

# Shot by Both Sides

## Tax, the Accounting Profession and the International Public Interest

[Gabriel Donleavy]

**Abstract**— At the heart of a profession is a commitment to serve and protect the public. This paper offers a metaphor in the hope it provides insight into the nature and uses of the term, the public interest, in the international accounting profession. Is the international public interest the black hole at the centre of galaxy of global professional accountancy? Does the relationship of tax haven and accountants lend insight to the issue?

**Keywords**—public interest, accounting codes, tax havens

### Introduction

This paper offers a metaphor in the hope it provides insight into the nature and uses of the term, the public interest, in the international accounting profession. Aristotle recommended the use of metaphor for its exceptional usefulness in granting insight. The metaphor is the Galaxy with a massive black hole at its centre around which spin myriads of stars and the stars in turn host their own solar systems. What keeps them in equilibrium is gravity. If each public accounting association is like a star or sun with its branches as planets and individual accountants as inhabitants of those planets, then we can easily see that each sun is different from every other sun and its values, practices and interpretation of the public interest will be distinct. Following the globalisation of the accounting profession we now have a galactic centre around which all the national professional suns revolve. Real galaxies have at their centre massive black holes whose supreme gravity keeps the whole galaxy from spinning off in to outer space. The accounting galaxy has at its centre a black hole whose event horizon is police by IFAC. IFAC presides over the worldwide spread of notions of what the public interest means in the various accounting professions around the world. The public interest developed its present character during the Enlightenment. Our current problems with the nature, meaning, boundaries and value of the public interest stem from intellectual events in that episteme, most particularly from the ideas of the father of modern economics.

The Enlightenment did not invent the notion of the public interest in the West. The notion of the common weal was a core medieval belief and it echoed ancient Rome's notion of a Res Publica. What was new with the Enlightenment was the idea that public welfare, specifically the wealth of entire nations, was not just compatible with private selfishness, but, through markets, actually rested on it. Arguably one of the most important turning points in our entire intellectual and social history Adam Smith's (1776, 434) raising of his invisible hand to provide a mechanism whereby private greed could be transmuted by free market alchemy into public prosperity, and into national capital accumulation. Earlier schools of thought, notably the so called 'positive theology' promulgated by the School of Salamanca, had approved of trade because it promoted brotherhood and fellowship among men (Grice-Hutchinson 1952, Elegido 2009). Adam Smith (1776, 16), however, took fellowship as humanity's pre-existing natural state, since it was manifestly the case that people lived in

communities where they continually transacted with one another. Smith (1776, 17) also stated that self-interest was the natural inclination of most people, so that they traded from that self-interest, not to form emotional attachments with others nor to express their benevolence towards them. Every subsequent confounding of the public interest with the aggregation of mercantile private interests derives from this one notion.

Labour parties, social democrats and socialists had, and have, a view of the public interest that does not depend on the invisible hand for its coherence; whereas conservatives, neoliberals and many of the factions in the new alt.right depend crucially on it for their idea of a public interest anchored in private ones. In any one country, therefore, the content of the public interest may be argued to depend greatly on the views of the party in power. This may mean that issues like tax evasion, prima facie conflicts of interest, creative accounting for expenses are viewed as compatible with the public interest under one government but against it by the next one. However, even Nobel Prize-winner Milton Friedman and British Prime Minister Margaret Thatcher had some notion of a public good, albeit largely sourced in national capital accumulation in his case and in old fashioned national interest in hers. Both saw the national interest as having a salience that the idea of the public interest lacked. The national interest is per se a concept posited defensively against the rest of the world. It a long way from the national interest to the public interest, but what both have in common is the need for agents to be spokespersons, interpreters, even in a sense apostles, of either of these doctrines, since there is no equivalent of a constitution, a basic law or tablet of stone which states immutably what the essence of either the national or the public interest actually is. Accordingly, one effect of either doctrine is to empower and legitimise its spokespersons. In this sense we are still in the pre Enlightenment age of King Louis 14th's "L'Etat c'est moi" in that we accept the idea that public interest *is whatever its most senior spokespersons reportedly say it is*.

