The Tax Dialogue on corporate responsibility

The Tax Dialogue: on responsible tax for sustainable development

A BACKGROUND PAPER PREPARED FOR AN INTERNATIONAL CONFERENCE IN LONDON
THE 26TH OF OCTOBER 2015

DISCLAIMER

This paper has been prepared as background for the discussions at the international conference organised by Christian Aid, Share Action, and IBIS on Monday 26th October 2015. The paper is not reflective of the policy positions of the three organisations.

The Tax Dialogue is an initiative run by IBIS and financed by Danida. This conference is a part of this initiative.

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INTRODUCTION

This paper has been developed as background for an international conference on Monday October 26th 2015, hosted by Christian Aid, Share Action and IBIS. It outlines some of the latest developments, practices and research around tax responsibility, as far as businesses and investors are concerned. In recent years tax has moved to the forefront of discussions about corporate responsibility and businesses and investors have found new and innovative ways of engaging with the issue. Taxation has also been highlighted as a key means of financing sustainable development.

The conference is aimed at practitioners in corporate responsibility and in tax. Our hope is that it will move beyond explosive media scandals and create a space where stakeholders can debate tax and corporate responsibility from a developing country perspective.

The conference will also look ahead, at making certain ideas more concrete, clarifying the role of the diverse actors in this journey and asking key questions. How can we make the dialogue more concrete through propositional and practical examples? What is the ongoing role of this type of dialogue - and how do we ensure it also tackles the issues relevant for developing countries?

The day will be split into three sessions and cover the following areas. For each one, rather than closing the debate, a series of dilemmas will be posed for further discussion:

1. Responsible tax in the development agenda
2. Tax and responsible investment
3. Responsible tax principles for businesses

We believe that enhanced dialogue between civil society, companies and investors contributes to the identification of practical and institutional solutions to current tax dilemmas. An example of a successful process is the 'Tax Dialogue' in Denmark. Since it was initiated in 2014, a series of roundtable discussions have taken place on specific aspects of taxation and development[1]. In the UK meanwhile, the CoVi-led dialogue, supported by KPMG since 2014 has created a space for multi-stakeholder dialogue about responsible taxation for the common good. It has led to a proposal for an All Party Parliamentary Group (APPG) on responsible taxation, among other proposals[2]. On the investor side, Christian Aid and ShareAction have held meetings with investors concerning the "taxing questions" that investors can ask at companies' AGMs, about their tax risks.

SESSION 1: RESPONSIBLE TAX IN THE DEVELOPMENT AGENDA

It is through respecting, protecting and fulfilling civil, political, economic, social, cultural and environmental rights that the state earns its legitimacy to tax [3]. Businesses also have a responsibility to respect human rights and by acting responsibly, particularly in tax matters, business and investors can help improving the rule of law and thus reduce the scope for corruption.

1 http://thetaxdialogue.org/workshopsthetax-dialogue/

2 http://covi.org.uk/wp-content/uploads/2015/07/Re-building-a-social-compact-on-responsible-tax_CoVi_publication-on-23July2015-FINAL.pdf

3 http://www.cesr.org/downloads/fiscal.revolution.pdf

The year 2015 has been an important year for the international tax debate and for development. The Sustainable Development Goals (SDGs) agreed in September at the UN General Assembly (UNGA) represent a once-in-a-generation opportunity to incentivise the private sector to take bold steps, individually and in concert, towards responsible taxation. Achieving the ambitious SDGs has been estimated to require an additional $2.5 trillion[4] a year in developing countries. Tax revenues will be a critical part of this financing, alongside international trade, aid and private finance, all of which should fulfil the criteria of sufficiency, equity and accountability[5]. Increased tax revenue has been shown to significantly improve health outcomes[6] and estimates show that taxation is critical for achieving the SDGs[7].

