

Practice Note

The Ethics of Transfer Pricing and the Role of Management Accountants

Janek Ratnatunga¹

Management Accountants who have studied the topic *Environmental and Social Management Accounting* (ESMA) know the arguments well.

Governments believe that, ethically, corporations should pay taxes in the country in which a profit is made; whilst corporations believe that they must act in a manner to maximise value to their shareholders. Thus, they believe it is ethical to transfer price profits to low-tax (or even no-tax) regimes in a legal manner. Tax avoidance is ethically and morally acceptable say corporations, whilst tax evasion is not. And to that effect, big corporations hire an army of tax accountants and advisers to ensure that no laws are broken or perceived to be broken.

Against this ethical conundrum, it is interesting to study the list of submissions to the *Australian Parliamentary Inquiry into Corporate Tax Avoidance*. First, the list itself it reads like a Who's Who of not only Australia's, but also the World's biggest tax avoiders, with names like News Corp, Apple, Google, and their advisors from the global audit firms Deloitte, Ernst & Young, KPMG and PwC.

Their submissions have four common themes.

The *first theme* is to call piously for multilateral action (via organisations like the OECD) to address tax avoidance. In fact, the Australian Chartered Accountants (whose members are mostly in those global audit firms that are advisers to tax avoiders) held a seminar on the need for multilateral action. This is like giving the fox in charge of the chicken coop. The Chartered Accountants know well that OECDs and G20s don't make laws – they make communiqués and manifestos. Sovereign nations make laws. They are aware that the *best way to get no action is to wait for global action*, because they know, deep in their hearts, that global action is an endless dream that never comes true.

The *second theme* that all of these submissions have in common is how much "economic contribution to society" they generate. We create jobs! We contribute to a country's economic growth! Google, Apple and News Corp all say this. However, other corporate citizens such as Wesfarmers and Harvey Norman (in Australia) pull their weight on the tax front and create jobs too, as do thousands of small-business people who can hardly afford to set up associated companies in the Bahamas, Switzerland or the British Virgin Islands.

The *third theme* is to set up an illusion about how much taxes are really being paid. For example, Google Australia states that it "paid" \$7.1 million taxes in the last annual report (an accounting number). However, despite all its complexities, anybody can find out how much tax was actually paid by a company. This is done by looking at the cash-flow statement in a company's financial accounts. Here one can see how much money came in the door in any year and how much tax, to the dollar, was actually paid in that year. So, for Google, one can see that its total tax expense was actually only \$466,802 for the year (not \$7.1 million). Even more illusory is that its \$2 billion-plus in revenue from selling advertising services to Australian companies advertising Australian products to Australian people on computers sitting in Australia is not even counted as revenue in Australia. This Australian

¹ First Published: Ratnatunga, Janek (2015) "The Ethics of Transfer Pricing: Are Management Accountants Above It All?", *On Target*, ICMA Australia Newsletter, 19(3), May-June, pp.1-2.

revenue is, in fact, booked through another Google entity in the low-tax regime of Singapore. Simply put, Google Australia and its Tax accountants deem that Australian revenue to be Singaporean.

The *fourth theme* evident in these Senate submissions is their knack of “cherry-picking” information convenient for their argument. For example, the submission by the Minerals Council mixes up royalty payments with taxes to show that high taxes are being paid. Just like the practice of tax law itself, it is all about which data one selects to help one's case. It is nothing to do with the truth. This total disregard for ethics by corporations and their tax advisors has worrying and immediate implications for the execution of tax policy. But what are the solutions?

The Australian Taxation Office (ATO) is pushing to introduce the *External Compliance Audit Program (ECAP)* scheme, which will outsource the monitoring of tax compliance to none other than the companies' auditors themselves!

In effect, this puts the poachers in charge of the game park; the fox in charge of the chicken coop, etc.

The ECAP is principally a cost-cutting move. But the ATO's official line is that Chartered Accountants and their multinational clients are somehow higher-minded than other taxpayers and therefore should be entrusted with self-regulation. This is despite that fact that PwC was caught out misleading government committees in Britain and the United States over schemes marketed to clients that involved sham structures and profit-shifting via Luxembourg and Switzerland. KPMG and Ernst & Young have been called up by US Senate subcommittee and accused of actively marketing tax shelters and profit-shifting arrangements. The point is that the Big 4 will always be conflicted.

They are part of the problem, not the solution. The evidence is that their ethics are focused on their own bottom-lines, not honesty and integrity in dealing with Australian tax and regulatory authorities.

Further to this conflict of interest, the Minerals Council of Australia, which speaks principally on behalf of foreign-controlled multinational mining companies, has filed its submission with the inquiry. Much of its argument against taxing mining companies further, or in a more efficient way, relies on research prepared for it by Deloitte. Although it is partnering in the ECAP scheme with the ATO and big corporate clients, its work for the Minerals Council demonstrates it can hardly cope with even the basic conflict of interest between its duty to uphold accounting standards and the advice it gives its corporate clients.

It is the opinion of this author that by setting up the ECAP, the ATO has outsourced its key process, one that earns them the biggest tax revenue, to a conflicted third-party. This is akin to when IBM outsourced the disc operating system of its PC to a man called Bill Gates. That was known as the biggest outsourcing blunder ever! The ECAP may be a worse blunder by the ATO.

So where do management accountants sit? As they directly do not provide tax avoidance advice, are they above it all? Can they take an ‘holier than thou’ attitude vis-à-vis all those Chartered Accountants and CPAs who provide direct tax avoidance advice? Perhaps they can.

But management accountants do have to take tax implications into consideration when considering international business decisions such as location issues in setting up international operations; the choice of channels of distribution; dumping and countervailing taxes, and in pricing and exchange exposure management. In considering tax implications of such projects and other related management issues, it is urged that they consider the ethical implications in addition to the usual value creating aspects, in their decision making.