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Tax Avoidance as an Ethical Issue for Business

This Briefing explores corporate taxation and specifically the issue of tax avoidance as a business ethics issue.

As part of good governance, companies will seek to minimise their tax liability through 'tax planning', making the most of the tools and mechanisms which the government makes available to them specifically for this purpose: allowances, deductions, rebates, exemptions, etc. They will make choices about how to pursue their business goals in the light of all the implications – which include the tax consequences.

While tax planning is seen as compliant behaviour, tax avoidance is more of a grey issue. The term 'tax avoidance' is used to refer to legitimate but maybe aggressive use of things such as financial instruments and other arrangements to obtain a tax result not intended, or anticipated by, the government. The use of overseas tax havens is one example. Most of the debate about tax avoidance has centred on the taxes businesses pay on their profits – corporation tax in the UK – but other taxes can also be affected, including VAT.

'Tax avoidance' is different to 'tax evasion' which refers to a situation where a company tries to reduce tax liability by falsely suppressing income or inflating expenditure, recording fictitious transactions, etc. Evasion is fundamentally illegal.

What makes tax avoidance a business ethics issue?

Avoiding tax by 'bending' the rules of the tax system is not illegal, but it is seen by many as operating within the letter rather than the spirit of the law. Countries set out in laws how their taxes should apply; businesses are expected to pay their taxes due under the law. The issue falls into the realm of ethics because businesses have a choice about their approach to interpreting the law and hence paying taxes. Whilst remaining legal in all it does, where a business draws its ethical line regarding how to interpret the tax laws and arrange its affairs, is subject to a good deal of discretion. This can extend to where it pays its taxes.

Tax avoidance has been branded by some as an 'immoral' and unethical practice that undermines the integrity of the tax system.

Tax as a social responsibility

Paying a 'fair' amount of tax in the countries in which they operate is seen as a responsible thing for a company to do for the social good; providing the funds for public services such as healthcare, education and for public investment in infrastructure, be it in the developed or developing world .

At a time when government spending cuts are having a real impact on the everyday lives of people, some say it is morally indefensible for multinational corporations be avoiding paying their fair share of UK taxes. Avoiding tax is avoiding a social obligation it is argued. Such behaviour can leave a company vulnerable to accusations of greed and selfishness, damaging their reputation and destroying the public's trust in them.

Company directors will often argue, however, that their responsibility is to maximise the value they deliver for their shareholders and that includes keeping tax costs to a minimum within the realms of what is legal.

Public attitudes

It has been widely alleged in the media that many multinational companies, apparently operating very successfully in the UK, are paying little or no local corporation tax. In its latest estimate for 2010-11, Her Majesty's Revenue and Customs (HMRC) put the tax gap figure at £4.1bn[1]. This is the difference between the amount of corporation tax *actually* collected and the amount that *should* be collected if all companies complied with 'the spirit of the law'. Some campaigners believe that the real figure could be £12bn[2] or more. According to a 2011 ActionAid report[3], 98 of FTSE100 companies use tax havens to reduce their corporate tax bills. This has attracted much negative media coverage as well as attention from campaign and public interest groups such as UK Uncut and the Tax Justice Network. The result is that corporate tax has become a major business ethics issue (see Box 2).

Public anger over tax avoidance increased in 2012, according to a survey of the British public by Christian Aid[4]. It found that four out of five people agreed that tax avoidance by multinationals made them "feel angry". The survey also revealed that a third of Britons say that they are boycotting companies which do not pay their "fair share" of tax in the UK. In a 2012 IBE survey carried out by Ipsos MORI, 'tax avoidance' was the second most important ethics issue that the British public think business needs to address[5]. In spite of the contribution that they make in other ways to national economies, multinationals operating in developing countries (where large proportions of people live in poverty) have been met with much public disapproval for paying little or no corporation tax (e.g. Associated British Foods in Zambia)[6].

The governments which set the basis of corporation tax have also been the target of public annoyance. Almost three-quarters of Christian Aid's survey respondents agree that government has a responsibility to ensure that all UK-based companies pay the proper amount of tax in every country in which they operate. 85% of survey respondents agreed that it was currently "too easy" for multinational companies in the UK to avoid paying tax[7].

These survey results perhaps suggest a need for government to pay more attention to explaining their position on this issue and their interpretation of the law in order to bring more certainty for

[1] HMRC figures reported http://bit.ly/T1mcTa. The tax gap figure includes a number of factors – e.g. evasion, error, hidden economy, legal interpretation as well as avoidance.

[2] Richard Murphy of Tax Research UK: www.taxresearch.org.uk

[3] Available: http://bit.ly/qyztfi

[4] Full survey available: http://bit.ly/14WY5Mq

[5] More details of study available: http://bit.ly/T4JSaM

[6] See http://bit.ly/13OMWwz

[7] The current (April 2013) rate of UK corporation tax is 23% due to drop to 21% in 2014 and to 20% in 2015. For comparison, Ireland's is 12.5% and it is 0% in Bermuda, The Cayman Islands, The Bahamas, Bahrain, Guernsey, Vanuatu and the Isle of Man. The rate for the United States is 35%, France 33.3% and Belgium 33%.

business. Businesses themselves need greater internal engagement around the decisions and circumstances behind their tax position. This then needs to be communicated externally, telling the story behind the business decisions that have lead to where and how much tax has been paid. This transparency would help restore trust with the public.

