identify aggressive tax planning structures for audit.

Muddying the waters involves adding complexity to a corporate structure by introducing additional entities whether they be of a corporate, trust or partnership nature. It is not too difficult to imagine the challenge for a local Revenue Authority to examine say 500 entities with virtually no financial reporting and find a blatant profit shifting or other tax avoidance arrangement.

Although these measures will help the perception that overall tax risk is reduced in relation to a particular aggressive tax structure, it is recognized by the Big 4 accounting firm that the structure will carry tax risk and in one sense the firm is seen to be sharing the risk even though such charging is typically heavily in favor of the firm and charged at premium rates with little actual financial risk actually borne by it. For a period of time, the multinational company is given the illusion of success and often the tax saving is paraded by the multinational company's executives for internal political purposes.

As the KPMG tax shelter and PWC transfer pricing Lux Leaks structures have shown, the outcomes are not always favorable and can result in a hugely expensive outcome to the downside for the previously confident multinational's executives. Those same executives in the multinational will be no doubt be scurrying for cover if they have not already been dismissed by their Board.

One approach used by Big 4 accounting firm Partners, particularly in the emerging economies, is to sell what is known as an *advocacy piece* on a taxation matter. This is essentially designed to state a multinational company's position in relation to a particular tax matter in that jurisdiction. The advocacy piece is usually well crafted and is placed on the relevant file in preparation for a tax audit by the local Revenue Authority.

Of course, the relevant tax position will be secured if the relevant Revenue Authority never examines the issue for which the advocacy piece was drafted and the Partner earns what must be regarded as a very safe fee. However, it is quite a separate matter if the local Revenue Authority examines the advocacy piece and disagrees with it. The advocacy piece which may have always been a ticking time bomb has now exploded resulting in a potentially very expensive tax outcome for the multinational company in terms of primary tax adjustments, penalties and penalty interest and damage to reputation with all stakeholders.

The preferred approach from an ethical and risk viewpoint is not to use advocacy pieces but to seek a binding opinion or ruling from the local Revenue Authority. In this way, the acceptability of the tax argument is determined at the outset, which eliminates tax risk completely for the multinational company. The importance of this point cannot be underestimated! The removal of risk is attractive to every Director as every Director is subject to potential law suits for negligent conduct.

As part of a preferred tax risk management process, it is important that the Directors of the Board and senior financial management make proper enquiries as to the true basis for the advice. As an advocacy piece does carry tax risk, the Board should properly consider whether it wants to include such positions as part of its Board Mandate. The Board of an ethical multinational company will simply say no we don't!

While *scoping studies* are often presented as a cost saving measure to focus on material issues, in reality they are often a way of building up fees for the firm. There are other tricks of the trade to increasing fees for a firm including the slow drag. Under this method, the most certain tax aspects of a particular transaction are established initially to build up fees and expectations through detailed advice and then the deal-breaker usually as a result of an offshore issue is presented positively at the end as a very fortunate outcome of using a major international accounting firm. This begs the question in these days of instant global communication how this could possibly occur, but the multinational companies should address this question as part of selecting their external advisers.

Stacking of meetings with large numbers of staff members has always also a long term play of the Big 4 accounting firms, particularly when compared with the international law firms. Having five, six or seven Big 4 accounting firm staff in a major meeting to one or two internal staff is not unusual in my experience.

This cannot just be explained by the alleged greater specialization of the Big 4 accounting firms.

Uncertainty is undoubtedly the friend of the Big 4 firms in terms of fees on complex transactions. These fees may well be multiplied several times where a dispute arises in relation to the transaction with the relevant Regulator or Revenue Authority and the matter is then fought through the Court system. The ability to communicate and establish confidence in the argument being pursued is essential to the generation of such fees.

The mastery of this approach is to create the impression in the mind of the client in respect of an adverse outcome by the Courts that the judiciary did not properly understand the argument and had simply got a perfectly sound argument wrong in making a poor decision. Nevertheless, organizations ethical or otherwise require advice on risk areas as early as possible in a project to establish deal-breakers and avoid unnecessary wastage of resources.

Certainty unquestionably is the objective that multinational companies should strive for and Board Mandates to operational staff must reflect this approach to avoid costly outcomes often years after the initial transactional structure was put into place.

It is very hard to ignore the explosion of *electronic communication* by the Big 4 accounting firms to their clients and prospective clients. In the days prior to the advent of email and indeed the internet, even the largest clients of the Big 4 accounting firms (or more correctly their antecedents) would perhaps only receive a quarterly paper newsletter through physical mail updating them on contemporary taxation and other regulatory matters. Now it would be unusual if a day passed by without an email communication from each of the Big 4 firms. Whether such emails be considered a sly manoeuvre or promoting the myth of infallibility of a Big 4 firm, there is little doubt that there are very large numbers of PR personnel employed by the Big 4 firms to produce such favorable material on the firm.

This should be compared with the major international law firms which produce and distribute a fraction of such material to their clients. The question remains as to whether all the PR material produced by the Big 4 accounting firms does anything to improve the quality of the advice actually sought by clients and the answer is probably not. Notwithstanding, it does by and large improve the perception for clients of being looked after and in this regard does provide a strategic advantage for the Big 4 accounting firms over the international law firms.

It should be said that the Big 4 accounting firms or individual Partners within the firm can also be somewhat unkind to their own departing senior staff to shore up their own personal commercial interests. Following my resignation from the third of the Big 5 firms I worked for and following a rather unsubtle *national merger* (but what was in reality just a

Goodfella's mafia style turf war between State offices of the firm), I was forced to sign a confidentiality agreement by my new national boss who I shall refer to as Mach (not his real name).

The leverage used by Mach was the verbal threat that if I did not sign the confidentiality agreement:

My name would be blackened within the commercial community and I would never work again.

It was a highly structured and premeditated threat, flawlessly executed, made behind closed doors, with nobody else present to witness the statement and disturbingly with a finale from Mach of a wry smile of arrogant satisfaction. It was meant to be intimidating and it was!

As mentioned previously, there was a national merger of offices occurring at the time so I certainly do not believe that I was the victim of a wider plot as such, as my professional blood merely joined what was a clearly expected thick coat of carotid flow red already on the walls. Nevertheless, Mach who has now left the firm had very serious assassination form based on both his reputation and on my subsequent discussions with those who had endured similar experiences by him. Indeed, a number were so badly affected that they never did work in taxation advice again either in a major law or accounting firm or a major corporate.

It was also well evident that Mach held a similar reputation with his fellow Partners many of whom correctly recognized that Mach's assassinations were seriously damaging the firm commercially with many respected taxation advisers leaving the firm one way or another. Mach was also a proponent of going above local management in head office visits in circumstances where he failed to win a mandate, which did not exactly endear him to clients either.

Mach's tale does raise one of the key problems associated with the partnership structure in terms of what to do with dinosaur Partners who have lost touch with conventional and acceptable behaviours in a professional and client environment. It is one of the strongest arguments for separating ownership of a firm and the provision of professionals services. In a corporate environment, Mach would not have survived.

In my case having written the only two books in the country on transfer pricing (even to this day) one of which had the endorsement by way of foreword of the top tax official in the country, I thought my goodness (and a few other unprintable thoughts). I also knew I was well covered by the law of duress, which invalidates a contract in such circumstances despite the fact that such contracts always include a clause that the contract was freely signed with no duress. Nevertheless, it was enough of a threat for me to head off to commerce rather than accept an offer from another of the Big 4 accounting firms.

Finally, as noted in Chapter 4, there have been persistent rumors around the corporate tax world regarding an alleged secret deal between Revenue Luxumbourg and the Big 4 accounting firms around the introduction of EU disclosure requirements. If scuttlebutt, so be it, but this position can obviously be tested by clarification from the parties involved, their clients, regulators, politicians or indeed the ICIJ.

If correct, however, it does raise the level of sly manoeuvres to a disturbing new level. A Revenue seeking to avoid disclosure of agreed tax arrangements with all four of the Big 4 accounting firms in a single meeting carries very serious implications for the global community and for the Big 4 accounting firms. If acted upon by the Big 4 accounting firms, it underlines the argument for break up rather than self regulation.

Notwithstanding, with so many back to back tax scandals and the sheer volume of documents unearthed in both the Panama and Paradise Papers that this may alas potentially end up simply being a footnote in this book alone.

Chapter 8

#Women Know – A Me Too Life for Women in the Firms

In 1984, when I started my career as a young graduate in one of the antecedent international accounting firms to the Big 4, I recall one the Partners (now deceased) observing the skills quite freely to me of a female Senior Manager in her early 50's named Candice (not her real name) who was extremely polished in her professional behaviour, gave outstanding professional advice and was always even tempered and helpful to all involved including a very green taxation lawyer such as myself. At that time, Senior Manager was the level immediately below full equity Partner earning somewhere around one quarter of a full equity Partners, but with only a slightly lower charge out rate to clients and a larger budget in terms of personal billable hours.

Candice is one of the smartest people this firm has ever seen. Great technical skills, clients love her. If she was a man, she would have been a Partner 20 years ago.

It has been only in very recent times with the emergence of the *#Me Too Movement* following the revelations surrounding film mogul Harvey Weinstein in October 2017 that women have spoken out *en masse* about the abuse of power within the film industry not just extending to inequality of pay but the far more insidious sexually harassment and sexual assault extending to both aspiring and established actresses alike.

These women bravely stood up after decades of institutionalized sexual abuse and should be congratulated as Time Magazine did in their 2017 Persons of the Year Edition for speaking out on their often painful disclosures silently bearing years of psychological scarring and must be fully supported to eliminate such abuse of power from both within the film industry and from society as a whole.

More slowly to come forward to support these women are the men who although not directly involved in such abuses knew of their existence, but did not speak out at that time either because they believed this was part of the culture of the industry or they did not simply want to compromise their own careers. It is naive to believe that such abuses are unique to the entertainment industry and indeed are prevalent to a varying degree in all industries where men have power over women including the three major accounting firms l have worked for.

Although I had already completed this Chapter prior to the Harvey Weinstein revaluations which discussed case studies of women l knew personally and respected who had been sexually harassed and left the Big 4 accounting firm because of it, it was a comment from my own partner in life which called me to question my own personal position in *simply accepting* what the Partner of the firm had said to me at the time without pushing back and saying this was shamefully wrong.

The words she said were: *Women know Georgie!* And indeed they do and for all those men out there who merely accepted and did not push back as I did at the time, we are arguably equally as culpable in not speaking out earlier and allowing such abuse to continue. I encourage everyone to do so now!

In 1984, political correctness was not exactly the greatest priority with the (all male) Partners and the actual quotes used in this Chapter will reflect this. I recall the Partners quite often and openly heading off to a local table dancing club for a very long Friday afternoon returning much later. Clearly disheveled and worse for wear the Partners still had no problems telling off the more junior male staff for not putting in on a late Friday afternoon.

This was also a generation of male Partners who wanted *a vibrant woman* to be his secretary. A female HR manager who I had befriended explained the recruitment process to me in the following terms:

They want vibrant! Vibrant does not mean competent, it means under 25 and gorgeous. It is just a caveman thing and the winner is the one who drags the best looking girl in to his cave.

Nevertheless, as Bob Dylan classically sung of the era a little earlier in 1964:

The times they are (were) a-changing.

And indeed this was the case in the 1960's and no doubt for the better! In 1984, feminism was more than well on its ascendancy with Germaine Greer's famous tomes on feminist issues *The Female Eunuch* (1970) and *Sex and Destiny: The Politics of Human Fertility* (1984) presenting the feminist bibles for a generation of emerging and powerful women. Certainly, the women in my law school class were confident, intelligent, harder working, achieved better results, were not afraid to take on the men *and outnumbered us*. These women could not be messed with and they took you down very quickly if you did. They were not my equal, *they were much more than my equal!*

Some prominent feminists such as Susan Faludi have asserted in her well known book *Backlash: The Undeclared War Against Women* (1991) that by the 1980's there was already a growing movement in business against stereotyped and unattractive images of career women. However, when it came to women in firms, the male Partners of their generation were hardly inclined to be reading a Greer or a Faludi on the finer concepts of feminism and understanding the emerging and empowered new generation of women. These women by their own choice were deservedly the potential and rightful Partners of the future.

To a large degree, this generation of male Partner was arguably the product of an aberrant period in the twentieth century. The baby boom years were years of plenty following the extreme trauma of World War II. Real choices were now available and those who went down the family path tended towards non-working mothers. However, this was the real choice of the parents and not an indication of female enslavement in the home.

The first international organization to advocate women's rights, the International Council of Women, first met in Washington D.C. in 1888 with eighty speakers and nine countries represented. With the suffragette movement advocating the vote for women in the early 20th century, women were demanding and gaining a greater role in society. By the roaring twenties and building through the 1930's, women were entering the professions in unprecedented numbers. With the outbreak of war and men away fighting, women took the place of men in roles required for the war effort including all of the trades. But then peace came!

Unfortunately, when this formidable new generation of women educated under feminism in the 1980's met the old generation of male Partners raised with the cultural influence of their mothers at home in the 1950's, it was always going to be a bad honeymoon and a worse marriage.

Although the firms in more recent times have attempted to address women's issues as such, these issues were and remain substantial impediments to the attractiveness of the firms for professional women. This is disappointing to say the least as in my observations over 30 years, there is no doubt that on average female Partners are simply far better in providing quality advice than their male counterparts, many of whom seem to rely on the guffaw rather than talent. It was initially curious for me to observe that when I have been involved in discussing such issues in larger forums that the men lead the discussions and not the women. I once asked a very senior female figure in a large organization who I knew had very strong views on the women's issues being discussed as to why she did not raise a comment during the discussion. She remarked:

It is absolutely deliberate! I see no point in setting myself up for ridicule and separation by my male colleagues and bosses. I want to be judged on the quality of my work and not the fact that I am a woman.

One of the greatest impediments often cited by women in leaving the firms is that they are sick of the Old Boys Club! This is entirely reasonably as the Old Boys Club is very real and it is a very real disadvantage for women. There is no mystery as how the Old Boys Club has come about. The culture has arisen through centuries of all male private schools, sporting clubs, exclusive all male city clubs and other male bastions. The Old Boys Club is essentially a product of male bonding, is strong, encourages nepotism and cronyism and unfortunately tends to generate professional fees more easily for the male Partners. Culturally, one of the hallmarks of the Old Boys Club has been the derision of women both sexually and professionally. From the viewpoint of female Partners, how steeled must they be to walk in to a room of male Partners who suddenly fall silent.

As discussed in Chapter 8, the placement of senior staff in to a client organization is one of the established hallmarks of Old Boys Club. At the end of the day, it is the Boards of the major clients of the Big 4 accounting firms who should appropriately hold the power of the Old Boys Club at bay. A Board's first duty is to its shareholders in terms of appropriate risk management and not to its external accountants in terms of fees. As such, the Board Mandates should be framed in such a way to ensure that objective criteria are used in selecting external advisers on an independent basis rather than a relationship basis. Apart from delivering a standard of advice which will be superior in terms of risk management, it will also allow for the emergence of quality female advisory Partners. Nevertheless, easier said then done!

There is little doubt that much would achieved by the still male Partner dominated Big 4 accounting firms if all female support staff (and indeed all staff) were selected on objective criteria published both within the firm and externally, rather than the more traditional historical basis of *vibrancy*. In fairness to the firms, not all male Partners are necessarily Type A chest beating womanizers and the majority are most certainly not.

Nevertheless, the Partnership structure under which these Type A Partners are part owners of the business has almost certainly in past times contributed to a culture of entitlement. I remember from my earlier days in the firms an unsettling experience when I had just finished a friendly but business discussion with a younger woman in the data processing area (as the typing pool was described then) on how to set out a client briefing paper when a 5 foot 4 inch unmarried Type A Partner snidely commented as I left the room:

It is not for the likes of you to swim in the company (secretarial) pool.

There is no doubt that the issue of children between the new generation of professional women and the older generation of male Partners of the Big 4 accounting firms has been an exceedingly rocky one. Some twenty years ago, a female friend of mine who I shall refer to as Katy (not her real name) after twelve years with one of the antecedent Big 4 accounting and on the cusp of partnership found herself unexpectedly pregnant (to her husband). Katy was immediately stressed by this as to what the reaction of the firm would be to her pregnancy. For the first four months, Katy sought to cover up the fact for fear of detection of her pregnancy by wearing jackets at all times. During a team meeting, Katy's male reporting Partner and mentor of many years deliberately humiliated her in front of a number of junior members of her team that Katy was *getting fat or was pregnant.*

The attitude of the Partner (now deceased) immediately changed from that of supporting mentor to one of the characters of the 2011 hit movie *Horrible Bosses!!* Suddenly Katy's client assignment deadlines tightened, Katy was required to work many more and later nights, Katy had to go to to the reporting Partner's office for meetings in contrast to the established practice of the reporting Partner going to Katy's office and suddenly Katy's professional performance in the view of the Partners of the firm had dropped and indeed they were wondering whether she was really Partnership material at all!

