

# eBOOK PREVIEW

## PENTOLOGY VOLUME 2

### BIG 4 BIG MYTH

## Chapter 1

### The Mafia, the Yakuza, the Triads and other Secret Societies

Although now more than seventy years distant in human history, the words of the 32<sup>nd</sup> President of the United States of America, Franklin Delano Roosevelt, toll as ominously true today as when they were first delivered:

*The liberty of a democracy is not safe if the people tolerate the growth of private power to a point where it becomes stronger than the democratic state itself.*

It has been estimated that the aggressive taxation avoidance industry through its advisers organises and executes international transfer pricing arrangements (transfer of taxable profit) and other highly questionable international tax arrangements avoiding taxes, including tax shelters, in the order of US\$1,000 billion *every year*. If the Lawmakers in the various Governments around the world ultimately deem this to be a head of taxation fraud, which it is at least on the border of, then it is a crime that in financial terms would be unprecedented in human history *every year*.

To understand the scale of these taxation avoidance behaviours, one should examine the economic output of the leading nations in the global economy. If the international tax avoidance industry was a sovereign nation at US\$1,000 billion it would rank 16<sup>th</sup> in the world's economies. Of course, the scale of such aggressive taxation behaviours may be larger than that since *reporting taxation avoidance activities* tends not to be part of the disclosure requirements of the major companies that undertake such activities.

Sadly, even less is said of the real victims of this crime. The total development foreign aid budget of the world's nations in 2013 was some US\$134 billion or *no more* than about one seventh of the estimated *take* of the international tax avoidance industry.

Homeless women, uneducated youth and children dying of curable diseases in third world countries are but a few of the many victims resulting from the peddlers of greed within the taxation avoidance industry.

How often do politicians speak of the necessity for restraint or austerity (as British Prime Minister David Cameron was criticised for following the recent Mossack Fonseca tax scandal) and require budget cuts on these perceived *soft targets* to meet falling revenue projections? Yet, the same Lawmakers will readily accept invitations from the Big 4 accounting firms to appear at tax conferences and other gala events, watch major sporting events in luxurious corporate boxes or discuss the tax requirements of the *important people* in private dining rooms around the world. Seemingly, it becomes more important to give the

billionaire a US\$100 million tax cut for a new casino than to provide the required benefits for the underprivileged, unlikely to be ever invited to these luxurious Big 4 accounting firm entertainment facilities. While not all politicians will be *gamed* by the Big 4 accounting firms for taxation advantages for their clients, sadly too many will!

Politicians or indeed the wider society must never consider taxation *a game!* It is the duty of politicians to responsibly raise taxation from the revenue base and to appropriately allocate those funds back to society. In order to do this and meet their wider duties in a democratic system, the politicians should or ought to have *a deep understanding* of *both* the *responsible raising* and the *moral allocation* under the taxation process. Such a duty, of necessity, must be *independently* exercised to ensure integrity.

As the taxation scandal involving Panamanian law firm Mossack Fonseca disclosed by the International Consortium of Investigative Journalists (the ICIJ) has shown, the Big 4 accounting firms are not the only merchants of tax products nor the most aggressive. However, they are unquestionably the largest, the most sophisticated and the most powerful. Conceivably, they are also the most deceptive because if one walks in to any of the 30 offices of Mossack Fonseca around the global tax havens, one definitely knows that one has entered the doors of an aggressive taxation law firm. This cannot be said about the taxation practices of the Big 4 accounting firms!

In commercial terms, the estimated combined turnover in 2016 of KPMG, Ernst & Young, Deloitte Touche Tohmatsu and PricewaterhouseCoopers ("the Big 4 accounting

firms") will be in excess of US\$130 billion employing more than 800,000 staff. If the Big 4 accounting firms were a sovereign nation, at US\$130 billion, it would rank 61st in the world's economies somewhere between Angola and Morocco.

