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Abusive Tax Avoidance and Responsibilities of Tax Professionals

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Abstract

Abusive tax avoidance reduces the effectiveness and equity of fiscal institutions, and hence contributes to significant levels of deprivation in both developed and developing countries. In the first part of this paper, we outline the main reasons for the existence and scale of abusive tax avoidance, with emphasis on factors that exacerbate the problem in the developing world. However, our main project in this paper is normative. We argue that tax professionals, such as lawyers, accountants and financial advisors, have strong obligations to help remedy the deprivation caused by abusive tax avoidance. To make our case, we present three connective grounds that serve as criteria for remedial responsibilities: causal contribution, benefit and capacity to assist. Although these criteria sometimes pull in different directions, when all three converge there are especially strong grounds for assigning responsibilities to the relevant set of

actors. Applying this convergence approach, we demonstrate that tax professionals contribute majorly to abusive tax avoidance, benefit greatly from its persistence, and have significant capacities to reduce its extent. One result of this analysis is that tax professionals—especially large accountancy, legal and securities firms—ought to do much more to address tax avoidance than merely comply with existing legislation. We also argue that these responsibilities are consistent with, indeed required by, widely accepted standards of professional integrity.

Keywords:

Economic development | Tax abuse | Tax professionals and responsibilities | Remedial responsibilities | Fiscal corruption | Abusive tax avoidance

Notes

1. Hanlon and Heitzman (2010, 137) adopt a similar definition.

2. The latter category is often called “tax planning” or “tax mitigation.”

3. Note that we do not restrict our definition to explicit tax-reductions within a given tax year, as many abusive tax avoidance arrangements spread tax benefits across multiple tax years in an attempt to escape detection by authorities.

4. For similar estimates see Cobham (2005) and Kar and Freitas (2012).

5. Older estimates include staggering amounts as well. See, for instance, Cobham (2005) and Oxfam (2000, 3).

6. For a detailed account of KPMG's tax shelter activities, see PSI (2003).

7. KPMG eventually accepted a deferred prosecution agreement, admitting criminal wrongdoing and agreeing to pay $456 million to the US Government (IRS 2005).

8. Guerin was sentenced to eight years in prison and ordered to pay $190 million (Hurtado 2013).

9. For an example, see PSI (2006, 389). We comment on the reforms introduced by the American Jobs Creation Act (AJCA) in Section 6.

10. An anonymous reviewer for this journal wonders whether we need to argue for a further claim for our argument to have force, namely that tax-reduction practices that undermine the intent of legislation are morally unsupportable. The reviewer concedes that we do discuss the idea of fairness underlying tax law and the need to pay one's fair share. The reviewer also notes that we present a compelling picture of the hardships faced by both developed and developing states and the unfairness of shifting the tax burden on to less well off citizens. However, the reviewer believes we should consider whether, in addition, we need to argue for the claim that those practices that undermine the intent (as opposed to the just the letter) of legislation are morally unsupportable. We thank the reviewer for this comment and for encouraging us to think through the issues. We believe that in the context of our particular argument, we do not need to take on this large and general issue. Rather, for our purposes we believe it is sufficient to argue that tax practices that undermine the intended results of legislation (results that can indeed be reasonably expected given good evidence) are morally unsupportable. Such practices undermine the effectiveness and equity of revenue collecting institutions, leading to deprivation for people whose capabilities depend on government funded initiatives. We have argued that tax professionals contribute toward, benefit from, and have the capacity to prevent these sources of deprivation. We hope that readers will be sufficiently persuaded by these connections between tax professionals and tax-related deprivation to accept that professionals have at least some obligations beyond conforming to the letter of the law.

11. There are a number of objections that could be made to the arguments we make in this paper. There is a view (with a fairly long history) that lawyers are independent from their clients and so are not morally responsible for their clients' behavior. Lawyers can, for instance, represent criminals without being criminals themselves. In fact, the practice of offering legal representation relies on just such a distinction for the legal system's being able to protect people's rights robustly. Moreover, lawyers have duties to represent their clients' interests and these fiduciary duties might well extend to advising their clients about loopholes in the law, including loopholes in tax law. Far from advice about making use of tax loopholes being morally objectionable, perhaps the conscientious lawyer ought to advise her client of just such options when they exist. Furthermore, tax shelter cheats are entitled to legal representation when they face charges and so a lawyer who takes on such a case without having designed the

particular tax product is no more guilty of her client's offenses than a lawyer who agrees to defend an accused murderer.

There are many responses to this cluster of concerns but here we highlight just a few. To take the last concern first, our primary target in this paper is those teams of tax professionals for whom three key responsibility factors converge: they are causally implicated in designing or implementing the problematic tax product; they benefit from these products; and they have excellent capacity to remedy the defective situation. These professionals often operate in highly organized teams, so they share responsibility for what they do together, even if an individual professional participates in only one highly predictable part of the process (such as legal challenges). As we saw in the Wyly case, lawyers are often core members of this team. Lawyers who only represent tax shelter cheats but have not causally contributed to the situation nor benefited from it and are not part of a team who provides such services, are not our primary target.

We would challenge several of the assumptions that underlie many of the objections. First, the actions of lawyers and those of their clients are not so easily distinguished in the cases at issue here. Rather, they work together in crucial ways when the teams of tax professionals create the products which will help clients avoid the tax in ways quite contrary to the spirit of the law (i.e. they fail the Canadian test discussed). Second, there are limits to the kind of partiality lawyers may show for their clients' interests, even when they have fiduciary duties. These limits are frequently defined by courts, professional associations and other regulators. As we show in the final section, we believe plausible interpretations of the codes that govern the relevant professionals do support our case that the partiality limits were violated for the worrisome tax products. Recent court decisions and proposed regulation changes support our case. Third, in many cases the lawyers are involved not only as legal advisors but also as dealmakers who have considerable economic interest in the success of the products about which they are offering legal advice. Legal fees may well depend on successfully completing transactions, with premium billing rates applying to successful transactions and reduced fee structures for transactions that fail to close. We may therefore have reason to worry about conflicts of interest being in play. These conflicts may dispose legal advisors to violating professional norms about responsible legal judgment that gives proper consideration to public interests and other stakeholders who will be harmed by the successful operations of abusive tax products. Fourth, it may also be worth pointing out that we might well have one set of standards for practicing criminal law and the

standards may differ for commercial and corporate law. Much of the force of the objections relies on what we think appropriate in criminal law, but it is a further question whether similar standards should unreflectively apply to corporate law.

Additional information

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