Over the subsequent months, the comments of her reporting Partner grew increasingly more abusive. The straw that finally broke the camel's back on this totally unacceptable behaviour was the comment from her reporting Partner in Katy's ninth month of pregnancy:

When your waters break, make sure you clean up your office before you get yourself to the hospital.

Fortunately, these still were the days when the Human Resources Department still had the word *Human* in it and typically supported staff rather than the organization. In complete exasperation, Katy complained immediately to a senior female HR executive who was also absolutely outraged and organized a severance package based on one year's salary. Katy left that day and was just happy to be out of the firm with no interest ever again in being a Partner. However, the reporting Partner received no sanctions for his harassment of Katy. The lack of sanction quite reasonably raised the question in Katy's mind whether there was a covert agenda in the firm which both she and the HR executive were unaware of.

Such were the times but one must wonder how many, many more female victims were there of similar systematic discrimination by male Partners and how do those women feel today as they see the names of the firms that sheltered and protected these Partners through unscrupulous practices adorn the night sky of their home cities. I hope that one of them writes an interesting and thoughtful book on discrimination of women in the Big 4 accounting firms and exactly what it meant to them!

The Big 4 accounting firms have moved in this area but had to legally providing a much more supportive environment for their female professional and support staff by providing a well advertised range of maternity leave benefits. While this no doubt assists in the retention of women within a Big 4 accounting firm, is this strategy part illusion?

Louise Ashley and Laura Empson of the Cass Business School at City University in London explore this theme in a very interesting research paper and very well entitled Convenient Fictions and Inconvenient Truths: Dilemmas of diversity at three leading accountancy firms.

The paper addresses the question of whether the business case for diversity in relation to gender and flexible work is fatally flawed. There is no doubt that there is strongest of moral, if not legal grounds, for justifying actions around the diversity question. However, the road to partnership is about the generation of fees and time in the office. Until the Big 4 accounting firms can demonstrate that their Partner numbers are drawn in equal proportions from each of the groups within the staff population which are the subject of these diversity actions, they have simply failed in this endeavor.

Despite a generally appalling record by the Big 4 Accounting firms during these times on discrimination against women in the work place, sexual harassment for female professional and support remains the blackest of black marks against the Big 4 accounting firms. While not wanting to trivialize sexual discrimination in any way, it tended to be against more mature women such as Chloe and Katy described earlier in this chapter.

In the 1980's and 1990's, what is now undoubtedly considered *legally* as sexual harassment and morally as repugnant, was often just seen as *sport* by the young male professional staff of the Old Boys Club. For young women choosing not to pursue matriculation or higher university education, starting a career with a major accounting or law firm was considered highly desirable as a name on one's employment record. Starting as young as 14 years of age as trainee Girl Fridays (junior administrative staff) or junior apprentice secretarial staff was common in the antecedent) Big 4 accounting firms.

Disturbingly, many were pressured in to sex under threat of losing their jobs by these young Turks of the Old Boys Club. Unfortunately, and no doubt unwisely, some young women no doubt swayed by both the firm name and their own new found sense of bravado were willing victims to these young Turks for games like *sex in the stacks* being sexual acts performed in between the filing cabinets containing hard copy files and other client documentation. That bravado quickly faded to humiliation as the young Turks boasted loudly about their conquests around the firm cloisters often in earshot of these girls.

There was no sexual harassment training in those times to protect young women or caution young men regarding inappropriate office behaviours towards women. Various figures have been quoted in the literature regarding the percentage of women that were sexually harassed or discriminated against in the 1980's and 1990's that ranges from 30 to 70 per cent. Today, one per cent would be regarded as unacceptable. These young women commonly left the firms emotionally traumatized and the self entitled and self satisfied young Turks often went on to become Partners

Inappropriate sexual behaviour was not limited to the 1980's and 1990's nor was it limited to the the lower and middle levels of the Big 4 accounting firms either. When I wrote my first book in the early 1990's, I did a roadshow on the new international tax discipline of transfer pricing. After one my lectures, Anna (not her real name) bounced up to me with my book in her hands saying:

George, I have bought your book!!

Anna was no doubt a pin up girl for the new generation of professional women being intelligent, hard-working, ambitious, confident and very engaging. Anna also must have read my book better than I wrote it having progressed through two of the Big 4 accounting firms to the country Board of a third in some 12 years.

Unfortunately, Anna was the only female Partner on that Board in what was based on Anna's subsequent revelations a highly chauvinist firm in the true spirit of the Old Boys Club. It appeared the the Old Boys began to drop their guard in terms of their behaviour towards her with much sexual innuendo both in personal discussions and more formal Board discussions. This clearly took its toll on Anna who appeared on the edge of breakdown when I saw her last before she not surprisingly stood herself down from the firm and sued for sexual harassment. I asked her at the time whether she was okay and she simply looked down and shook her head.

As is common with such sexual harassment matters, the case did not go to trial with much leaking to the media of accusation, counter accusation and denial. I knew Anna was going to win, not that a real victory was possible, when I received a subpoena from her all female legal team requiring that I produce a copy of all correspondence sent to me by the firm relating to Anna's case There was none, however, a similar subpoena was sent to a large number of major clients of the firm who responded angrily to the request for the inconvenience in having to respond. The firm settled immediately on a confidential basis with a beaming Anna and her legal team appearing before the media. A satisfying result no doubt for Anna, but I believe a pyrrhic overall for women in firms.

My personal disappointment was that Anna may well have made a strong country head if not an eventual board member of a Big 4 accounting firm. I believe Anna could have set about dismantling the Old Boys culture within the firm for the better and for ever. Once again, it was the weaknesses of the men that caused the problem so many of whom in such circumstances rush behind the strength of the brand name of the firm when they are threatened individually.

While there have no doubt been many Harvey Weinstein-like males in every industry where abuse of power is possible against women, it is the same *en masse* outing that occurred within the film industry that will ultimately prove effective against such men in all industries including the accounting industry where it is yet to occur.

It is one of the strongest reasons yet for dismantling the partnership structure in the Big 4 accounting firms in favor of a company structure to ensure that there is a clear separation of ownership from the key service providers when it comes to abuse of power against women.

A male Partner should not be protected from abuse of power against female staff members or indeed female Partners. Equally, the firm should not be seen to be protecting such Partners who abuse their power because of their status in a firm. *For such men, the clear message must be* for evermore *TIMES UP!*

Chapter 9

The Importance of being Ethical

The world is awash with demands from politicians and the public alike that the multinational companies supported by the advisory firms that serve them *act ethically* in relation to all operational matters, *not just taxation*. However, what is perceived as ethical by one generation or indeed a different society in the same generation may not be perceived as ethical to the next. This is why ethics generally is an area which must constantly be revisited for rebasing in contemporary circumstances and the same is true in relation to the relatively new field of *taxation ethics*.

Who would argue today that the capturing and enslaving of free people in their homeland to labor a lifetime in a foreign country under appalling conditions is somehow acceptable? Similarly, the suggestion of returning to a system that denies the democratic vote for women or requires women to give up their careers on marriage would be equally abhorrent today to every schoolgirl. Further, who today would dare argue against the love bond shared between a same sex couple and not allow them to legally express this through marriage? Yet, these views were entirely conventional in the days of our grandparent's grandparents and in the case of denying same sex marriage shamefully in our own very recent times!

In business, the minimum wage, safe working conditions, annual leave, sick leave, redundancy payments and the provision of savings for retirement were all heavily resisted at the time of proposal. Today, they are considered to be the basic rights of all employees in all Western economies yet it is perversely and conventionally accepted by many in these Western economies that these same rights be denied to workers in third world economies to produce a cheaper consumer good.

In today's increasingly transparent Internet world, businesses and their officers are under increasing scrutiny and therefore increased pressure to ensure that ethical behaviours generally are promoted within their corporate cultures. In the case of companies operating in more than one jurisdiction, the pressure is even greater due to the reality of different laws and societal values applying in each jurisdiction in which the multinational company operates.

For example, most jurisdictions advanced in the corporation law are moving towards establishing strong positions against corruption by banning all forms of financial incentives *or bribes* to secure business contracts. Other cultures may simply view such payments as being in the nature of goodwill and are entirely acceptable. An ethical approach would be to adopt a global prohibition on anti-corruption while a more aggressive approach would be to secure contracts through an independent agent familiar with local customs.

Another example relates to the variation in *environment protection standards* where most advanced jurisdictions will apply strict rules in relation to industrial emissions while less advanced jurisdictions do not.

For those old enough to remember the industrial catastrophes of Bhopal in India in 1984 where over 500,000 people were exposed to methyl isocyanate (MIC) gas and other toxic chemicals and in 1986 in Chernobyl in the former USSR where a nuclear power station meltdown resulted in an uncontrolled radiation release over much of Europe, the need for tight emission controls is entirely self-evident.

Nevertheless, international businesses continue to readily seek low cost industrial solutions under typically less regulated circumstances in third world countries weighing reputation risk against potential financial gain.

A more contemporary example of poor corporate ethical behaviour was Volkswagen's choice to design, build and sell eleven million diesel motor vehicles that cheated United States and other environmental protection standards in respect of motor vehicle emissions. When the United States in 2015 correctly commenced a criminal investigation into Volkswagen on the discovery of the deception, Chief Executive Martin Winterkorn offered his deepest apologies and stated that he would be ruthless in getting to the bottom of the scandal, further stating that:

The irregularities contradict everything that our company stands for.

If Volkswagen truly did so, the manipulation would never have occurred. Most people would probably believe that Herr Winterkorn should have instead *immediately* offered his resignation and soon after he did so *under public pressure.*

All these outcomes, whether positive or negative, are the subject of *choices* or decisions made by Directors on Boards and their operational management. Ultimately, there is a clear and simple choice for such officers *to act ethically or not to act ethically*.

Equally, the Lawmakers in every Government of the world have the capacity to also make a choice whether to allow such unethical behaviours by way of legislative means. In this regard, the control to act ethically or not in the corporate context firmly rests with the independent decision-making of these executives and their Boards and the Lawmakers who serve the relevant jurisdictions.

It is the basic premise of this work *that ethical outcomes and behaviours are the product of a conscious decision making process.*

There was certainly a time when the world of taxation avoidance seemed so alluring, so tempting, so seductive, so forbidden. that one could just imagine oneself driving a luxury sports car along the coastline of a tropical tax haven or to some ritzy ski resort in a

European tax haven to a sprawling villa or ski lodge *purely funded* by one's tax avoidance practices brilliantly organized by our team of international taxation advisers leaving a befuddled Revenue Authority in one's wake.

For a while this may well have been the case, but the world of taxation has changed considerably since the high water mark of open and outright tax avoidance in the 1960's and 1970's becoming a very high stakes game today involving extremely sophisticated and covert avoidance mechanisms as demonstrated by the law firms Mossack Fonseca and Appleby in the Panama and Paradise Papers tax scandals respectively.

Firstly, the taxation law itself has evolved vastly in favor of the Revenue Authorities backed by Lawmakers, with the introduction of general anti-avoidance provisions, specific tax loop hole blocking legislation, risk assessment of taxpayers and greater duties on Statutory Taxation Officers signing off on the tax processes of companies.

Secondly, the Revenue Authorities have become increasingly more knowledgeable of the internal taxation practices of companies and tax advisory firms by way of the introduction of senior staff from both. One must, however, correctly point out that against this the tax advisory firms and companies themselves have traditionally hired heavily from the Revenue Authorities to gain an understanding of Revenue practices and defeat them.

Thirdly, the introduction of Internet based search engines and data analytics has profoundly increased the Revenue Authority's capacity to identify inappropriate tax behaviours by companies and individuals.

Fourthly, international pressure has mounted on countries conventionally known as *the tax havens* that essentially peddle tax incentives without any other economic motive. This is in contrast to countries such as Singapore, Israel and China which legitimately use taxation incentives to encourage the development of new businesses to generate employment opportunities for citizens of those countries.

While the rather unsubtle tax schemes of the early days of tax avoidance practices are now largely considered outdated in terms of current norms in the more advanced economies, there are still Partners in the Big 4 accounting firms that continue to encourage aggressive tax practices as smart or well worth the risk of which PWC's Luxembourg *LuxLeaks* transfer pricing scandal is a prime example of.

It is the view of this work that these practices are *neither smart nor worth the risk* and should on average result in an economic loss to an organization pursuing such practices, rather than the expected windfall tax gain sold by the Big 4 accounting firms provided the Lawmakers are indeed diligent and construct taxation laws with this objective in mind such as the recent changes by the European Commission to address the Luxembourg question.

For the purpose of definition, *tax ethics* is simply the choice to work on an ethical or no risk tax basis.

One extremely important objective is to open up the debate on how the global society should address aggressive tax practices and encourage the introduction in to law of *ethical tax practices* through *ethical tax regimes* perhaps offering a discount to the corporate tax rate for companies agreeing to the the requirements of the regime. This is not just an issue for the Lawmakers or their constituents, the accounting or legal professions or the universities that train them, or indeed the Western or democratic nations, *it is a question for the entire society.*

Everybody in some way is negatively affected by the outcomes of aggressive tax practices, *except* those who choose to seek financial gain from such practices to the general cost of mankind!!

From a social conscience viewpoint, what elected Lawmaker today would have the moral turpitude to argue in public that a nation's foreign aid program to provide housing and education for war orphaned children in Africa should be scrapped to allow the maintenance of aggressive tax behaviour by billionaires and global corporates. Yet, this is precisely what is happening in practice. Answering a clear need for education in respect of ethical tax practices is also an important objective of the overall five works planned in this tax ethics series.

For the purposes of these works, *taxation risk* is defined simply as any negative consequence arising from non-compliance with the taxation law including financial costs and reputation risk.

It is important to recognize that there are more than just financial costs as downside risks to non-complying or aggressive taxation behaviours.

The focus on *reputation* with respect to the conduct of taxation matters by organizations has become increasingly important in modern times for at least three reasons.

Firstly, many Revenue Authorities around the world now focus on risk ratings for at least corporate taxpayers and high net worth individuals and will increase audit activity and other risk-rated surveillance for such perceived non-complying taxpayers.

Secondly, the public's growing general awareness and lack of acceptance of aggressive tax practices through the Internet and other popular forms of mass communication has forced a retreat (or at least a rethink) on such aggressive tax practices by major corporates and high net worth individuals.

Thirdly, the growth of risk management practices has also meant that reputation risk is commonly identified by major corporates as a key risk with rigorous procedures and controls designed to protect the organization from any potential matters that could damage its reputation including adverse tax outcomes and aggressive tax behaviours.

It is clearly arguable that the promotion of *ethical* tax behaviour by an organization or major corporate carries with it not only commercial cache, but also the ability for multinational company officers (and perhaps high net worth individuals who may own them) to sleep soundly at night knowing that there are no tax risks about to haunt them on their awakening. In the limited lifespan we are all subject to, these benefits including a potentially higher share price should not be ignored.

In this respect, it is important that all roles involved in the taxation process within the multinational company's operational structure be duly recognized and factored in to the multinational company's ultimate approach to taxation.

There are other interested parties or external stakeholders to the organization who will have either a financial interest and/or a possible moral or legal interest on the choices made by the organization in respect of taxation matters. These include current shareholders of the company, potential shareholders or investors in the company, financial institutions that are currently lending or considering the lending of monies to the company and a range of regulators.

It is important to recognize that such external stakeholders will or should be concerned about any form of poor corporate tax behaviour as an indication of wider indiscretions within the company, a point that should not be lost on the Directors of the multinational company.

There are essentially *four key elements* to an ethical tax approach being:

1. Operating *within the taxation law* with appropriate support from external tax specialists whether they be conventional or ethical;

2. Working *with the Revenue Authorities* and Regulators on matters where clarification or certainty is required;

3. *Lobbying* for changes to the taxation law with Regulators or Policy Makers where considered desirable or where clarification from Revenue Authorities could not be obtained; and

4. Not accepting *any risk* to reputation by way of tax matters.

It must be recognized that conducting a multinational company's tax affairs in an ethical or conservative manner *does not* mean a negative financial outcome.

