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Tax responsibility
The business case for making tax a corporate responsibility issue

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Summary

Corporate responsibility (CR) decisions, like any other aspect of business, are driven ultimately by a company's obligation to secure strong returns for its shareholders. The adoption of a new issue within a company's CR agenda therefore depends on the recognition of a business case, usually focused on risk minimisation, by a company's management and investors.

With this in mind, a growing number of businesses and investors are concluding that there is a business case for viewing tax planning through a CR lens. Drivers include the increase in public scrutiny of corporate tax avoidance, and a renewed effort to tackle tax avoidance by revenue authorities in developing and developed countries.

An effective CR response to tax planning must be based on three insights: (1) compliance with the letter of the law is no longer sufficient to protect business from the risks associated with tax planning; (2) lack of transparency around tax planning leads to increased risk; (3) it is the structures and practices of tax planning that are at the heart of tax responsibility, rather than the amount of tax paid, which is an outcome of these practices.

Businesses should therefore:

- create a company tax policy setting out the principles they apply and the practices they rule out; disseminate this policy to internal and external stakeholders;
- ensure board level oversight of internal tax policymaking;
- disclose a range of qualitative and quantitative information on their tax practices and their impacts;
- work with peers and stakeholders to formulate a mutually agreed code of conduct.

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Foreword

Tax payments are an important part of businesses' economic contribution to the countries in which they operate. Tax in developing countries can help provide the funds to expand much-needed public services such as healthcare and education, to alleviate poverty and disease, and for public investment in infrastructure. In short, tax helps provide the basic building blocks for economic growth.

Multinational companies' (MNCs') activities result in significant tax revenue for developing countries, both from the taxes that they themselves pay, and from those paid by their employees, consumers and other businesses in the supply chain. Here we focus on the taxes that MNCs themselves bear, their particular responsibility.

MNCs' corporate income tax payments represent a major component of both actual and potential tax revenues in developing countries. Ghana, for example, relies on foreign-owned businesses for the lion's share of its corporation tax, which in turn represents almost one sixth of the country's total tax revenues.[1]

So the gap between actual and potential revenues that still remains in multinational taxation represents a large amount of potential increased funds for governments' development efforts. ActionAid's study of SABMiller, for example, estimated a corporation tax gap for that company of 20% across Africa, rising to 100% in Ghana, where this particular company had paid no corporation tax at all for several years.[2]

The growing public interest in the taxation of multinationals means that it is not tenable for any government to impose or increase taxes on ordinary people while there is a perception that the burden is not also falling on businesses and elites. Such situations in the past have contributed to significant political instability in many developing countries.[3]

And while admirable efforts are now taking place at national and international level to create and enforce legislation on corporate taxation in low-income countries, this work is in most cases only at an early stage. It will be some time before they are able to mount a consistent challenge to the many tax planning strategies employed by multinational businesses.

This is why organisations such as ours believe that corporate tax responsibility in developing countries means exercising restraint when it comes to tax planning. To do so is to take an enlightened view of a business's long-term interests, and it is a sensible business decision: investors and business leaders are increasingly waking up to the risks associated with the pursuit of aggressive tax strategies in developing countries.

This discussion paper aims to facilitate dialogue between business and tax campaigners by examining the business case for tax responsibility and making recommendations for companies. By acting now, businesses have an opportunity to demonstrate a forward-thinking approach and commitment to corporate responsibility.

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1. Introduction

This paper is a response to the growing public interest in corporate tax planning, demonstrated by the growth in media coverage and campaigns focusing on it. It builds on a number of publications from the past few years that have sought to discuss how a corporate responsibility (CR[4]) perspective might be applied to taxation, by adding the perspective of three NGOs with experience in dialogue with companies and investors on sustainability issues.[5]

The paper begins by illustrating how tax planning intersects with CR principles, focusing on the growing risks associated with tax planning. We highlight a number of perspectives from businesses and investors that illustrate the growing recognition of the business case for such work.

Next we set out the three key insights that underpin our analysis, drawn from analogies with other CR issues and from the experiences of companies caught up in criticism of their tax planning. Finally, the paper proposes a four-step action plan for businesses seeking to apply CR principles to tax planning.