Multinational corporations (MNCs) already account for a large part of the tax base in developing countries; their tax payments are thought to be roughly twice as important as they are in rich countries, as a share of total tax revenue.[8] However, the International Monetary Fund (IMF) has recently estimated that the costs of tax base erosion and profit shifting are higher in developing countries, both in the short run and in the long run.[9]

Dependence on corporate tax payments is especially acute in countries where the extractive industries supply a large share of government tax and non-tax revenues. For example in Peru, the Yanacocha mine which was partly financed by the World Bank's International Financing Corporation has been found to contribute little in tax revenues. In this case it points to a tax stabilisation agreement signed in 2004 during the Fujimori regime, and to the abnormal overhead costs that well exceed its competitors'[10]. Developing country governments and civil society consider extractive industries as high priority for international tax reform discussions.

Arguments about tax dominated the UN Financing for Development (FfD) talks in Addis Ababa in July 2015. The OECD's role in making the international tax rules was maintained but developing nations wanted greater international tax governance under the auspices of the UN. The outcome was not – as they hoped - an agreement on a new tax body but rather a small expansion of the time committed to the existing UN expert committee work[11].

This UN committee already contributes with its work to adapt international tax rule guidance to the needs of developing countries[12]. In Addis, the UN also launched specific guidance on how developing countries can protect their tax bases[13]. These manuals are complemented by existing capacity-building efforts[14] and Addis secured additional effort in this regard, with the launch of the Addis Tax Initiative (ATI)[15] which doubles existing support for tax capacity-building by a group of 30 donor countries. Capacity-building is very important, because developing countries generally have less staff, especially in their international tax departments. However, training and capacity-building should reflect the particular needs and conditions of the countries in question to be effective. In recognition of the need for greater corporate responsibility on tax matters, the ATI also recommends the addition of an 11th principle to the Global Compact.

4 http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=937

5 http://www.actionaid.org/sites/files/actionaid/the_elephant_in_the_room_-_how_to_finance_our_future.pdf

6 http://www.thelancet.com/journals/lancet/article/PIIS0140-6736(15)60574-8/abstract

7 http://ecdpm.org/publications/european-report-on-development-2015/

8 https://www.imf.org/external/np/pp/eng/2014/050914.pdf

9 https://www.imf.org/external/pubs/ft/wp/2015/wp15118.pdf

10 http://www.latindadd.org/wp-content/uploads/2015/02/The-YANACOCHA-Case.pdf

11 http://www.un.org/esa/ffd/ffd3/wp-content/uploads/sites/2/2015/07/Addis-Ababa-Action-Agenda-Draft-Outcome-Document-7-July-2015.pdf paragraph 29, page 7.

12 http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf

13 http://www.un.org/esa/ffd/wp-content/uploads/2015/07/handbook-tb.pdf

14 http://www.un.org/esa/ffd/wp-content/uploads/2015/08/2015TP_BackgroundNote.pdf

15 http://www.un.org/ga/search/view_doc.asp?symbol=A/CONF.227/L.1

In October 2015, the OECD revealed the final conclusions of its Base Erosion and Profit Shifting (BEPS) project and released them just before the IMF and World Bank annual meetings. Its proposals aim to tackle aggressive tax avoidance by multinational companies. While they can be seen as a tax milestone, they will do little to meet the critical needs of developing countries.

The BEPS project covers key areas for the (primarily OECD) participating tax authorities, which should help improve tax collection, including the country-by-country reporting master file and additional tax information exchange agreements. While the OECD eventually managed to include a selected number of developing countries in the BEPS project, and has expressed hope that implementation will be done "on an equal footing", its agenda was set for and by developed countries. It does not comprehensively address developing countries' problems.

A further difficulty is that since only 34 countries are OECD members, different rules have[16] and are likely to emerge in the future. A wider set of 127 countries are members of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, but they are unlikely to equally adopt OECD guidelines.

