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Tax and ethics

Can pay, should pay

By Oliver Balch

As tax blasts its way onto the public agenda, companies should concentrate on where they pay, as well as how much

Four years ago, the world was a different place. JPMorgan still signed cheques, "bailouts" were what sinking seafarers did and we were all a lot better off.

So when the Oxford Centre for Business Taxation asked companies about corporation tax, the conclusion was categorical: the issue was "too complex or obscure" for the average man on the street.

How things change. In March 2011, more than half a million citizens took to the streets of London to protest against "tax injustice". Spearheaded by the campaign group UK Uncut, their anger homed in on big business. Tax "dodging" by large companies, it was claimed, is costing the UK exchequer £95bn in lost revenue every year.

The speed at which tax has become a major public issue in the UK and elsewhere is astonishing. Tax hardly has the emotive appeal of slave labour or toxic waste. Yet its explosion onto the public agenda is not entirely surprising. In times of fiscal tightening and spending cuts, all eyes turn to the question of who pays what into the public pot.

"In a time of austerity, you've seen campaign groups look around and ask if the burden is being borne by all in an equal measure," says Louise Rouse, director of engagement at UK campaign group Fair Pensions.

Media attention has played its part too. In the UK, the Guardian newspaper ran a series of "Tax Gap" investigations into big brands. Likewise, in the US, the New York Times has turned the spotlight on the tax policies of corporate giants such as GE and Google.

Tax practices may be attracting headlines, but the ethics of tax is not entirely new. Corporate tax payments in the developing world have long been the subject of scrutiny. The Extractive Industries Transparency Initiative, for example, which attempts to increase disclosure of payment by natural resource companies to governments, dates back to 2002.

Responsible business issue

What definitively is new, however, is the general recognition that tax is now a core responsibility issue for business.

At its most basic, the ethics of taxation ultimately derives from companies' social contract with the countries in which they operate. Taxes fund public goods such as education and healthcare. When large companies evade or avoid tax, governments are left with one of two choices: cut spending, or tax individuals and smaller domestic businesses more.

Mitigating tax payments may not be illegal, but neither is it entirely responsible when such practices negatively impact a country's social and economic wellbeing. So argues John Christensen, director of the Network for Tax Justice, a UK-based campaign group.

"In other words, don't use aggressive tax avoidance and evasion and then try to pretend that you are engaged in a corporate responsibility agenda. The two are quite simply incompatible," he says.

The message appears to be seeping into the C-suite. Andrew Witty, chief executive of GlaxoSmithKline, recently condemned the habit of international companies to "float in and out of societies" depending on tax regimes. The practice is "completely wrong", he told the Observer newspaper.

What's good policy?

- Abide by a general **"anti-avoidance** principle".
- Acknowledge that tax has **major economic impact** on society and is therefore a responsibility issue.
- Report on tax policies and practices in annual **accounts** and corporate responsibility **reports**.
- Adopt **tax mitigation** techniques subject to consideration of their social and economic impacts.
- Integrate tax policy and practice in **corporate governance** systems.
- Report tax on a **country-by-country** basis.
- List all **subsidiary entities** and publish accounts for their activities.

Source: Tax Justice Network

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Responsible approaches to tax

Management steps

- Create a company tax policy setting out the **principles** to be applied and the **practices** ruled 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 your tax practices and their impacts.
- Work with **peers** and **stakeholders** to formulate a mutually agreed code of conduct.

Source: Action Aid/FairPensions

Have you paid an appropriate level of tax?

"Appropriate levels of tax" are the rates stipulated by the **relevant tax authority** within the country where the company's tax liability falls, minus 3%. The lower figure is because **taxable profits** and **accounting profits** are not the same thing.

As a result, it is unlikely a company will pay exactly the tax rate laid down in law on its declared taxable profits. The rate may be higher because some costs allowed for accounting purposes are disallowed for tax, such as IT equipment and other capital items.

Source: Profit Through Ethics/See What You Are Buying Into standard

Don't be a tax dodger

Ethics aside, a compelling business case for responsible tax planning can also be made. Reputations are at risk. Recent months have seen protesters camped out in front of Boots, Top Shop, Vodafone and a host of other high street retailers.

It's not just bad press companies need to worry about. A "tax dodger" badge, fair or otherwise, can lead to a host of costly repercussions, from legal challenges to the loss of favourable tax status.

"Once a pattern of uncertainty in taxation reporting is known to exist, then it is possible that a company may trade at a discount to its true value for fear that further uncertainties will be revealed," consultancy firm SustainAbility stated some years ago in a far-sighted report on tax.