An *ethical approach*, if appropriately followed, will result in a number of clear benefits including:

1. The elimination of tax penalties, penalty interest and interest on late payment of taxes;

2. Reduced fees from external advisers;

3. Reduced costs on tax audits and other engagements with the relevant Revenue Authorities;

4. The elimination of court costs;

5. Financial gains through lobbying;

6. Financial gains through reduced internal resources of multinational companies being spent on tax matters;

7. Financial gains through optimizing intended tax benefits as opposed to unintended tax benefits; and
.
8. No short term or long term downside surprises for individual Directors or Boards

Aggressive tax behaviour is simply an approach to taxation that is not ethical and introduces tax risk. At its extreme, aggressive tax behaviour includes tax fraud, however, there are many circumstances less than tax fraud such as reckless indifference or negligent behaviour that will introduce tax risk for a multinational company.

It is arguable that failing to set an appropriate tax policy and not advising one's external advisers about a company's risk tolerance when seeking advice is bordering on negligent behaviour but it certainly should be regarded as loose tax practice. While there is a duty to advise on tax risks for advisors, the matter in terms of its importance is underlined from the multinational company's viewpoint by clearly articulating its tax policy by way of Board mandate – particularly if it is an ethical tax policy!

For example, if a senior staff member presents as legitimate advice an advocacy piece on a taxation matter before the Board, this could introduce tax risk as the opinion may not be correct. In such circumstances, it is important that the Board make reasonable enquiries as to the true basis for the advice and, if necessary, independent advice sought. Merely accepting external advice without any internal review introduces tax risk for the same reason. Clearly, neither seeking external advice, nor internally raising the issue, would be reckless.

Further, poor tax risk management and governance practices can result in a taxpayer being viewed or categorized as taking an aggressive tax approach by the Revenue therefore increasing its tax risk rating. The taxpayer must take care in this regard.

While probably beyond the day to day focus of a tax specialist, a company officer dealing with complex tax matters or indeed a member of the public, an interesting question arises for the purist as to the relationship between ethical tax behaviours and the resultant financial outcome. As mentioned earlier in this introductory Chapter, it is the premise of the ethical approach that ethical tax behaviours *will produce* a financially profitable outcome over time and over a level playing field or should at least do so provided the Lawmakers are doing what they are supposed to be doing in terms of appropriate lawmaking.

This operates on the assumption that all taxpayers will commence at a *baseline* tax liability position and take advantage of *tax benefits* intended by the tax law such as investment allowances or research and development tax concessions.

The ethical taxpayer will then work with the regulator on uncertain positions or promote changes to the taxation law, which only means a potential upside tax position for the ethical taxpayer.

The aggressive taxpayer will pursue his legal avenues, but will risk only downside positions in the event of a loss that includes penalties, penalty interest and loss of reputation.

Aggressive tax practices create the illusion of success that may represent an opportunity for short-term internal political gain. However, this should properly be considered as a potential tax liability and appropriately recognized and reported as such under the accounting standards in the company's accounts. In the spirit of the Joint Stock Companies Act, the founding legislation of the profession, accuracy and transparency in financial reporting is required as the minimum standard. Anything less would be misleading to investors and potential investors.

Penalties, penalty interest, interest on late payment of taxation and loss of reputation do not occur where a taxpayer has chosen the ethical or no risk or conservative tax path and hence represent (or should represent) a permanent difference between the two choices *carrying important implications for Lawmakers which must be adhered to in any civilized society!*

Chapter 10

The Ethical Tax Journey – The Rise of the Scribe.

One of the themes explored in this second volume of the tax ethics series is whether the private power of the Big 4 accounting firms has simply grown to a point where it is actually compromising the electoral mandates, economic capabilities and rational economic decision making of the Political Leaders of many of the major democratically elected countries of the world.

Given the substantial fall in taxation revenues received by the major Western economies and the evidence presented of the vast scale of international tax avoidance activities designed by the Big 4 accounting firms and allied law firms such as Mossack Fonseca and Appleby, there is little doubt that the world has a major problem with international tax avoidance.

The real questions are, firstly, does the world actually recognize the causes behind the problem to the extent it should, secondly, are the trusted Big 4 accounting firms *actually trustworthy* and, thirdly, what can be done about it?

The Lux Leaks, Panama Papers and Paradise Papers tax scandals exposed by the ICIJ strongly indicate a critical and global weakness in the understanding of the international tax avoidance issue by the Political Leaders and Lawmakers of the world *or possibly a* self *serving indifference* of which ex-Prime Minister Sigmundur Gunnlaugson of Iceland who resigned shortly after being named in the Mossack Fonseca tax scandal is an example.

In a clearly orchestrated argument by the tax avoidance industry, the perception is that because these arrangements are *technically legal* in these tax havens they are somehow legitimate in nature. The reality is that the most heinous of activities throughout the history of the law have been entirely legal *until they have been made illegal by the Lawmakers!*

In a quite extraordinary statement, which demonstrates just how effective and accepted this argument on legality has become in relation to aggressive tax practices, President Obama in 2015 commenting on the Mossack Fonseca tax scandal said:

There is no doubt that the problem of global tax avoidance generally is a huge problem. The problem is that a lot of this stuff is legal, not illegal.

One must say that it is very unusual for the Leader of the Free World and his advisers to be so badly caught out on an issue of such global significance!

There is also very real concern regarding the substantive economic reasons supporting corporate tax cuts as stimulating competitiveness and growth in any first world economy, when they have already at least halved in all the Western economies over the past 25 years and tax cuts do not typically drive economic competitiveness.

A much sounder framework for economic competitiveness has been raised annually as the *12 Pillars of Economic Competitiveness* at the Davos Economic Forum for many years. The 12 Pillars are immensely important in developing what I believe are the real building blocks of international competitiveness through targeted tax incentives designed to reward investment risk for real growth in such areas as innovation.

In reality, no self respecting multinational would avoid a first world market if a target gross profit before tax can be achieved on a consistent basis which is the main criteria for investment by large companies and multinationals rather than speculation around the prospective or current corporate tax rate in a target market (See generally Appendices 3 and 4).

Notwithstanding, this does not mean that every Lawmaker does not understand the problem and, in fact, many do and argue for caution or change in relation to handling the potential situations where aggressive tax practices may well be inadvertently encouraged rather than discouraged through inadequate economic analysis (and one should add an unjustified drop in the corporate tax rate to this).

An interesting example in point are the comments of 2016 United States Presidential candidate and

Senator, Bernie Sanders, who in 2011 in arguing against the proposed United States free trade agreement with Panama made the following comments quoting in part Citizens for Tax Justice:

A tax haven has one of three characteristics. It has a no income tax or a very low rate of income tax, it has bank secrecy laws and it has a history of non-cooperation with other countries on exchanging information about tax matters. Panama has all three of those and they are probably the worst.

The Revenue in virtually all of the Western economies certainly recognizes the problems associated with aggressive tax practices through small nations allowing themselves to be seduced by the peddlers of greed for financial gain. However, the Revenue even with their typically wide search powers often exceeding those of the law enforcement authorities in their home jurisdictions have been brutally hogtied when it comes to the investigation of offshore international related party transactions through tax havens or between tax havens.

Although there has been a system of bilateral international tax agreements in place for about 60 years between the major economies for the purpose of allocating taxes between the two jurisdictions, including rules around the exchanging of information and laying down the foundations to prevent income being taxed in both countries, that is avoiding double taxation, the system simply has not been effective as a result of incomplete information, snail mail communications and the obvious failure of tax havens to participate in such bilateral arrangements.

The international tax avoidance industry through the various tax havens in which it operates has simply become too sophisticated to be managed by mere exchange of information between just two jurisdictions outside the tax haven network. Unfortunately, this will *not be solved* by the expansion of multilateral international tax agreements initiated and championed by the European Union. Nevertheless, such measures *will assist* in this process. As the old saying goes, *knowledge is power*, which has been clearly demonstrated by the recent releases of the ICIJ.

As has been noted throughout this tax ethic series, there is no global regulator or any similar body to appropriately monitor the Big 4 accounting firms let alone the aggressive tax haven activities of the Mossack Fonseca's or Appleby's of this world. Fortunately, there are some Government backed international organizations examining the question of international tax avoidance including the activities of the peddlers of greed controlling the financial sewers within the tax havens network.

One such body is the Organization for Economic Co-operation & Development (the OECD) which has a specialist unit dealing with how to address the question of international tax avoidance. The Director of the OECD's Centre for Tax Policy and Administration is quietly spoken and affable Pascal

Saint-Amans who is well experienced in both finance and taxation matters and has provided strong leadership championing a number of improvements to the global taxation system to combat international tax avoidance.

These include exchange of information *on request* by Revenue Authorities between the major economies of the World being currently implemented. However, it must be recognized that while the OECD does provide an environment to explore international tax issues, *it is a think tank* and neither a replacement for a regulatory body nor a lawmaker.

As there is no global Government to pass effective laws against international tax avoidance, it is the responsibility of the Lawmakers in each jurisdiction to pass such laws to protect their revenue bases from depletion through avoidance activities. As with links in a chain-link fence, it is important that each country's anti-avoidance laws and regulatory structure be both uniform and strong in their application. Such measures are necessary to maintain integrity. Accordingly, it is necessary for the international community to meet and agree a universal set of principles relating to the problem of international tax avoidance and to apply them across all countries.

Arguably more important than finding the holy grail, but less important than finding a cure for cancer, developing a universal set of taxation principles and regulatory rules requires experienced, objective and independents minds. The principles themselves do not have to be overly complex, the center of power being derived from their universal application across all jurisdictions. For example, the governing taxation principles may be reduced to just three key concepts (and l apologize in advance for mentioning these principles twice more in this work albeit in different contexts).

Taxation Principle 1: All jurisdictions should encourage ethical tax behaviours by way of economic incentives through discounts in the corporate tax rate or other real incentive measures.

Taxation Principle 2: All jurisdictions should ensure that appropriate punitive measures reflecting the fraudulent nature of aggressive taxation behaviours be implemented including incarceration.

Taxation Principle 3: All expenses originating from a jurisdiction internationally characterized as a tax haven will be denied a tax deduction in the home jurisdiction.

The Regulatory framework must be built around the original intent of the accounting profession which was to protect investors and other stakeholders from financial harm by ensuring integrity within the financial system. Given the breadth and scale of tax scandals (without considering the major accounting scandals such as Lehmann Brothers and Enron), there is little doubt that bigger has not meant better for the Big 4 accounting firms.

Too big to fail is not exactly a credible argument that can be realistically used to cover up unprecedented tax frauds and it is now time for each jurisdiction to act in a coordinated manner to curb the rise in power of the Big 4 accounting firms and break them up!

The logical first step is to split the the audit and taxation functions of each of Big 4 accounting firm in to standalone specialist audit and taxation firms to allow for advice to be independently and appropriately given in these two key areas of commerce. This will largely eliminate the clear conflict issue arising from the one firm providing both taxation advice and auditing a company. Having worked in three firms, there is a well worn path between the offices of Tax and Audit Partners dealing with matters on a client of mutual interest to the Firm.

Once this has been done and to create an appropriate level of competition in the market then each of the specialist audit and tax firms should be split in two to create eight specialist audit and eight specialist taxation firms. Today, reducing the size of regulated entities such as banks is not unusual and has been done to achieve greater regulatory control thus reducing overall risk for all stakeholders.

It must be recognized that each of the sixteen firms would still have a combined turnover of US$140 billion and on average would be about the same size as when Arthur Andersen & Co collapsed in 2002. As such, the sixteen firms would still be vast multinational organizations by global standards, but small enough to fail in the event of a regulatory impropriety on the scale of the KPMG tax shelters or Lux Leaks.

Such an outcome could be achieved by just two regulatory principles and three taxation principles which are revealed in all their simplicity in Chapter 11.

The application of universal principles to reduce or eliminate international tax is not necessarily difficult but it does require credible political will and so Iceland's Gunnlaugsson or Britain's Cameron although at quite different ends of the perceived tax culpability scale are unlikely to lead the charge despite Cameron's very strong speech at the Davos Economic Forum. Cameron's case in benefitting from what was a fairly modest financial gain from the sale of a stake in a Panama offshore trust *set up by his father,* the Blairmore Investment Fund, demonstrates just how difficult it is for a politician to be perceived

However, political will is driven by political pressure (or possibly just political convenience) but the question remains who or what can generate such an extreme level of political pressure so as to force the Lawmakers of the world to act in a coordinated manner to address international tax avoidance. Certainly, it will not be the Big 4 accounting firms, the multi-national corporations or the super rich as they all have a vested interest in preserving the status quo.

I must admit I was somewhat surprised and pleased that the unexpected hero to bring this globally important issue forcefully on to the political agenda was the not so humble investigative journalist. Fortunately, not the one that revealed Kim Kardashian's bra size, but no less a global network called the International Consortium of Investigative Journalists (the ICIJ).

Founded in 1997 by American journalist Chuck Lewis, the ICIJ consists of some 190 journalists operating in 65 countries and describes its existence in the following terms:

The need for such an organization has never been greater. Globalization and development have placed extraordinary pressures on human societies, posing unprecedented threats from polluting industries, transnational crime networks, rogue states, and the actions of powerful figures in business and government.

The news media, hobbled by short attention spans and lack of resources, are even less of a match for those who would harm the public interest. Broadcast networks and major newspapers have closed foreign bureaus, cut travel budgets, and disbanded investigative teams. We are losing our eyes and ears around the world precisely when we need them most. Our aim is to bring journalists from different countries together in teams - eliminating rivalry and promoting collaboration. Together, we aim to be the world's best cross-border investigative team.

As the ICIJ advises on its website, cross-border investigative journalism is among the most expensive and riskiest in the world. Without formal funding (and requiring donations for its continuing work), the ICIJ was able to do what no Revenue Authority was capable of identifying and that was to expose the two largest tax frauds in history. More importantly, the ICIJ also revealed the clear weakness in the existing taxation and regulatory processes which have allowed these massive tax frauds to not only occur but thrive unabated until detected by them.

The well honed skills of the ICIJ came to the forefront of conscientious of global politicians in the Mossack Fonseca tax scandal. In what is called by journalists a drop (dropping a nuclear bomb), the story was released simultaneously through more than 40 news outlets around the world with a profound impact across all levels of society and rocked Governments.

It immediately claimed the scalp of the Icelandic Prime Minister Sigmundur David Gunnlaugsson who was heavily involved in a Mossack Fonseca tax structuring arrangement and left then British Prime Minister David Cameron reeling and resigning shortly thereafter as politically unelectable Prime Minister.

There is little doubt that these journalists are the 21st century equivalent of the heroic astronauts who lives formed the basis of the book The Right Stuff if the term may be borrowed from Tom Wolf's tome of the early days of the US space program. There is little doubt that these journalists have proven that the pen is infinitely mightier than sword!

In launching the first volume of my tax ethics series *Corporate Tax Ethics - A Journey for Mankind*, which essentially describes the process by which a no risk or ethical tax position may be achieved for multinational corporations, I worked with Michael West who was then with Australia's Fairfax to explore the response to what is essentially a principles based approach for international taxation as opposed to a more prescriptive approach.

Michael and I had previously collaborated on a very important article on how the class system in Australia had influenced hamburger pricing in our two leading ski resorts and established that the burger in the plebeian resort was actually more expensive than the burger in the patrician resort which arguably reversed the entire class structure of Australia.

When we commenced research for his series of articles on international tax avoidance, the work had already been considered by the highest levels of the Australian Revenue with Second Commissioner Andrew Mills concluding his thoughtful and balanced foreword to the book with the following comments:

Although ambitious, this book provides the groundwork for businesses that wish to make good tax ethics a non-discretionary part of their ethos. I recommend this book as essential reading for anyone with an interest in good business practices and for *those who want to make tax compliance their minimum standard.*

It must be emphasized that Andrew Mills and I had agreed prior to its commencement that that the work would be entirely independent of any views of the Australian Revenue and this would allow the work to represent the considered position of the International Society for the Promotion of Ethical Tax Behaviours and on which the Australian Revenue could independently observe.

A view was also sought from Alex Malley, then Chief Executive Officer of CPA Australia which is by far the largest accounting body in Australia who provided the following comments:

The publication on corporate tax ethics raises some interesting concepts relating to business structuring and tax, and is timely given the ongoing international focus on multinational tax avoidance, plus the recent Lux Leaks and this week's Panama papers.

For example, the concept that taxpayers who get the equivalent of a 'Heart Foundation tick' from revenue authorities as ethical taxpayers - and as such a tax rate discount - is certainly lateral thinking with a focus on driving more ethical conduct in corporate Australia.