For developing countries, in addition to the relative significance of tax avoidance and the impact of responsible tax policies and practices on their economies, it is also important to note their particularities when tackling international challenges. For one, their tax administrations have significantly fewer resources and the democratic legitimacy of tax incentives is open to challenge. Civil society and the media can react with astonishment to the amounts of taxes being avoided through incentives, due to their high social cost.

Given these particularities or specific country context, corporate tax policies might translate into tax practices in different ways than in OECD countries. Tax policy and its implementation, just like any other business practice, should be adapted to a country context. For businesses and investors, the particularities of developing countries and emerging markets in relation to tax can be particularly risky, if not properly taken into consideration. Given the SDG agenda and the critical roles of both tax and private finance in achieving sustainable development, this concern is likely to become ever more important.

It is therefore important to better understand how MNCs' tax policies and practices can be brought in line with not only the letter but the spirit of the law – and how they can contribute to sustainable development. Corporate responsibility in relation to tax is not separate from wider corporate responsibility in developing countries but part of every business' contribution to social and economic development, alongside creating good quality employment, contributing to a clean environment and creating innovative goods and services.

16 Brazil's transfer pricing rules adopted in 1996 follow fixed margins rather than arm's length prices, while China adds 'locational savings' due to cheaper labour and conditions to its transfer prices – even though both are G20 members.

Dilemmas for discussion on responsible tax and the development agenda:

Economic substance and economic development – companies are often challenged on the alignment of their tax returns with value added in different parts of their global value chain. When this challenge is seen through a developmental lens, it is also about the distribution of value-added in their global value chains.

Tax incentives and sustainable development – both negotiated and ordinarily available tax incentives have emerged as a topic of corporate responsibility, because they represent major lost tax revenues which are needed for financing the newly agreed Sustainable Development Goals (SDGs).

Tax and developing countries – How should international tax rules be adapted for developing country contexts? Could enhanced reporting or human rights due diligence help address the issues?

SESSION 2: TAX AND RESPONSIBLE INVESTMENTS

Responsible Investment means investment which takes account of companies' environmental, social and governance practices, on the basis that these can have an impact on the financial value of these investments. The potential social impacts of companies' tax practices are outlined above and it is clear that these can be significant. As a result, many tax authorities have taken action to limit multinational companies' ability to avoid tax and more regulation is likely. Investors in companies whose profits are currently inflated by their tax practices may well see a fall in the value of these companies as they are forced to change. Therefore unsustainable tax practices present a valuation risk to investors.

Companies' tax practices have also come under public scrutiny and many companies exposed to have been avoiding tax have suffered significant reputational damage which has in turn hit profits. For example, a consumer backlash followed the revelation that Starbucks had paid no corporation tax in the UK for a number of years. This may have contributed to Starbucks' announcement in April of a fall in sales for the first time in 16 years.[17] Eager to stem the tide, the company first offered a voluntary payment of £20million over two years[18] and subsequently announced the relocation of its European HQ to England.[19] Considering the potential risks associated with regulatory changes, it is important for investors to interrogate investee companies on their views about the likelihood of regulatory reform and their contingency planning.

Recent research from the Insead Business School has revealed that shareholder value is undermined by lack of transparency linked to subsidiaries in tax havens. The study finds that greater transparency around subsidiaries increases shareholder value and recommends that pension funds and institutional investors should actively seek transparency.[20]

Currently there is a significant lack of transparency around companies' tax practices, making it difficult for investors to assess the risks they face. According to a 2013 report by ActionAid[21], only three of the then FTSE 100 com-

17 Sky News, "Starbuck sales fall for first time in 16 years", 25 April 2014, http://news.sky.com/story/1249095/ starbucks-sales-fall-for-first-time-in-16-years

18 Starbucks, "Starbucks commitment to the UK", http://www.starbucks.co.uk/our-commitment Neville, S. & Treanor, J., "Starbucks to pay £20million in tax over next two years after customer revolt", The Guardian, 6 December 2012 http://www.theguardian.com/business/2012/dec/06/starbucks-to-pay-10m-corporation-tax

