A guide for companies on responding to the tax debate

CORPORATE CITIZENSHIP
Part of The Good Relations Group

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Tax: Time for action

Tax as a corporate responsibility issue

Tax is now an unavoidable issue for responsible companies. Although the issues are complex, the approach to managing and communicating tax need not be. Effectively addressing the issues requires clarity of thought, consistency in action and a willingness to communicate simply.

Three years ago we published our Tax Map, to steer companies and critics through the debate. Now we have distilled our experience in working with them into this practical guide.

In this publication we examine why tax is an issue. We then set out a step-by-step methodology for understanding the facts, identifying principles, developing a policy and communicating with stakeholders.

We set out the ten questions that companies should be able to answer, if they are to engage effectively in the debate.

By following this guide, any company can take action on tax.

Although the issues are complex, the approach to managing and communicating tax need not be.

1. Definitions

Campaign groups, the media, politicians and companies are mired in language gymnastics on tax. Previously the test was 'is it legal?' Now the crux of the debate is whether an activity falls into one of three broad categories:

1. **Evasion -** the under-declaration of liabilities that is illegal –i.e. a Court would judge it to break the law in a jurisdiction.
2. **Avoidance –** legal tax minimisation, but considered by some to be unethical where the use of 'artificial mechanisms' avoids the intended spirit of the law.
3. **Planning –** the legal and acceptable mitigation of taxes within the normal course of business activity.

In practice, the distinction between avoidance and planning is largely subjective and much of the tax debate is about what's considered fair. Companies who enter the debate must first show there is a reasonable basis for the arrangements they make and the taxes they pay. If they can provide the context, and use clear , simple language to explain, then others can judge what constitutes fairness.

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Why is tax an issue?

Taxes are never popular – even if, as Benjamin Franklin said, they are inevitable.

Governments must raise tax to pay for those activities that society believes should be paid for in common. Agreement on what those activities are varies significantly between societies – the government of Sweden is responsible for the provision of more services than the government of Singapore. However, both governments are obliged to raise taxes to defray their expenses.

Even societies that have reached a broad consensus about the appropriate limits of state provision suffer disputes about what is a fair balance of taxes between business and individuals; between direct and indirect taxes; between the wealthy and the poor.

The concept that crops up again and again in the debate is fairness.

The period of austerity following the global financial crisis has led hard-pressed tax payers (both individuals and corporates) to question whether some companies are being fair in their tax management. Many, but not all, of the issues relate to taxes on corporate income.

A strong strand within the controversy relates to developing economies. Weak governance is seen as leaving these jurisdictions particularly exposed to sharp tax practices by multinational companies. For many, the perceived imbalances between weak states and strong multinational companies are central to the debate.

Scandals in the making

Media coverage of the issue is growing. Indeed one could be forgiven for thinking that every day of the week brings with it a new tax scandal. Here are a few examples from around the world.

- **The use of loans:** This is where a multinational company 'lends' money from a subsidiary in a low- or no-corporation tax regime to a subsidiary in a high-tax regime. The debt repayments are then offset against corporation tax in the high-tax regime, thus reducing the multinational's global tax bill. The Financial Times reported how Cadbury, formerly a "beloved British confectioner"[1] had used this mechanism;
- **'Shell' companies incorporated in low tax jurisdictions:** The classic here is Delaware, described by the New York Times as a tax haven – home to nearly half of all public corporations in the USA but a state so small it is only entitled to one Congressman.[2]
- **Intellectual Property and Royalties:** Multinationals can derive benefits from domiciling intellectual property in low-tax jurisdictions. The Netherlands, seen as the main European nation fostering this practice, has recently acted to clamp down on it.[3]
- **Centralised procurement:** Consolidating procurement functions in low tax jurisdictions is another mechanism that critics target as being used to reduce tax.

Some companies have been lambasted for using a combination of these practices. For instance, Starbucks' evidence about its tax practices drew this response from Margaret Hodge MP, Chair of the UK Public Accounts Committee: "In Switzerland you [made] 20% profits on every coffee bean bought in the UK, on which you pay only 12% [Swiss] tax; you have not been able to explain the 6% royalty [paid to the Netherlands] in any meaningful way; you charge for loans to your own wholly owned subsidiaries at least 2% above the going rate."