Nevertheless, it would be a mistake to assume the commercial power of the Big 4 accounting firms is the equivalent of an Angola or a Morocco *or somewhere in between*. The reality is that the Big 4 accounting firms individually and collectively now have greater power and influence globally than any commercial institutions in history. Certainly, the Big 4 accounting firms present themselves as the guardians of international commerce. The real question is how do the Big 4 accounting firms exercise such enormous power in reality and are they transparent in their execution of it? And more importantly for the wider society and humanity generally, *who guards the guardians* to ensure appropriate integrity in the decision making and actions of these firms?

Surprisingly, not one of the Big 4 accounting firms has decided to follow the extremely lucrative financial route of publicly listing on one of the major bourses such as the London or New York Stock Exchanges. Given the growth and stability of earnings, such a Big 4 accounting firm stock would be considered a highly attractive proposition for conservative investors such as retirement funds and other institutional investors. Therefore, one would expect a stock price on an initial public offering of at least 15 to 20 times earnings and more depending on growth projections that conceivably could result in a US\$100 billion float price or more for any of the Big 4 accounting firms.

This surely must be viewed as highly attractive for *any* retiring Partner of the firm or indeed any Partner of the firm. Nevertheless, no Big 4 accounting firm has listed and therefore is not subject to any of the strict listing requirements of the bourses including material disclosures that would affect the stock price.

Further, there are no global regulators so there is no central agency charged with the responsibility of monitoring the Big 4 accounting firms. Instead, this has been left to the prudential or financial regulators in individual countries, particularly the United States or by less formal means by organizations such as the ICIJ.

The high water mark in regulatory action against the major international accounting firms occurred on 6 May 2002 when the United States financial regulator, the Securities and Exchange Commission (the SEC) charged the United States partnership, Arthur Andersen LLP (*Limited Liability Partnership*), of the former Big 5 accounting firm, Arthur Andersen & Co, with the felony crime of obstruction of justice. Arthur Andersen LLP senior figures allegedly directed staff to destroy evidence relating to a pending investigation by the SEC of one its largest clients Enron Corporation.

On 15 June 2002, just six weeks later, Judge Michael Chertoff in the United States District Court found Arthur Andersen LLP guilty. Under US Federal Law, a person or an organization found guilty of a felony is forbidden from undertaking an audit of a public company. As an immediate result of the conviction, the US audit practice of Arthur

Anderson LLP had its audit licence withdrawn and ceased its US audit practice on 31 August 2002 triggering an effective worldwide collapse of the firm.

While the decision was affirmed on appeal to a higher Court, on 31 May 2015 the United States Supreme Court in a unanimous finding reversed the original decision in favour of Arthur Andersen LLP. While in theory Arthur Andersen LLP could have continued to practice, the lucrative accounting business was long gone as was the potential for a rich initial public offering which occurred in the case of its prodigal fraternal twin Accenture. The formerly great Arthur Andersen LLP has been essentially reduced today to a holder of various investment assets for retired Partners of the firm. The Enron / Arthur Andersen story is indeed an extremely interesting one!

There have been other spectacular forays by Regulators in to the world of Big 4 accounting firm impropriety. On 29 August 2005, KPMG admitted to and accepted a settlement with the United States Justice Department in what was then the largest tax fraud case ever filed. The tax fraud involved the generation of more than US\$11 billion in falsified tax losses by KPMG resulting in tax evasion of in excess US\$2.5 billion. In addition, nine individuals including a former Deputy Chairman and two former Heads of Tax of KPMG were charged with conspiring to defraud the Inland Revenue Service by concocting taxation shelter transactions, together with false and fraudulent factual scenarios to support them and then filing tax returns that claimed the US\$11 billion in tax losses.

The taxation shelters were targeted at individuals requiring a

minimum of US\$10 million in tax losses. A percentage of the desired tax loss would then be paid to KPMG, certain law firms, and others instead of paying billions of dollars in taxes owed to the Government. To further the scheme, KPMG, the individual defendants, and their co-conspirators allegedly filed and caused to be filed false and fraudulent taxation returns that claimed falsified tax losses. KPMG agreed to pay US\$456 million in fines, restitution and penalties as part of an agreement to defer prosecution of the firm. Not the best August day at KPMG, but potentially not the worst either! This case is discussed in more detail in Chapter 4.