The risks associated with CR issues can have a lasting impact on businesses, and recent examples of corporate tax planning highlighted in the media have demonstrated that the same risks associated with other social and environmental CR issues also apply to tax planning. There is now an opportunity for businesses to develop new and innovative approaches to tax responsibility, by taking into account the impact of their tax strategy on their stakeholders and the wider economy.

2. The business case for tax responsibility

In this section we argue that the corporate responsibility lens can be usefully applied to tax planning, given the growing risks associated with it, the relationship between these risks and the level of 'aggressiveness' of a company's tax position, and the concern expressed by investors.

2.1 Tax planning is a corporate responsibility issue

In 2007, researchers from the Oxford Centre for Business Taxation interviewed the heads of tax of nine large multinational businesses in the UK, as well as a number of staff from Her Majesty's Revenue & Customs (HMRC).[6] They asked participants' views on the relationship between tax planning and corporate responsibility. Of the companies surveyed, only two had considered the inclusion of tax planning within their CR policies, and in both cases their boards had rejected this suggestion. The researchers noted a recurring view that "paying corporation tax is not a 'moral or 'social' issue and thus is not a factor in the CSR agenda." As the example in the box below shows, this type of response is not uncommon when CR issues are first raised with businesses.

In our experience, a definition of corporate responsibility needs to be drawn more widely than 'moral' considerations, to encompass both (1) the consideration of a business's impact on society and the environment, beyond its obligation to comply with the letter of the law, and (2) the consideration of the potential impact of environmental and social issues on a business's long-term performance. Tax planning clearly falls within both strands of this definition.

The most successful CR initiatives are generally those for which the company has recognised a clear business case. In most cases, the business case for CR is about minimising two kinds of risk: corporate reputation damage, and more direct financial loss. It may also take into account an enlightened shareholder value perspective, based on the notion that long-term rewards to investors are sometimes optimised by decisions that result in less than maximum short-term returns.

The trajectory of a corporate responsibility issue

It is not uncommon for businesses to respond when a new CR issue is raised by suggesting that they do not have a responsibility in that area. For example, as Nike's director of compliance, Todd McKean, explains, the company's initial attitude to criticism for labour rights violations in its supply chain was, "'Hey, we don't own the factories. We don't control what goes on there.' Quite frankly, that was a sort of irresponsible way to approach this."[7] The company now employs over 100 people to work on CR 'compliance'.

Any large business must have an explicit or implicit tax policy, which states how 'aggressive' its chosen approach to tax planning will be. A paper from PricewaterhouseCoopers (PWC) highlights various types of risk associated with tax planning. It characterises corporate tax policy as a scale of activities (shown below) ranging from safe, with low potential returns, to risky, with high potential returns. "The organisations on the left hand side," PWC argues, "might be the ones who: are inherently cautious; spend more time managing risk; are more concerned about compliance risk; are concerned about their reputation. The organisations that position themselves on the right hand side of the scale: are more aggressive; accept that they will have more compliance risks; have a higher materiality level; are less concerned about upsetting revenue authorities; spend less time managing tax risk."[8]

Low	Medium	High
0	5	10
Conservative Low appetite for risk		Aggressive Risk taker

Although the PWC paper suggests that CR is relevant to reputation risk, 'compliance risks' (the risk that an aggressive activity will be found to be non-compliant) also affect the predictability of future returns to investors. The foundations of CR policymaking – which include enlightened shareholder value, risk management and consistency with corporate values – provide a useful guide when reaching decisions about where a company wishes to be placed on this scale.

A paper from KPMG's business school argues as follows:

"Because CSR is a way of doing business rather than an 'add on' to normal business processes, companies should consider how their chosen approach to CSR applies to all aspects of their activity, including the management of their tax liability. They should then be in a position to give a reasoned justification of their approach to key tax issues such as the use of tax minimisation techniques, which is consistent with their approach to other CSR issues."[9]

Indeed, PWC states that such considerations already play a role for some companies: "More than one tax strategy we have seen have included policies such as 'We will not undertake any tax planning transaction which would reflect adversely on the group if details of it were to be published in the business pages of [Daily Newspaper Title].'"[10]

Two PWC partners wrote in the OECD Observer in 2010 that, "large companies, if they have not already done so, should start to think about where tax fits into their approach and strategy on corporate responsibility. Not all companies will want to be a leader in this area, but not to have a position could well be a risk."[11]

