# Responsible Tax

*A debate hosted jointly by The Chartered Institute of Taxation, HMRC and SustainAbility, at the Commonwealth Club, London on Tuesday 26 June 2007*

## Introduction: What has tax to do with corporate responsibility?

Tax is the latest potential issue to emerge as part of a consideration of the economic impacts that companies have in relation to society generally. The question is whether, and if so in what way, a company's approach to its tax affairs should be viewed as a component of its corporate responsibility. A variety of stakeholder groups are actively reviewing the approach that companies take to their tax policies and planning. This interest is in turn reflected in, and driven by, the media coverage of the issue, which has increased significantly in the last few years, albeit from a low base. With the growing involvement of governments, the media, non-governmental organisations (NGOs) and even religious groups, the issue is being transformed from a narrow technical discussion for specialists into potentially one of more direct relevance to corporate responsibility (CR).

In the UK leading NGOs, government regulators, the media, investors and the tax community itself have all become actively involved, publishing regular reports and opinion pieces. There is every sign that this level of interest will continue. Elsewhere in the world, the level of debate has been more muted. A number of trends suggest, however, that the issue may emerge elsewhere. For example:

Corporate responsibility reporting is led by multinationals and therefore leading companies can be expected to expand their reporting of wider economic impacts including tax

The payment of tax in developing countries is emerging as a key issue within the broader discussion about corporate responsibility and tax. NGOs, in particular, now believe tax is a key component in the development agenda and can be expected to maintain a focus on this issue

Wider efforts aimed at combating corruption, terrorism and organised crime are likely to prompt scrutiny of the role of multinational corporations and their involvement in tax havens, with requests for greater transparency

Increasing use of fiscal instruments to achieve social and environmental objectives, such as carbon taxes, are likely to foster wider discussions of the contribution companies make to national exchequers.

What is becoming increasingly apparent is that a purely technical approach to tax planning is not enough to ensure that a company's treatment of tax is in line with their underlying business values. This distinction between a financial and legalistic approach to tax and an accountability-driven, economic approach is at the heart of the emerging debate. Instead of focusing exclusively on an absolute boundary between illegal and legal approaches to tax, there is an argument that companies should, perhaps, focus on understanding what is considered to be responsible practice on tax, and what is considered to be irresponsible. Considering tax as a CR issue does not mean that more tax must be paid than the law requires. Nor does it mean that tax planning should cease. The laws of most countries offer alternative ways in which real economic transactions can be structured and companies make choices about how to organise their business; these choices often carry different tax consequences.

Making such choices is a legitimate - and indeed necessary - management activity but it also has economic consequences outside the company, and stakeholders are increasingly holding companies accountable for these. The question is how far these choices are compatible with the traditional view that tax is simply a cost of doing business and as such management have a duty to reduce it to a minimum. This is what is bringing the issue into the CR debate.

This Responsible Tax debate was an opportunity for delegates specially invited to provide a representative cross-section of key stakeholders, to explore responsible tax issues, and in so doing:

- consider whether tax should be considered as a Corporate Responsibility issue
- discuss the definition of responsible tax and begin to identify what this may mean in practice; and
- establish the level of interest in taking the responsible tax debate forward.

The discussion was conducted under the Chatham House Rule and facilitated by Julian Hawkins (Deloittes).

## Setting the scene

Douglas Flint, HSBC (Introduction and Chair)
Geoff Lye, SustainAbility
John Whiting, PwC
Dave Hartnett, HMRC
Kenneth Lee, Citigroup

**Douglas Flint** welcomed delegates and, in setting the scene, referred to a Financial Times article from 25 June, which had argued the role of responsible tax in bringing benefit to society. He then offered a personal perspective on the competitive advantage a responsible tax philosophy can create, by supporting a sustainable tax base in countries within which companies operate. This, in turn, can support the development of top talent which organisations can attract and maximise.

**Geoff Lye** of SustainAbility described his 'Triple Bottom Line' model, in which three interrelated dimensions underpin Corporate Responsibility - Economic Prosperity, Environmental Security and Social Justice. He argued that Economic Prosperity, the equitable creation and distribution of wealth, was the least explored of these.

Principles of fair pricing, fair wages and fair trade were well-established and largely understood by all key stakeholders, including the media. However 'fair' contribution to tax was considerably less so (although press coverage of tax and corporate responsibility was steadily rising) and was a potentially fertile area for research, which SustainAbility have now completed.

The research showed that businesses understand the differences between **evasion** and **avoidance**. But from avoidance through to **mitigation** Geoff Lye posed the question, "Is there a line above which business could be regarded as acting **reasonably**, and below which they could be regarded as acting **unreasonably**?". He argued that some would say **mitigation** was that line. However, he saw a shifting ground of liability – from **Legal** (using the court of law) to **Moral** (using the court of public opinion).