In response to such criticism, some companies argue that there are legitimate business reasons for these arrangements. Others say there is nothing wrong with using provisions which governments have put in place, provided they stay on the right side of what is legal.

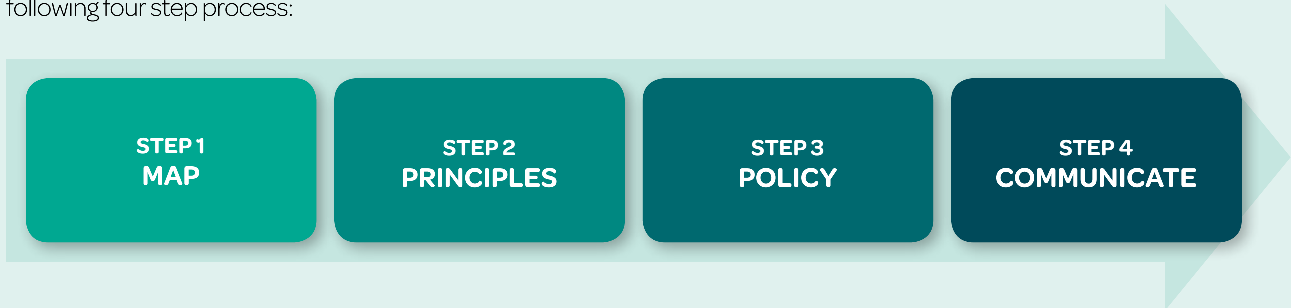
Whatever their point of view, few companies seem able to articulate their policy or justify their practices in terms their stakeholders can understand - the reasonable basis for the arrangements they make and the taxes they pay. By following the steps set out in this paper, companies can join the debate.

Taxes are never popular – even if, as Benjamin Franklin said, they are inevitable.

[1] Financial Times Cadbury: http://www.ft.com/cms/s/0/90b042b4-d4ff-11e2-b4d7-00144feab7de.html
[2] http://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html?_r=0
[3] http://www.tax-news.com/news/Netherlands_Clamps_Down_On_IntraGroup_Tax_Evasion____62294.html

Getting a grip on the issue

Companies must develop a responsible approach to tax and talk about the issue more effectively. We recommend the following four step process:



STEP 1: Map – get the facts straight

The first step is to understand what's currently going on. Too many businesses make the mistake of talking about tax before understanding their current actions (See "Trap One").

Trap One
Why you need to get your facts straight before talking about tax

Some businesses think that tax is simply a communications issue. Trying to communicate on tax before going through a rigorous internal assessment is like marketing a product before you've tested whether it works.

Companies should begin with an internal exercise before embarking on high-profile external communications. In some cases, the data, principles and policies are readily available. In others, they will need to be identified and collated from across the business or developed from scratch.

Corporate Citizenship first developed the Tax Map (see page 6) in 2011 to unpick the spectrum of tax practices and simplify the ideas into six categories. At one extreme is Risking Evasion. At the other end is Principled Obligation. We define this as: "effectively paying more tax than the legally permissible minimum in certain jurisdictions for ethical, principled or political reasons".

We have used this Map with companies around the world to help them to get to grips with their approach to tax. We have found it particularly effective in providing a shared language for an internal conversation between tax colleagues and other business functions, notably communications, corporate responsibility and public affairs.

The categories in our Map are not 'hard and fast'. In reality companies that do not already have a consistent corporate approach find that they have practices that fall into several different categories depending upon time, type of tax, jurisdiction or business division.

In order to use the Tax Map effectively, many businesses need to undertake an exercise to gather the data on what's going on. Companies should ascertain how much tax the business is paying to and collecting on behalf of governments, local and national. It is important that this is not just corporation tax; other taxes need to be considered too (see "Trap Two"). They should record where the company is taking advantage of tax incentive schemes and provisions, such as capital allowances or free trade zones.

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Mapping tells a company where it is on tax. The more important question is where does it want to be? And why?