It is worth noting that Australia already has a system which has features of ATO approvals – such as the advance pricing agreement system. Corporate responsibility is a balancing act between maximizing *shareholder returns within the law and demonstrating greater corporate social responsibility.*

The conversation about initiatives to align these competing interests is, in many respects, a paradigm shift. Initiatives such as this represent a significant contribution to this conversation. It helps move us from a rules-based, regulatory model towards a greater reliance on principles and practice to encourage better outcomes.

We have no doubt that the recent focus on MNEs and tax avoidance, as well as new laws and sanctions for tax avoidance, have brought about more attention to tax structuring arrangements in the boardroom. This in turn is likely to be impacting behavioural and cultural change.

Another game changer is the 100 international tax-sharing agreements that Australia now has in place – this means that for the first time the ATO will be able to see the whole transaction and not just those parts that a taxpayer chooses to share with them.

The model proposed, rewarding ethical entities with a reduced corporate tax rate, is worthy of further consideration and research to address any suggestions that taxpayers without the imprimatur of the revenue regulator (ATO) are less than ethical.

In his comments, Alex Malley in an overall endorsement correctly observes and emphasizes the importance of cultural change from a rules based approach where unintended tax benefits may be exploited to a principles approach where Board members and individuals make a choice as to whether to act ethically or not.

Having received the endorsement of the Australian Revenue and also the lead professional services organization in the country, the principles raised in my tax ethics series were put before the Big 4 accounting firms for their consideration in the following set of questions:

1. Admission of past mistakes does create an environment for positive change. What are the major mistakes of the tax profession and how should they be rectified?

2. Rozvany advocates a system of economic incentives to encourage ethical tax behaviours. Such a system would also be supported by much tougher penalties to eliminate gaming of the tax system. What does your firm recommend in introducing such a system?

3. Rozvany advocates an opt-in system for the ethical tax regime but with the incentive of a 5% discount in the corporate tax rate for those companies who elect to do so. Do you agree with this and why?

4. There is a view that the Big 4 accounting firms have accumulated too much private power to regulate? If given a choice, would your firm prefer to split accounting and tax into separate firms or split the firm down the middle to create competition? Are

there other potential solutions to resolve this issue?

5. The Lux Leaks scandals have been devastating for the Big 4 firms. What is your firm doing in terms of risk management to control “rogue” partners or rogue member firms?

6. Transfer pricing and other aggressive international tax structures cost the global community some $US1 trillion a year. What is your firm doing to rectify this following Lux Leaks?

7. Rozvany proposes the implementation of an ethical or no-risk tax profession which he outlines based on 30 years of experience advising major clients. There is clearly room for such an approach. How would your firm do this?

8. There is a link between tax avoidance, money laundering, organized crime and terrorism. It is called the money flow. How does your firm filter its clients to ensure that this link is broken?

9. Antoine Deltour, the whistle blower at the center of the Lux Leaks scandal, is on trial next month for his alleged crimes in disclosing the contrived tax arrangements while also winning a major European Parliamentary award for the same act. Does your firm agree that similar whistle blowers should be prosecuted?

10. One of the objectives of the International Society for the Promotion of Ethical Tax Behaviours is to

establish charities for the victims of tax avoidance - the most underprivileged in our society including the homeless in our streets, children dying of curable diseases in third world countries, foreign aid programs, abused children all of whom receive inadequate funding. Given the carnage caused by Lux Leaks to government revenue, how much will your firm be contributing to these victims through the Society?

At the time of publication three of the Big 4 accounting firms (Deloitte, PricewaterhouseCoopers and Ernst & Young) returned a comment along the lines of Celine Gordine-Wright at Deloitte Touche Tohmatsu which was as follows:

Thank you for getting in touch last week regarding the article you are working on around George Rozvany's new book. We appreciate the approach to contribute to your article, but have decided to respectfully decline your offer on this occasion.

KPMG had undertaken to provide a response at the time of publication and I must give KPMG some credit here and particularly *Grant Wardell-Johnson* who is the Leader of KPMG's Australian Tax Centre and is always prepared to engage in a robust discussion on the various tax matters which is the whole idea taxation ethics series – *constructive discussion with the objective of greater financial integrity!*

If I may digress slightly, I should declare also that KPMG were my chosen corporate tax advisers for the

16 years preceding my resignation from corporate life to write the first two books in the five book series on tax ethics. In my experience, KPMG Australia's taxation advice was always ethical, commercially sound and was neither aggressive nor were any of the combined views of KPMG and myself ever rejected by the Australian Revenue. The longest serving Partner during this 16 period was a softly spoken and highly intellectual gentleman by the name of *Jeremy Hirshhorn* with whom I discussed a range of ethical taxation issues over the years.

It was no surprise to me when Jeremy suddenly resigned KPMG as a Partner and accepted the very senior and influential position of Tax Counsel at the Australian Taxation Office (ATO). Both Jeremy and *Andrew Mills*, Second Commissioner at the ATO, in my opinion both share the right balance of commercial and revenue experience along with a strong position in relation to the taxation ethical issues which should govern society as a whole. In my view, one of them will be the next Australian Commissioner of Taxation when the current Commissioner, *Chris Jordan*, retires in 2024.

In terms though of the overall response of the Big 4 accounting firms to the information requested by Michael West and information and comments generally requested from journalists, one must assume that the myth of infallibility will always kick in and therefore very little of meaning will ever be said.

It would appear too cloistered a view given that I have now written four books on high demand areas within the international tax world over 25 years while the 1,000,000 odd staff at the Big 4 accounting firms have not attempted to address any of these areas individually or seemingly collectively in a substantive way. *Perhaps, they may be forgiven for not writing this particular book!*

Chapter 11
A Message for Our Times

When I commenced this work on the Big 4 accounting firms, a close friend, Dr Owen Williamson, who has known me since our school days at Wesley College in Melbourne, Australia asked me *whether I had a death wish?* As a man who has served the community as a specialist surgeon and physician with great distinction and great humour and one who has also asked the difficult questions since we were 12 years old, the question was more than reasonable, as it always is, and required a response. The answer was:

Thanks Owen, I definitely do not!

However, as my late father Professor George Rozvany who revolutionised the world of civil engineering through his work on optimization of structures said:

Taking the opportunity to advocate positive change if one has the ability to do so is not a choice but a moral responsibility to society.

As mentioned in the Preface, the role of the tax ethicist as with an external auditor to an organisation is to objectively examine the existing systems, in this case the taxation systems, and to provide views and suggest improvements on the overall integrity of those systems from both the viewpoint of the organisation and the viewpoint of the wider society. While this audit is written as a book, the objective is exactly the same as an external auditor to identify weaknesses and suggest improvements to stabilise and ensure integrity to those systems for the benefit of mankind.

The reality is that every person born to this earth has the capacity to make *individual choices* during what is a disturbingly limited lifespan. Each choice will have a definite outcome. Some choices result in the expansion of human knowledge and result in great benefits to mankind. Other choices are far more self-serving and seek to benefit only the individual decision-makers.

As Martin Luther King said:

Morality cannot be legislated, but behaviour can be regulated. Judicial decrees may not change the heart, but they can restrain the heartless.

Aggressive taxation behaviours may be viewed by some as little more than a game of chance in the casino of life. Such behaviours only seek to financially benefit the individuals who seek to *play the game* to the detriment of the wider society with many very real and vulnerable victims *who need society's compassion and support the most!*

The global community must also note the clear links between aggressive taxation behaviours, money laundering, corruption, organized crime and terrorism of which 9/11, the Brussels bombings and a long chain of terrorist events since and before are chilling examples.

This money flow is unquestionably the *financial sewer* of humanity and it be must be recognised that criminal organizations such as the Mafia, the Yakuza and Triads and terrorists alike generally *do not adopt conservative tax practices* as part of their modus operandi but *do use* the same tax avoidance structures as their corporate cousins *at the right end of town*. The true numbers of victims of aggressive tax avoidance behaviours may never be known, *but must never be forgotten!*

If an engineer were to deliberately substitute sub-standard materials to cut costs and a major bridge collapsed as a result, would society seek to reward the engineer for his deception? If a senior executive in a bank were to defraud that company of tens of millions of dollars, would that executive receive his full bonus at the end of the year?

If a specialist doctor were to avoid necessary surgical training to go skiing and a patient is disfigured as a result, would his medical board enquire as to whether the snow was good? In all these cases, the answer would be a resounding *no!* Yet, against all moral sense the aggressive tax behaviours continue to seemingly thrive pushed by the players in the aggressive tax industry, *the peddlers of greed!*

As stated throughout the Tax ethics series, tax is *not a game*!! It is the action of the Lawmakers to responsibly raise the funds from society while protecting the Revenue base from aggressive tax practices and to morally allocate those funds back to society. Lawmakers must have *a deep understanding* of the *responsible raising, the required protection and* the *moral allocation* under the taxation process.

Balance is extremely important in this regard. Lawmakers spending time *only* with *the important people* of society and their sycophantic advisers will never deliver this deep understanding as the rich, the aspirational rich and those that serve them *are driven by their own interests*. Lawmakers should ensure that they also directly talk to and *personally touch* the circumstances of those less fortunate than themselves.

Lawmakers do need to look into the eyes of the mother who can no longer afford the necessary medicine to ease her child's pain from a *curable disease* because a billionaire needed a tax break on a casino. Or perhaps sit down and share a sandwich with a homeless person, find out how he or she got there and consider the funding of a program to assist their return to mainstream society or develop programs to prevent others falling in to such an unfortunate position. Or perhaps giving appropriate financial support to a 22-year-old War Veteran who gave three of his four limbs in the service of his country, rather than funding an exemption for a $20 million gain on the sale of a principal residence of a property developer. Or perhaps even a social worker trying to run an education program for the responsible and effective raising of early age children by single mothers as my Partner's mother did only to have that program cut due to perceived necessary short term budget cuts inexplicable in either human or long term economic outcomes.

The individual people who are the voters of our democratic nations scattered across our global society would be wise to pause, take a deep breath and consider how aggressive tax practices *affect those around them*. Again, there is *a simple choice* between voting for Lawmakers who *will act* on aggressive tax behaviours and those who *will pander* to the top end of town with a view to only lining their own pockets through highly paid appointments in retirement after delivering valuable favours during their political careers, a clear and common dereliction of duty.

While ultimately the voters will decide on whom to grant the next legislative mandate at the end of a Government's term by way of the election process, the immediate legislative agenda is still very much the choice of the present elected Lawmakers.

In a casino, *the house* controls the odds to ensure a profitable outcome for the owners. In any jurisdiction, *the Lawmakers* similarly can well control the inter-election outcome of aggressive tax behaviours for the benefit of their constituents, rather than merely bleating about their budgetary woes or attacking their opposition politicians. In such circumstances, inaction or lack of effective action by Lawmakers is undoubtedly part of the problem.

As President John F. Kennedy famously said (which he incorrectly attributed to Edmund Burke):

The only thing necessary for the triumph of evil is that good men do nothing.

The introduction of Laws that specifically encourage ethical tax behaviours by way of, for example, the discounting of corporate tax rates (and perhaps a premium for those taxpayers electing not to be ethical) should be carefully considered in a form appropriate to that jurisdiction and enacted. It does not matter whether that jurisdiction is generally *high tax* or *low tax* as the outcome against tax behaviours will be the same. A repeat of the Lux Leaks, KPMG tax shelters, the Panama Papers or Paradise Papers tax scandals should never occur again and Lawmakers can and should ensure this is their clear objective under their elected mandates.

Lawmakers who purport to be against aggressive tax practices must ensure that the outcome of their actions is consistent with their stated policies. Aggressive tax practices should not be seen to be *smart* nor *worth the risk* to an organization pursuing such practices.

Personally, I am very looking forward to the first politician who stands up in his or her House of Government and proclaims the necessity for an ethical tax regime and successfully steers it through their legislature to become taxation law.

The vision is now for the major corporates, the Lawmakers and the international firms to take the lead, look at those who are far less fortunate around them and move positively and cohesively to act on the ethical tax front to ensure ethical tax practices become the norm to create a better global society.

The specific challenge for the Big 4 is to ask themselves are they true to the ethical foundations of their profession and the society around them and, if not, what should they be doing to correct this? Splitting taxation and audit services in to separate firms will increase integrity. Splitting of tax firms and audit firms into separate firms will create competition. Such measures are extremely important to society and should be seriously considered.

Despite my largesse in this work, the overwhelming majority of Big 4 Partners are not criminals and have no intention of acting criminally. Nevertheless, each of these Partners has the ability to create positive change individually and collectively and ultimately it is this measure that their families and society will ultimately judge them upon in retirement.

The five volume tax ethics series has a strong focus on the adoption internationally of a universal set of principles to address the serious problems caused by tax avoidance behaviours to the global society in which we all live.

The advantage of a principles based approach is that the average citizen *will understand* how this major global crisis is being addressed. The tax ethics series advocates just five basic principles that will unquestionably confront and substantially reduce the damage wrought on society by the scourge of international tax avoidance. Although these five principles are discussed earlier and mentioned subsequently in the appendices, they are worth reinforcing for both Lawmakers and their voting constituents (and those who like reading the last Chapter first in a book which I am one).

They are:

Taxation Principle 1: All jurisdictions aggressive *should encourage ethical tax behaviours by way of economic incentives through discounts in the corporate tax rate or other real incentive measures.*

Taxation Principle 2: All jurisdictions should ensure that appropriate punitive measures reflecting the fraudulent nature of aggressive taxation behaviours be implemented including incarceration.

Taxation Principle 3: All expenses originating from a jurisdiction internationally characterized as a tax haven will be denied a tax deduction in the home jurisdiction.

Regulatory Principle 1: All jurisdiction must ensure that an accounting or professional services firm or organization does not provide both taxation and audit services to the public.

Regulatory Principle 2: All jurisdiction must ensure that there is sufficient competition in both taxation and audit services to provide an orderly market.

As with the opening to this volume of the tax ethics series, it is fitting to end with the words of President Franklin Delano Roosevelt:

The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little.

As for my role in this, my mother will quote from the movie *Monty Python's Life of Brian:*

He's not the Messiah, he is just a very naughty boy! Now go away!

Indeed, the reader must go away and consider what their own personal contribution will be in relation to the conundrum of international tax avoidance, whether it be by way of positive or negative action. As I said, it is ultimately one of personal choice for every person born to this earth to decide where they sit in on this matter.

The international tax avoidance industry is indeed the most alluring and darkest of mistresses who is not only rich and powerful, but has had too many lovers and she has simply lost her way. There is little doubt that one will lose objectivity if one spends too much time with her.

Accordingly, I have come to the realization that it is simply impossible for one person to write all five books in the tax ethics series *nor is it right to do so!* As a result, I will be putting down my quill on the table and will not be picking it up again allowing others to complete the last three books in this five book tax ethics series.

I have no doubt there will be some criticism of the views recorded in this book and no doubt some personal criticism *of me* as well because that sadly is the expected outcome of a proposed and sensible change to a powerful and established autocracy with vested self interest.

It is, however, important to recognize that the views expressed in this second volume of the tax ethics series, whether they be of an audit nature or not, are predominantly *not my own* and are mainly drawn from the facts ands views expressed by the Partners of the Big 4 accounting firms themselves. *I am merely the scribe and as the saying goes – do not shoot the messenger!*

Acknowledgements and Notes to the Appendices

In writing this book and associated appendices, I would like to acknowledge the contribution of an eminent group of thought leaders in this area including investigative journalist and Walkley Award winner, Adjunct Professor Michael West of Sydney University, social demographer Professor Bob Birrell, Treasure Islands author and expert commentator on the international tax avoidance question, Nicholas Shaxson, Pulitzer Prize winner and Donald Trump biographer, David Cay Johnston, Kris Neslund, Professor in Accounting and Law at Baldwin Wallace University, Naomi Fowler of the Tax Justice Network and BAFTA Award winner and Academy Award Nominee Joshua Oppenheimer.

These good folk have generously given their time in sharing their views on the ethical tax question in developing this important area of knowledge for humanity and advising how to better approach these issues from a journalistic, literary, logical or common sense viewpoint. Apart from the four incredible women in my life, my mother Ann, my partner Aninha, my daughter Annaliese and my puppy Truffle, I would also like to thank my IT guru Andrej Petkovski who has opened my eyes to the dark arts and sciences of the cyber world.

Appendix 1 provides an example of the extent of international tax avoidance of multinational companies encouraged by the major international accounting firms and named as such by the

International Consortium of Investigative Journalists as involved in 2014's Lux Leaks tax scandal involving the release of *just* 28,000 documents.