19 Sky News, "Starbucks moves EU HQ to London after Tax Row", 25 April 2014, news.sky.com/story/.../starbucksmoves-eu-hq-to-london-after-tax-row

20 Bennedsen, Morten: Using Tax Havens Secretly is Bad for Shareholders; Insead Knowledge; June 2015.

21 ActionAid, "Tax Responsibility: An Investor Guide", April 2013

panies published what ActionAid regarded as an adequate tax policy. The absence of a published policy does not necessarily mean that no policy exists. However, the lack of disclosure means investors need to inquire explicitly about a company's tax practices. A 2014 report from Christian Aid[22] referred to the FTSE100's "enthusiastic use of opaque jurisdictions"[23] and highlighted that some 36% of all FTSE 100 subsidiaries are located in jurisdictions where the relevant authority does not require company accounts to be publicly accessible for a fee of less than either $10 or €10. Even when using the most comprehensive fee-charging database of company information, Christian Aid found that 73% of FTSE100 subsidiaries located in these 'non-transparent jurisdictions' did not report their turnover; 80% did not report assets and 67% do not report employee numbers[24]. Yet it is precisely this information which would help investors to distinguish between a subsidiary carrying out commercial activity and a one being used for aggressive tax planning.

The risk to investors of companies' tax practices, particularly considering their lack of transparency, has led to a number of initiatives in recent years. The Fair Tax Mark was launched in 2014 and is awarded to companies which are transparent about their tax practices and pay the "right amount of corporation tax at the right time in the right place"[25]. It provides investors with a certification standard to look for and something towards which businesses can aim. In 2015, FTSE4Good introduced a tax transparency indicator[26], with the aim of giving investors further information about companies' tax transparency. The issue is also receiving greater attention from ethical rating agencies, which will mean that over time investors will have more information on which to base their decisions.

Investors also have a role in improving companies' tax practices and the transparency around them. In particular, investors can encourage investee companies to publish a comprehensive tax policy which sets out the company's approach to tax planning beyond compliance with the law, details where the company is headquartered for tax purposes and sets out how the company's tax practices are integrated with the company's corporate responsibility objectives.

Investors can also encourage companies to engage in better public reporting of their tax payments, such as public country-by-country reporting. Although the majority of multinationals currently resist requests for such disclosures, upcoming regulatory changes mean that such resistance may ultimately be futile. The UK has already committed to implementing the OECD's recommendation that companies must disclose country-by-country data to tax authorities[27] and once this is in place, arguments about the cost of collecting the data will be rendered void, while civil society will continue to press for public disclosure.

Corporate tax practices pose a potential risk to companies' value and are therefore something which investors need to be aware of. Owing to a lack of transparency, investors are largely in the dark about these risks, so it is vital that investors push for greater disclosure from investee companies on their tax practices and how they are managing ever-increasing risks associated with these.

22 Christian Aid, "FTSEcrecy: the culture of concealment throughout the FTSE", [ ] 2014

23 U.S. Department of the Treasury, " Fact Sheet: 'Treasury Actions to Rein In Corporate Tax Inversions', 22 September 2014 http://www.treasury.gov/press-center/press-releases/Pages/jl2645.aspx p.13

24 U.S. Department of the Treasury, " Fact Sheet: 'Treasury Actions to Rein In Corporate Tax Inversions', 22 September 2014 http://www.treasury.gov/press-center/press-releases/Pages/jl2645.aspx p.19

25 http://www.fairtaxmark.net/

26 http://www.ftse.com/products/indices/F4G-ESG-Ratings

27 HM Treasury, & David Gauke MP. "Britain leads clamp down on international tax avoidance", 20 September 2014 https://www.gov.uk/government/news/britain-leads-clamp-down-on-international-tax-avoidance

Dilemmas for discussion on responsible tax and the development agenda:

Fiduciary duty – companies avoid tax in order to increase profits and make good returns to investors. Investors are often beholden to their beneficiaries and clients to receive good returns on their investments. However, investors may also have a duty to consider their wider impacts.