At the centre of professional accounting associations like a sun is the legitimating notion of the public interest. Since the public interest is opaque, variable and contested at the national level, we should not expect at the international level that IFAC or any other international regulator will be able to offer a clear elaboration of the public interest when most national bodies have failed to do. However, IFAC has made a very strong effort to do exactly that, as is shown in the next section.

### IFAC

The International Federation of Accountants, IFAC, has some 159 members and associates in 124 countries worldwide, representing approximately 2.5 million accountants in public practice, industry and commerce, the public sector, and education. (IFAC 2011) It claims that it "serves the public interest by continuing to strengthen the worldwide accountancy profession and contributing to the development of strong international

economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant”.

IFAC is the primary spokesperson for the international profession and speaks out on public policy issues.” (IFAC 2009).

The key item in IFAC's list of objectives, because it is beyond that which is in national codes, is the encouragement of convergence. However, the question arises - convergence to what exactly? Any international isomorphism of professional accounting codes of ethics would be subject to the same criticisms that were levelled at the original Conceptual Framework projects of the FASB and (then) IASC; namely, that they merely codified existing practise without considering, extruding, erecting or creating general principles a priori from which valid and coherent ethical standards may be derived. It takes a generation or more to forget the practical origins of a conceptual framework when this happens, and that burdens the framework with the opacity and incoherence that codes induced from existing practise are likely to possess. The conceptual difficulties of erecting such a framework a priori are formidable at the international level, before even dreaming of enforcing them effectively at national and institutional levels. Accordingly the IFAC pathway to formulating an international level of public interest is, so far, a quite pragmatic and practical exercise.

At no point, moreover, is tax brought specifically inside the IFAC regulated space. The international public interest in tax policy and administration has to date been led by the OECD while the profession itself has kept a somewhat low profile.

### **Tax Codes and Accountants' Ethics in Practice**

Several studies have found tax practitioners' ethics to be set lower than the average for accountants in general. For the tax practitioner, it seems there is no question of the interests of the community trumping the interests of the client except when crime is involved and not always then (Davenport and Dellaportas 2009). Congruent with that is a preference for contractualism as an ethical framework rather than a framework based on such a thing as society (Cruz et al 2000). In the same vein, succeeding in the practice of tax representation and advice was not seen as requiring ethical behaviour in the survey of Big Four practitioners by Marshall, Smith and Armstrong (2010)

Arthur Anderson's association with the Enron scandal, especially its alleged role in jointly creating some twelve tax avoidance schemes had lasting effects on public trust of accountants (Guardian 2003). Andersons had tied its reputation to its alleged integrity (McMillan 2004). Similarly in the UK, the Big Four escaped serious retribution for their role in the Global Financial Crisis. Thus in 2014, the Big Four still held 95 per cent plus of the FTSE 350 audit market, suggesting their grip on the large company audit market was still very considerable and largely able to absorb shocks (Fogarty and Jones 2014). To put it differently, the financial public is one where clients take precedence over society. For the rhetorical tactic widely used by the Big Four to divert attention and blame is to externalise the locus of

control for their activities (Whittle and Mueller, 2012). In particular, the unsatisfactory constraints of the legislative environment are emphasised to create distance from any associated agency and blameworthiness. Contemporary tax law is portrayed as an unfortunate by-product of former times, which the Big Four also have to endure; thus, they paint themselves as subject to, or victims of, external forces, tax complexity and globalisation, over which they have no control and to which their professional practice is subjugated within the current arrangements (Addison and Mueller 2015).

Factors which drive some tax practitioners toward some regard for the public interest have been identified in a number of studies in the last decade or so and they are summarised in the next three paragraphs.