SustainAbility sees a distinction between passive and active tax responsibility:

| | Passive | Active |
|---|---|---|
| Accountability | Tax as cost to be minimised | Tax as a key economic impact |
| | Correct to letter of law | True to spirit of law |
| | Take advantage of differences in legal systems | Pay tax where best determined profit was earned |
| Transparency | Based on 'need to know' | Based on stakeholder 'right to know' |
| | Segmental disclosure | Full disclosure by country |
| Consistency | Tax policy incidental to corporate governance | Tax policy integrated into corporate governance |
| | Details of local rates as focus | Global application of tax principles as focus |

**John Whiting** of PwC argued there was a well-established, tri-partite relationship between tax authorities, advisers and taxpayers (corporate and individual). Focusing on company tax, he identified a further number of key stakeholders – from governments and NGOs through to investors and employees.

PwC have developed the '**PwC Total Tax Contribution Framework**' which acknowledges that "there is more to life than corporation tax". It gathers together all tax activity and views it as a whole because:

- The tax environment is changing
- It provides a good measure of what companies contribute in taxes
- It is not an economic model; rather it provides data – and a common language - on actual business taxes paid.

The "**Tax Transparency Framework**" has been developed from discussions with companies and stakeholders and a review of the tax communications of the FTSE 350. It covers three key areas - tax strategy and risk management, tax numbers and performance, and total tax contribution and the wider impact of taxes.

The framework does not advocate a change to financial accounting standards; rather it should be seen as a stimulus to discussion of a subject rising up investor and boardroom agendas, and a means of showing the benefits of increased transparency on (total) tax. John Whiting argued that Total Tax Contribution and the wider impact of taxes would:

- Demonstrate how tax impacts the wider business strategy and results of the company
- Support disclosure of the impact of tax on shareholder value
- Enable clear communication of the economic contribution of all taxes paid by the company.

**Dave Hartnett** of HMRC said that it was generally agreed that HMRC and UK business shared the same ambitions:

- mutual trust
- an appreciation of commercial drivers, but an acknowledgement that tax is rarely the sole driver
- a tax administration that knows what it's doing
- speedy resolution of issues
- change through consultation.

All parties operating in the tax environment - businesses, tax advisers and tax administrators - have to accept change. HMRC acknowledges that its challenge is to move away from a traditional way of looking at businesses, which assumes they are adopting aggressive tax strategies, and to focus more on **risk**.

He believed that in the UK the morality debate in relation to tax had not been useful and that responsible tax behaviour was now a more helpful focus. In particular, multi-nationals needed help on how and what to declare about 'other country' activities. He was finding that business leaders are concerned about their reputation as tax payers and the cost of not being reputable.

He felt that, in business tax matters, at times the black letter of the law was not enough. In addition he identified:

- Disclosure - the act of "laying bare"
- Transparency – active disclosure as ongoing behaviour
- Dialogue – between tax administrations and businesses
- Proportionality – a challenging issue for tax administrators, they needed to learn to be more proportionate in the way they addressed tax issues.

**Kenneth Lee** of Citigroup described why financial analysts care about taxation. His clients are investors and they are interested in taxation for a variety of reasons. They are also concerned about differing kinds of tax risk – cashflow, regime and reputational. Citigroup research had established that a fall in tax of, say 9% was equivalent to increased annual revenues of 8.7% - the tax lever.

Citigroup's strategy for advising investors (at least, as far as tax is concerned) therefore focuses on screening for stocks with very low tax rates and those with high tax rates, and using effective rates rather than cash tax rates.

## Plenary debate

Delegate consensus was that the focus of the discussion should be on corporate responsibility and taxation in a global context, not just on UK business activity and its relationship with HMRC.

After listening to the scene-setting presentations, delegates identified two key questions that most needed debate.

Responses to each question are summarised below. They reflect the variety of views expressed by individual delegates and should not be interpreted as general agreement on all points.

### Question 1: Responsible tax - what exactly is the problem?

Responses fell into four predominate themes:

***1) An acknowledgement that there is an issue***

It is an issue worth debating, and potentially quite a big one, at least in terms of public perception. The fact that people were there to debate responsible tax reflected the importance of the issue. While some felt it was not a big problem in the UK, there was general agreement that there was an issue on the global scale. For example, it would be undesirable for a business to suddenly find a territory had unexpectedly decided to re-organise its tax obligations, to try to curb what it perceived as irresponsible tax behaviours by businesses.

***2) Business positions***

By analogy with climate change, should businesses be ahead of the curve on responsible tax – and address it before others force them to? On the question of fairness, although this may make sense for individuals, it was more difficult with organisations. Globalisation has led to a need for increased transparency as part of business accountability.

Companies do not care particularly about the state of the 'playing field' as long as it is level. If the UK is going to get tougher than elsewhere, then this is an issue for UK businesses; choices then arise about moving liability across national tax regimes. Becoming competitive in certain tax niches is one option for businesses, and this raises questions about whether or not this is responsible tax behaviour.

