

The background image shows a large, modern industrial building under construction. The structure is primarily composed of a dense, vertical grid of steel beams forming a skeletal frame. Some horizontal beams and red support rods are visible, particularly towards the top. The sky above the building is clear and light blue.

Think Ahead

ACCA

12 tenets of tax

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 170,000 members and 436,000 students in 180 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 92 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

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Introduction

ACCA first published its '12 Tenets of Tax' in a policy paper of 2009. Now, in 2011, tax has become one of the key strategic issues of the age. Barack Obama made promises to act against tax havens one of the key elements of his successful election campaign¹ and, following his inauguration there was a sudden flurry of concessions issued by private wealth centres ahead of the April 2009 G20 summit, caused by immense political pressure over the issue. As the global economic crisis has put public finances under unprecedented strain, so the pressure on governments to protect their tax bases by clamping down on both avoidance and evasion has become more pressing, and fuelled by a simple need for funds as much as political ideology.

At the same time, tax in recent years has risen sharply up the boardroom agenda. It is seen more than ever as an issue that directly affects the bottom line and companies, with their fiduciary duty to maximise shareholder returns, have increasingly looked to tax-efficient planning as part of their corporate strategies. At the same time, the increasing relevance of the CSR agenda and the politicisation of multinationals' tax strategies has led to a tension in boardrooms as companies try to balance the competing demands of shareholders and consumers, preserving profits while promoting an 'ethical' brand.

Whether working in a highly developed and complex industrialised economy or struggling for the first time with issues of industrial growth, urbanisation and technological advances in an emerging economy, tax administrations the world over face the same fundamental issues. International business is increasingly mobile while individual taxpayers are demanding more from their governments.

ACCA'S 12 TENETS OF TAX

- 1 A presumption to tax neutrality
- 2 Openness and transparency
- 3 Simplification
- 4 Certainty
- 5 Accountability and regular review
- 6 Tax policy is a percentage of GDP
- 7 Efficiency
- 8 Tax shifting and hypothecation have a role to play
- 9 Tax is a matter of national sovereignty
- 10 Tax is subject to the rule of law
- 11 Respect for Human rights
- 12 Avoidance of double taxation

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

Analysis

As tax rises up the political agenda, ACCA believes that a clear exposition of what makes an efficient and just tax system in the 21st century remains essential, and has revisited the 12 Tenets to take account of the wider tax landscape and the new pressures facing governments.

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

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

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

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

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

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

The other maxims are less contentious. Maxim II forms our point 4 below. A society's tax system must be known and understood by all its adult members; otherwise, they cannot play their part to the full. Maxim III is hard to argue against though is not always adhered to in practice. Maxim IV forms our point 7 – though it could be said this is the area where Smith's theory is furthest from modern reality, given the costs of the state's taxation apparatus and the subsequent cost of advisers to represent taxpayers.

Given the complexity of modern economies and society, it is a challenge to apply the tenets of even the greatest thinkers to contemporary tax systems. Smith could hardly have imagined the advances in communications and technology which have led to the concept of tax competition, the level of state expenditure as a proportion of GDP in many countries or the almost universal reliance of governments on withholding of payroll and consumption taxes to collect the bulk of their revenues. Unlike Smith, ACCA does not offer the following points as universal truths, but believes that if followed by governments these twelve policies would represent the basis of effective tax systems around the world.

The 12 Tenets of Tax

1. A PRESUMPTION TO TAX NEUTRALITY

Tax distortions can artificially encourage certain kinds of economic behaviours over others. Tax policies should be non-discriminatory unless part of a declared discriminatory policy, such as one which is aimed to discourage undesirable behaviours. There is a wider political question about the extent to which it is appropriate for taxation to be used as an instrument of social policy (eg penalising smoking by heavy duties, or environmental taxes to mitigate climate change). ACCA's view is that this use of tax by elected governments is legitimate but such taxes should then meet the other principles such as being transparent, simple and effective. Governments should be wary of the effect on the complexity of the tax system of too much tinkering to 'reward' certain groups of taxpayers.

There has been criticism that the global financial crisis has been exacerbated (though not caused) by policies in many tax regimes allow companies to deduct interest payments against tax but not returns on equity. As a result both leveraged buy-outs by private equity organisations and the holding of debt rather than equity by institutions has increased, which fuelled the credit boom which preceded the economic downturn. The IMF has argued² that governments should consider changing their rules which have effectively encouraged companies to seek finance via debt rather than equity and allowed individuals to take out larger mortgages. The IMF has voiced its fear that 'corporate level tax biases favouring debt finance including in the financial sector are pervasive, often large and hard to justify given the potential impact on financial stability.'