Subsequent tax scandals revealed by the International Consortium of Investigative Journalists such as 2016's Panama Papers tax scandal in relation to the aggressive tax law firm Mossack Fonseca and 2017's Paradise Papers tax scandal in respect of offshore magic circle member Appleby have provided increasingly rich sources of confidential electronic documentation at 11.5 million and 13.4 million documents respectively. While it would be useful to include such documentation as a book filler, at 24.9 million documents most readers would pass by the time the reading of such an immense book was finished.

Appendices 2 to 5 provide a range of articles written by myself on a range of contemporary taxation matters falling outside the major taxation scandals, but nevertheless are themselves of global significance.

Appendix 2 - *The EU Commission Decision on Apple – a* law *Prelude to the Aftermath of the People's Tax Revolution* reflects on the growing and rapidly expanding people's movement within Europe against the scourge of international tax avoidance. The action of the EU in 2016 to take on one of its own in Ireland on competition grounds rather than traditional taxation was not only highly commendable but ground breaking. It will be interesting to observe whether this initiative in the use of competition law for taxation purposes becomes part of a growing legislative arsenal against international tax avoidance or merely remains an interesting but isolated sidenote.

Appendix 3 - *The Bonfire of the Big 4 Accounting Firms – An Ashen Prelude to Armageddon* explores the reasons behind the financial fragility of the Big 4 accounting firms including under-insurance, under-capitalization, conflicts, insufficient financial transparency and the lack of an international regulator and the potential for a simultaneous collapse of all four firms under the weight of lawsuits driven by increasing Director's responsibilities in respect of risk management.

Appendix 4 - *To Cut or Not to Cut – That is the Question* examines the weaknesses and possible motivations in decision making of our Political Leaders in reducing the corporate tax rate on the basis of improving competitiveness without any substantive economic proof.

Appendix 5 – *Malcolm Bligh Turnbull – An Errant Founding Father Turned Politician of Fortune in Tax Avoidance Paradise* examines the approach to taxation of the current Australian Prime Minister and former US Partner of the prestigious investment bank Goldman Sachs.

Appendix 6 – *Interview by Michael Vaughan, PHD candidate at Sydney University studying Civil Society's Engagement with International Tax Justice Issues* – Given my extensive record of successful public advocacy, Michael was interested in interviewing and exploring the conditions for successful *mobilizations* and what factors influence civil society’s decision-making. This was an interesting discussion for me and one I certainly welcomed from the viewpoint of encouraging *the young and the keen* to hone their skills in advocating positive change for society. *You are allowed to have fun while doing this and I certainly have!*

Appendix 1: Companies Named by the International Consortium of Investigative Journalists as involved in the Lux Leaks Scandal

i2PCT, 3i Abbott Laboratories, ABN Amro Group, Abris Capital Partners, Abry Partners, ABS – CBN Broadcasting Corporation, Abu Dhabi Investment Authority, Accenture, ACE Group, Acergy Group (now Subsea 7), Advent International Corporation, AEA Investors, AHW Capital Management, AIG, Alexander Eriksen, Alfa Group Consortium, Allco Finance Group, Amazon, AMB Property Corporation, Amcon Allied Equity Holdings, Ameriprise Financial, AMP Capital Investors, de Spoelberch Family, Aozora Bank, Apax Partners, Guardian Media Group, Apex Capital Management, Apollo Global Management, Apple, Arcapita, Arch Capital Group, Archangel Diamond Corporation, Arison Group, Artal Group, Ärztekammer Westfalen Lippe, Atomico Audley Capital Advisors, Avenue Capital Group, Avery Dennison Corporation, AVIVA, AXA Group, Babcock & Brown, Balderton Capital, Ball Corporation, Baloise Group Banca Delle Marche Group, Banca Popolare Dell'Emilia Romagna, Banco Bradesco, Banco Itaú (now Itaú Unibanco), Banque Martin Maurel, Baring Private Equity Asia, Bayerische Landesbank. Baytex Energy Corp, BC Partners, Belfor, Bjarne Borg, Blackstone Group, Bluebay (now Royal Bank Of Canada), BNP Paribas / Crédit Agricole, Boston Consulting Group, Bridgepoint, Brookfield Asset Management, Bucher Industries Group, Burberry Group, Cargill, Carlyle Group, Catalyst Investment Managers, CB Richard Ellis Group, Centerbridge

Partners, Charterhouse Capital Partners, Chateau De Berne, Cheyne Capital Management, China Petrochemical Corporation (Sinopec), China Yunnan Metallurgical Group, CIRCOR, CITCO, Citigroup, Cliffs Natural Resources, CNP Assurances, Coach, Commerzbank AG, Companhia Brasileira De Distribuição, COMPASS Group, Cordea Savills, Covidien Group, Credit Suisse, Damovo Group, Dawnay, Day & Co., Dean Foods, Delff Management, Developers Diversified Realty Corporation, DNB Nor Group, Doughty Hanson, Draper Fisher Jurvetson, DST Systems, State Street Group, Dubai International Capital, DUET Group, Dyson, EFG Group, Emulex, Encore Consumer Capital, Englefield Capital (now Bregal Capital), EQT, Equity Trust (now Doughty Hanson), ESO Capital Group, Eurohold, European Property Investors, Eusa Pharma (now Jazz Pharmaceuticals), Evraz Group, Experian, Fairfax Financial Holdings, FedEx Corp, Fidelity, Field Point Group, Financière Lafayette, Finmeccanica Group, Fonciere Inea, Foresight Group, Foster Wheeler, Foyer Group, FREO Group, Friends Provident, Fung Group, Future Fund, G.J. Hannink, Gategroup, Gazprom, GE Group, Government Of The Emirate Of Abu Dhabi, Gigamedia Limited Group, Gildemeister Group, Glanbia, GlaxoSmithKline, Golden Gate Capital, Golding Capital Partners, Goodman Group, Graymont Group, Great Atlantic & Pacific Tea Company, Groupe Caisse D'Epargne / Groupe Banque,Populaire, Groupe LCF Rothschild (now Groupe Edmond De Rothschild), Groupe Rothschild, Gruppo Banca Sella, Harbinger Group, Hauck & Aufhauser, Health Alliance Group, Heinz, Henderson Group, HG Capital, Hideal Partners, Highland Capital Partners, Hines, HNA Group, Home Credit Group HSBC, Hutchison Group, Hypo Real Estate Group IAM, ICAP, Iceberg Qapital, IK Investment Partners, IKEA, Informa, Intelsat, Intergenia, International Flavours & Fragrances, Intesa Sanpaolo Group, Investcorp / Barclays, IVG Immobilien, J Chahine Capital, J.C. Flowers, Jardine Matheson Group, JER Partners, Jones Lang Lasalle, J.P. Morgan, Julius Baer Group, Kaupthing Bank (now Arion Banki), KBL Lombard International Assurance, King Street Capital Management, Knight Business, Kohler, Landesbank Baden-Württemberg, Langres Investment Limited, Lehman Brothers, Li Family Trusts, Lion Capital, Livingstone Brothers, Lombard Odier, Lubrizol (now Berkshire Hathaway) LVMH Moët Hennessy Louis Vuitton, Macquarie Group, Mark IV Industries, Maus Freres, McGraw-Gill Companies, Mercapital (now N+1 Group), Merrill Lynch, SATPO Group, Mettler-Toledo, Meyer Bergman, Millipore, Montagu, Moorfield Group, MYLAN, Navistar / Caterpillar, New Gulf Engineering, Nikko Cordial Securities (now SMBC Nikko Securities), Nippon Sheet Glass, Nordic Capital, Nordson, Northern & Shell, Oaktree Capital Management, Office Depot, Olayan Investments Company Establishment, Olympus Capital Asia, Pacific Century Group, Pala Investments, Palamon Capital Partners, Paloma Industries, Panorama Capital, Paul Capital, Pepsi Bottling Group, Permira, Perry Capital, Procter & Gamble, Prospector Offshore Drilling, Providence Equity Partners, Prudential, Public Sector Pension Investment Board, QuadD-C Partners, Quilvest, Ramius, Reckitt Benckiser, Reso, RMK Timberland

Group, Rockspring, Rosebud Real Estate, ROWAN Companies, Rubus International, Sanpaolo Group (now Intesa Sanpaolo Group), SberBank, Schawk, Schroders, Ship Trust / Tree Trust, Shire, Signa, Sisk Group, Skandinaviska Enskilda Banken, SOCFIN, Société D'administration Et De Gestion Atlantas, SAGA, Sportfive Group, SR Technics, Stabilus, Staples, Star Capital Partners, Starwood Capital, Sun Capital, Swire Group, Sykes Enterprises, TDR Capital, Tele Columbus, Tele2 Group, Temenos Group, TEVA Pharmaceutical Industries, The Heesen Family, Tiger Global Management, Tiger Partners, Timberland, Tinicum, Titan International, TMD Friction, Tower 2008 Charitable Trust, Towerbrook Capital Partners, Trafalgar Overseas, Tyco Group, UBI Banca, UBM Group, UBS, Unibanco Brazil (now Itaú Unibanco), Unicorn Investment Bank, Unicredit Group, United America Indemnity (now Global Indemnity), United Technologies Corporation, Upline Group, Value-Call, Vastned Offices / Industrial NV, Verizon, Vermilion Energy Trust, Veronis Suhler Stevenson, Vers.Werk Der Zahnärztekammer Westf. Lippe, Vistec Electronic Beam Lithography Group, Vitec Group, Vitruvian Partners, Viva Group, VKGP, Vodafone, Volkswagen Group, VTS Group, Warner Chilcott (now Actavis), WE Group, Weather Investments, Weatherford International, Wendel Group, WGZ Bank, White Mountains Insurance Group, Wolseley, Yamana Gold and York Capital Management.

Appendix 2 - The EU Commission Decision on Apple – a Prelude to the Aftermath of the People's Tax Revolution (2016)

In 1964, when Bob Dylan wrote his immortal protest song, *The times they are a-changing*, the peoples tax revolution of today was just 52 years away. While many issues have altered little over the years such as whether *a-changing* is an actual word or not, attitudes towards multinationals and their advisers are clearly in transition towards much greater transparency, accountability and indeed a corporate ethical tax framework.

It was not surprising that the strongest *protest* statement came from Apple's own CEO Tim Cook who described the European Union's imposition of an unprecedented 13 billion Euro (US$19.2 billion) tax bill on Apple as *total political crap*. It would have been somewhat interesting if the EU had the capacity to impose jail time for foreign CEO's of company's who committed major tax fraud. This should be the case as this is a crime of vast proportions on society and deserving of a jail sentence and Cook readily admitted *moral culpability* through his words.

More importantly, the comment is so far distant from the current values in society and yet so telling of the true attitudes of the top levels of major corporations and indeed the superrich. In a true democracy, the leaders of the major corporations and indeed the super rich have *no greater entitlement under the law than a homeless person of a single vote!*

If the leaders of corporations and the superrich have a greater entitlement over a nation's law than a homeless person then there is no longer a democracy. We simply have a Government for hire to provide law services to the rich and powerful. In Australia's case, we clearly no longer have a democracy. I have worked with all the major advisory firms and all the major investment banks for the last 32 years so I know these folk extremely well – they desire power and wealth not equality under the law or democracy. *If they can get an advantage over society they certainly will!*

The duty of Government is to ensure that this does not occur. Let us face reality, we have a Prime Minister who was unquestionably a brilliant investment banker but let us look at just two decisions.

Firstly, the proposed sale in to private ownership of the ASIC Register which maintains the financial records of all corporations resident in Australia including the major corporates and multinationals with their incredibly complex and shifting layers of operating entities. *Transparency* is a basic tenet of a democracy particularly when it comes to the financial records of the major corporations and multinationals. In many countries of the world such as the United Kingdom, there is no charge for accessing financial records.

Any financial charge on transparency will automatically cut out access for a proportion of society. An increased charge though private ownership will only allow true access to the more elite levels of society. For example, access to the financial records of a group of companies with say a hundred entities over 5 years currently costs A$19,000 in Australia. How much will this be in private hands? In round terms, with a typical return on equity demanded by a private investor, *let us say A$100,000!*

Secondly, the proposed drop in the corporate tax rate. In reality, tax competitiveness does not translate in to commercial competitiveness. As confirmed by the World Economic Forum over many years, tax does not even appear in the top 12 factors for commercial competitiveness. In fact, the majority of the most competitive economies in the world are high taxing. The drop in the corporate tax rate will cause cuts to welfare programs which will be passed on to shareholders of companies who are typically from the wealthier classes.

Following the worldwide outrage of the Luxleaks and Mossack Fonseca tax scandals, there is no doubt that the people's tax revolution has commenced and is gaining momentum and is putting pressure on Governments. What is important about the EU Apple case is that it is a timely and obviously targeted decision against one of its own member States.

There are a number of important implications to this.

1. The EU is sending very clear message to all Member States to tidy up their acts on international tax avoidance.

2. It is very likely to either put a complete end or at least inhibit the favourable tax rulings system to individual companies operating within the EU block. This will put considerable pressure on the US and the UK to do likewise with their associated tax havens such as Delaware and the British Virgin Islands.

3. The position taken is what responsible Government should be to reign in what is irresponsible decision making. The action of Ireland to appeal the decision against the interest of its own constituents is proof of a Government who has lost its direction and should properly lose the support of its electorate.

4. The use of competition law opens up a potentially new set of powerful legal weapons against tax avoidance by ensuring a level playing field on tax decision making and the law in this area is almost certainly likely to be strengthened based on experience.

5. It is possible that Ireland may leave the EU as a result of the decision. This is a matter for the Irish but they certainly must contemplate future international action on taxation which may render such a decision as facile.

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The EU action is a reminder for all Governments to think creatively on how to address the scourge of international tax avoidance. The EU approach is indeed very impressive. Merely allowing company tax revenues to fall through weak action on international tax avoidance and even worse cutting corporate tax rates on unverified assumptions is a clear sign of incompetent Government. As Victor Hugo said:

There is nothing more powerful than an idea whose idea has come.

Appendix 3: The Bonfire of the Big 4 Accounting Firms – An Ashen Prelude to Armageddon (2017)

Although just nine years since the last Global Financial Crisis, it would seem that world has a suppressed what it means to be on the edge of economic cataclysm. A new generation of predominantly anemic elected representatives in the guise of lawmakers cavort on their electoral success in our halls of power and indeed the leadership apex of most of the Western economies. Short political lifetimes and even shorter political terms together with the style of the new generation of political aspirants of everyone *being different* to captivate social media and the all important *patronage* of the rich folk has largely resulted in politicians incapable of independently identifying current risk areas for a potential global financial crisis, let alone either independently or dependently developing prevention strategies or total solutions for such an event. If you don't believe me, just ask your elected representative what the top four risks are for a GFC and what are his and her broad plans for addressing them.

Even those who remain from those treacherous times, few apart from perhaps German leader Angela Merkel can claim both leadership and a meaningful contribution to their nation's handling of the GFC. So consign to oblivion President Trump for a moment and consider the political emergence in 2020 of a more alluring and unquestionably more female conscious President Kim Kardashian. To whet the line of questioning on the GFC risk issue (and you will now know why from your first attempt), you may wish to suggest that the top 4 risks may well be the self proclaimed *Guardians of International Commerce*, the Big 4 international accounting firms Deloitte, Ernst & Young, KPMG and PWC whose names adorn as symbols of economic efficacy the skylines of every major commercial hub in the world.

This article probes this question and may well give the reader some indicators as to why this may not be as absurd as the Partners in the Big 4 accounting firms will have you believe.

When it comes to global financial crises, let us assume that Mark Twain was correct in saying:

History doesn't repeat itself, but it does rhyme.

So it is unlikely that a global financial crisis will occur on quite the same terms as in 2008 with a cancerous growth of purported AAA rated financial instruments, but it will occur and certainly in a way that is complex beyond belief, riddled with *how could this possibly occur* causes and outcomes, a global stampede of both rational and irrational investors to investment assets of relative safety such as gold and totally unprepared Governments around the world desperately seeking a way out. History has many examples of unusual causes for major financial crashes including *tulip mania* in early 16th century Holland where the pre-crash value of a single Viceroy tulip bulb reached some 10-14 times the annual income of a skilled craftsman or some US$600,000 in today's dollars before a catastrophic decline in February 1637 to the more sober 2017 prices some 380 years later.