Mapping by jurisdiction is vital. This needs to be set against a measure of business activity. If 80% of your business is in the United States but you only pay 20% of your taxes there, then American stakeholders may raise questions that the business will need to have answers to. Multinationals by definition work in many different jurisdictions. In some cases, decision making is devolved to a local level; in others it is highly centralised. However, even companies where the Group level thinks it has a thorough understanding of tax practices around the world are likely to need to map out this decision making to confirm that this is the case. Serious inconsistencies of practice in an organisation undermine confidence in the organisation's integrity – and, if exposed, can be hugely damaging to reputation.

The information derived from this exercise can enable a company to plot its position, or variety of positions, on the Tax Map (see page 6).

Mapping tells a company where it is on tax. The more important question is where does it want to be? And why?

Trap Two
Why it's not just about corporation tax, it's about total impact

Many companies make the mistake of limiting the debate to corporation tax. In fact, at heart, it ought to be about the role of companies in society, particularly what contribution they make to economic and social development. Companies need to understand, measure and communicate on tax in the context of their wider impacts.

Campaigners, the media and politicians mainly seem to want to talk about corporation tax. And yes, much of the criticism that companies face is over the decisions that they make regarding corporation tax. Therefore, stakeholders are most interested in contributions to public finances that the firm itself controls.

However, companies make a bigger contribution to public funds, not just taxes borne (that the company pays at its own cost) but also taxes collected (which someone such as an employee or customer pays, but the firm collects). For some sectors (such as alcohol and tobacco), other duties and levies can be much bigger than corporation tax. For extractives, governments sometimes gain an equity stake in a concession or royalties on sales, the payments from which are another form of contribution to the public purse.

That is why tax is just one part of the company's overall impact on the economy. Businesses employ people and pay wages across their value chains, invest in skills and new technologies, and produce products and services that have a value. Businesses can also assist authorities with capacity building through providing training and expertise.

Too many companies talk about tax as an abstract obligation that is separate from their wider impacts. By setting the discussion in the context of economic contribution overall, companies can have a more meaningful conversation on their roles and responsibilities.

The Corporate Citizenship Tax Map

Type	Definition	Example
1. Risking Evasion	A policy that a Court might consider illegal, fraudulent and deceptive, such as declaring less income or hiding profits.	Deliberately complicating transactions in an attempt to hide financials from authorities – with potentially catastrophic effects on the shareholders, as Enron discovered.
2. Trading for Tax	Business activity that is initiated primarily for the purpose of creating a tax advantage.	Creating temporary, cross-border trades with offshore entities, designed to profit from tax differences.
3. Surprising Structures	Widespread use of structures and ad hoc decisions to minimise tax, often resulting in activity that bears little relation to the underlying economic reality. The normal course of business is distorted and the results would appear surprising if described to someone external who is not a tax expert, such as a customer.	Realising profits in a new, offshore subsidiary when little economic activity actually takes place there. Moving company headquarters to a new jurisdiction in which there is no business history and no real commercial activity.
4. Balanced Compliance	Tax is minimised within the normal course of business activity and considered as one component of any business decision. Decisions always have a genuine commercial purpose separate from tax – new transactions or subsidiaries are never created solely for tax purposes.	Choosing to realise profits from a one-off transaction in the lowest tax jurisdiction when faced with a choice between several jurisdictions – where economic activity takes place in all of them. Locating centralised procurement in the lower of several tax jurisdictions with which the company has established operations.
5. Active Engagement	Systematic and consistent declaration of tax to match underlying commercial activities. Tax is paid where profits are made – aiming to follow the spirit as well as the letter of the law. Tax is still minimised within this framework, but not at the expense of one country over another.	Deciding the approach to tax obligations with regard to the proportion of sales that the business makes in different jurisdictions worldwide.
6. Principled Obligation	Effectively paying more tax than the legally permissible minimum in certain jurisdictions for ethical, principled or political reasons.	Deciding not to save tax by relocating company headquarters overseas due to "economic patriotism". Actively seeking to contribute to economic development by locating production or service centres, even if taxes paid are higher than elsewhere.