***3) Private equity***

The private equity issue has put responsible tax on both the public and political agendas. Perception is a big part of the problem eg taxation of individuals in the sector.

Risk (reputational and financial) and reward – the question businesses have to ask themselves is: “How responsible does my business need to be to stay competitive?”.

***4) Suspicion of HMRC motives***

Is this a new way of 'dressing up' tax, and for HMRC to address tax issues; and will businesses end up paying more tax? Is enabling the tax system to keep up with changes in the market a problem for HMRC?

## Question 2: What are the barriers to responsible tax adoption and what is the business case for achieving it?

Businesses will act responsibly in relation to tax if there is a 'win' for both company and local territory. But there is no competitive advantage in being a first mover in the responsible tax arena. However there will probably be a tipping point, beyond which those who do not commit to responsible tax are likely to come under scrutiny from HMRC/local tax authorities.

Tax issues are more difficult for the public to understand; consequently businesses may see less incentive in responsible tax. To counter this, some thought that HMRC should consider introducing rewards/incentives for businesses to introduce responsible tax. There should be a ‘trade’ or ‘deal’ - responsible tax behaviour by businesses in exchange for principle-based drafting of legislation, and the removal of anomalies by the tax administration.

As businesses consider integrating tax matters into governance, it is now more likely that boards (rather than just corporate tax departments) will look at the broader view of tax incentives. If HMRC can be seen to be rewarding openness, this could be an incentive.

The lack of trust between business and HMRC is a barrier, despite consultations. Labels such as “avoidance” and “litigation” are unhelpful and encourage a sterile debate, leading to disclosure for other than responsible tax reasons. Increased transparency means that responsible tax issues will have a bearing on reputation and shareholder value. Therefore there is a business case for responsible tax.

The tensions between a business's responsibility to minimise tax cash costs (although a misconception, as increasing shareholder value is the key legal responsibility), and the responsibility to manage tax affairs around a 'national rate', could create barriers if different approaches are adopted. However, many tax departments still see their primary role to reduce total cash outlay, although this does not necessarily equate to maximising return to the shareholder. Businesses should take a longer-term view.

From a market perspective there would be no competitive advantage in a low-tax policy; and indeed, from a corporate viewpoint there may be competitive advantage in not adopting such a policy.

Regarding tax incentives, questions of trust and also sophistication arise; HMRC needs to 'up its game' at all levels of the organisation, not just at the top.

## Summing-up and ideas on how to take the debate forward

Delegate consensus was that the responsible tax debate is a complex issue which is worth taking further. It is not a one-sided issue which concerns only the behaviour of businesses – the tax administrations, investors and advisory professions have a share of the responsibility.

On the strength of the comments which came out of the discussion of barriers to the adoption of responsible tax practice, and the discussion on how to take the debate forward, the following activities could usefully be pursued:

### *Keep talking*

This dialogue wouldn't have taken place ten years ago and the fact that it is happening now already indicates progress. HMRC is urged to keep the responsible tax debate going through its Business Customer Unit. The debate now needs broadening to involve people who otherwise wouldn't want to engage in this kind of debate, whether in the administration, business or the advisory professions.

### *Bring advantages to the surface*

HMRC could make it clearer what the advantages of responsible tax are for businesses, in terms of its interaction with them. In other words, they could consider introducing some sort of rewards or incentives for businesses who introduce responsible tax behaviours. Possibly this might include adopting principles-based drafting of legislation; the removal of anomalies; and rewarding openness in business dealings with HMRC. However, it was accepted that this also included making the disadvantages clearer. A ‘big stick’ will always be needed for some; perhaps tax authorities hadn’t always drawn enough of a distinction in the past.

### *Build trust*

Businesses and HMRC could build trust between each other more easily by avoiding the use of unhelpful labels and emotive terms such as “avoidance” and “litigation”. Both parties could usefully review their ‘tone of voice’ in interactions with each other. It is hoped that HMRC and businesses will develop a more mature relationship with each other and a lighter-touch interaction through increased levels of trust. HMRC should consider ways to ‘up its game’ at all levels of the Department.

### *Effective Tax Rate vs. Shareholder value*

Businesses and the tax advisory profession could usefully resolve the debate about whether a business has a responsibility to minimise tax cash cost or rather to increase shareholder value. The latter involves taking a longer-term view of the role of responsible tax in the management of overall risk and expectations of investors.

### *Research*

Kenneth Lee's research was acknowledged to be hugely valuable and the fact that there is no evidence of a competitive advantage in lower effective tax rates for businesses was something of a revelation for many present. More investigation could usefully be done (by all stakeholders) into the potential impact of changes in company tax positions on investors, and also into both perceptions and levels of understanding of tax issues.