2.2 Tax planning poses significant and growing risks to business

Reputation risk

The 2007 survey by the Oxford Centre for Business Taxation found that a majority of respondents believed that, "corporation tax issues seem to be too complex or obscure for the media and the public to understand. Accordingly, the issues are not covered in the media or they go unnoticed by the public." Just two of the nine respondents thought that tax might come to be a part of the CR agenda in the future. According to the researchers, the participants suggested that, "this would happen only if the media and the public begin to focus on taxpaying and tax planning as important social issues."[12]

Wind forward four years, and this minority appears to have been proven right. As the Financial Times describes:

"Tax is becoming an important source of reputation risk. Increasingly, businesses are weighing up whether they are vulnerable to attack and how they should respond if they become the target of a campaign. The risks might seem limited by the dry, complex nature of corporate tax planning, which does not lend itself to eye-catching campaigns. But over the past decade campaigners have begun to focus on it with the same zeal as they apply to more immediately emotional issues such as the environment or child labour."[13]

Quoted in the Observer newspaper just a few months ago, Andrew Witty, Chief Executive of GlaxoSmithKline, appeared to concur with the idea that tax planning and public trust in businesses are linked. "One of the reasons why we've seen an erosion of trust broadly in big companies is they've allowed themselves to be seen as being detached from society and they will float in and out of societies according to what the tax regime is. I think that's completely wrong."[14]

As governments in the UK and across the globe begin major reductions in public spending, the ethics of corporate taxation have come into the spotlight for campaigners and the media alike. While the issue was highlighted as long ago as 2004, from 2009 onwards the focus has intensified.[15]

The Guardian's 'tax gap' series of investigations in 2009 included case studies of many well-known brand names, explaining in simple terms the types of tax planning activities undertaken.[16] The following year, reputation concerns led Barclays to resort to a high court injunction to prevent the publication by the same newspaper of leaked documents outlining some of its tax planning structures.[17]

As fiscal retrenchment began in the UK in 2010, businesses including Vodafone, Boots and Barclays found their high street stores occupied by 'UK Uncut' protestors, intent on branding these companies as 'tax dodgers'.[18] These protests touched a popular nerve, with the Daily Mail voicing support: "To service UK huge debt, the middle classes are paying ever more tax. Yet a group of the country's biggest firms are moving offshore – and denying the UK exchequer hundreds of millions."[19]

Reputation risk has expanded beyond the UK. In the US, both Google and GE were the subject of recent major investigations by news outlets.[20] Blanket coverage for the latter highlighted GE CEO Jeffrey Immelt's links to the Obama administration, creating embarrassment for the White House.[21] In May this year, the head of Argentina's revenue authority publicly accused four global grain companies of tax evasion.[22] Development agencies have also turned their attention to corporate tax practices in developing countries.[23]

Reputation risk can also arise from the actions of subsidiaries, as PWC's tax risk management manual states:

"Reputation risk – how much damage to the group's reputation can a local subsidiary do? This needs to be reviewed on a country-by-country (or subsidiary-by-subsidiary) basis. You also need to consider the impact your local reputation has on your ability to do business in that local country."[24]

The bottom-line impact of reputation damage

Damage to corporate reputation can impact directly on shareholder returns through its impact on the corporate brand and the cost of steps to mitigate it. But there is evidence that share price is affected by reputation damage in more ways than this. Investors may be concerned at more long-term damage to potential returns, and the possibility of further unanticipated risks.

The investor response to the large oil spill in the Gulf of Mexico created by BP's Deepwater Horizon oil rig is one example. An initial fall in BP's share price in the three months of the crisis became a structural fall in its market capitalisation relative to the industry as a whole, which exceeded the direct costs associated with clean up and compensation by many billions of dollars: though share prices in the oil industry rose 12% between 1 April 2010 and 31 March 2011, BP's share price declined by 26%.[25] Some observers suggested that this may be attributable to the cost of reputation damage.[26]

According to the New York Times, "Wall Street analysts warned that everything BP does from now on will come under increased scrutiny by regulators and that potential partners in drilling ventures may well look elsewhere." The newspaper cites Fadel Gheit, a managing director and oil analyst at Oppenheimer & Company: "In the last two years, it seemed BP had really cleaned up their act. Now it looks like a house of cards that has totally collapsed."[27]

