TACKLING THE TAX AVOIDANCE CULTURE

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Looking at the statements on Corporate Social Responsibility (CSR) of multinational corporations, it becomes obvious that company directors do not regard tax payment as a part of the CSR agenda.

The same holds true for the **World Economic Forum**. On their website there are 86 pages which refer to Corporate Social Responsibility but only three pages which refer to tax avoidance. Tax avoidance is not referred to in the World Economic Forum's **Partnering Against Corruption Initiative** despite the clear evidence that much tax avoidance is linked to illegal transactions, banking secrecy, offshore trusts, fraud and illicit capital flight.

Tax matters are also absent from the mainstream discussion about corporate governance. A report by **PricewaterhouseCoopers** has identified corporate governance as an important area of concern for institutional investors, with issues such as reduction of corruption, collusion, nepotism; inadequate disclosure and insufficient transparency of financial statements; inadequate enforcement of existing rules, and a lack of clear separation of company ownership and management. Nonetheless, the related areas of compliance with taxation obligations, not using aggressive tax avoidance techniques and transparency of reporting of tax planning measures are not mentioned in the PWC report on good governance.

This is so despite the fact that a series of corporate scandals in recent years, involving such high-profile companies as **Enron**, **WorldCom**, **Parmalat** or the Swiss **Erb Group** have drawn public attention to the growth of tax avoidance mechanisms such as transfer-pricing,

re-invoicing, offshore 'special purpose vehicles', corporate inversions, dubious charitable trusts and other vehicles for tax abuse.

Take the case of Enron, which until December 2001 was a WEF-habitué and widely heralded as the role model for the twenty-first century. Enron had a total of 881 offshore subsidiaries, of which 692 were incorporated in the Cayman Islands. They were used as part of an elaborate strategy to avoid taxes. From 1996 to 2000 Enron generated pre-tax profits approaching US$1.8 billion, but paid no federal income taxes and was in fact a net recipient of tax rebates.

Enron found willing helpers in the accounting, banking and law industries, as it has emerged that the company paid its advisers US$88 million in fees in order to avoid paying US$2 billion in US taxes. A 2,700-page report by a US Senate committee estimates that it will take 10 years to forensically examine all the schemes operated by the company.

Compelled by the profit logic, and by a legal principle which asserts that tax payers may organise their affairs in such a way as to pay the least tax possible under the law, the majority of large businesses have been structured so as to enable tax avoidance in every jurisdiction in which they operate.

A standard defence of this practice was given by **Mike Warburton**, a partner in **Grant Thornton**, one of the main auditing firms of Parmalat prior to its crash. Mr Warburton told the UK ***Sunday Times*** in February 2004 that: *«The complexity of the tax system creates loopholes which people legitimately exploit.»*

We dispute the assertion that this is legitimate. Our argument is not about legality, it is about responsibility and ethics. And as the ***Financial Times*** recently noted in a special report on responsible business: the Tax Justice Network *«has put the (tax avoidance) issue firmly in the context of corporate responsibility».*

The Corporate Social Responsibility agenda is driven by demand for an ethical approach to doing business. It is not possible to be ethical in one area of business conduct and to act otherwise in another area, and companies that function in this way reveal a major disconnect in their core organisational values.

Tax avoidance and aggressive tax planning enables companies to become economic free-riders, enjoying the benefits of corporate citizenship without accepting the costs, whilst also causing harmful market distortions and transferring a larger share of the tax burden onto individual taxpayers and consumers.

Taking a long-term time perspective reveals a dramatic shift in the distribution of the tax burden. In the US, for example, in 1953 families and individuals paid 59 per cent of federal

revenues and corporations 41 per cent. According to the most recent Statistical Abstract of the United States, this ratio has now shifted to approximately 80:20 in favour of corporations. A similarly dramatic shift has occurred in most countries This is scarcely evidence of companies playing a significant role in financing education, health, transport infrastructure, security and all the other services that the business community requires to flourish.

Far from acting as a legitimate disciplinary agent on high-tax, high-spend governments, harmful tax practices are symptomatic of an almost wholesale withdrawal of wealthy elites and multinational companies from their economic and social obligations. But concerns about tax competition and fiscal degradation lie deeper than the loss of state tax revenues that legitimately belong to the people. The ability of transnational corporations to structure their affairs through paper subsidiaries in tax havens provides them with a significant tax advantage over their nationally or locally based competitors. Local businesses, no matter whether they are technically more efficient or more innovative than their transnational rivals, will be competing on an uneven field.

In practice, of course, this differential tax treatment favours the large business over the small one, the international business over its national one, and the long-established business over the start-up. It follows, simply because most businesses in the developing world are smaller and newer than those in the developed world and typically more domestically focussed, that this inbuilt bias in the tax system now favours developed world multinational businesses over their domestic competitors in the developing world.

It is clear that policy measures are required to redress the distortions that have arisen as globalising companies have left nationally based tax regimes floundering. Multinational companies make use of aggressive tax planning strategies because they are able to operate in the legal vacuum that exists between nation states. The publicity surrounding the Enron case has ensured that directors and audit committees can no longer turn a blind eye to the role of tax schemes in the wider context, even if there remains a legal vacuum in some areas of tax law. Directors now need to recognise that aggressive tax planning strategies are not compatible with long-term sustainability, and therefore may even not be in the shareholder's broader interests.

Furthermore, the Corporate Social Responsibility debate needs fully to address the issue of how company directors should act on tax avoidance in the context of their CSR agendas. The current situation has not kept pace with the debate on CSR and should make way for a General Anti-Avoidance Rule that would guide directors in understanding their moral and ethical duties on tax payment.

Multinational companies should adopt clear CSR standards in the area of taxation, including requirements to publish all necessary accounting information and to refrain from the use of

profits-laundering vehicles created without substantial economic purpose. CSR reports should list the countries in which the company trades, how much profit is derived from activities in each of these countries, and where these profits are booked for tax purposes, indicating any special purpose vehicles that are used, and the extent of tax avoidance arising from the use of 'novel tax planning ideas.'

Only in this way can the relevant stakeholders, including governments, shareholders, employees and the general public obtain the information that they need to determine whether the organisations which dominate the globalised economy are acting as good corporate citizens.

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