The practicalities

We have used our Tax Map with companies' own tax teams to enable them to categorise the varieties of approaches that they adopt to different transactions, to understand the basis of those arrangements, and to test the consistency of action across the company. When we've reviewed how current practices are likely to be viewed from the outside, too often the company is not able to demonstrate a reasonable basis for the decisions they've made. The next step is to develop a clearer approach.

STEP 2: Principles – declare where you want to be

Businesses cannot develop a policy or communicate on tax without first setting out what principles guide their decision-making. The company's tax principles are the absolute and non-negotiable basis on which policy and practice are then built.

Based on our work with a number of companies, and a review of published guidelines, we have identified three aspects of responsible tax that we believe every forward-thinking company needs to be mindful of in developing its own approach.

Three Aspects of Responsible Tax

1. **Legal basis** – companies should act at all times in accordance with all applicable laws, and be guided by relevant, agreed international standards.[4] Companies need to be aware of not just today's laws, but the direction of travel and intentions of regulators in order to plan effectively for possible future laws.
2. **Value creation** – companies should aim to pay the right amount of tax according to where value is created within the normal course of commercial activity. Contrived or abnormal tax structures which have the sole intention of minimising tax should not be used; concern over secrecy jurisdictions (also called 'tax havens') should also be recognised – e.g. by committing to avoiding using such jurisdictions for aggressive tax avoidance.
3. **Transparency** - companies should recognise that stakeholders beyond national tax authorities have a legitimate interest in tax affairs. Openness about an approach to tax is fundamental – companies should: publish a **statement of principles on tax**, agreed by the board, that explains its position; put in place **robust policies and systems** for managing tax and ensuring adherence to the company's statement of principles on tax, including relevant training and channels for employees to raise concerns confidentially; and seek to build **strong, trusted relationships** with tax authorities, in a spirit of mutual respect, and be open with other stakeholders about these relationships.

Company tax principles must be owned by the Board. The Tax Principles must reflect the character and values of the company. They must provide a firm basis on which to construct practical policy to guide management (see Step 3: Policy). They must be broad and flexible enough to deal with the changes in citizens' and governments' views of what is reasonable that will doubtless occur.

In framing its tax principles the company needs to consider whether it has a position that it wishes to make clear on what an appropriate tax regime is. Some businesses have strong opinions on this issue, others have no publicly-stated opinion.

The perception that a company's tax principles and practices are not transparent is toxic. Boards are wise to set out a position on country-by-country reporting of taxes. Many companies have resisted this level of granularity. They claim that it imposes an undue administrative burden upon them or would make relations with governments difficult. Given that more and more companies are adopting this approach and that companies are normally obliged to make country-by-country returns to tax authorities, the reality is that more companies will embrace this transparency in the years ahead – voluntarily, or by regulation. Furthermore while a citizen of Swaziland or Switzerland may be interested in a company's global tax bill, it may be more relevant to know how much a company contributes towards their own government's expenditure. Our view is that country-by-country reporting is becoming the norm. Companies swimming against this tide will face an increasingly challenging time.

The practicalities

From our discussions with a cross-section of multinational companies, campaigning NGOs and government officials in recent years, we believe that addressing the following questions overleaf will assist companies in drafting Tax Principles that address the three elements of responsible tax: the legal basis, value creation and transparency.

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[4] In particular, the OECD Guidelines for Multi-National Enterprises and the ICC Commission on Taxation are relevant. However consideration needs to be given too to the work of the BIAC Committee on Taxation and Fiscal Affairs, the proposals set out in the OECD's Action Plan on Base Erosion and Profit Shifting and to comments and papers issued by NGOs who have addressed the issues

2. Questions for Drafting Tax Principles

Law

1. Working within the law is a given. But do you view the law as an unwelcome impediment or a helpful guide? How far does your stance take into account relevant international standards and developing best practice?

Value creation

2. Do you aim to pay your taxes where value is created? What criteria do you use to judge this?
3. Companies that use contrived or abnormal structures to minimise their tax bear the risk of severe criticism. What structures do you consider to be contrived or abnormal? What criteria do you use to come to that judgement?
4. Secrecy jurisdictions (aka 'tax havens') are associated with aggressive tax avoidance (though companies may have perfectly legitimate reasons for having subsidiaries registered there). Which jurisdictions do you recognise as secrecy jurisdictions? Do you offer a public explanation for your presence in these jurisdictions? Whilst there may be historic reasons, what are your future plans?