Financial risk

The potential risks associated with allegations surrounding tax planning are not limited to the reputation damage itself. While responding to public attacks on companies' tax affairs can create significant costs for businesses, more significantly they can provoke a re-examination of tax settlements with major consequences for the companies concerned. As Calvert Investments notes:

"Reputational damage may lead to liabilities for external costs associated with a company's operations, greater difficulty in permitting that could lead to project delays or cancellation or the loss of favourable tax status or other forms of government financial assistance."[28]

Financial costs have frequently followed public criticism in this area. Three such examples emerged in the first half of 2011 alone:

- Civil society activities in response to allegations of tax evasion by the global mining company Glencore in Zambia have included the submission of an official complaint using the OECD Guidelines for Multinational Enterprises.[29] The campaigners have emboldened the Zambian government to demand tax repayments in excess of US$100 million.[30]
- The UK's National Audit Office is scrutinising the publicly-maligned settlement between Vodafone and Her Majesty's Revenue and Customs, which it has been suggested may be worth as much as £6 billion, as part of a broader review of tax settlements with large businesses provoked by the criticism surrounding this deal.[31]
- The Wall Street Journal reported that civil society allegations concerning SABMiller prompted discussions among revenue authorities in five African countries, which may lead to tax audits of the company.[32]

Risks may also extend beyond those cases in which there is public criticism of tax planning, in particular the compliance risk resulting from being challenged in a tax audit. As the consultancy 'Corporate Citizenship' argues in a recent discussion document:

"Clarity around tax is not just about reputation; there is a wider business case too. Reducing long-term uncertainties, avoiding sudden changes in regulation and minimising costs from legal challenge are in the company's interests. The efficient and orderly collection of taxes makes for a better company and a stronger society."[33]

In Argentina, the world's four largest grain traders are the subject of an official tax investigation, as a result of which tax repayments could run to hundreds of millions of dollars. According to the Guardian, the Argentinian revenue authority "is seeking to claim US$476 million (£290 million) for what it says are unpaid tax and duties from Bunge, $252 million from Cargill and $140 million from Dreyfus."[34]

In India, Vodafone is in a dispute worth as much as £3 billion, according to the Financial Times. [35] It is one of several companies fighting to defend tax haven schemes that have been challenged by the Indian Revenue Authority.[36]

2.3 Investors are concerned by the risk posed by tax planning

The potential risks arising from certain corporate tax practices are of increasing concern for investors. As David Zion, a Managing Director at Credit Suisse, is quoted as saying in 2007:

"Corporate taxes are a giant black box for investors…if investors learn that a company bears more risk than was known before, that could have an impact on their estimates of future cash flows and the return that investors would demand (ie, increased tax risk should increase cost of capital), which could affect valuations."[37]

Tax disputes can be worth hundreds of millions or even billions of pounds, which in the case of active disputes are usually provided for in company accounts. But as the examples above demonstrate, the growing climate of more aggressive interventions by revenue authorities, and greater public scrutiny of multinationals' tax affairs, means that potential future liabilities go beyond those provided for in this way. And as we have illustrated, the reputation risk attached to such instances can impact on investor returns in other ways, as well as affecting share price beyond the cashflow costs.

Increasingly, investors want their investee companies to provide more information on their tax policies. Calvert Investors argued in a memorandum around US transparency legislation published in 2010 that the disclosure of payments to governments on a country-by-county basis would greatly assist investors in natural resource extraction companies in assessing risks in three areas: country-specific risks, "including political risks, such as the production disruptions due to conflict and the expropriation of assets or economic risks involving changes in exchange rates and inflation," tax and regulatory risks, and reputation risks.[38]

Henderson Global Investors also argues for more transparency in a paper on tax matters. "The way a company manages its tax affairs," it states, "is directly relevant to shareholders, influencing important figures in the accounts and thus company valuations and investment decisions."[39]

The paper goes on to argue that the financial risks associated with tax planning are considerable:

"As a fund manager Henderson Global Investors has a responsibility towards its clients to maximise the financial return on the investments it makes for them. Companies that on moral grounds voluntarily pay more tax than is legally required may adversely affect the financial performance their shareholders expect. Nonetheless, business risks associated with matters of responsibility and ethics, and not simply with the letter of the law, are a legitimate interest for investors. Arrangements that minimise the amount of tax paid in the short-term may be detrimental in the longer term if they prejudice the company's relationship with tax authorities and additional costs are incurred in complex dispute resolution, or if the company's wider reputation is harmed. An aggressive tax strategy might require considerable resources to be applied to manage the positions taken."

