

# 2

## Moral Outrage and Righteous Indignation

### Context

From 2012 onwards we have started to see a strange phenomenon. A case of moral outrage and righteous indignation focused on the banking industry. Unfortunately, there was some fire where the smoke was. The case of Barclays Bank, and others, ‘fixing’ LIBOR, JPMorgan, HSBC and others, were mired at one point or another in similar cases where the ‘public’ were presented with all the bad bits about the banking industry at the same time. Banker’s bonuses were also an easy target and the calls for more regulation of the banking industry were rife, as well as calls to split the larger banks into retail (low risk) and investment (high risk).

This focus on banking was only the latest in a series of high profile cases where the inner workings of an industry were opened up to scrutiny. We had previously seen the UK Parliament engulfed in an expenses scandal that saw the same reaction. In that case, members of parliament had (and have) a system of expenses since they need to be able to service the needs of their constituents locally, as well as be present in Parliament in London from time to time. How those expenses are claimed and what can be claimed were laid out in a set of rules. When it became clear that some members of parliament were ‘abusing’ the system, the resulting furore was aimed at them, even though, in many cases, a close scrutiny revealed that they were within the rules. It is interesting that no-one criticised those who made the rules for failing to devise a better system. It was the moral outrage that people could be ‘self-centred’ that drove Parliament to change the rules (relatively quietly) while pillorying those who had transgressed.

In more recent times we have continued to see similar transgressions that would seem to indicate that it almost doesn't matter what regulation you put in place, someone will find a way around it. The Panama Papers leaks associated with Mossack Fonseca again highlighted that, despite years of previous outrage, those shouting the loudest were, at the same time, often breaking the very rules they were criticising.

## **FATCA**

The object of FATCA is to prevent, deter, detect and correct tax evasion by Americans.

America has a voluntary tax system in which tax payers are expected to disclose their income both from domestic and foreign sources. At the same time, the US government claims the right to tax the global income of its citizens.

The US has some of the highest taxes on the wealthy in the western world. A wealthy American can expect to pay a marginal tax rate of around 40–50%. It is therefore natural to expect that some will find ways to hide their income and the cash reserves that generate that income.

## **Avoidance or Evasion?**

Tax evasion is different from tax avoidance. Tax avoidance is the use of legal means to mitigate the amount of tax to be paid. This is often achieved by the use of specialist advisers who know and understand the loopholes and strategies which exist in any complex tax system (and all tax systems are complex). Tax evasion on the other hand is the deliberate breaking of the law to achieve the same objective.

No system is, of course, static. What, today, is tax avoidance, tomorrow may be deemed tax evasion, and so the tax system is in a state of constant flux with regulators trying to catch up with those in the markets trying to find innovative ways to avoid paying tax, or worse, evade tax.

In 2012 we also saw a moral dimension enter this space. The sub-prime crisis and financial crash of 2008, the following global credit crunch and subsequent double dip recession, the results of which are still with us today, were caused by two activities. First, financial institutions, led from the US, lending without adequate controls or oversight of whether those being lent to were capable of re-paying their debt. Second, the public, again led from

the US, accepted this 'easy money' in the knowledge that even small changes in the market would make it difficult or impossible to repay the debt that they had incurred. In other words, 'it takes two to tango'. There is usually an uneasy truce between the financial firms on the one side, who maintain strong lobbying presence in Washington, DC to argue for rules that allow them optimal freedom to pursue their business and profit led interests, and 'the public'. The public have their views too, but in many cases that view is seen through the lens of the media.

In 2012, we saw the triumvirate of public, media and financial services explode, when some of the activities of some of the banks and brokerage houses were found to be 'risky' if not illegal. No-one complains when someone takes a risk and the result is a win. But, equally, no-one seems to feel any sense of culpability in the current financial state of the world, quite the opposite. It was *all*, the fault of the financial services industry. The media certainly fed this monster and the politicians reacted as one might have predicted. Moral outrage. The outrage had to be 'moral' because otherwise, they would have had to recognise that (i) there were always two halves to the culpability and (ii) they were the ones who were (and are) responsible for the legal and regulatory framework that should act as the guardian.

Let me put it another way. If you borrow money and your lender does not do sufficient due diligence, then clearly they are culpable. But equally, and this is the part that people conveniently over-look, if you agree to borrow the money, there is both a legal and moral obligation on you to make sure that you understand the terms of the arrangement (you're the one signing the contract) and that you can repay the debt. If the debt goes toxic—there were two sides that agreed the terms. Let's not forget that we're not really dealing with complex financial instruments here, as some have led the market to believe. The sub-prime crisis that triggered all this, was about normal Americans signing up to mortgage deals that were too good to be true, and which they had good reason to know that they may have problems repaying. Yes, the financial firms were also culpable. The reason the products were too good to be true, was a lack of due diligence on the borrower's ability to service the debt, and the underlying principle that they were packaging this debt and risk up and laying it off in complex ways around the world, in order to be able to offer the easy money in the first place.