Of course, where irresponsibility becomes illegality, the costs can run far higher. Commodity traders Bunge, Cargill and Dreyfus could face bills running into hundreds of millions of dollars if an investigation into unpaid taxes and duties by the Argentine government goes against them.

So what does a responsible approach to tax look like? Campaign groups are fighting it out with corporate tax departments to determine just that. Companies aren't paying enough, according to the former. All legal requirements are being met, respond the latter.

Amid this polarising debate, one thing seems certain: tax avoidance, tax evasion and abuse of tax havens and offshore secrecy laws all lie beyond the pale.

A small number of corporations opt for the wrong side of the law. They often do so with the active complicity of accountants, banks and law firms – a practice John Christensen describes as "wilful blindness".

Most large companies, however, operate within legal boundaries. They are too big and too visible to do otherwise. When it comes to tax, however, legality is not the watertight defence it used to be.

"The argument that 'we are obeying the law and everything that we are doing is technically permissible' no longer washes in the court of public opinion," says Rouse of Fair Pensions, which recently published a joint paper on the issue. That leaves many companies exposed.

To date, aggressive tax avoidance strategies such as "transfer pricing" and the use of tax havens have

been perceived as permissible behaviour.

Now, the public mood (if not the letter of the law) is shifting. As well as reducing tax income for the state, tax avoidance effectively penalises national business that don't have the capacity to shift assets offshore and the like.

The safe ground, according to all parties, lies in legitimate tax planning and mitigation. Indeed, shareholders could reasonably argue that any business that fails to take full advantage of existing tax agreements or explicit exemptions is behaving irresponsibly.

Transparency trumps

A major reason behind the current confusion is companies' own management of the issue. Many corporations don't have a uniform tax policy. For those that do, the policy is often not applied consistently across all the company's operations.

The first task for any corporate responsibility manager, therefore, is to determine their company's current practice. On the back of that information, a policy should be agreed and steps taken to see that it is implemented.

Naturally, any responsible tax policy must explicitly rule out any illegal activity. The list of other non-negotiables is open to debate, however. Among the steps suggested by responsible tax advocates are: abiding by a general "anti-avoidance principle"; considering the societal impacts of tax mitigation; and publishing financial accounts for subsidiary entities (see box).

The priority above all is transparency. Tax is not an issue that will go away and so companies must "articulate their position clearly", says Peter Truesdale, associate director at London-based consultancy firm Corporate Citizenship and author of a recent report on responsible tax management.

"This doesn't necessarily mean companies paying more tax – but it does mean companies identifying a coherent and credible position on tax, and finding simple language to defend it in," he adds.

To assist in that process, Corporate Citizenship has developed a tax map to enable companies to chart where, how and what they pay in taxes.

In terms of disclosure, the vast majority of companies go no further than the statutory requirement to include an overall tax figure in their annual tax and accounts. That will "almost certainly" have to change, Truesdale says. "In the modern world, you can't get away from articulating a position and providing sufficient information to show that you are doing it."

The spotlight is turning in particular on corporate operations in developing countries, especially those with "material" tax bills. A case in point is Ghana, where one sixth of the country's entire tax revenues derive from foreign-owned businesses.

Greater disclosure of overseas tax payments is currently under consideration by European and US legislators. Some companies – but not many – are pre-empting the possibility of future regulation by publishing tax payments on a country-by-country basis.

A notable example is Rio Tinto. The mining giant recently "redesigned" its approach to tax disclosure, publishing payments made to governments in each of its main operational markets.

In its recent dedicated tax report, the company states that its $7.4bn tax bill for 2010 marks a "significant contribution to public finances" for the countries where it operates. The report also voices concerns about the threat of tax increases in the future.

Going public is not without its risks. Governments, shareholders and the general public will all have their opinion on whether a company's tax payments are fair or not.

The debate over tax and ethics is only just getting started, however. By making its payments clear, companies such as Rio Tinto earn a legitimate place in the discussion. More should join them at the table. ■

Emerging practices on tax

British American Tobacco supports the "gradual and predictable" increase in taxes on tobacco.

Anglo-American, for five years, has published "taxes borne and claimed" in both developing and developed countries, as well as an effective tax rate by country and weighted average for the company as a whole.

McDonald's publishes a headline tax figure for the company as a whole ($1.1bn), plus its total bill for social and income taxes in its top nine markets year-by-year.

SAB Miller talks of a "tax footprint" and reveals the split in its taxes between developed and developing countries.

Exxon Mobil publishes its total payment in direct and indirect taxes and duties in the UK (£5.1bn) and compares this to total government expenditure (about 1%).

Source: Tax, Reputations and Responsibility, Corporate Citizenship, May 2010

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