Shafer, Simmonds and Yip (2016) found a strong positive relationship between tax professionals' belief in the importance of corporate ethics and social responsibility (the stakeholder view) and their level of professional commitment. They also found that tax professionals who more strongly believed in the importance of corporate ethics and social responsibility were *significantly* less likely to express intentions to facilitate tax fraud by a client. Their findings suggest that higher levels of professional commitment may predispose individuals to possess greater moral fortitude in upholding professional standards in the face of client pressure to commit unethical or fraudulent activities. (Shafer Simmonds and Yip 2016)

Bobek and Radtke (2007) asked tax professionals to rate their firm's ethical environment and to report if they had faced an ethical dilemma. Those who had faced ethical issues were less likely to describe their firm's ethical climate as strong. Differences were found between partners and their staff regarding the ethical environment, with the former believing dilemmas are less common and better accommodated by the firm than the latter (Bobek *et al.* 2010a, 2010b).

Significant associations were found by Shafer, Poon and Tjosvold (2013) between ethical climate, professional commitment and organisational commitment. Participants' degree of affective commitment to their profession was associated with a higher level of ethical commitment. Professionally committed employees reported less conflict and greater commitment when they felt the firm placed more emphasis on the public interest. Taxation specialists perceived the least emphasis in the firm on serving the public interest.

Blackburn et al. (2010) found SME's trust in their accountants depends on their perception of their worth as general business advisers

### **The Ethical Calculation of Tax Practitioners**

Our starting point in discussing the public interest in the accountants' tax advising practise is the nature of tax itself. On the left hand we can adduce views such that of Compin (2015) who asserts that a democratic state's ability to protect its citizens depends on their acceptance of just and necessary taxation. Breaches to this public contribution weaken not only the foundations of social redistribution but also the concept of an effective state. Further left is Simon McRae from the charity War on Want asked “How can a company

say it is socially responsible and not pay tax? This is contrary to a socially democratic society," (Anonymous 2008)

On the right hand are the supporters of the tea party, neoliberals generally and the alt.right. An American judge who had a lot to say about accountability in his career, clearly enunciated the ethics of tax minimisation thus. Justice Learned Hand [sic], (in his dissenting opinion in *Newman*, 159 F.2d 848, 850-51, 35 AFTR 857 (CA-2, 1947)): "There is nothing sinister in arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; 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." (Sherman and Brinker, 2006). Cant it may be: Kant it is not.

Practitioners struggle to serve two masters, albeit imperfectly. Where they strike the balance is difficult to predict, as people differ in how aggressive they are willing to be. Practitioners want to be ethical and rarely are willing to take positions that they perceive to be dangerous to their livelihood. The fear of audits is also shared. The qualitative nature of relationships looms as a disproportionately important factor, and one that is not well-appreciated in the literature. (Fogarty and Jones 2014).

### Tax Havens

All the issues of concern in this paper – the international public interest, client privilege, accountants codes and a cost benefit approach to tax advising - these all meet on the battlefield of tax havens. The role of accountants in the continuance of tax shelters, base erosion and evasion of tax in the countries where corporations conduct their main business is a uniquely appropriate field to measure the ethical claims of accountants' codes of practice and accountants' ethical behaviour in their actual practise.

The OECD defines a tax haven as a jurisdiction with no or nominal direct tax, no transparency, no exchange of information agreements and a territory that houses companies with no genuine activity in that jurisdiction (Anonymous 2008). Compin (2015) characterises a tax haven as "a country or territory which amasses vast amounts of capital for the benefit of natural or legal persons seeking to escape their own countries' taxes and thus undermining their budgetary balances and social development projects". The Tax Justice Network has a much wider view, for it identifies London as the biggest tax haven in the world, (Anonymous 2008) though it does not match any one of the OECD ingredients. That London is a place from international tax minimisation is organised does not by itself mean the UK is a tax haven, only that it contains people who aid and abet tax haven activity, as is to be expected of a global financial centre until there is a massive change of culture around tax in the finance community.

