TAX AVOIDANCE: THE ETHICAL QUESTION FOR BUSINESS

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Tax avoidance: the ethical question for business

Contemporary debate surrounds corporate taxation. Some view the modern organisation in the context of globalised production, multi-national supply chains and an international competition for capital. Prudence dictates that tax is minimised, ensuring difficulty for authorities in imposing tax rates.

Others see fair payment of tax as a key element in a creditable, equitable tax system trusted by the general public; an obligation expected to be met by organisations who benefit from the structures of society around them.

It is widely accepted that an aspect of any organisation's governance will include tax planning; utilising the various reliefs, exemptions, rebates, contributions, deductions or other allowances the government has made available to them. It is good practice to have a legitimate, compliant strategy in this field, as would be expected of any operational area within a business.

Tax avoidance, however, goes beyond planning in that businesses may arrange their financial affairs in a manner that aggressively takes advantage of available mechanisms, reaching a tax outcome that is beyond the point government intended with their original legislation. Although legal, tax avoidance "often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage" (HM Treasury, 2015).

It is important to distinguish this from tax evasion which is considered fraudulent, ergo illegal, and can be defined as a deliberate failure to declare and account for any taxes owed (HM Treasury, 2015).

A question of ethics?

The ethical aspect is apparent when viewing the discretion a business has. The ability, within certain parameters, to legitimately manage the amount of tax paid (interpreting the law to their advantage) empowers an organisation with the choice over how much they contribute financially to government.

Although tax avoidance is not illegal, it is considered by some morally dubious, with 61% of the public expressing that it is never acceptable to use a tax avoidance scheme (Shah, 2015), corporate tax avoidance being listed ahead of all others as one of the issues companies most need to address (IPSOS Mori, 2015) and 62% of those surveyed domestically stating it is unacceptable to legally avoid tax (YouGov, 2013).

The issue has gained particular prominence since the 2008 "financial crisis... people experiencing austerity have a different kind of interest in the decisions that are taken about taxation and spending" (Cobham, 2016 as cited in Financial Times, 2016). Following this has been a period of declining real wage growth (Machin, 2015) and public spending austerity measures aimed at eliminating the deficit (Deloitte, 2016). With the subsequent effect on living standards, coupled with a reduction in scope of public services, the contribution or lack thereof by organisations opting for tax avoidance has attracted particular attention.

Impact of avoidance

Organisations such as Starbucks (Bergin, 2012), Google (ITV, 2017) and Amazon (Bowers, 2015) have faced media scrutiny for alleged tax avoidance. In Google's case a government select committee advised they rely on a "deeply unconvincing argument… despite clear evidence" that their domestic sales took place abroad, in a lower tax jurisdiction (Committee of Public Accounts, 2013).

Increasingly, action is being taken to tackle to tax avoidance. There has been over £1bn invested in HM Revenue & Customs (2015) "compliance activities since 2010 to tackle non-compliance including evasion and avoidance" plus a commitment with 90 other countries to "share information on bank and other financial accounts, starting in 2017" (HM Revenue & Customs, 2015).

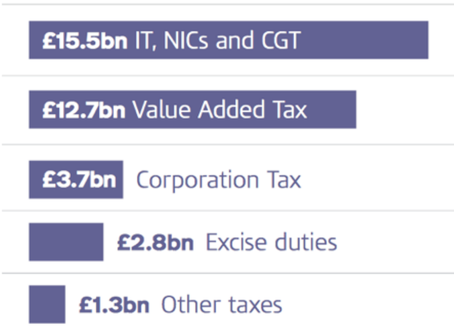

Figure 1: Value of the tax gap by type of tax (HM Revenue & Customs, 2016)

Despite tentative efforts, the issue remains persistent with varying estimates on the effect tax avoidance has on the tax gap, which is the difference between expected (or rather how much should be collected) and actual government tax revenue.

Official figures, as cited in Figure 1, calculate the corporation tax contribution to this as £3.7bn (HM Revenue & Customs, 2016) whilst other reports conclude there is a larger gap, such as £19.1bn (Murphy, 2014).

At whichever end of the scale the true impact lies, there is no doubting it is a negative one, that tax avoidance takes place, public attitudes are hostile towards it and the government is taking steps to reduce it. Yet, none of this is to say organisations that practice tax avoidance are acting illegally or have a moral obligation to pay.

So, why pay?