Tax planning and reputation – investors need to consider risks beyond the financial risks of tax planning, such as reputational risks. If a company's reputation is damaged, its profits and investment returns will be affected, so this must be taken in to account.

SESSION 3: RESPONSIBLE TAX PRINCIPLES FOR BUSINESS

Tax responsibility is not a set of simple guidelines or principles for a CEO or tax practitioner to deliver, considering its diverse reputational implications and impacts on the realisation of people's human rights. What a responsible business should do is to identify areas that can be perceived by other stakeholders as constituting irresponsible behaviour, such as the use of tax havens or abusive use of transfer pricing, and take positive steps to address such concerns through responsible behaviour. Businesses would argue that this may make them less competitive or place them at a greater risk of accusations of wrongdoing. However by taking positive steps, businesses improve their tax governance and contribute to social and economic development, which has benefits to business in the long-term.

The multinational nature of companies has become increasingly important in recent decades and international tax co-operation has failed to keep up with the pace of change. Intra-firm trade is estimated to represent between 30%[28] and 60%[29] of all world trade. To regulate it, the OECD has established principles since the 1960s[30] based on arm's length prices – those which would have been applied to transactions between unrelated trading partners[31]. However these rules leave much room for interpretation by companies and revenue authorities alike in calculating taxable income. Despite the OECD BEPS project, this uncertainty remains unchanged.

The economist Joseph Stiglitz has argued at the World Bank and IMF annual meetings that companies need to adhere the "most important corporate responsibility of all – paying your fair share of taxes"[32]. This comes in addition to his critique of the current international tax system as part of his work with the Independent Commission on the Reform of International Corporate Taxation (ICRICT).[33] It is clear that the global system governing tax matters is still flawed and that there will be continuing pressure for more transparency and accountability, especially in relation to the impacts of corporate tax planning on developing countries' tax bases. Again this underlines the need to explore further the relationship between tax, development and corporate social responsibility.[34]

Tax has become a heated topic because the rules that govern corporate taxation do not fit the public perception of what constitutes responsible behaviour. As a result, business, tax advisors and tax authorities are suffering a crisis of distrust. Tax practitioners should recognise that tax strategies have

28 Alexander Yeats, "Just How Big Is Global Production Sharing?", in Fragmentation: New Production Pattern in the World Economy, Sven Arndt and Henryk Kierzkowski, eds. (Oxford, Oxford University Press, 2001); Alfonso Irarrazabal, Andreas Moxnes and Luca David Opromolla, "The Margins of Multinational Production and the Role of Intra-Firm Trade", Journal of Political Economy, vol. 121, No.1 (February 2013) and Peter Egger and Tobias Seidel, "Corporate taxes and intra-firm trade", July 2010. Available http://www.etsg.org/ETSG2010/papers/seidel.pdf.

29 http://www.oecdobserver.org/news/archivestory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html

30 http://www.oecd.org/ctp/tax-global/3.%20TP_Legislation_Suggested_Aproach.pdf

31 For an introduction to the evolution of the international tax system and norms, see Avi-Yonah, R. 2007, "International tax as international law: an analysis of the international tax regime", http://www.amazon.com/International-Tax-Law-Analysis-Cambridge/dp/0521618010#reader_0521618010

32 http://edition.cnn.com/2015/10/09/opinions/stiglitz-tax-avoidance-globalization/

33 http://www.icrict.org/

34 https://www.christianaid.org.uk/images/tax-and-sustainability-2011.pdf

an impact on a range of stakeholders – especially those most vulnerable in society, including especially women and marginalised groups. The only way to rebuild this trust is for companies to be transparent about their activities which have major impacts on the common good - and improve the practices and impacts themselves. This will demonstrate both responsiveness and the fact that the company has nothing to hide.