KPMG, the world's fourth largest accounting firm, reached an agreement on August 29, 2005, with the U.S. Attorney's office for the Southern District of New York to pay \$456 million in exchange for the dismissal of all criminal charges stemming from KPMG's creation and marketing of tax shelters between 1996 and 2002-shelters that "assisted high net worth United States citizens to evade individual income taxes on billions of dollars in capital gain and ordinary

income." While the settlement enables KPMG to avoid prosecution, the (now ex-) partners who were at the heart of the firm's tax shelter practice remained subject to criminal charges. The settlement allowed KPMG to survive. Had the government's criminal prosecutions continued and been successful, KPMG could have met a fate similar to that of Arthur Andersen. (Sherman and Brinker, 2006)

Market fundamentalists defend the existence of tax havens. Dan Mitchell of the Cato Institute, for instance, believes low tax jurisdictions actually have a valuable role in the global economy." They facilitate the efficient allocation of capital, encourage savings and investment and because of tax competition they encourage better policy in the rest of the world," he says. Compin (2015) argues that the development of tax shelters, international tax minimisation and the proliferation of shell companies in tax havens is driven by a significantly large element of conservative Anglo-American culture which are opposed to all regulations, taxation and the concept of a welfare state.

Criticism of accountants for their active role in promoting and defending tax havens is widespread. For example, Christensen, (2007, 11) argues that accountants exploit their privileged status to undermine national tax regimes by facilitating activities which straddle the border line between the legal and the illegal, the ethical and the unethical. Despite the fact that many of its practitioners hold professional status, the culture of the tax dodging industry is wholly subversive of democratic good practice

The tax authorities are slowly increasing their investment in their war against base erosion to tax havens/ In the US for instance, anyone who organises, sells or promotes a tax shelter under US law is subject to a penalty. There is no requirement for the IRS to establish that an investor relied on the false statement. Making the statement itself triggers the penalty. (Cash, Dickens and Mowrey, 2007). The penalty, however, is the lesser of \$1,000 or 1 percent of the gross income derived from the shelter. If a penalty is assessed for aiding and abetting, no penalty will be imposed under the abusive tax shelter provision. (Cash, Dickens and Mowrey, 2007). In contrast, the penalty under IRC Section 6700 for a promoter of an abusive tax shelter *who makes a false or fraudulent statement* is 50% of the gross income derived from the activity. The penalties only become fierce when the activity becomes criminal in the conventional sense, but serious omission of assets in a tax return would itself already be criminal fraud; and it is hard to conceive of effective tax evasion or international minimisation being effectively achieved without the act of omission, concealment or misrepresentation in the tax return – at least in the spirit of the law. In the letter of the law and given the criminal law need to establish guilt beyond reasonable doubt and with mens rea – deliberate intention – successful tax evasion, especially on an international scale, need only involve the planning and thought necessary to make proof of fraud and its mens rea beyond reasonable doubt difficult to prove. This may explain why ever inventive market forces have begun to see the registration of patents for tax minimisation strategies themselves (Kowalski, Schauer and Paul 2009). This authorises charging royalties to copy registered tax minimisation strategies or being sued if a strategy is employed too similar to one already registered. The mindset that registers a tax strategy as subject to a

patent could in some neoliberal utopia of hardly any taxpayers paying hardly any tax an enterprising accountant register a patent for the lawful paying on time of tax due, so that s/he could sue every subsequent taxpayer who paid their taxes as the lax part of the law requires.

IFAC's code of ethics does not explicitly mention tax havens, duties to the tax authorities or the proper limits on an accountant's contractual bonds of privilege and confidentiality. The profession in general has not adopted a position against the existence or the use of tax havens to minimise their clients' or their own international tax liability. The space thereby vacated is up to now filled by the OECDA particular focus of the OECD/G20 will be ensuring implementation of the four minimum standards arising from the Project to tackle Base Erosion and Profit Shifting (BEPS) – on harmful tax practices, tax treaty abuse, country-by-country reporting and dispute resolution mechanisms – which will be subject to a peer review process, alongside ongoing monitoring of the other elements of the package. So it was agreed in Kyoto by some 80 countries in 2016. (OECD 2016)

### Conclusion

Dellaportas and Devonport (2008) found Cochran's (1974) typology of public interest theories valuable in their extensive discussion of the term in an accounting context. The typology can be considered not useful enough, however, to add insight to, rather than merely rebadge, the political nature of the public interest interpretations, especially with respect private interest legitimacy discourse and the continuing salience thereto of the invisible hand.