While the deeper issues of whether neutrality is best served by taxation of income or consumption may never be amenable to definitive resolution, ACCA argues that governments must seek to remove the distortions in their own national tax systems (which also includes, for example, tax incentives being given for businesses to structure themselves in a certain way) and work together to try to iron out the differences in tax bases which give rise to tax arbitrage. For example in the EU, there are still many barriers which frustrate the workings of the Single Market.

The sharing of best practice and knowledge between countries, of the sort envisaged by the G20 in the new era of financial regulation, could certainly be useful in the international tax world. It is important however, that this does not stretch into cartel-like behaviour which would damage the global economy.

2. OPENNESS AND TRANSPARENCY

Tax payers should understand what they are paying, why they are paying it, and what the benefits of paying will be. Paying tax may never be fun, but engagement with a demonstrably fair tax policy will be more palatable.

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

ACCA believes that most countries' tax systems suffer from political positioning in the creation of tax policy rather than taking account of what would be best for the economy. This inevitably leads to poorly thought-out legislation, instability and complications in the system. And due to the complex and specialist nature of taxation we tend not to see sufficient scrutiny of the draft legislation during the democratic processes in many regimes.

Too often, consultation processes on tax policy either do not exist or are flawed exercises where Government policy has already been decided and are carried out largely for appearances' sake. On major issues of tax policy, there should be clear consultation where the differing options are specified at the start, and properly considered with an audit trail including unambiguous minutes and written responses.

In a policy paper of March 2009, ACCA promoted the use of independent tax policy committees. The proposal was that there should be a body of experts, separate from government- which would be tasked and empowered to formulate and propose tax policy. In addition, it would also have the express remit to seek to simplify tax systems which globally are far too complex.

2. Debt bias and other distortions: Crisis-related Issues in Tax Policy. IMF staff paper June 2009.

Government, under this model, would set the overall economic framework of the tax environment. It would need to define the public policy objectives (eg environmental, social welfare) in terms of public finance demands and fiscal targets that taxation measures were designed to achieve.

It would be of benefit to society, individuals and businesses if there was a clear link from tax take to its application – ie taxpayers could see where the money is being spent. Issues such as ‘green taxes’ have fallen victim to cynicism as the public has not been convinced that the revenue raised has been spent on activities to help the environment but is simply an additional revenue-raiser cloaked with an environmentally-friendly banner. While we are not convinced that such ‘hypothesation’ of particular taxes to specific areas of spending is practicable, we do believe that there should be greater clarity in the public finances showing expenditure projections and how these are to be financed.

3. SIMPLIFICATION

ACCA believes that tax legislation and operations should be as simple and straightforward to understand and to comply with as possible. Complexity in the tax system is in itself a distortion of the economy, diverting productive energies into non-productive administration. Research shows that globally companies spend almost two months per year complying with tax regulations – 15 days for corporate income taxes, 21 days for labour taxes and contributions and 21 days for consumption taxes.³

It is essential too that the *volume* of legislation is kept to a minimum. Much of the increase in tax law and administration in recent years⁴ is due to the number of new anti-avoidance measures introduced by tax authorities. Small businesses in particular have no time to engage in esoteric tax planning and are simply trying to cope with the volume of laws. Changes in tax law - particularly those which reverse previous tax breaks or incentives and which businesses have planned on the basis of - should be kept to an absolute minimum.

4. CERTAINTY

Certainty is another key requirement – and an area where tax systems in many jurisdictions can be criticised in terms of certainty of outcomes or operations. Many tax systems call upon the tax payer to self assess their liability to tax, yet the wording of the legislation may make it impossible for tax payers to accurately establish their liability under the law. The UK and US authorities do not explicitly ban certain types of tax planning, which are within the law, but nonetheless take a negative view of them. (In the US these are sometimes referred to as ‘abusive transactions’). Companies using these legitimate tax planning techniques may find themselves having to report to the authorities or becoming the subject of onerous tax enquiries. Often these artificial ‘blocks’ are used by the tax authorities as a way of ‘fine-tuning’ the legislation where it is unclear where the boundaries of acceptable tax planning are drawn.