In light of all this, companies could consider using BEPS as a stepping stone towards more corporate responsibility in tax matters. They can also voluntarily go further, with public country-by-country disclosure and disclosure of other documentation to help address tax-related concerns in the public eye. Voluntarily going beyond what the OECD and G20 have agreed could also significantly help developing countries, while demonstrating a strong commitment to rebuilding trust in corporate tax practices.

Responding to concerns is also about understanding those concerns and laying out the answers for the public. In other words, it is not necessarily about how much you pay, but how you arrive at what you pay. Some business behaviour—and tax advice— puts tax revenues at risk and deprives states of resources they need to realise human rights. Therefore, the tax behaviour of business can no longer be treated outside the purview of the corporate responsibility to respect human rights. It is important for businesses to assume the full responsibility when applying advice and guidance from third parties when structuring their business and establishing tax practices.

In conclusion, there is a need for business and authorities to take action and rebuild trust in the corporate tax system. A recent mapping that reviewed 45 sources of recommendations for responsible tax practice by multinational companies (MNEs) found that almost all proposals fall into eight areas of tax responsibility: tax planning practices, public transparency and reporting, governance of the corporate tax function, relationships with revenue authorities, impact assessment, policy and practice in developing countries, tax lobbying and tax incentives.[35] To date, however, the report argues that most proposals have focused only on tax planning and public transparency and reporting. Current responsible tax indicators, such as FTSE4Good or Oxfam's Behind the Brands, only focus on tax transparency and the management of tax strategy, while they could also focus additionally on use of tax incentives. Overall, the mapping finds that very few existing indicators reflect the particular situations of developing countries.

The Confederation of British Industry (CBI) has developed a set of responsible tax principles that touch on a company's public disclosure, relationship with the revenue authority and alignment of tax planning with economic activity. The CBI principles permit all tax incentives and consider tax as a business cost. A principles-based approach is needed in this area.[36] Tax incentives and the process of acquiring them is likely to become a future concern for businesses. Companies such as Unilever[37] and SAB Miller[38], which disclose geographical and globally broken-down tax data to the public, could consider revealing further information on the use of tax incentives and special tax regimes.

35 http://www.actionaid.org.uk/sites/default/files/publications/responsible_tax_practice.pdf

36 http://www.cbi.org.uk/media/2051390/statement_of_principles.pdf

37 https://www.unilever.com/sustainable-living/what-matters-to-you/tax.html

38 http://www.sabmiller.com/docs/default-source/investor-documents/reports/2015/our-approach-to-tax-2015.pdf?sfvrsn=4

Dilemmas for discussion on responsible tax principles for business:

Tax principles and tax rules – are the principles-based approach and corporate responsibility approach needed as a transition to globally accepted rules, or will responsible taxation remain a component of tax systems no matter what the rules are?

Tax transparency and business competition –the public considers that companies should disclose their tax payments as taxes pay for the realisation of human rights. Companies meanwhile argue that disclosure may have competitive disadvantages if they disclose more than their competitors.

Tax and responsibility – tax has emerged as a corporate responsibility topic due to its critical role in financing public expenditure and contributing to good governance, as various actors have come to discover that paying taxes involves a dimension beyond legal compliance.

CONCLUSION

This conference paper has explored three dimensions of the tax and corporate responsibility agenda in relation to developing countries and the financing of sustainable development. The key interactions in this paper have been between the public, investors and businesses, who are the main actors in corporate responsibility. If it is the role of the businesses to demonstrate responsible behaviour, then it falls on the public and investors to hold companies to account on matters that affect their capacity to enjoy basic human rights.

The Tax Dialogue is proposed as a method of dialogue concerning key tax and corporate responsibility themes. Their aim is to create a race to the top in terms of responsible tax practices, supported by public reporting that leads to forms of stakeholder accountability, risk and reputation management as well as positive impacts on the lives of real people.