So, a most dangerous situation began to arise in 2010 and 2011. Even though there was culpability on both sides to create the global financial crash and continuing recession, the public, fuelled by the media, found the blame game way too easy, targeting the banks and brokers. Since the regulatory and legal frameworks could not be changed overnight by normal

means, capitalism had a new enemy—moral outrage. There are two problems with moral outrage. First, in our modern society, we use laws (and our appointed agents the politicians) to translate the ‘majority’ view of morality into a set of laws. The trick is to minimise the set of laws in order to maximise the degree of freedom that people have within their society whilst keeping them safe, well fed and able to help the society prosper. The question is how well ‘people’ determine what’s ‘moral’. When you’re facing a mountain of debt (that you helped create), your job is in jeopardy and the world seems to be falling apart around you—is probably not the right time to be judging what’s moral. Secondly, outrage. Well the problem here is simply that fire feeds fire. The media have played an important role in fuelling the ‘outrage’ part of this equation and the public have played into this at every step. It’s usually politicians who are blamed for diverting attention from one thing in order to hide something going on elsewhere. In this case, the public had its attention expertly diverted by the media, who pointed the finger of blame at the financial services industry as the sole wrong-doer. The politicians, unable to use the framework of law and regulation to show how well they had it ‘in hand’ raised the hand of righteous indignation in order to be clearly seen on the same side as their electorate. Judgements about morality as the foundation for changes in law or regulation, are hardly best made when your emotional state is ‘outrage’.

So, yes, the world was in a deep and continuing financial crisis. Yes, the financial services industry has a level of culpability. But the public share part of that blame. They put the politicians where they are. They accepted the easy money when it was there—they created the conditions in which the financial services industry acted. And the public believed the media when they created the fire of moral outrage.

This point is nicely made by the problem that UK comedian Jimmy Carr had in 2012. Mr Carr had used a special scheme, provided by an adviser, through which he ended up paying very little tax. This is tax avoidance. When this scheme came to light, it was with stunning speed that the then prime minister, David Cameron, announced to the nation that Mr Carr’s activity, while technically legal, was morally reprehensible. This caused Mr Carr to apologise publicly and change his financial affairs—even though he had done nothing wrong. This highlights the dangers inherent in a moral attitude to tax. Mr Carr’s only actual tripwire was that he had been specifically making a point of humorous outrage in his comedy sketches about how banks could get away with paying very little tax, by using, as it happens, the same sort of approach that he himself had already taken. True, that’s an embarrassing situation, but neither the bank nor Mr Carr were

doing anything illegal. If anyone was to blame, it should be the regulator. They made the rules, and they didn't write them clearly enough to preclude what someone, at some future point, would view as wrong. Equally, Mr Cameron is not in charge of the morals of British society and had no right, in my view, to abuse his position as Prime Minister, in order to make a moral comment about an entirely legal activity. The reason is that, while accepting that the activity was legal, he created a reputational issue for Mr Carr because no-one, conveniently, drew the line between tax avoidance and tax evasion. The public, again fed by media oversimplification, essentially thought Mr Carr was evading tax, when he was actually just doing what he had every right to do under the rules of the time.

The people who usually 'bash' the wealthy are often those, who, were they put into the same position, would almost certainly do exactly the same thing. Morality is like Einstein's theory of relativity—it depends on the viewpoint of the observer.

I also want to take this opportunity, since it is relevant to the argument over FATCA, to make three more points.

My first is that whatever gets said in moral outrage about the wealthy not paying their fair share, all western governments know that most of the cash that pays for their country to work—comes disproportionately from the wealthy. Behind closed doors, the biggest angst in the tax system is trying to figure out where the tax line is, above which, the wealthy will start to move all their money elsewhere. It's a balancing act and sometimes governments get it wrong, but they do spend a lot of time trying to get it right. Overall, for example, both in the UK and the US, over 70% of the cash that government spends, outside of gilts, comes from taxes on the wealthy. Time spent by government fiddling with marginal tax rates for those at the bottom of the wealth pyramid is diversionary behaviour and makes very little real difference. There is also always a missing factor in this 'fair share' concept. It's the rich who create many of the jobs that those throwing the rocks have. The other major employer of course is government itself, via the public sector, and most of their money comes from...the rich.

In this climate, it's probably not surprising that wealthy Americans, in fact wealthy people everywhere, end up in some balance of tax avoidance. But that fire is not fuelled by the media in the first instance. That fire is fuelled by the accounting firms who analyse the rules for loopholes and create the avoidance plans. I choose not to call them 'schemes' as that's too close to 'scams'.