Investor concern is likely to increase further as public attention continues to focus on corporate tax practices.

3. Towards responsible tax planning

In this section we apply CR principles and past experiences to the question of tax responsibility, to draw out a number of insights that should inform a CR response to tax planning.

3.1 Narrow legal compliance is not sufficient to protect a business from these risks

It is frequently argued that tax compliance is solely a legal matter, to be interpreted and enforced by revenue authorities and, if necessary, the courts. Proponents of this view argue that there is little sense in criticising a company for undertaking practices that have been approved by revenue authorities. Hence the view expressed by one respondent in the Oxford survey that, "his firm's CR policy does not extend to paying more tax than is due under the law; they are not interested in 'making donations to government'."[40]

Yet this framing is incomplete. Businesses take decisions on a daily basis that rest on the trade-off between lowering their tax liability and managing the risks associated with doing so, as demonstrated by the PWC scales previously discussed. There has always been a clear business case for adopting a low-risk tax position, and businesses that adopt this approach have incurred a greater tax liability than they would have done under a more aggressive strategy.

It is this decision-making process that can be viewed through the corporate responsibility lens. "There is a 'way to do tax'," argues a paper from KPMG's business school, "that is responsible in its attitude to the society within which the company operates, and which is good for business... this will sometimes involve making higher tax payments than the legal minimum to which the liability could be reduced."[41]

Earlier we defined corporate responsibility as including activities which exceed a company's legal obligations, and there are numerous instances where a company's compliance with the legal minimum regarding a social or environmental issue has not been sufficient to protect it from negative public opinion and/or financial loss (see box).

Living wage initiatives exceed the legal minimum

Compliance with the local minimum wage is little defence in the court of public opinion when 'sweatshop' wages are uncovered in a company's supply chain, because minimum wages can still be portrayed as 'poverty wages'. Popular opinion (and increasingly industry best practice) expects more, and businesses have begun to respond by adopting living wage policies in the developing world that set a higher minimum standard than the legal limit.[42]

In 2010 Marks and Spencer became the first retailer to set a target, committing to "Implement a process to ensure our clothing suppliers are able to pay workers a fair 'living' wage in the least developed countries we source from, starting with Bangladesh, India and Sri Lanka by 2015."[43]

In the same way, public opinion is at present crystallising around the notion that companies should pay their 'fair share' of tax, which in many people's minds precludes the use of aggressive tax planning. A majority of people in the UK believe that it is, "wrong for businesses to employ controversial but legal means of reducing their tax contribution."[44] Against this background, Corporate Citizenship conclude that:

"The traditional defence of compliance is dead; the distinction between evasion (illegal) and avoidance (lawful) has dissolved in the eyes of governments, NGOs and citizens."[45]

3.2 Lack of transparency contributes to the risk faced by businesses

As well as investor demand for more information, companies are facing significant reputation risk as a result of a lack of transparency on tax practices. There is a strong argument – and precedent in other CR areas – that by being transparent, a business can reduce the potential for reputation risk.

The fashion industry is one such precedent. Faced with the continued contradiction between campaigners' assessments of their ethical performance and their own public relations statements, a number of major garment companies' CR reports – such as Gap Inc (see box) now use transparent and objective measures that show their impacts – both positive and negative – over time.

Sustainability reporting by Gap Inc

Gap Inc's social responsibility website includes a data centre where, at the time of writing, figures from four years' worth of factory audits can be viewed, demonstrating areas where progress is needed and, at times, where the quality has fallen. The data is presented against each provision of the company's code of conduct, allowing stakeholders to monitor compliance with individual provisions.

Likewise, companies are facing calls for more transparency on their tax practices, and in particular for a country-by-country breakdown of financial results. There are proposals for both voluntary and mandatory country-by-country reporting, with governments at European Union level and via the G20 and the OECD expressing interest in these ideas. Legislation passed in 2010 requires companies listed in the US and engaged in natural resource extraction to disclose payments to governments on a country-by-country basis.[47]

Some companies have begun to respond to this demand. A 2010 survey of tax reporting conducted by PriceWaterhouseCoopers concludes that: "Over the last five years a group of leaders in tax reporting in the FTSE has emerged. These companies are going well beyond the required disclosures on tax in reporting standards and talking about different aspects of their tax affairs. They see a business case for being more transparent on tax and have concluded that the potential benefits outweigh any potential risks."[48]