This is unacceptable for companies trying to plan their business activities and who need certainty. It should always be possible for different taxpayers who look at legislation to come to the same interpretation of the law. And it should not be possible for authorities to challenge long-established practice, which businesses are accustomed to, on an obscure point of law.⁵ Taxpayers must have certainty over Revenue authorities’ interpretations. Authorities should establish a proper and efficient clearing mechanism for complex anti-avoidance provisions.

3. Paying Taxes, World Bank, 2008. Time recorded is in hours per year.

4. Francis Chittenden, *Perspectives on Fair Tax*, ACCA, 2008.

5. The Arctic systems case involved IT consultant Geoff Jones and his wife Diana who won a long-running legal battle with the UK tax authorities in 2007. See http://www.thisismoney.co.uk/small-business/article.html?in_article_id=422721&in_page_id=10

5. ACCOUNTABILITY AND REGULAR REVIEW

Tax systems should have a review principle whereby tax legislation is periodically overhauled and consolidated to bring it up to date and make it easier to follow. Outdated laws should be removed. Incentives operating to promote long term aims, such as investment in green infrastructure, should have been designed to incorporate regular reviews to ensure that the aim of the legislation is being met.

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

6. TAX POLICY IS A PERCENTAGE OF GDP

ACCA accepts that the current unprecedented economic turmoil may require special measures from governments. Notwithstanding current conditions, we believe that levels of taxation should be clearly stated as a percentage of Gross Domestic Product, as far as is practicable. History has shown that too rapid a rise in the taxation burden to a level unsupportable by the economy can do immense harm and governments should monitor the rate of change in tax levels to avoid fiscal shocks in already weakened systems from proving fatal.

In countries such as the UK and US, the trend prior to the current economic conditions has been for tax revenues to rise in recent years.⁶ In other countries, increasing the tax receipts to GDP ratio by tightening the tax compliance system has been a higher priority for authorities such as the International Monetary Fund.^{7 8}

ACCA does not seek to enter the political debate on the appropriate level of tax and public spending. But substantial tax increases represent a significant burden on businesses and individuals and should be subject to an impact assessment before being introduced. These impact assessments should be used to challenge the need for new regulations and to establish an accurate and updated estimate of costs. Once new measures are put into place there should be a means of measuring and evaluating their impact in terms of their proclaimed public policy objectives. Government should rationalise and set a target of tax levels as a percentage of GDP as part of its economic management and then be held to account via objective measurement and variance analysis.

7. EFFICIENCY

Tax systems should be efficient for governments in terms of their ability to secure the revenue due and to prevent tax leakage and the development of a black economy. But it should also be efficient for taxpayers in terms of their ability to comply with its requirements. It should not be forgotten that small businesses represent the bulk of economic activity in most countries and regulation can have a disproportionate effect on small firms, as the smaller the business the heavier the compliance cost. Research has shown that the smallest companies incur five times the administrative burden per employee than larger firms⁹ and so every effort must be made to increase efficiency of the system. Some test questions for administrations to consider might include: Can related companies be treated as single entities for VAT and other tax purposes and so be able to make only a single tax filing? Do multi-enquiries of the same taxpayer by different parts of the tax authority take place? Are the size of tax returns and the numbers of new or revised forms which need to be completed reasonable and can the taxpayer have flexibility between completing a paper return or an electronic return?

6. Revenue Statistics, OECD, October 2006.

7. Statement by IMF deputy managing director Takatoshi Kato at the conclusion of a visit to Mozambique, 26 July 2005.

8. Statement by the International Monetary Fund, Delivered by Mohsin S. Khan, director, Middle East and Central Asia department, at the Pakistan Development Forum, Islamabad, 25–26 April, 2005.

9. Businesses' Views on Red Tape, OECD, 2001.

Governments should embrace new technology where practicable to streamline the administration of the tax system. Tax is part and parcel of economic activity, and as economic activity changes so should taxation. Computerisation of banking systems, the virtualisation of trade and commerce and the move to technologies such as e-invoicing has profound implications for the measurements and remission of taxes on income and consumption in particular.

8. TAX SHIFTING AND HYPOTHECATION HAVE A ROLE TO PLAY

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

Governments must look to use tax policy as an instrument of positive change by incentivising investment in new cleaner technologies across a wide range of industries. When combined with other tax reductions, green taxes should be seen as a positive step rather than a threat to taxpayers. Governments across the world are beginning to take significant steps to creating a low-carbon economy¹⁰ and accountants should help to identify the emerging fiscal incentives which will be a crucial part of that.