So where would a newly elected President Kardashian seek such advice from? There is little doubt that each of the Big 4 accounting firms is well capable of producing a substantial report for the White House on potential risk areas, potential actions to mitigate such a risk and so forth. In my humble opinion, however, it is extremely unlikely that the respective tribal cultures of each of the Big 4 accounting firms of being *the best* would allow an open admission of the potential collapse of one or all of their own as a trigger for a GFC despite the implosion of accounting behemoth Arthur Andersen & Co in 2002 and the near collapse of one of the current Big 4, KPMG, in 2007 as a result of fraudulent tax shelters.

I digress slightly to explain briefly the world of risk which has only emerged as a discipline in relatively recent times. Typically, guided by a Chief Risk Officer, it is a Board of Directors duty to its shareholders to identify key risks to the organization, a policy in relation to each key risk perhaps including an acceptable risk tolerance, a set of procedures to deal with such risks, a set of of controls to ensure that the risk is appropriately dealt with and testing of those controls to ensure that the controls themselves are effective in ensuring that the risk is appropriately dealt with.

The risk function has emerged strongly from the pack for the simple reason that calling a risk wrong could easily result in a multi-billion law suit for a Board of Directors not just in relation to tax risk but in relation to other risks to the organization such as environmental risk of which the industrial catastrophe of Bhopal in India in 1984 is a prime example with over 500,000 people being exposed to methyl isocyanate and other toxic chemicals.

However, tax risk arguably looms as the largest of all risks due to the continuing seductive appeal of international tax avoidance to generate large financial gains for an organization through persuasive selling techniques and the use of tax structures which have little impact on its day to day running. For example, while no doubt initially perceived as a clever tax planning gain by Apple through the use of an Irish structure, the subsequent US$14 Billion "unexpected" tax bill from the European Union on competition grounds was not only foreseeable but highly likely under well established transfer pricing rules let alone the generally unexplored but compelling argument for Governments under competition law.

Apple CEO Tim Cook's well reported comment of *total political crap* would have no doubt have upset many Europeans and most certainly those in power in the more moderate EU economies. However, it may have been enough to stir shareholders in to a class action against the Directors of Apple for the aforesaid US$14 Billion. It is somewhat unusual for Directors to have sufficiently deep pockets to sustain a lawsuit of US$14 billion and both plaintiffs and defendants alike would seek to join both the auditors and tax advisers on the assumption of their much deeper pockets - in this case Ernst & Young on both counts! It should be noted here that such tax structures are rarely used once in *international tax planning* by the major accounting firms and typically are sold many, many times to any client prepared to accept that the structure actually *works* or is prepared to take the risk that the structure will pass all relevant Revenue Authorities. Of significance, on a tax structure as long dated as the Apple structure used in Ireland and in a jurisdiction as compliant as the Irish whom immediately indicated their intention to appeal against the EU's decision, it is not inconceivable that $100 billion could be at stake on this structure alone. But let us dig further!

In the past two years, the Lux Leaks and Mossack Fonseca tax scandals have demonstrated to the public at large like never before a critical global weakness in the understanding of the international tax avoidance issue by our Political Leaders and Lawmakers. In a clearly orchestrated long term strategy by the tax avoidance industry, the perception is that because these arrangements are technically legal (in tax havens) they are somehow legitimate in nature. The reality is that the most heinous of activities throughout the history of the law have been entirely legal until they have been made illegal by the Lawmakers. In a quite extraordinary statement which demonstrates just how effective and accepted this argument on legality has become in relation to aggressive tax practices, President Obama in commenting on the Mossack Fonseca said:

There is no doubt that the problem of global tax avoidance generally is a huge problem. The problem is that a lot of this stuff is legal, not illegal.

One must say that it is very unusual for the Leader of the Free World (and one I must I say greatly respect) to be so badly caught out on an issue of such global significance! The point may be valid in an insular universe of political thinking ideal for the international tax avoidance industry, but Mr. President Sir you held the keys to the nuclear arsenal capable of destroying the world how many times over for eight years and yet you could not protect the almighty United States of America against a rocky outcrop tax haven of perhaps 300 people somewhere out there in the absolutely nowhere with taxation laws designed to enrich the locals, enrich further the rich of the world and add to the super rich of the world devoid of any social responsibility whatsoever?

At the same time, while the Western economies have essentially been collectively ineffective on the international tax avoidance front, they have all been falling over themselves to implement what must surely be the greatest confidence trick in history. As if from the tablets of Moses, the eleventh commandant (the one that accidentally chipped off at the bottom) states:

Thou shalt lower the corporate tax rate and receive bountiful economic returns.

While the argument likely had its origins in the establishment of the tax haven network and the requirement to fund a few hundred or thousand citizens following the loss of colonial patronage, there is no real evidence to support the argument that lowering the corporate tax rate (i.e. tax competitiveness) will lead to international economic competitiveness. Nevertheless, the Big 4 have pushed the argument mercilessly across the globe and it must be said with considerable success. Devotees of the Laffer curve suggest that a 30% corporate tax rate is about right for maximizing corporate earnings and Government revenue alike. This is a view I have some considerable sympathy with and I believe "a fair base price to pay for civilization".

A much sounder framework for economic competitiveness has been raised annually as the *12 Pillars of Economic Competitiveness* at the Davos Economic Forum. The 12 Pillars are immensely important in developing what I believe are the real building blocks of international competitiveness through targeted tax incentives designed to reward investment risk for real growth such areas as innovation. This may be described mathematically as follows:

Good Tax Policy = Appropriate Corporate Tax Rate + Targeted Tax Incentives for Real Growth

Merely cutting the corporate tax rate will not achieve this! Further from a tax ethics viewpoint, erosion of the tax base of any country in the world will contribute to the global scourge of stripping the global poor of necessary foodstuffs to eat, real opportunity through education and saving tens of millions of lives globally through an entirely conventional health system. In the context of a Global Financial Crisis, it also means that many Western Governments will not have the cash reserves available to buy their way out of the next GFC. So again mathematically:

Bad Tax Policy = Cutting the Corporate Tax Rate

As the reader may have gathered, we are building what is currently both a contemporary and realistic global scenario where Directors of major companies could be sued for US$15 billion for failing in their duty to appropriately manage a company's tax risk through conventional risk management practices, potentially a US$100 billion law suit against a Big 4 accounting firm for a single tax planning structure and perhaps potentially US$1 trillion or more in potential law suits against the "Big 4" accounting firms for tax planning structures that "did not work" all of which is likely to have every litigation funder in the world salivating at the prospect of super big pay days.

Remember, we are talking about the Big 4 accounting firms who collectively audit 99% of all global companies with a turnover of US$1 billion, a cartel unprecedented in history and one borne to carry immense responsibility. When you consider that the "Big 4" themselves have a turnover of more than US$130 billion between them or about US$35 billion each and these guys are all in professional services so when it comes to disclosing their own financial position and insurance cover to ensure proper protection against a potentially very large figure in terms of lawsuits, we would expect a magnificent series of glossies setting down all financial and insurance and reinsurance information. After-all, these are the key factors in assessing risk and required by every client and potential client to do so and well understood by the Big 4.

Well try as my journalist colleague Michael West did (see michaelwest.com.au), all four held a dignified silence on the matter. Although such a response does carry an implication of "unworthiness", it does allow for some reasonable journalistic speculation on the matter. We gather that all four do self insure and, if they do, then it would *usually* make sense from a properly assessed insurance viewpoint to pool these risks to *decrease* overall risk. However, if the Big 4 individually and collectively under-estimate their insurance risk and under-insure through low premiums then they will not have sufficient insurance cover in all circumstances to meet legal pay outs. Typically, a first tier insurer will assess, pool and price risk correctly thus removing risk entirely for an insured so why take on risk which could lead to the demise of the firm when the business is professional services and not insurance?

In part, one must recognize that each of the Big 4 firms has a strong tribal culture each purporting to be "the best". I am the first to concede after 32 years working in various capacities with all the Big 4 firms that they are undoubtedly very good in what they do, *but not infallible*. A Director cannot rely on an opinion of itself before shareholders otherwise why does the role exist. A Director must properly exercise his or her judgement on the integrity of the opinion lest the opinion is wrong exposing the Director to potentially extremely large lawsuits. If this occurs, a belief in one's case and particularly one based on cultural bravado is simply naïve when it comes to the objective world of assessing, pricing and placing risk. As a result, the insurance bastion, the first major protection of the Big 4 accounting firms, must inevitably fail.

What about all that capital the Big 4 are sitting on, says the man in the corner – there must be plenty of it arising from those big profits – why don't you look at the consolidated accounts? Excess capital is one reason an organization may embark on the risk of a self insurance policy but since not one of the Big 4 accounting firms produces consolidated accounts on a global basis it is not possible to assess this or anything else regarding the total capital position of the Big 4 and its capital implications. Furthermore, if consolidated accounts are not produced, then there would appear to be no requirement to state internal accounting firm policies either. The accounting policy for liabilities arising from existing or potential lawsuits would be an interesting one to examine as to where exactly each Big 4 accounting firm sits in terms of its conservatism or aggression in respect of lawsuits. An aggressive policy will mean that a lesser amount will be set aside for successful lawsuits which will mean a further reduction in the capital position of the firm. In a Machiavellian world provided the Partners have protected their own position and could immediately reconstruct the old firm in to a new firm, overdrawing earnings in the event of a firm collapse leaving the former firm shell with a vast negative equity position may just make financial sense. If this was the case, then this would mean a fragile capital position thus the the second major protection of the Big 4 accounting firms, could easily fail.

They all got a big name – they can just raise capital on the market by way of an initial public offering, can't they, says the man in the corner knowingly. Given the runaway success of Accenture, formerly Andersen Consulting, the consulting arm of former accounting giant Arthur Andersen & Co, this is well achievable. It is ultimately only a question of choice for the existing Partners, but there are a numbers of factors which means the process would take some years and could not be done in a time of pending financial failure.

Firstly, the Big 4 accounting firm would have to consolidate all member firms' interests in to a single entity capable of being listed on a stock exchange from the existing position of independent ownership and the various commercial arrangements between the member firms. By way of agreement between the member firms, this is by no means insurmountable and there are specialist financiers who undertake this type of work although probably more generally in the context of merging accounting or legal firms.

Secondly, a Big 4 accounting firm would become subject to the strict listing requirements of one of the major bourses presumably either the London or New York Stock Exchanges or perhaps both in the case of a dual listing. This would then require the listed Big 4 accounting firm to make appropriate disclosures in accordance with those rules on price sensitive matters including pending lawsuits and the outcomes of existing lawsuits against the firm. Depending on the disclosure requirements, this may be a considerable challenge for a Big 4 accounting firm seeking to optimally manage its downside reputation risk in the event of an adverse Court finding. Nevertheless, the alternate argument is that the Big 4 accounting firm would merely be subject to the same disclosure requirements as most of its clients and clients would welcome this.

Thirdly, a publicly listed entity of this scale similar to the licensed insurers and banks would require an appropriately disciplined regulator to ensure that the Big 4 accounting firm would comply with appropriate regulatory standards. Again, a centralized regulatory control would be seen has highly attractive within the investment community in setting strict standards, mitigating risk and applying appropriate sanctions to inappropriate commercial behaviour by senior operatives, rogue or otherwise.

Fourthly, a Big 4 accounting firm would need to introduce the roles appropriate to a publicly listed entity for risk mitigation with the same or very similar accountability and sanctions for underperformance including dismissal. This would lead to far greater accountability for risk taking behaviour and likely reduce the frequency of such behaviours. An ounce of prevention is worth a pound of cure! There is little doubt that the investment community would perceive the introduction of a robust risk management system as an attractive feature.

Fifthly, the reward structure within a Big 4 firm where an equity Partner may earn four to ten times the income of a senior staff would require some consideration. However, given the success of Accenture this should be achievable.

Overall, it would seem more than curious as to why a Big 4 accounting firm has not chosen to go down the path of an initial public offering when it is precisely the above characteristics required for an IPO that would likely attract the leading multinational companies as their service provider from a Governance viewpoint. Furthermore, from a financial position, it is also conceivable that a Big 4 IPO may attract a US$80-100 billion windfall gain in addition to shifting the burden of an insolvent firm for the existing Partners which surely must be of some interest to those close to retirement.

In the world of "black swan" events, the inquiry must arise in the case of *the expected* tsunami of legal claims against a Big 4 accounting firm, how much would be enough in the current circumstances to cause a collapse of a Big 4 accounting firm? Such information is obviously not publicly available but no estimate places a Big 4 accounting firm's resilience for lawsuits above US$10 Billion. As mooted, in the discussion on self insurance and a possible joint insurance pool deliciously suggesting the possibility of the *BIG ONE* means the collective defenses of the four firms is no more than US$40 billion and may be as little as US$20 billion. It is not too difficult to assume an adverse outcome of arguably US$1-2 trillion of lawsuits arising from toxic audits and taxation misadventures. One must also recall that a single regulatory action may also cause the demise of a major global accounting firm as it did in 2002 with the US SEC withdrawing the audit license of Arthur Andersen & Co

In such circumstances, there is a natural chain of events to global financial annihilation. If the Big 4 accounting firms collapse simultaneously and former Partners scurry to shore up their own financial positions, 99 percent of companies with a turnover of US$1 Billion or more will not have their accounts audited. A lack of audited accounts means that these companies will not have their results accepted by the bourses and major trading markets of the world. In turn, this means that the market is incapable of appropriately valuing these companies and as a result fear engulfs all bourses and trading markets. As fear rapidly turns to panic and panic turns to desperation as stockholders scream “sell” in an unprecedented calamitous decline in stock prices where buyers are rare and proposed solutions even rarer. In such circumstances, it is simply impossible for the Governments of the world to initiate an effective and coordinated response. Suspension of trading markets is mere folly and only defers the inevitable as blue chips fall by 75 per cent, speculative stocks by 95 percent as gold hits US$10,000 an ounce and the GDP of all Western nations drops 30 per cent immediately and within weeks to 50 per cent. Buyers at this stage cautiously re-enter the shattered markets for speculative profiteering only as the Governments of the world haplessly explore *economic stimuli* with coffers emptied by decades of aggressive international tax avoidance orchestrated by the Big 4 accounting and the greatest confidence trick in history, that by dropping the corporate tax rate your country will be *economically competitive*.

When I commenced my analysis on the Big 4 accounting firms, a friend who has known me since my school days asked me whether I had a death wish? The answer is I definitely do not, but taking the opportunity to advocate positive change if one has the ability to do so is not a choice but a moral responsibility to society. As such, the same moral responsibility applies to each and every Partner of the Big 4 accounting firms. Ethical behaviours by firms in all spheres in which they operate is clearly necessary if the firms are to ensure their longevity and their general confidence within the community. But there is also a crystal clear opportunity for each Big 4 accounting firm to break away from the curse of the archaic partnership structure and take *the profession* into the 21st century as a true guardian of international commerce. This requires a change in leadership style and direction by a Big 4 accounting firms to unwind the present Federation of individual partnership interests, National Firms and the plethora of mysterious internal international transactions which present as a Big 4 accounting firm in to a single company interest capable of an IPO. Although certainly a major undertaking, the journey of Andersen Consulting from half of the former Arthur Andersen & Co in to today's IT powerhouse Accenture stands as a glowing precedent. But an IPO with all its regulatory requirements is only part of the solution to deliver a superior performance by the Big 4.

Given the arguable fragility of the Big 4 and their dominance in global commerce, a joint comprehensive review of all Governance and regulatory requirements within the Big 4 by the Appointed Government Auditors and Financial Regulators of the world's leading nations appears long over-due and should be regarded as imperative.

There is no doubt global community is beginning to comprehend tax scandals such as LuxLeaks and the disclosures around Mossack and Fonseca the extent of aggressive taxation behaviours. The obvious question must arise as to why these structures were passed by conservative auditors charged with the responsibility of verifying financial statements and identifying risks to the organization.

The specific challenge for the Big 4 is to ask themselves are they true to the ethical foundations of their profession and the society around them and, if not, what should they be doing to correct this? Splitting taxation and audit services in to separate firms will increase integrity. Splitting of tax firms and audit firms into separate firms will create competition. Such measures are extremely important to society and should be seriously considered.

Irrespective of the recommendations, lawmakers in each jurisdiction will require guidance in order to frame supporting legislation. The advantage of a principles based guidance approach is that all stakeholders will readily understand the objective of the principle prior to turning it to potentially complex legislation.

Based on the above inherent risks to global financial stability, the following principles are beyond question:

Regulatory Principle 1: All jurisdictions should ensure that an accounting or professional services firm or organization does not provide both taxation and audit services to the public.