Despite the best of intentions of a regulator, the ultimate outcome may not be as planned. While certainly not great for the retired Arthur Andersen partners and their formerly very healthy firm paid retirement pensions, the demise of Arthur Andersen & Co created “the Big 4” and an extremely limited choice in international accounting service providers for the global multinationals. This significantly strengthened the position of the Big 4 accounting firms at the top of world commerce. This lack of choice is illustrated by the following example. If a multinational has an emerging conflict, perhaps through a merger or another transaction, or is simply dissatisfied with the service provided by its current Big 4 accounting firm then there are just three remaining service providers from the Big 4. If there is a conflict or dissatisfaction position with one of these firms or more than one conflict situation with two or more firms, then there is simply no effective choice in service provider.

This has essentially resulted in what must reasonably be

viewed as cartel-like behavior *technically illegal in most parts of the world* where charge out rates have grown well in excess of inflation and are now reaching the princely sum of US\$1,400 for one hour of a Tax Partner's time or US\$23 per minute. Experience has shown that when one firm increases its charge out rates the other firms will follow that lead. Despite the problems caused by the demise of Arthur Andersen & Co, the KPMG action was more successful from a regulatory viewpoint and did result *at least temporarily* in improved tax behaviors by that firm. However, what happens when the regulator averts his eyes and addresses other issues!

Since the time of these events, there have been many other major lawsuits and investigations against Big 4 accounting firms including matters in respect of Lehmann Brothers, J P Morgan Securities, Adelphia Communications Corporation, Tyco International Ltd, the World Bank, Worldcom, Hewlett Packard, Freddie Mac and AIG to name just a few.

Unlike the Big 4 accounting firms offering a range of professional *financial* services to multinationals, the Mafia, the Yakuza and the Triads are involved in different areas of *professional service* but follow similar business models. Generally, all three are involved to various degrees in the manufacturing and distribution of illicit drugs, have interests in both legal and illegal gambling establishments, various forms of extortion including protection rackets, predatory loan arrangements (loan sharking), various forms of white collar crime including embezzlement, legal and illegal brothels and various internet based schemes including theft identity and internet fraud. While there is no official reporting of

financial information by the various crime families, by all other informal accounts, like the Big 4 accounting firms, business is booming.

Common to the Big 4 accounting firms, tax evasion issues have been a thorn in the side of the crime families. The most celebrated case of taxation and crime families was that of Mafia boss Alphonse Gabriel Capone commonly known as Al Capone. Born in 1899, Capone left school in sixth grade and immediately joined the street gang of Johnny Torrio in Brooklyn, New York. In 1920, Capone joined Torrio in Chicago who had risen in the ranks of the Colosimo mob gang. With Colosimo's execution and retirement of Torrio to Brooklyn following an assassination attempt, Capone became Mob Boss. With business opportunities aplenty for alcohol related activities during the Prohibition era, Capone was all-powerful and untouchable and leading the rich life in Chicago having developed an impressive network of beneficial relationships with a range of public officials and the unions.

The party came to an end for Capone when he was sentenced on 24 November 1931 to 11 years in a United States Federal Penitentiary required to pay some US\$215,000 in back taxes, US\$50,000 in fines and US\$7,692 in court costs. It is tempting to ask who were Capone's tax advisors at the time and did they receive any jail time? The answer is not the fellow inhabitant of Chicago at that time, Mr. Arthur Andersen, who held the highest of personal ethics in his professional conduct. At the time of the Capone trials his personal motto was *Think straight, talk straight* - a great example to any young accountant! But the Capone conviction is actually relevant

today on the question of appropriate penalties for tax avoidance by Lawmakers – Capone was the top guy and the conviction sent a powerful message to the community. If Steve Jobs had ended his days in jail for the tax crimes of Apple, how would have the business community reacted today in terms of its approach to aggressive taxation practices?