Transparency

5. Corporate tax is a public not a private issue. Does your policy exceed legal requirements? What is it that you have committed to be transparent about, and to whom? Have you set out a reasoned position on country-by-country reporting?
6. Healthy tax principles foster strong, respectful relationships with tax authorities. What guidance do you give about how to foster and perpetuate appropriate relations with the tax authorities?
7. Developing economies in particular can benefit from increasing the capacity of the tax authorities. Do you set out a commitment to assist tax authority effectiveness? Does this make provision for joint working with civil society partners? How do you avoid conflicts of interest?

STEP 3: Policy – organise to deliver your principles

The third step for the business is to put in place the right policies and processes to manage tax. High-level principles are a necessary, but not a sufficient, condition for tackling the tax issue.

Without detailed policy guidance, efficient systems of application and effective monitoring of results, no set of tax principles will deliver the right results. The degree of prescription and detail within central policy guidance varies considerably between companies. Regardless of the level of detail, the tax policy must make it clear to practitioners what is ruled in, what is ruled out and where to look to for guidance.

For instance, do your tax principles allow for new trades to be initiated for the sole purpose of tax minimisation? If not, do your policies make this clear to tax practitioners? If they do, does the policy give sufficient guidance to the practitioners as to the extent to which that is the case?

Strong governance around tax is crucial. Board involvement is vital. Internal consistency with your Tax Principles is an absolute necessity. Adequate systems are needed to monitor compliance and reporting frameworks must be put in place. It is also sensible to build in the ability to review and refresh the policy as new information or issues come to light. As a minimum a board is wise to review the effectiveness of the policies at least annually.[5]

The practicalities

Moving from policy to practice can be challenging for companies. We know from our work on identifying best practice, writing policies and facilitating internal conversations that a frequent concern is how to move from ideas to implementation.

We have found that companies are wise to consider the questions overleaf as they shape their policies and systems:

[5] For more on governance, see Tax Responsibility: An Investor Guide, ActionAid, 2013

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3. Moving From Policy to Practice

8. Having good principles crafted in Head Office cannot alone guarantee delivery on the ground. Does your policy have Board approval? Does it explain the detail of how high principle is turned into effective action?
9. Every policy needs a detailed implementation system. What pre-specified processes, KPIs, stewardship and whistleblowing systems are in place to ensure effective implementation? How often and how are these systems reviewed?
10. Do you commit to report fully and in a straight-forward manner, at least annually, about how you measure up against your Principles? What additional information will you seek to put into the public domain to give stakeholders confidence that you are serious about the policy?

STEP 4: Communicate – entering the debate about fairness

A company that does not define its narrative on tax allows others to write the story for it.

The business needs to be able to defend its approach to tax as reasonable and fair and show that implementation is consistent.

The company's story must be capable of convincing the key audiences: other taxpayers (corporate and individual) that the company is not shirking a fair tax burden; governments that it is not using contrived structures to get out of local taxes; and development campaigners that it is not unduly disfavouring developing countries.

Above all, no matter how complicated the issue, the language used must be simple

The story may have to be used in defence of the company's actions but it cannot be solely defensive.

Tax has proved to be an issue where the company cannot successfully enter debate coming off the back foot.

The practicalities

Before releasing a policy or statement to the outside world, many companies chose to test it with trusted advisors as well as critical campaign groups. By understanding the potential limits to a policy, companies can refine it and prepare answers to common questions.

Above all, no matter how complicated the issue, the language used must be simple (see "Trap Three").

The crucial litmus test for every communication on tax should be to ask the question: "does this enable one of our key stakeholders such as a customer to understand that we have adopted a reasonable basis for our approach to tax?" If so, they will be able to form a view about whether that is fair.

Techniques we have used to help answer this question include benchmarking best practice on policy statements, holding roundtable discussions on tax, and monitoring the evolving debate around the world.

Trap Three
Why talking in business jargon is fanning the flames

The issue of tax presents a huge communications challenge for two reasons.