Both Rio Tinto and Anglo American publish an annual breakdown of tax payments made to governments by country and by type of tax, as well as other qualitative and quantitative information.[49] Many other companies now include a discussion of their tax approach and more limited information on tax payments within their CR reporting. SABMiller, for example, notes the "widespread and legitimate interest in the amount we contribute directly to economies locally, regionally and globally, and particularly, in our contribution to government finances through taxation."[50]

The Global Reporting Initiative provides a framework that has been widely adopted for corporate responsibility reporting, and which has contributed to greater trust in CR reporting. It already includes a provision on tax disclosure:

"e) Payments to government: all company taxes (corporate, income, property, etc) and related penalties paid at the international, national and local levels. This figure should not include deferred taxes because they may not be paid. For organisations operating in more than one country, report taxes paid by country. The organisation should report which definition of segmentation has been used."[51]

It also adds that,"To better assess local economic impacts, [all financial disclosures] should be presented separately at country, regional or market levels, where significant. Reporting organisations should identify and explain their criteria for defining significance."[52]

The experience of the garment industry, as discussed above, suggests that for many companies, the benefits of improved reputation and risk management outweigh any costs arising from improved reporting and greater transparency. By laying out the full extent of tax payments, businesses can build trust in their statements at a time of significant public cynicism. For example, Barclays could have more effectively managed criticism from the media and parliamentarians had it been more open in this way (see box).

How selective disclosure of information increased damage to Barclays' reputation

In January 2011, Barclays was forced by the UK parliament's treasury committee to disclose the value of its UK corporation tax payments. Testifying in front of the committee, Barclays' CEO Bob Diamond stated that the company paid £2 billion in taxes in 2009. The committee was incensed when Diamond admitted that this figure included payroll taxes incurred by Barclays' employees, not by the bank itself. When Diamond was not able to disclose a breakdown, one committee member retorted: "then we don't know what, as a corporate entity, you're paying." Coming at a time of distrust in the banking industry, the misleading disclosure became a story in itself.

This was compounded when Barclays eventually divulged that its UK corporation tax payment was just £113 million of the £2 billion originally cited. The Guardian newspaper calculated an effective tax rate of just 1%. The confusion had arisen because Barclays had disclosed only the UK tax figure that had been required by the committee, and this had been compared with its global profits. In fact, the company "paid over £1 billion in corporation taxes worldwide," according to group finance director Chris Lucas, writing in response to the Guardian article.

Had Barclays given a breakdown of its profits and tax payments by country, this mistake would not have arisen, those following its disclosure would have gained an accurate impression of its tax contribution, and the company would have inspired much greater trust.

3.3 From quantitative to qualitative responsibility

A KPMG paper on tax and corporate responsibility suggests that responsible behaviour in the area of taxation should be identified through quantitative means: "in contrast to many other aspects of its business activity, the relevant question as regards [a company's] tax liability is not how it pays it, but how much it pays...a company cannot vary the quality of its tax payment; only its quantity."[58] Crudely put under this analysis, the more responsible a company is, the more tax it would pay up to a certain point, such as the headline rate in its country of domicile.

Analysing the amount of tax a company has paid might well allow certain conclusions to be drawn about its tax practices. But it is important to remember that financial results are the outcome of underlying practices which themselves are the subject of corporate responsibility.

From a development perspective, a company's overall tax position is in any event not the most helpful measure of responsibility. This is because:

- business decisions in which tax is a factor may have development impacts that extend beyond those on the company's immediate tax position; and
- the tax impact on developing countries of a particular business decision may be greater than the aggregate impact on the business's position.

Consider, for example, a business decision to centralise procurement services in a low-tax jurisdiction. By centralising procurement, the business achieves many non-tax efficiency savings. In addition, as KPMG's advice on 'Tax Efficient Supply Chain Management' sets out, "incorporating tax arbitrage into supply chain structures (typically by optimising the location of the key supply chain functions, assets and risks) realises benefits well beyond conventional operational savings on their own."[59]

The negative consequences for developing countries of such a decision are twofold. First, taxable profits are reduced by the transfer of profitable functions out of the country. For the multinational business, the tax saving in the developing country is likely to be offset by a (smaller) tax liability in the low-tax jurisdiction; the cost to the developing country is therefore greater than the company's saving. Second, the quality of the company's investment in the developing country has been reduced by the removal of this high-value function: it reduces positive spill-over effects such as skills and technology transfers and backward linkages into high-skilled local businesses; since high-skilled posts tend to be higher paid, it also reduces personal income tax receipts.