Based on the sheer scale of the KPMG tax fraud (or indeed the Lux Leaks scandal), Capone must be viewed as a little unlucky. Although there were some lengthy jail sentences for three persons from other firms associated with the KPMG tax fraud, the charges against the 13 KPMG staff indicted and tried were dismissed after the judge hearing the case found that prosecutors had violated their legal rights to counsel by placing undue pressure on KPMG not to pay the defendant's legal costs. This resulted in no jail time being served for any member of staff from KPMG involved in the US\$11 billion tax fraud. Not the most exemplary of sentences for the Big 4 accounting firms in what was then the largest *detected* tax fraud in history!

There is little doubt that the Yakuza and the Chinese triads are also extensively involved in tax evasion. An interesting emerging case is that of *alleged* Yakuza crime boss Kenichi Shinoda who heads up the 23,000 strong Yamaguchi-gumi, the largest Yakuza crime gang in Japan. In early 2015, some ten per cent of the gang allegedly split off to form a separate Yakuza gang. Speaking at the prestigious Foreign Correspondents' Club of Japan freelance journalist and Yakuza expert Atsushi Mizoguchi citing a recent arrest of a head of another rival Yakuza group on tax evasion charges based on

memos showing cash transfers, speculated that the new rival gang would be in a position to leak similar information to police leading to the arrest and conviction of Shinoda. It is a long way from speculation to conviction, but the evidence necessary to convict would provide an interesting insight into the world of the Yakuza.

Despite many headline grabbing arrests and busts around the world, Police action has barely slowed the advance of organized crime into everyday life. As the crime gangs have grown larger and more sophisticated in their operations, detection of their crimes has grown more difficult. Similarly, the Big 4 accounting firms have grown so large and influential that they have largely risen above international regulatory control of which the Lux Leaks scandal is a prime example.

Nevertheless, major lawsuits and settlements do occur on a regular basis for each of the Big 4 accounting firms, which suggests that clients and stakeholders have now become one of the quasi-regulators of the Big 4 accounting firms along with the investigative journalists. But this is not an easy road either!

As previously stated in the Pentology *albeit* to a different intended audience, aggressive taxation behaviours may be viewed by some as little more than a game of chance in the casino of life. Such behaviours only seek to financially benefit the individuals who seek to play *the game* to the detriment of the wider society.

The question for the Big 4 accounting firms is should they be playing this game at all from an ethical viewpoint? The founders of these firms including the late great Arthur

Andersen espoused the highest of ethical standards in building the accounting profession and indeed these actions were based on the very solid laws introduced in the mid nineteenth century under the *English* Joint Stock Companies Act, which led the world in this regard. Certainly, many of the actions of the Big 4 accounting firms described in this book would hardly be described as *professional* then or now in the accounting profession or any other profession. Nevertheless, the Mafia, the Yakuza and the Triads may well consider some of the actions of the Big 4 accounting firms to be highly impressive to them, perhaps the tax avoidance work in the tax havens, but this is a matter for them to discuss.

In Francis Ford Coppola's 1974 blockbuster *The Godfather Part II*, Kay Corleone played by Diane Keaton pleads to Michael Corleone played by Al Pacino, her Godfather husband:

**Kay Corleone:** "*It made me think of what you once told me: "In five years the Corleone family will be completely legitimate." That was seven years ago"*

**Michael Corleone** "*I know. I'm trying, darling*".

Michael Corleone in the end, despite his initial best of intentions, was simply too drawn to the money and the power to ever turn the family business *legitimate*.

The Big 4 accounting firms may well ask themselves whether they are now in the same position that Michael Corleone found himself in. Ultimately, it is a straight question of choice going forward for each of the Big 4 accounting firms. Given the scale of the tax frauds discussed

in this book, there is certainly not unlimited time for this choice!