One reason is that the corporation is living in a relative golden age of favourable government policy. Between 1976 and 2016, the United Kingdom saw the main rate of corporation tax decrease from 52% to 20%. For comparison, during the same period the basic rate of income tax fell from 33% to 20%, however this was partially offset by increases in employee national insurance contributions, rising from 6.5% to 12% (Institute for Fiscal Studies, 2016).

In addition, with the standard rate for value-added tax growing from 8% to 20% (Institute for Fiscal Studies, 2016) coupled with an increase in other indirect taxes, including "large real increase in duties on road fuels and tobacco" (Pope & Waters, 2016) the shape of domestic tax policy has been clearly more beneficial to organisations than for the individual. Pro-business reforms and an extended period of national economic restructuring, particularly those taking place following the 1979 general election (Matthews et al., 1987) have created the platform and incentive for organisations to thrive, retaining a greater share of profits.

Further still, in providing “one of the lowest corporation tax rates of the major global economies” (Maugham, 2016), with the headline rate far below the global average of 27%, plus a further 3% corporation tax cut planned for implementation by 2020 (Gov.uk, 2016), the United Kingdom has proven itself as one of the most tax friendly advanced economies. Simple tax compliance, without need for avoidance, already provides a globally competitive advantage. Some organisations are even concerned corporation tax is becoming too competitive, advising that “reducing the corporation tax rate beyond the 17% set for 2020 will have limited impact and risks alienating the public” (PwC, 2016).

This segues into the second reason, in which the ethically aware consumer is increasingly considering tax amongst other activities, such as environmental awareness or fair trade endorsement, when making consumption decisions. Fair Tax, an accrediting body who provide recognition to organisations which “report on their tax practices transparently” (Fair Tax, 2017) have grown since their inception in 2014, with the FTSE 100 energy firm SSE amongst those to gain accreditation (SSE, 2015). This development, plus adoption of the Fair Tax mark by business correlates with public attitudes towards the issue.

Additionally, a study found that 45% of people either strongly or tended to agree that they “reconsidered using a company’s products or services that has avoided paying tax in this country” (IPSOS Mori, 2015), and there has been a rise of protests with the goal of “tax shaming” these organisations (Barford & Holt, 2013). Any decision a business takes which may impact their reputation, and subsequent income, will be taken very carefully. Tax avoidance has increasingly become one of these decisions, with growing public rejection for those who opt to.

Payment of tax is also, it must be remembered, not a zero-sum transaction. The premise of taxation is that it is in return for services, provided by government, who seek to benefit all stakeholders in society. Figure 2 provides a breakdown of public sector expenditure (HM Treasury, 2016) which corporation tax contributes to. Within these, education, the legal system, infrastructure and security represent a sample of the public services organisations benefit from.

Without a robust legal system, there may be less confidence to invest if there were, for example, concerns regarding the strength of intellectual property rights. An educated work force provides the pool of talent which an organisation selects their ultimate resource, people, from.

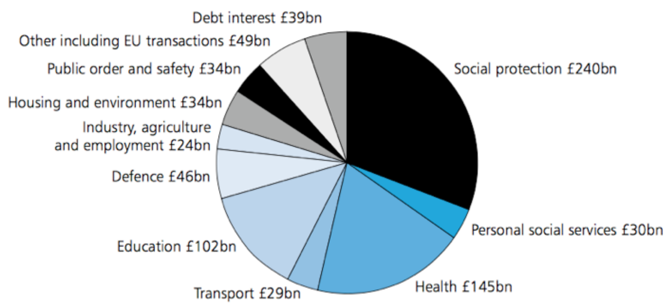

Figure 2: Public sector spending 2016-17 (HM Treasury, Budget 2016)

Security, at a national and local level is necessary for a working environment unencumbered with safety concerns whilst reliable infrastructure, such as energy and transport, are fundamental for a business to function, whether transporting goods, employing staff who commute or relying on high volume online transactions.

Without funding, services diminish. There are fair questions around efficiency and the scope of services a government should provide, though to some extent these are answered democratically via the electoral choices made by society, in which organisations are an active participant.

It is also democratic society which allows organisations to incorporate themselves, becoming ‘limited’, with the company “legally separate from the people who run it” (Gov.uk, 2017) which creates a separation of debt and individual responsibility. This privilege requires transparency; of directors, accounts and in taxation.

Tax compliance also reduces the potential for corruption and money laundering. Avoidance, taking advantage of legal loopholes, particularly across borders “increases the chances for the corruption of officials and/or financial corporatists… initiating a vicious cycle of mischief and illegitimacy” (Tavares, 2013). It is natural that tax compliance, which provides an accurate portrayal of a company’s financial position, expenditure and income, reduces the potential for corruption.