The irony is that those in relevant positions can hardly say that they don't know what's going on, nor that they could not stop it much more simply

and effectively than with FATCA. The biggest ‘circuit’ in the industry is the one where the people in the regulatory sphere, leave that public service for a while and usually end up in highly paid jobs at the accounting firms. Those same people, usually after a few years, end up cycling back into government service. The knowledge of what’s going on has always been there.

So, my biggest challenge in looking at the context of FATCA is that the world which created FATCA, and in which it operates, is founded on moral outrage, a failure by the public to recognise or take their share of responsibility. The knowledge that the wealthy, the jobs they create and the taxes they do pay are a critical part of the equation and finally that, apart from the public, everyone else knows what is actually going on and diverts the public attention at relevant and opportune times. The question of today’s society is not what’s fair, nor what’s moral. These are things, the perception of which can be manipulated. It’s who decides what’s relevant and when is opportune.

The framework in which this all operates, as we know, is law and regulation. The law in this case is the HIRE Act and the regulation, what we’ve come to know as FATCA. Over the last twenty years, the world has undoubtedly changed. From a regulatory perspective, what the UK called ‘light touch’ regulation is actually what is more commonly known as ‘principles based’ regulation, as opposed to rules based regulation.

Both have their good and bad points and, with FATCA, we are headed firmly down the route of rules based regulation.

We all strive for certainty in an uncertain world. That imperative leads to the false proposition that with rules, you can contain, define and completely control a system. That, by having rules, you somehow create certainty out of chaos. Of course, any physics undergraduate will tell you that this is a frivolous position. You cannot measure or control a system without affecting the system in some way. Equally, the more complex the system, the more unlikely it is that your rules will be sufficient to encompass all possible permutations of how those rules might be interpreted, applied or avoided.

The converse in human society is to have principles e.g. do no wrong; do what’s fair; do what’s right. That’s an equally frivolous position because, as I pointed out, who defines fair, wrong and right? Those value principles can and do change over time.

So, to regulate financial services, with a view to addressing tax evasion, a rules based system would have to be enormously complex—much more complex, by orders of magnitude, than the current tax system. Equally, a principles based system would need to have everyone outside and inside the system agreeing on what is right and fair etc. Neither system will ever

work without the other. Yet the public yearn, and the politicians and media hold out the view that it can somehow be achieved.

What does this have to do with FATCA? Well, FATCA is a reaction to my foregoing points and to the world in which we currently live. There are many outside the US that believe that FATCA is both disproportionate to its intent and politically the worst example of extra-territoriality seen in recent times.

Will FATCA achieve what it set out to achieve? Probably not; at least not in the way originally intended.

One of the biggest myths about FATCA is that it's a withholding tax system. It's not, it's a reporting system with penalties that just happen to be applied via a tax system. However, its convergence to IRC Chapter 3, the QI rules—which is a tax system, has some interesting consequences. It starts to create a system which has dual objectives—tax income and evasion deterrence. These have heretofore been separate issues. Moral outrage is bringing them together and I'm not sure that's a good thing.

The foregoing has addressed mainly the evasion pursued by individuals via the financial services system and the extension of FATCA into the OECD's AEOI and CRS is a matter of further discussion later in this book, as it triggers more of an operational and cost effect than one of moral outrage. However, tax evasion also takes the form of corporate misbehaviour and interestingly there is much more considered outrage in this area. Companies such as Amazon, Starbucks and Apple have all come in for criticism and, in some cases, investigation, for their tax strategies. Again, for anyone placed into a similar position and with a remit to serve shareholders, some of these strategies are understandable and, for the most part are defined as avoidance and not evasion. In this context again we see the effect of concepts of fairness and ethics that, while they have no legal force, can create seismic shifts in corporate behaviour on the basis that brand values, reputation and thus revenues, can be damaged by what, in any other business would be deemed a back office administrative activity. Many of these cases are raised in the public awareness by the increasing impact of social media, and of larger numbers of people expressing their views immediately and on-line. Earlier in 2017 United Airlines became very painfully aware of the speed with which brand reputation can be damaged. Many of those mentioned already have seen similar campaigns to boycott companies because of their perceived bad tax practices. This is what has also led to the OECD Base Erosion and Profit Shifting framework (BEPS).

It is difficult not to have some sympathy with a company that employs many thousands of people (who all pay taxes from their wages and indirect

taxes such as VAT on purchases they make with them) at hundreds of retail outlets (that generate business rate taxes) and that in turn support a myriad of secondary support industries. The fact that legislatures write inadequate laws, and regulators write overly complex and porous regulation, brings no outrage. In such cases, the argument from governments, on behalf of the people, that corporation tax from these firms is the sole (or even major) contribution to tax revenues is simplistic at best and disingenuous at worst.