Firstly, tax is highly complex. Reams of paperwork and armies of accountants are the mainstay of the modern multinational. The temptation is to hide behind a veil of complexity and assume that because tax is poorly understood, opaque communication will cause criticism to go away. The opposite is the case. Companies that fail to communicate on tax in a way that ordinary people can understand will not only fail to get their point across, they will be seen as having something to hide.

Secondly, ordinary people and consumers are actually interested in tax – albeit limited to select brands. Online Google searches for "Starbucks tax avoidance" increased more than 5000% in the 12 months to August 2013. Google searches for "Google tax avoidance" were up 170%. Although most people do not read long reports or download tax policies, companies still need to communicate with people on tax. This is because communication is normally through the media. If the company cannot explain in everyday terms its approach, how can it expect the media to do so?

Any attempt to communicate on the issues needs to use simple language that normal people use and understand. For example, the ideas of "deferred liabilities" and "OECD guidelines on transfer pricing" are not everyday expressions, whereas "postponing a payment until next year" and "international rules on what one company can charge another" are more understandable.

Some companies lament the fact that the media "don't understand" their approach to tax. But some of the most aggressive investigative journalism on tax has been undertaken by specialists at Bloomberg and the Financial Times. It is not the media ignorance that is driving the debate on tax, it is company actions – and failure to communicate effectively, that is fanning the flames.

Time for action

Only a few years ago tax was a closed-box issue, not seen as part of the corporate responsibility agenda. It was a matter solely for governments and tax experts.

This is no longer the case.

Across the globe, the question of companies and the taxes that they pay is a live and central issue of public debate.

Prudent companies address the issue. As this paper has set out to demonstrate, while the tax issue is complex, the approach needed to manage it is simple.

For companies facing or likely to face questions on tax, now is the time for action.

4. Ten questions about tax principles, policies and processes that all companies should answer

Law

1. Working within the law is a given. But do you view the law as an unwelcome impediment or a helpful guide? How far does your stance take into account relevant international standards and developing best practice?

Value creation

2. Do you aim to pay your taxes where value is created? What criteria do you use to judge this?
3. Companies that use contrived or abnormal structures to minimise tax risk critcism. What structures do you consider to be contrived or abnormal? What criteria do you use to come to that judgement?
4. Secrecy jurisdictions (aka 'tax havens') are associated with aggressive tax avoidance (though companies may have perfectly legitimate reasons for having subsidiaries registered there). Which jurisdictions do you recognise as secrecy jurisdictions? Do you offer a public explanation for your presence in these jurisdictions?

Transparency

5. Corporate tax is a public, not a private, issue. Does your policy exceed legal requirements? What is it that you have committed to be transparent about, and to whom? Have you set out a reasoned position on country-by-country reporting?

Relationships and capacity

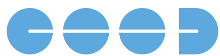
6. Healthy tax principles foster strong, respectful relationships with tax authorities. What guidance do you give about how to foster and perpetuate appropriate relations with the tax authorities?
7. Developing economies in particular can benefit from increasing the capacity of the tax authorities. Do you set out a commitment to assist tax authority effectiveness? Does this make provision for joint working with civil society partners?

Policy and systems

8. Having good principles crafted in Head Office cannot alone guarantee delivery on the ground. Does your policy have Board approval? Does it explain the detail of how high principle is turned into effective action?
9. Every policy needs a detailed implementation system. What pre-specified processes, KPIs, stewardship and whistleblowing systems are in place to ensure effective implementation? How often and how are these systems reviewed?
10. Do you commit to report fully and simply, at least annually, about how you measure up against your Principles?

About Corporate Citizenship

Corporate Citizenship is a global corporate responsibility consultancy that uses clear insight and a simplified approach to sustainability to deliver growth and long-term value for business and society. We work globally across industry sectors. Our work takes us to Europe, USA, Asia, Africa and Latin America. We help our clients make the smart choices that will enable them to survive and thrive in an increasingly challenging business environment. Corporate Citizenship promotes the idea that companies can be a force for good. We advise global client list on a number of areas: strategy, reporting, supply chain, socio-economic impacts, inclusive business models and assurance. Our long standing clients include Unilever, Abbott and Vodafone.



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