Green taxation is one area where it is particularly important that there is international co-ordination, partly because of the global nature of the environmental problem and also to prevent polluting companies moving operations to avoid the taxes. Arbitrage opportunities here would defy the purpose of protecting the environment.

It should, however, be recognised that a significant shift in the tax base which places a great deal of reliance on green taxes at currently recognisable rates will probably prove unsustainable in the long term. This is because where such taxes are imposed on emissions and general pollution, a successful system will erode its own tax base. This is not merely theorising but a realistic medium-term prospect where the UK government, for instance, intends to reduce CO² emissions by 80% by 2050. Therefore, the way forward may be through a well balanced and broad tax base as well as relying more on regulation to drive down pollution.

9. TAX IS A MATTER OF NATIONAL SOVEREIGNTY

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

It is the quality of the underlying tax system – rather than a simple focus on comparative tax rates – which is of interest to companies. An ACCA study¹¹ of the tax systems in Hong Kong, Singapore, the US, UK, Australia and Canada in 2008 revealed that accountants believed the first two fared clearly better than the others on key issues such as tax fairness, complexity, transparency and above all, sheer volume of tax laws. Retrospective changes to tax laws and stealth taxes were also criticised and the situation was exacerbated by lack of communication and an aggressive attitude on the part of the tax authorities to taxpayers. If this perception takes hold for long enough with no effective action to ameliorate it, a country's tax system could seriously damage prospects for inward investment and competitiveness.

10. *Is the Green Economy Coming?*, ACCA, February 2009.

11. Francis Chittenden and Hilary Foster, *Perspectives on Fair Tax*, ACCA, 2008.

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

It is a difficult issue to balance the rights of sovereign nations to set their own tax rates and policies with the danger of low tax regimes causing retaliatory action and trade wars. ACCA supports the principle of nations being free to determine their tax affairs within the context of a global competitive environment. And it is important that powerful, but high-tax countries (for example in 'old Europe') do not use their influence to pressurise neighbouring countries and emerging economies to give up lower-tax regimes in the name of 'harmonisation', which can be a means to cover up economic inefficiencies. The same can be said of G20 pressure on tax havens – while transparency and efforts to prevent tax evasion must be supported, actions motivated by protectionism and dislike of the downward pressure that low-tax jurisdictions engender, cannot be.

10. TAX IS SUBJECT TO THE RULE OF LAW

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

Honourable Learned Hand, US Appeals Court Judge,
Helvering v. Gregory, 69 F.2d 809 (1934).

'Taxes are the price we pay for a civilized society.'
Oliver Wendell Holmes Jr.

Taxpayers are under a moral obligation to pay the level of tax set by the law. There is a clear division between tax **avoidance** (or planning, or mitigation), which is legal, and tax **evasion** which is not. The former is the legal exploitation of the tax regime to one's advantage, to attempt to reduce the amount of tax that is payable by means that are within the law whilst making a full disclosure of the material information to the tax authorities. In contrast, tax evasion works outside the rules by trying to frustrate legal obligations by hiding income through nondisclosure, or improperly taking deductions that one is not qualified for.

But governments increasingly try to blur the distinction between the two by using phrases such as 'unacceptable tax avoidance' which is not helpful to taxpayers or their advisers. Tax law must be clear and certain and it should be remembered that businesses will look to minimise tax impact as a part of their normal commercial activity. Tax is a business cost like any other and company directors typically have a fiduciary duty to run the business in the most cost effective manner.

As the case above reminds us, it is not unethical to minimise ones taxes. But while most businesses try only to comply with the law, there have been many cases of convoluted tax planning schemes which are designed not for any proper business purpose but to exploit loopholes in the law and avoid its spirit. ACCA does not support this artificial activity, which could be considered the equivalent of the creation of some of the extremely complex financial products, designed to get round banking regulation and which have had such a disastrous effect on banks.¹² Such actions, which may generate short-term financial advantage at the cost of long-term value, cannot be supported.

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

11. RESPECT FOR HUMAN RIGHTS

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

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

A similar approach throughout tax jurisdictions should become the norm.

12. AVOIDANCE OF DOUBLE TAXATION

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

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

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

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

Conclusion

ACCA believes that taxation is a dynamic economic and social tool and must inevitably change in nature as national economies and business sectors develop. Green taxes, for example, were unheard of 20 years ago, let alone 200. But there are also some enduring maxims from Smith's day whose relevance is still undimmed. ACCA would be pleased to discuss the points raised in this paper with policy-makers and other stakeholders.