Reasons to avoid

For all the benefits of compliant payment, there are no legal qualms with avoidance that doesn’t veer into evasion. An approach that suggests organisations should operate within “the spirit of the law” (Parliament.uk, 2015) is a fallacy, as it only serves to highlight a redundant law, or set of, that are ill conceived or unenforceable.

Linked to this is the convoluted nature of the tax code, rendering even tax compliance an expensive, onerous, task with senior tax professionals “now charging up to £1,000 per hour” (Martin, 2016). Given that the leading tax guide has “doubled in length to 22,000 pages since it was last measured… in 2005” (Martin, 2016) the structural opportunities for avoidance are apparent.

Within the existing tax framework, it could even be argued that avoidance is tacitly encouraged, if not intended. In a system where similar substitutes offer different tax rates “the same economic transaction can take numerous forms which may have significantly different tax treatments” (Bowler, 2009). Allowing for the classification of transactions encourages organisations to arrange these in a tax preferential manner, an option any organisation may reasonably pursue.

Minimising tax liabilities allows for the re-allocation of untaxed capital, potentially encouraging investment and growth. It has been observed that a “10 percentage point increase in the first-year effective corporate tax rate reduces the aggregate investment to gross domestic product (GDP) ratio by about 2 percentage points” (Djankov et al., 2010), highlighting the negative correlation between higher taxation and lower investment. An organization may be better equipped to contribute to society, via their own growth and subsequent creation of opportunities, provided they use retained profits for this purpose.

Logic follows that, given avoidance is legal and an established practice, failure to participate may leave an organisation at a competitive disadvantage. When rival organisations are able to utilise greater resources as a result of tax efficiency, proficient management suggests adaptation of the practices that allow a rival to gain an advantage in order to reduce it. This also applies internationally, where avoidance may be required to simply match compliant organisations operating out of low tax territories, such as Monaco which "does not have a general corporate income tax" (IBFD, 2015).

Double taxation, the "levying of taxes on the same income (or capital) of the same taxpayer in the same period across two jurisdictions" (Baker, 2012) presents a genuine concern avoidance can overcome. Although modern tax treaties may include double-taxation agreements, these are not always in place or necessarily comprehensive; managing tax in a manner to prevent this issue is vital for an organisation's finances.

Finally, although tax resistance, or "conscientious rejection" (Brennan, 2012) has historically been the preserve of the individual, there may be circumstances, such as during what may be considered an unjust war, in which corporations opt to express ethical values. Although avoidance as a mechanism for this appears the antitheses of moral behavior, it remains an important outlet.

Conclusion

Corporate tax avoidance occupies an increasingly prominent role in public debate. In the context of reducing public expenditure, greater scrutiny has given way to negative public perceptions, whether expressed via opinion polls, tax shaming or ethical consumption choices. The adverse impact on public revenue is established, even if the extent of this is disputed.

There are genuine reasons to minimise tax receipts. Double taxation, although a declining issue, remains applicable and providing an advantage to competitors who legally avoid taxation themselves is a clear problem.

Even so, these concerns are minimal in comparison to the longer term impact avoidance has on society and business; tax revenues form the fabric of governance required to provide the services stakeholders benefit from. A widening tax gap, growing public opposition plus the potential for corruption not only diminishes these services but democracy itself.

Government can make better use of available policy levers. Simplifying tax, reducing complexion will remove loopholes and the potential for creative accounting. Working multilaterally with other jurisdictions, as has been the case with double taxation, can lessen the scope for organisations to manoeuvre income solely for avoidance. Enforcing existing laws and taking decisive action against avoidance schemes will deter abuse of the system.

Organisations can also play their part, by practicing and promoting acquiescent tax behaviour. Corporate social responsibility (Gupta & Sharma, 2009) lends weight to the idea that the modern organisation has a greater sense of their role in society; applying ethical policies alongside core economic activity, benefiting stakeholders beyond a transactional relationship. Contradiction exists when this takes place within organisations who also avoid taxation; if an organisation is truly eager to encourage ethical behaviour, tax compliance, which could be viewed as the ultimate form corporate social responsibility, is a good starting point.

Nevertheless, it is up to individual organisations to decide their tax approach. There may be a distinction between avoidance, technically operating within the law, and compliant behaviour. Where this is not a legal distinction, it is up to government to remove areas of ambiguity; tax decisions taken remain an ethical question for business.

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