England's Charity Commissioner had a useful insight into the overlap between charity and the public interest thus: - 'A distinctive feature of charities is the fact that those responsible are trustees with no personal financial stake in the charity. This principle of altruism is fundamental and reflects the essential public spiritedness of charity' (Fries 1994). Such a definition, if applied to the idea of the public interest precludes any notion of contractualism or any shaking of Smith's invisible hand.

In contrast we have the market fundamentalism of the likes of Ayn Rand. Ayn Rand (1967, 126) has characterized the "public interest" as the "intellectual knife of collectivism's sacrificial guillotine." "Since there is no such thing as the 'public interest' (other than the sum of the individual interests of individual citizens), since that collectivist catchphrase has never been and can never be defined, it amounted to a blank check on totalitarian power ... industry, granted to whatever bureaucrats happened to be appointed...."

The public interest does not appear to have a precise meaning and existing definitions are inadequate to serve the accountant's daily and ongoing responsibilities (Baker, 2004, p. 12; Canning and O'Dwyer, 2001, p. 278; Sikka et al., 1989; Willmott, 1990, p. 318). The concept of the public interest in accounting lacks precise meaning. In the absence of a definitive meaning capable of practical application, members of the accounting profession are unlikely to understand the concept of the public interest as having any practical salience capable of trumping their internalised contract based loyalty to their paying clients, (so long as they stay away from excessively high risk evasion strategies). The public interest means whatever those in charge

say it means and it is therefore an unpredictable and somewhat arbitrary phenomenon. To begin to become the stable and reliable touchstone of legitimising rhetoric, it would need to have a generally accepted explicit set of postulates a priori. Until that happens, the black hole at the centre of the international accounting profession will not command enough gravity to keep the stars in its orbit from going their own way following their own national interests. That in turn means there will continue to be insufficient trust by the public in the accountants or by the accountants in the tax authorities or by the tax mandarins in their political masters for there to be enough gravity to keep the member associations from recognising any federal initiatives by IFAC at the centre, except by way of mere lip service or the probably coincidental aligning of a national professional association's view with IFAC's view. In such a scenario, we will continue to see the displacement of accounting bodies by oversight boards, by Sarbanes Oxley style laws and by the initiative being seized and maintained by such bodies as the OECD, while the profession conspires with its clients to minimise not only tax but also regulation more generally.

There are of course many honest accountants whose genuine regard for the public interest means that they do not always or necessarily act as the client's consigliere. Such accountants, especially those outside the big four are the ones who whose dilemma is most acute. In the absence of evidence to the contrary we may just as well assume that a majority of professional accountants are honest, respectable and law abiding as suspect they would all be consiglieres for amoral clients if they could secure them. Indeed the latter assumptions looks somewhat "deplorable". Achieving the difficult balance between the clear, contractual and cash anchored requirements of the client base on the one hand and the opaque, vague and mysterious requirements of the public interest on the other hand is a continuing challenge to the accountant's professional judgment and integrity. In those cases where the requirements of the public interest are relatively clear, the tension suffered by the accountant will be sharper. The extract below from the eponymous song by the group called Magazine puts very well what it is like to be attempting to maintain professional integrity under the twin pressures of the professional duty of client confidentiality and adequate fealty to the tax authority.

'This and that, they must be the same.  
What is legal is just what's real.  
What I'm given to understand  
Is exactly what I steal.  
I wormed my way into the heart of the crowd  
I wormed my way into the heart of the crowd  
I was shocked to find what was allowed  
I didn't lose myself in the crowd  
Shot by both sides  
On the run to the outside of everything  
Shot by both sides  
They must have come to a secret understanding'  
(Shelley and Devoto 1978)

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