Regulatory Principle 2: All jurisdictions must ensure that there is sufficient competition in both taxation and audit services to provide an orderly market.

Taxation Principle 1: All jurisdictions should encourage ethical tax behaviours by way of economic incentives through discounts in the corporate tax rate or other real incentive measures.

Taxation Principle 2: All jurisdictions should ensure that appropriate punitive measures reflecting the fraudulent nature of aggressive taxation behaviours be implemented.

Taxation Principle 3: All expenses originating from a jurisdiction internationally characterized as a tax haven will be denied a tax deduction in the home jurisdiction.

It has been put to me by a very senior Partner from a Big 4 accounting firm insolvency practice and l think a comment well worth closing on"

"Over the past 40 years, the tax divisions (of the Big 4 accounting firms) have pushed what is considered an acceptable tax risk by generally conservative companies to extreme levels without any substantive net long term economic gain. This is completely at odds to the other major divisions of any full service accounting firm including audit, consulting and insolvency where there is a true economic gain at typically reduced risk. *There are two vastly different creatures living uncomfortably under the same skin. Division is inevitabl*e!"

Appendix 4: To Cut or Not to Cut – That is the Question (2016)

With the Australian Federal election now over, the Government and Opposition appear in a cheery mood fully believing they have *both* done well in the campaign. As most everybody knows, the newly elected Australian Government has committed itself to cutting the corporate tax rate along with most Western economies in recent times in this case by 5% over 10 years costing some A$48.2 billion as advised by Australian Treasury Secretary John Fraser. The Opposition Labor Party has announced that it will oppose the tax cut. Who is in fact right? Sadly, both of our major parties would appear well of the mark in terms of their analysis and proposed action.

The Government based its corporate tax rate cut decision on a much criticized Report prepared for the Australian Department of the Treasury by Chris Murphy, Director, Independent Economics and Visiting Fellow, ANU. Various commentators have suggested the the Report is *divorced from reality* and Murphy & Co are wrong in their assumption that Multinationals will which change their behaviour positively in terms of international tax avoidance. It must be said that Murphy's views no matter how loosely they are framed are protected to a large degree by what some have called *the awe of the Big 4*.

Most of you will be familiar the Big 4 international accounting firms, EY, KPMG, PWC and Deloitte who are generally known for not being backward in coming forward with aggressive tax behaviours. Tax scandals such as Luxleaks, Swissleaks, Mossack Fonseca and the US KPMG tax shelters have focused the world on these aggressive tax behaviours.

While the structures developed by the Big 4 and sold to largely accepting and unwitting multinational clients were passionately considered *legal* at the time, they certainly did not fall within the spirit of the taxation law of most Western economies. Let us also recognize the fact that *everything was legal* before it became illegal including all the most heinous forms of human behaviours so shame on any politician who comes with that anemic argument when addressing the issue of international tax avoidance.

But the purpose of this op-ed is not to address the legally marginal activities of the Big 4 which costs the global economies a mere US$1 trillion or so per annum or to point out that the current system is badly broken and so, so, so easily manipulated, but to examine instead how the Big 4's views were able to get the lead economies of the world to give up tens of trillions of dollars, pounds or Euros in consolidated revenue.

The argument or perhaps more accurately *the most successful confidence trick in history* put before and amazingly accepted by the lead economies is that *in order to remain internationally competitive, you must lower your corporate tax rate.* This has become the mantra of virtually every Government on the planet seemingly conjuring up in Politician's minds the likes of a World Cup, a Euro 2016, a World Series, a Super Bowl or more locally for me an Aussie Rules Grand Final (apologies to most of the world about this last code) with National pride at stake if we do not lower the corporate tax rate. The argument is so successful and persuasive that it has a Rasputin like effect on our politicians (or perhaps more accurately Rasputin had a *Big 4* effect on the Imperial Czar of Russia and his family).

While there is economic evidence to suggest that tax breaks do work for the tax havens of this world or indeed other third world countries seeking to gain a genuine economic foothold, there is no persuasive evidence that shaving a few percentage points from the corporate tax rate work of a first world economy will translate in to a surge of investment by multinational companies particularly when every Western economy is doing it. There may, however, be some argument to suggest that for capital *exporting* first world economies such as the United States, profits are more likely to be repatriated to the homeland for reinvestment either domestically or internationally particularly where there have been clear tax impediments to the return of that capital than capital *importing* first world economies such as Australia where the opposite is true merely converting less taxed profits in to higher dividends to offshore owned multinationals and their super rich owners.

The realty is that tax is well down the list of considerations when appropriately examining a commercial entry in to a foreign jurisdiction. If you can't make a profit on your business, then why proceed! We are talking about real markets, not tax havens which should immediately raise the spectre of tax avoidance. Further, while corporate tax rates have generally halved across the major economies in the past 25 years, international tax avoidance through tax havens, tax shelters and transfer pricing arrangements has grown to cancerous proportions with the rise in private power of the Big 4 accounting firms.

Let us examine what happens in practice between a Board and its Chief Taxation Officer in optimizing the tax outcome of a Multinational.

Firstly, a decision must be made as to the Board's Tax Mandate or operating instructions to the Chief Taxation Officer. This may vary between a *conservative* or zero risk taxation mandate where there is essentially full compliance with the taxation law or an *aggressive* or a high risk taxation mandate where the Board backs the Chief Taxation Officer to *go for it* so to speak or somewhere in between.

Commercially, one must weigh up the risk to the organization in terms of failure and its various associated costs and penalties and the financial benefit of success of the aggressive taxation behaviours. In more recent times, *reputation risk* to the organization has become a factor for Boards but let us put this aside for the moment. What I can definitely say is that a reduction in the corporate tax rate does not enter the equation because the impact on the benefit and cost side is the same and does not change the risk equation at all - in other words it is completely risk neutral. In my entire career advising hundreds of Multinationals, I have never seen or heard of a Multinational Board change its Tax Mandate as a result of a drop in the corporate tax rate.

What will change things in terms of aggressive taxation behaviours so detrimental to the budgets of the Government's of the world is a change in that risk equation. Enter the concept of the Ethical Tax Regime. The primary principle of the Ethical Tax Regime is very simple and easy to implement - if a Multinational acts in accordance with the taxation law and can demonstrate this to the Revenue, then the Multinational will be rewarded by a discount to the corporate tax rate and tax certainty no doubt very appealing to Boards.

But this must also be supported by a strong penalty regime on the other side for those companies *opting out* of the regime and are caught out by the Revenue in an aggressive tax behaviour which is outside the taxation law. Accordingly, under the Ethical Tax Regime there is a clear shift in the risk equation as result of which a competent Chief Tax Officer should properly ask for a reassessment of the Board Tax Mandate from the Board as a result of a change in the risk equation.

Nice, Baghdad, Orlando, Lahore, Brussels, Grand Bassam, Jakarta, Instantul, San Bernardino, Paris, Ankara, Maidguri, Souse, Tunis, Sydney and Yemen are shocking reminders of the importance of National Security. In each of the Western economies, hospital systems, education and the under-privileged are seemingly the subject of endless *austerity measures* in an attempt to *balance budgets*.

So how do our elected representative justify this incredible distortion of the tax system in favour of measures that largely only benefit the shareholders of multinational companies at the cost of necessary social services in the homeland. Well they simply cannot do so morally, ethically, logically or electorally and such an approach must be considered a dereliction of duty to their voting public.

The Panama Papers tax scandal revealed the extent of political self interest when it comes to the tax planning arrangements of politicians.

It must be said that any politician involved in aggressive tax planning cannot be seen to be acting impartially on the enactment of avoidance busting taxation legislation let alone one that unquestionably is *the greatest tax confidence trick in history.*

Appendix 5 – Malcolm Bligh Turnbull – An Errant Founding Father Turned Politician of Fortune in Tax Avoidance Paradise (2018)

If there was ever was a name that should have been carved in stone as a founding father of the Republic of Australia, it should have been Malcolm Bligh Turnbull, but let us call him MBT because *it is shorter to write.*

We all know *MBT* to be a man of exceptional ability with the gift of a golden tongue, a can do everything *candy* man, but for who's beckoning? It must be remembered that MBT has had almost two decades of unprecedented opportunity to change this Nation for the betterment of all Australians, but has now arguably largely squandered his potential for greatness in the Australian history books for what appears to be largely personal financial gain and political position.

In mid-December, in what surely must be the lamest of all Republican speeches for the man who drafted the 1999 report for the Australian Government on an Australian Republic only to now advise that the time would not be ripe for such a move *until after the end of Queen Elizabeth II's reign!*

This was a view never actually shared by our beloved Queen who not only expected, if not endorsed, an Australian Republic as a mark of maturity for what was after all only a former penal colony where England sent its worst criminal offenders and had certainly well matured in 1999 to be a First World Nation.

A little more disturbing is the current view of our purported *Republican* Prime Minister being the same as those of *Royalist* Prime Minister John Howard who echoed the views of Australian war time Prime Minister Sir Robert Menzies!

Let us face it, with the world at war, it would not have been Sir Robert's best strategic move to declare independence from the British Empire with only 7 million people and the German and Japanese forces at full strength between ourselves and *the homeland*. As for the relevance of MBT's comments, it is far more likely that the Queen is muttering under her breath that:

We are not going to bloody well die until Australia has become a republic!

As for taxation – unfortunately, this is not MBT's best area either, noting the well researched and considered views of sidekick, awarding winning investigative journalist and *should be* political aspirant Adjunct Professor Michael West of the University of Sydney's School of Social and Political Sciences on *his top 100 hit list* of major corporate tax avoiders in Australia.

Although I have pointed out to Michael that perhaps his title should be *A Junk Professor* given its prestigious but *sans remuneration status*, Michael has unquestionably done real groundbreaking and highly impressive research in demonstrating the ease by which the big multinationals such as Glencore and Exxon move profits out of this country down the MBT super highway of international tax avoidance.

Michael's work has been enough to attract the likes of Pulitzer Prize winner and Donald Trump biographer, David Cay Johnston, to Australia for a chin wag on 3 November 2017 at the *Dark Money and Democracy* roundtable at the University of Sydney - *Full* Professor Michael West *or perhaps Prime Minister Michael West* does sound better after all, *eh Michael?*

For the mere voting punters though *such as myself*, international tax avoidance is made up of 3 broad areas (and MBT is no stranger to any of them) being:

1. *Use of tax havens* - MBT has held investments in tax havens including the Zebedee Growth Fund and MSD Torchlight Partners, Ugland House, George Town, Grand Cayman which has a zero corporate tax rate but also CVC Global Credit Opportunity Fund, Goldman Sachs Private Equity Fund and a number of other offshore interests. Of some particular interest though according to the Register of Members Interests is the acquisition of a very unusual offshore asset being a mosaic of MBT being *a gift* from the Prime Minister of Vietnam on which he paid the gift duty of $275 to the Collector of Public Monies. *Mystery surrounds the true reason for this disturbing acquisition!*

2. *Shifting profits out of high tax jurisdiction to a low tax jurisdiction* – well MBT again because *any self respecting investment banker* will advise you, let alone an old boy of Goldman Sachs, that this is precisely why you put your investment in to Cayman's and let them ride.

3. *Dropping of the corporate tax rate* – MBT should be a little embarassed at this one given his sophistication in the financial world and the well publicized views espoused each year of the world's top economists on economic competitiveness at Davos with no mention of a cutting the corporate tax rate as stimulating anything but further corporate tax cuts in a race to the bottom.

While having the inside track to smash international tax avoidance as a former investment banker, not to mention genteel Prime Minister lawmaker, MBT has unfortunately for aficionados of cricket made the aristocratic *and unhurried* icon of English cricket Baron Michael Colin Cowdrey of Tonbridge look like an Adam Gilchrist on meth (mind you with a career strike of 82 runs per 100 balls Gilly was bloody fast without meth. Unfortunately, not MBT though!)

However, justifying an Australian corporate tax cut on Trumpy's US tax cut would be the equivalent of our Australian Test Cricket Captain Steve Smith scoring a century for the old country. This is because corporate tax cuts by a *capital exporting* nation such as the US tend to encourage repatriation of profits to the homeland for distribution to shareholders or for reinvestment domestically or internationally which will produce growth and this was certainly the case with US tax cuts.

On the other hand, tax cuts by a *capital importing* nation *with no money coming home* simply encourages higher distributions to the overseas investors with little of the tax cuts being left onshore. In simple terms, *both tax cuts will favor US multinationals* and it would a little smarter to use the same money to encourage investment in innovative Australian sunrise industries – *a bit of real tax clangor for our PM!*

But it gets worse when we return to Michael West's examples of Exxon and Glencore because they pay no tax in Australia anyway, whatever the rate, simply by shifting profits out of Australia, offshoring, regular loss making restructures or taking advantage of other loopholes in the Australian tax law.

One cannot exclusively blame the multinationals for doing this when our Aussie lawmakers have let this occur *without an appropriate legislative response*. As a taxation lawyer, I would *absolutely pursue* the same weaknesses in the taxation law with enthusiasm anywhere for my clients, but for the moment we are talking about the taxation ethics of *our Prime Minister* in leading our nation and not the approach of a taxation lawyer to the matter.

As for MBT, it should be pointed out in his favor that as a previous successful *poacher* of the Australian tax system he should have been a successful *gamekeeper* but alas dropping the corporate tax rate suggests a more predatory purpose more likely to enrich the multinationals than create opportunity for Australians. *May be MBT simply forgot to change sides!*

Still the boy from Electoral Division of Wentworth became the Member of Parliament for the Electoral Division of Wentworth so surely MBT must be the man to back his constituents and protect Wentworth's patrician institutions such as White City Tennis Club which famously used to host the Australian Open one of the four Tennis Grand Slam events, but seemingly not in my experience as a Director on the last Board of White City fighting to save the Club from a predatory property play.

After writing a detailed email to MBT about the risks inherent in now Bennelong Member of Parliament John Alexander teaming up with billionaire property developer Lang Walker as financier against the members of White City after his promise to *develop the site in to a world class tennis club* securing a valuable option to purchase the site from the members.

After an email to him, MBT asked me *what can l do to help?* l explained the importance of saving an irreplaceable inner city institution and what needed to be done *never to hear from MBT again!* Alexander and Walker subsequently then divided up *a A$10 million profit* on the site selling out to the Hakoah Club after the *non tennis playing judges* of the High

Court of Australia unexpectedly reversed the *tennis playing judges* of the New South Wales Court of Appeal.

At the time, rumors swirled that Alexander was all but guaranteed pre-selection for a safe Federal seat with the Liberal Party at the behest of Lang Walker. MBT allegedly denied this to power brokers in the Jewish community slighted by White City's demise. Still it was nice to see John Alexander and MBT holding hands so soon after the successful same sex marriage vote at the recent Bennelong by-election.

One must remember, however, that it was MBT's forbear Captain William Bligh of Mutiny on the Bounty fame who completed a voyage of more than 3,500 nautical miles in a row boat after the mutiny in the middle of nowhere in the Pacific to reach safety in Australia. Bligh then began the process of bringing the mutineers to justice. No one got actually convicted but what chutzpah in terms of leadership, rule of law and devotion to his nation. *On balance, we seem to have elected the wrong Bligh!*

Appendix 6 – Interview with Michael Vaughan, PHD Candidate at Sydney University studying Civil Society's Engagement with International Tax Justice Issues (2018).

Michael Vaughan (Michael):

Thank you for allowing me to interview you today. What were the forces and personal experiences that brought you to your current work on the ethical questions in the international tax area?

George Rozvany (George)

As my father, Professor George Rozvany Senior, often encouraged with my tax advocacy work:

Taking the opportunity to advocate positive change if one has the ability to do so is not a choice but a moral responsibility to society.

So, just to start off, Michael, the area you are researching is highly specialized with very few recognized authorities who can really comment with deep knowledge based on extensive practical experience.

I am somewhat unusual in this area in that l have been involved in multiple facets of the international tax *avoidance* industry area operating at senior levels for more than three decades. Many consider me the most senior insider in the world to openly discuss the issues relating to this area of the taxation law and practice.

It is important to recognize that l am neither a *whistleblower* in the style of Antoine Deltour in relation to the LuxLeaks tax scandal nor a *critic* in way that is perhaps implied by Wikipedia in their entry of the Big 4 accounting firms. I approach the area as a tax ethicist, but also in the same way that an external auditor would by objectively examining the financial systems relating to taxation based on a two trusted source rule and then suggesting improvements to those systems.