This discussion points once again to the utility of country-by-country disclosures, but it also demonstrates that tax responsibility should be measured against qualitative reference points. For multinational businesses, these reference points are frequently geographical: the choice of where to locate assets and business functions; the use of structured products and 'mailbox' companies in particular jurisdictions. It is in making these choices that corporate responsibility applies.

4. An action plan for businesses

This paper has discussed why corporate tax practices are a CR issue and presented a business case for tax responsibility. We now suggest an action plan for businesses, including elements for inclusion in a company tax policy; development of an oversight mechanism; transparency; and an industry code of conduct.

4.1 Creating a company tax policy

Businesses should have a tax policy that is:

- developed in collaboration with CR staff and board members responsible for CR, with key decisions integrated into the company's CR policies and programmes;
- published, and all tax staff – as well as outside providers of tax advice and auditors – made aware of its contents; and
- regularly reviewed, with the review process including an assessment of the impact of tax planning activities on tax revenues in individual countries. This could be achieved by comparing the actual distribution of profits within the group to those arrived at using a simple formula based on the turnover, staffing and assets in each country.

A company's tax policy should seek to:

- define the level of aggressiveness of a company's tax planning, with reference to corporate responsibility principles;
- include qualitative in addition to quantitative benchmarks;
- provide for an assessment of tax revenue impact to accompany all major business decisions (the tax revenue impact on particular countries may differ from the tax impact on the business as a whole, but is a relevant factor for responsible decision-making);
- rule out certain tax practices; and
- outline criteria for tax negotiations.

4.1.1 Rule out certain tax practices

To ensure adequate risk management and appropriate CR, companies should consider ruling out certain tax minimisation practices. These include practices that, if uncovered in public, would expose the company to significant reputation damage. While a lay audience may not be able to unravel the full detail of a tax planning scheme, there are nonetheless certain practices that may fail the common sense test, or may appear to contravene a company's corporate values and approach to corporate responsibility principles.

These might include:

- locating valuable intellectual property in low-tax jurisdictions unless it was predominantly developed there or is predominantly exploited there;
- moving tax residence to a low-tax jurisdiction without a corresponding shift in economic activity;
- moving high-value business functions out of developing countries and into low-tax jurisdictions; or
- using structured tax planning techniques, such as 'double-dipping', under which tax allowances on one piece of income are claimed in two different jurisdictions.

4.1.2 Responsible tax negotiations

Corporate tax responsibility is not limited to how a company behaves within the law. It can also relate to how a company influences the law itself. This is most notable in the developing country context when businesses negotiate tax concessions from governments in return for inward investment. From a risk management perspective, if a business is paying no or very little tax in a developing country, the reputation risk may not be much different if this is a result of negotiations with the government rather than a result of avoidance techniques.[60]

As the KPMG paper suggests, **"it may be in the negotiation of the tax rules rather than in the approach to tax avoidance or planning that CSR principles have the greatest application... A commitment to 'fairness' may...give a company the incentive to concede more in negotiations than it feels that it would necessarily have had to do from commercial necessity."[61]**

4.2 Board oversight

Board level oversight is already an important issue for CR – 62% of Global Fortune 500 Companies have board level oversight for their sustainability policies.[62] Such oversight should be extended to tax planning and will be expected by concerned investors. "The challenge for boards is to determine how best to achieve the goals of legal compliance, shareholder return, and corporate responsibility," state Henderson Global Investors. "It is good practice to formalise the response to this challenge into a documented tax policy, and to keep this up-to-date through regular board level reviews."[63]

Board level involvement in the governance of tax decisions is also seen as important by revenue authorities. One element of HMRC's definition of a "low risk" taxpayer is that the business, "has clear accountabilities up to and including the board for the management of tax compliance risk and tax planning."[64]

4.3 Transparency

Transparency is an essential part of CR and is imperative both for exercising and demonstrating accountability. Public disclosure enables investors to more accurately assess potential risks and determine whether companies are adequately addressing them.