Fairness

The public expects businesses to pay their ‘fair share’ of tax, which may not necessarily be the same as what the law requires or allows. What is a ‘fair’ amount is subjective. In 2008 HMRC declared that “*we want to make sure that the burden of tax does not fall unfairly on taxpayers who play by the rules and pay their fair share*”; but it gives no definition of what is to be regarded as ‘fair’. The Association of Chartered Certified Accountants (ACCA) acknowledges that it is difficult to define ‘fair taxation’ in a way that would satisfy all interested parties for all time.

The consultancy firm SustainAbility suggests a responsible and ethical approach is to see tax “*not as a cost to be avoided, but as a legitimate payment from wealth created to the countries and communities that contributed to the wealth creation in the first place*.” It states that tax policies should be underpinned by the guiding ethical principles of accountability, transparency and consistency. Its framework does not suggest that companies pay more tax, but rather that they ensure tax contributions are a demonstrably fair return to society.

Box 1: What tax rate is ‘fair’?
The amount of tax paid depends on profit and this can be a factor of actual performance or the way that the profit is calculated. In 2011, the energy firm Centrica paid a tax rate of more than 40% of their profit in the UK. In contrast, Google made £2.6bn of sales in the UK in 2012, yet contributed just £6m in corporation tax – a rate of less than 0.3%. Starbucks sold nearly £400m worth of products in the UK, but paid no corporation tax at all[8].

Tax in codes of ethics

It is good practice for companies to have a clear and transparent statement regarding their position on payment of tax. For companies that claim to operate according to a set of ethical values and commitments, it is these values that would be expected to underpin such a statement.

Some companies do address tax as an issue or commitment in their code of ethics (or similar guidance). The majority only declare a commitment to avoiding illegal tax evasion and abiding by the legal requirements of the countries within which they operate. Two examples of this are L’Oreal and Old Mutual. Vodafone (who have been in the media accused of tax avoidance in the past) has a stand-alone ‘Tax Code of Conduct’ that states its commitment to paying what is legally required “in accordance with rules set by governments” and that it is the government’s decision to decide what is a ‘fair’ amount of tax to pay. However, some, like Rolls Royce go further, to make specific reference to abiding by the ‘intention’ as well as the ‘letter’ of the law.

Future developments

Corporate tax avoidance will be an agenda issue at the G8 summit in June 2013. Prime Minister David Cameron has pledged to use Britain’s presidency at the event to clamp down on multinational firms

[8] See http://www.bbc.co.uk/news/business-20559791

that avoid paying UK taxes.

In the UK there is the proposed introduction of a General Anti-Abuse Rule (GAAR) intended to prevent those tax schemes that the government deems to be ‘abusive’ and which David Cameron has described as “morally wrong”. However, some argue that the new legislation should be a wider anti-avoidance rule, though that raises difficulties over what is ‘reasonable’ behaviour, being subjective, not easy to define and creating too much uncertainty for business.

Many investing firms with a socially responsible mandate say they take account of companies' tax practices when deciding where to invest but few actually screen out companies over tax issues. One exception is the FTSE Group which has said it was looking into excluding companies with what it called “overly aggressive tax reduction policies” from its ethical index, FTSE4Good. No timings have been confirmed on this move but the FTSE’s stance may reflect a future trend.

Box 2: Examples of recent corporate tax stories in the UK press

BBC News , 12th November 2012 : Starbucks, Google and Amazon grilled over tax avoidance

Article Summary: All three multinationals have admitted to using favourable European tax jurisdictions for their UK businesses in the past. Reuters revealed in late 2012 that Starbucks reportedly paid just £8.6m in corporation tax in the UK over 14 years - including reporting accounting losses when it was profitable. According to a report by the Guardian, Amazon generated sales of more than £3.3bn in the UK in 2011 but paid no corporation tax on any of the profits. Google's UK unit paid just £6m to the Treasury in 2011 on UK turnover of £395m, according to the Telegraph.
Full story: http://www.bbc.co.uk/news/business-20288077

The Guardian, 9th February 2013: British sugar giant caught in global tax scandal

Article Summary: Claims that British FTSE 100 multinational Associated British Foods (ABF) has avoided paying millions of pounds of tax in the poverty stricken African state of Zambia were made by Action Aid in February 2013. ABF’s subsidiary Zambia Sugar posted pre-tax profits of $123m between 2007-2012 yet it paid less than 0.5% in corporation tax to Zambia in the same period. Zambian public services have lost an estimated $27m – enough to put 48,000 children in school, it is claimed.
Full story: http://www.guardian.co.uk/business/2013/feb/09/british-sugar-giant-tax-scandal

The Telegraph, 8th January 2013: Major IT firms with government contracts accused of minimising corporation tax

Article Summary: Technology companies including IBM, Microsoft and Dell are accused of paying little or no corporation tax despite recording billion of pounds of UK profits. There is no suggestion that any of the companies were breaking the law however their actions were branded “irresponsible, unethical and unacceptable”.
Full story: http://bit.ly/ZrgYTY

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