By way of research and publication, I have written four books in complex but highly important areas of the taxation law - two on the international tax area of *transfer pricing* and two on the emerging area of *taxation ethics*. The last two published books have had the forewords written by the then Australian Federal Commissioner of Taxation, Michael Carmody, and the current Second Commissioner of Taxation, Andrew Mills.

To gain the imprimatur of a Commissioner or Second Commissioner of Taxation, one has to be not only highly disciplined in the work including one's approach to research, but one also has to be conservative in one's interpretation of the taxation law which has to fall either within or at last fairly close to the Revenue's viewpoint. It is simply not possible to gain a foreword from a Regulator at this level without a disciplined approach because the

Regulator's foreword will effectively endorse the views stated in the book and every Regulator knows this.

Such books are not generally written for or read by the man on the street and rely on who of the influential folk such as the Lawmakers, senior academics and the media actually reads and agrees with the stated positions to gain momentum for positive change, but getting a Commissioner's or other senior Regulator's foreword will certainly assist in the process. Therefore, a Regulator's foreword in respect of a book based on conspiracy theories is unlikely to ever occur.

My soon to be published work and second of five in the tax ethics, *Big 4 Big Myth - An Ethical Audit of the Tax Practices of the Big 4 Accounting Firms* although written for a broader audience and lighter style follows a similar disciplined approach to research under *the two trusted source rule*, that is, each source is not only trusted but independently verifies the other.

There have been many other successful forays in to the tax lobbying arena which is discussed in my first book in the tax ethics series entitled *Corporate Tax Ethics – A Journey for Mankind.*

In terms of tax professional experience, I have also worked in three of what were three of the Big 5 accounting firms including Arthur Andersen & Co and two major multinationals being a then top 10 ASX listed chemical manufacture (ICI Australia now Orica) and one of the largest general insurers in the world (Allianz).

In the last 16 years as Head of Tax at Allianz, l was also involved more broadly in looking at wider commercial matters such as running a couple of businesses and managing financial risk which included amongst other risks, investment risk, credit risk, taxation risk, financial disclosures risk and actuarial risk including pricing risk. Appropriate handling of these risks is critical for an insurer's success because it is a fine line when it comes to correctly pricing a risk and making a profit.

So while not understanding or knowing everything in detail about these functions, risk, for me, after 16 years is an area of expertise and one I can speak on with considerable authority. From my perspective, managing risk is critical in terms of Director's duties on a Board and it also must be recognized that superior management of risk leads to superior shareholder returns.

My work on transfer pricing did not arise out of academic interest at all but arose out a transfer pricing dispute which at the time threatened more than 50% of chemical giant ICI Australia's profit and the solution was simply to engage with the Australian Revenue to work out what was a yawning gap in the Australian taxation law governing more than 50% of Australian commerce *with no involvement whatsoever from the Big 4 accounting firms*.

The ultimate victory for ICI Australia in my drafting what are still the only transfer pricing books published in this country, including gaining the Commissioner's endorsement, in their *viewpoint did steal* what the Big 4 accounting firms do consider to be their boasting rights in providing transfer pricing advisory work to their clients. It was certainly outrageous and audacious to write those books but they are reminded that I have stolen their game forever because I can simply say I was the guy who wrote the book on transfer pricing in Australia.

Having also worked in three of the big four accounting firms, two major multi-nationals, plus working extensively with the Revenue, the media and various respected thought leaders in this specialized area, I am a indeed difficult animal to knock down.

It also helps to live by a policy of giving straight answers to straight questions which was the personal motto of Arthur Andersen, to be trusted by being trustworthy and to listen and be prepared to adapt or change my view based on arguments put to me.

It is, however, important to recognize that the views expressed in Big 4 Myth *are mainly drawn from the facts and views expressed by the Partners of the Big 4 accounting firms themselves!*

Michael: So what were the significant moments in you, shifting from working inside the big four, to

being more publicly critical of some of their practices?

George: It's interesting you say *critical!* As I mentioned before, I've been named by Wikipedia as apparently the ONLY CRITIC in the world of the tax practices of the Big 4 accounting firms, which I thought knowing what I do was actually extremely funny and I almost fell out of my chair when I first saw that piece while having dinner with my daughter Annaliese.

I showed her the piece and Annaliese looked coolly on remarking: *Thanks Daddy!! You just cost me my career in IT in the Big 4!!*

The comment made me laugh and I asked her to note the following points.

Firstly, you are highly intelligent, you are hard working, you are innovative, you are charming, you are conservative, you have integrity and I know that you are more qualified in human potential than 90 per cent of the Partners in any of the Big 4 accounting firms *so pity the first Big 4 accounting firm that refuses to give a job because I am your father.*

Secondly, this is essentially about law reform and creating the momentum necessary for long overdue regulatory changes that will only improve the operation of the Big 4 accounting firms, assist in stabilizing financial markets and protect globally those less fortunate in society.

Thirdly, most the views expressed in the first two books in the tax ethics series are predominantly the views of the Partners themselves from within the Big 4 accounting firms who I have had virtually daily contact with over more than 30 years and who spoke out and I think naming them would be counterproductive for real change.

Fourthly, how many times in your life when you have a legitimate complaint about a product or service have you been told *you are the first person to ever complain - right!!!*

Fifthly, all that is needed is one of the Big 4 accounting firms is to appoint me as Head of Tax Ethics to work with the existing Partnership on the ethical questions on concerns already widely held within by the Partners. *I can virtually guarantee that this approach will result in the leading global firm within five years!*

Michael: What do you think at a conceptual level, what if anything does tax justice mean to you?

George: It is a question of tax justice from whose perspective.

From the viewpoint of the Big 4 accounting firms themselves, it would be reasonably argued that their first duty is to their clients and they would champion the argument that tax justice for them would be the best possible result for their clients even though it may have been obtained through lack of transparency or uncertainty under the taxation law *which both carry an unquantified degree of risk.*

As a tax lawyer in practice, l must say that I also believed that my first duty was to my client as well, hence the extraordinary efforts l went to achieving the ICI Australia / Orica transfer pricing win. It is far more satisfying for me to deliver a risk free solution for the client through intelligent engagement with the Revenue prior to implementation or a positive change to the law through effective lobbying than to rely on the financially high risk approach of non-disclosure. For me as a tax lawyer, tax justice is delivering the maximum possible tax benefit under the taxation law *with zero risk.*

As a tax ethicist, tax justice is really about trying to get it right from the viewpoint of the entire society, not just certain parts of the society. In this respect, the role of the tax ethicist is to objectively examine the existing systems, to identify weaknesses and suggest improvements to stabilize those systems and ensure fairness within the tax system for all and, particularly, the less fortunate in society *who typically do not have a voice!*

Michael: And, do you think that there are different ideas about that relationship between tax and ethics or justice? Do you think that there are any differences with how that relationship is understood within professional fields, like in the

big four firms, versus academia or advocates, and what are some of those differences?

George: Well, building on my answer to your previous question, different people will approach the same or similar question from their own professional training and experience shaped by their own personal experiences and views.

Fairness, equity, justice, ethics are unquestionably regarded by most as laudable concepts and objectives in the professional and personal spheres in which they operate. However, there are clear professional tensions between these spheres which create unwanted noise in respect of the tax ethics question and it may be useful to have some examples of this to better understand where these forces are coming from with the prospect of removing them and allowing superior communication.

Firstly, let us consider the approaches of an investigative journalist and a tax ethicist! My friend, Michael West, who is no doubt one of the best investigative journalists in Australia consistently points out that I need *a hook,* that I must *name and shame* because that is the way to get you and your story noticed and create real momentum for change. In response, I would argue that I actually need the right people to openly discuss matters with me perhaps over decades for me to gain a deep understanding of the key issues in this complex area of humanity and propose changes with confidence that will be as effective as possible *in practice*.

Confidentiality in terms of my sources names is critical, because if I name and shame *or even have the reputation of naming and shaming* my sources, then all discussion ceases immediately. Such an outcome is totally counterproductive to the tax ethics process, which is to encourage open discussion from all stakeholders.

Secondly, let us consider the approaches of an academic and a tax ethicist! A senior academic such as a Professor will certainly be learned, with multiple degrees and having written many published works over decades all within the strictures of the great academic tradition. I have had both a dad and a step dad as Professors for all but two years of my life so discussions with Professors on absolutely everything in life is pretty normal for me. However, when it comes to research the world becomes a very cloistered place. For example, a *citation*, essentially another academic quoting you in their work, is important. So the idea is have lots of citations to confirm your academic stature and somehow the your position has more merit, rather than the actual merit of the position being discussed.

A tax ethicist will be more embracing of their own real world experience and observations and the informed views of others in framing positions. For example, a tax ethicist may correctly note that an adverse tax finding in the Courts is not only expensive in financial terms but may result in reputational damage to an organization resulting in reduced sales and profits. An academic in response will ask: *How do you know that?*

Finally, let us consider the approach of the Big 4 accounting firms and a tax ethicist. One of the most difficult aspects of the question on tax ethics is the reluctance of the Big 4 accounting firms to engage meaningfully on the subject. They seem to exist in a collective tribal myth *at a firm level* that they are always correct and tend be dismissive of other's views *by not dignifying those views with a response.*

This is in *complete contrast* to the individual Partners who do discuss such issues quite openly and has formed much of the material in Big 4 Big Myth. No person or organization on earth is correct in its actions or views 100 per cent of the time and everybody knows that.

Ultimately, it is open engagement by all stakeholders *not just tax ethicists* which will deliver the superior solutions for humanity on the tax ethics question.

Michael: Talking a bit more about the Tax Justice Network, I'm interested that their central policy prescriptions in this area, like automatic exchange of tax information, beneficial ownership, public country by country reporting, while not in conflict at all with your central arguments that you spoke about earlier.

It is only in relatively recent times and only after the completion and publication of my first book in the tax ethics series *Corporate Tax Ethics - A Journey for Mankind* that l became aware of the Tax Justice Network and its work.

To complete this foundation work in the tax ethics series including developing the basic concepts of tax ethics based on my 32 years in tax practice, took some nine months of pretty much round the clock writing. However, it did allow me to have perhaps a better understanding of the philosophy, approaches and the issues that the Tax Justice Network are pursuing.

Overall, l am extremely impressed by the work of the Tax Justice Network. They are a serious, committed and extremely knowledgeable organization of tax advisors with a strong, balanced and focused global agenda for tax reforms. I am yet to disagree with them on a single tax policy initiative and l am pleased to say they have allowed me to have *a much lazier* time as a tax ethicist than l would have thought possible on the tax lobbying front.

It is unfortunate that they are so maligned by the Partners of the major firms but l guess they need to protect their patch, however, if l was to choose one tax agenda for reform from all the major firms and the Tax Justice Network, *it would be the tax agenda of the Tax Justice Network!*

Michael: I guess to maybe rephrase the last question again, if the role of the Big 4 accounting firms is so central, to understanding how to

address some of these issues in tax ethics, why do you think that some of the other civil society plays like Tax Justice Network and NGOs for example, they don't really talk about the Big 4? They talk about these transparency measures, but they don't really talk about the big four, or even necessarily the corporate tax rate as you do.

George: As I said previously in the answer to your earlier questions, different professional people will approach the same or similar question from their own professional training and experience.

My focus on the Big 4 accounting firms is simply based on my experience of almost daily professional contact with them over 30 years both as an adviser within three of the firms and as a client of all four firms.

During this same period, I also engaged with all the major global investment banks on thousands of tax based financing and other tax based products which were developed with or exclusively by the Big 4 accounting firms. Examples of some of the more conservative arrangements *which still drew the ire of the Revenue* and were ultimately tested in the Courts included a sale and leaseback arrangement of a large chemical plant which was challenged on the basis of valuations and a debt defeasance arrangement where the future debt obligations in respect of bonds issued by the company were taken over by third parties on the basis that there was a taxable gain in the hands of the company.

In the 1990's in Australia, at the peak of the tax based financing boom, there were daily meetings with the investment banks backed by Big 4 accounting firm advice to consider new and developing structures. In the more recent decades, the game has moved to the international space with the ever burgeoning and seemingly unstoppable international tax avoidance operating through the tax haven network.

I think my primary use as a tax ethicist to organizations such as the Tax Justice Network (TJN) or the International Consortium of Investigative Journalists (ICIJ) is to explain what is going on currently in the aggressive tax avoidance industry so they may sharpen their respective approaches to obtain a better outcome for society as a whole.

Michael: So what do you think are the differences between Australia and some of the other countries in which a different approach has seemingly worked well such as Israel, Ireland and China or even perhaps Germany or the recent moves of the United States?

George: Michael, that is an extremely important question for me, if not a little challenging, and l will answer it openly!

You will appreciate that when l first started the tax ethics project some three years ago and tapping in to the clear public sentiment on the issue, l believed that there was a strong need for the global society to examine their taxation systems from an ethical viewpoint. I considered the matter of such importance that I decided to set aside three years of my life to work on what is a *pro bono* project for society but a cost to me of some A$1 million drawn from my personal funds.

The idea was to advocate and establish in Australia a Federally funded and the world's *first* international center for study on tax ethics. For a fairly modest budget of say A$30-50 million per annum, the tax ethics center would have brought together the world's best and brightest in this area. This would have built up real knowledge on tax ethics and what the actual impact would be on humanity. Such knowledge would and should be disseminated without charge to the world and, particularly, the Lawmakers of the world in shaping robust tax policies for the benefit of the whole of mankind.

While such an organization would of necessity have had to have the right to develop its own independent charter to attract the best and the brightest, it is the concentration of such brain power in to one single focused and dynamic organization that allows a superior performance to occur.

My late father, Professor George Rozvany Senior, used a similar model in establishing the International Society of Structural and Multidisciplinary Optimization in the 1980's which allowed giant leaps to occur in the world of engineering and resulted in the world's tallest building the Burj Khalifa in Dubai, Boeing's Dreamliner and the Airbus A380 amongst many other achievements.

I am not sure that I would necessarily qualify myself in the world's best and brightest, but l do certainly know two things.

Firstly. that that many folk working on the same project *as equals* will produce a far better result than one individual.

Secondly, that I do read the public and commercial sentiment well on tax matters and this has resulted in a long and successful career on tax advocacy with many substantial achievements which are discussed in Chapter 5 of the first book in the tax ethics series, *Corporate Tax Ethics – A journey for Mankind.*

While l have noted the strong and supportive international interest in this work both at a grass roots level and at that of the sophisticated commentator, l have been perplexed if not a little disappointed at the response of our Australian Parliament on the general question of a tax ethics centre with the exception of Deputy Opposition Leader Tanya Plibersek and Former Treasurer Wayne Swan. I will, however, acknowledge the rapid response in relation to my concerns over the proposed sale of the ASIC Register which was ultimately withdrawn.

From my perspective, this has led to a lot of frustration at times for which l expressly and sincerely apologize to my partner in life Aninha and my daughter Annaliese who have had to live with a rather crabby partner and dad for the last several years.

I have always stated that if I cannot successfully advocate the establishment of a tax ethics centre then I will simply concentrate the best partner, son and father to the three girls in my life.

Michael: That does point to a challenge with tax policy, because it can be complex and technical.

George: While both tax policy and supporting taxation legislation have certainly become more complex over recent decades, one could also reasonably argue that simplicity is always the preferred option.

When Parker Brothers introduced the first modern version of the Game Monopoly in 1933, the rules of the game were about 30 pages or so while the Income Tax Law of most countries was about 100 pages or so and both sets of rules were structured on fairly simple concepts.

At that time, it was well possible for a reasonably experienced lawyer to read *the entire* Income Tax Law of his or her country in the morning and provide correct legal advice in the afternoon. Similarly, a 10-year-old child typically mastered the Game of Monopoly during his or her first game which probably lasted about the same time as the lawyer took to read the Income Tax Law.

Now fast forward to today and place 30,000 pages of rules in your child's Game of Monopoly and you will immediately begin to understand why we have such a problem with the Income Tax Law internationally today. Complexity and uncertainty *largely by design* are the friends of the Big 4 accounting firms because there are the only organizations today now capable of providing end to end taxation advice for the multinationals because of the sheer scale of the tax advisers now required to provide correct advice in the respect of the minutiae of the Income Tax Law and other tax laws across the perhaps the one hundred nations or more in which they operate leaving the smaller accounting firms, the law firms and the in-house capabilities of the multinationals in their wake.

As I suggested earlier, one solution may simply be to abandon the Income Tax Law in entirety across the globe as no longer workable and replace it with a broad consumption tax (in our case a GST) on any acquisitions from within a country at an appropriate rate to meet the required Revenue needs of that country with no exceptions whatsoever.