Public disclosure can also encourage a more prudent approach to risk management. As noted in a recent ACCA publication, reporting not only has the benefit of communicating information to shareholders and other stakeholders, but also "helps the preparers of the reports by focusing their minds."[65]

Transparency can also help to create confidence that the company's behaviour is consistent with its statements of intent. This is the strategy pursued by Levi Strauss in its social reporting (see box).

Garment industry supplier lists

Garment industry trade unions campaigned for many years for major brands to disclose lists of their supplier companies. This information was seen as essential to allow trade unions to verify these companies' claims about working conditions in their supply chains.

For a long time companies resisted, stating that such disclosures would be commercially damaging and would leave them vulnerable to attacks by campaigners. Then, in 2005, Levi Strauss broke ranks and made its supplier list public. David Lowe, its senior vice president for global sourcing, stated at the time: "We believe that greater transparency within the supply chain will provide additional momentum for our efforts to improve working conditions in apparel factories worldwide."[66]

Levi Strauss has since been followed by brands including Adidas, Nike and Reebok.[67]

There is a range of information that companies should consider making public as part of their tax responsibility activities. A company should consider:

- publishing its tax policy and details of any code of conduct to which it is a signatory;
- explaining the steps it takes to reduce its tax burden, including a specific declaration of purpose for each subsidiary based in a tax haven;
- assessing and disclosing the impact of its profit-shifting activities on tax revenues in individual countries, for example by comparing the actual distribution of profits within the group to those that arrived at using a simple formula based on the turnover, staffing and assets in each country;
- disclosing breakdowns of tax payments and other financial information consolidated at the country level ("country-by-country reporting"), giving a simple snapshot of its contribution to each economy. This information should include a breakdown of tax payments and other significant financial information to set them in context. It should also include a full list of subsidiaries by jurisdiction; and
- making accounts for every subsidiary company downloadable from its website (many countries do not place registered companies' audited accounts on public record).

4.4 Developing a code of conduct

Accurately and precisely defining the line between acceptable and unacceptable practices is difficult – but no more so in the area of tax planning than other aspects of social responsibility. The last two decades' work in CR has led to the development of numerous codes of conduct in a variety of areas (see box). The most successful are those developed through multi-stakeholder initiatives, with collaboration from businesses, civil society organisations and sometimes governments.

In each case, a good code of conduct defines what are acceptable and unacceptable corporate practices, building a shared set of benchmarks accepted by all stakeholders. In general, if a code is agreed between a full range of stakeholders, all have an interest in promoting it, and so for businesses, compliance with the standards it contains offers a good level of protection against criticism.

Of course, in the absence of a multi-stakeholder initiative, companies can elaborate their own industry codes of conduct independently. The challenge in doing so is to work with interested parties to achieve an appropriate balance of stakeholder buy-in and realistic ambition.

Codes of conduct

One area in which corporate codes of conduct have been developed with some success is labour rights in global supply chains. Multi-stakeholder initiatives such as the UK's Ethical Trading Initiative (ETI) have forged a consensus between businesses, NGOs and trade unions as to the voluntary standards that companies should strive to attain. Signatories to the ETI's base code agree, for example, to ensure that workers have the right to join trade unions without discrimination, and to a ceiling on the number of hours' work that can be required per week. All agree about the end point, although expectations differ about the vigour with which companies should be expected to put it into practice.

5. Conclusion

CR policies have in the past been limited to initiatives that reduce harmful aspects of a business's impact on the environment and society, and the business risks associated with them – for example schemes to reduce pollution or improve staff welfare. But increasingly this approach is being challenged by the recognition that many of the risks that drive the business case for CR can only be managed through an evaluation of core business practices. CR has to become a way of doing business, not merely an add-on.

Tax planning, already embedded into the structures and ways of working of major multinational businesses, presents growing risks to businesses. In developing a CR response to it, much can be learnt from the experience of integrating other CR issues: defining and communicating a position, ensuring high level oversight and responsibility, becoming more transparent, and developing a shared set of principles between stakeholders. This paper has set out some suggestions for how responsible businesses can respond to this challenge.

The growing debate around corporate responsibility in the area of tax planning presents businesses with an opportunity to showcase their commitment to corporate responsibility, and their approaches to risk management. The challenge now is to translate this commitment into concrete steps that contribute to a positive vision of tax responsibility.

For further information

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Endnotes

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