CSR and the role of the state - the case of tax competition

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Structure

Corporate Social Responsibility:

- Standard conceptions and their weaknesses
- Formulation of a *minimalist* conception of CSR

Tax competition as a test case:

- A brief overview of conceptual and normative issues
- Some figures
- Applying a minimalist conception of CSR to taxation
- Some normative lessons and policy recommendations

Possible conceptions of CSR

1) Corporate responsibility beyond the letter of the law
- various argumentative strategies are employed to defend this position
- many of them emphasize the (at least in part) ethical motivations of the corporate decision makers

2) Stakeholder theory
- corporate decisions should be made by taking into consideration the perspective of more than just one of the groups that have an interest in the firm
- the costs of corporate governance increase substantially

3) A market-failure approach
- companies should internalise all the externalities that their economic activity generates
- theoretically neat, but difficult to implement

A puzzle for CSR

- The analogy with ‘playing fair’ in sports
- The limits of this analogy & the power of lobbying

⇒ Question that arises independently of the approach to CSR:

Can companies be motivated to promote a socially responsible and effective set of rules to govern their industry?

A minimalist conception of CSR

A possible formulation:

Companies have a social obligation to respect the rules of the game laid down by the regulatory framework

In particular:

1) Companies have an obligation to pay their taxes

2) Companies have an obligation not to undermine the respect of fiscal obligations

Question:

What can we learn from this case study as to the potential of corporate social responsibility on a broader scale?

Tax competition 101

1) Taxation of individual savings
- abolition of withholding taxes by the United States in 1984
- tax havens and tax evasion; 'round-tripping'
- the weakness of incomplete exchange of information

2) Taxation of multinational companies
- production as well as residence tax havens allow companies to minimise their tax bills
- some of the most current practices: transfer pricing, thin capitalisation
- Is there a "race to the bottom" of corporate taxes?

The impact on distribution

1) Exacerbates income inequalities
- more regressive fiscal systems (race to the bottom concentrated on capital; tax shift towards immobile factors)
- bank secrecy and the absence of information exchange favour tax avoidance / evasion by the rich
- tax competition boosts profits which benefits stockholders who tend to be richer

2) A significant pressure on public spending
- in developing countries in particular
- can compromise the ability of governments to provide an adequate amount of public goods as well as social insurances

3) Relocation of jobs
- prime example: Ireland

Some figures

- estimate of yearly annual tax evasion at the individual level: $255bn (Tax Justice Network)
- "Developing countries are estimated to lose to tax havens almost three times what they get from developed countries in aid." (Angel Gurria, Secretary-General of the OECD in November 2008)
- "The updated estimate of the overall gross tax gap for Tax Year 2001 - the difference between what taxpayers should have paid and what they actually paid on a timely basis - comes to $345 billion. … IRS enforcement activities, coupled with other late payments, recover about $55 billion of the tax gap, leaving a net tax gap of $290 billion for Tax Year 2001." (http://www.irs.gov/newsroom/article/0,,id=154496,00.html)
- What FTSE 100 companies paid in tax between 2004 and 2007: http://www.guardian.co.uk/business/interactive/2009/feb/02/tax-database
- 60% of world trade happens within multinational companies these days

CSR and "private wealth management"

The "easy" case:

In contrast to many forms of corporate tax planning, private "tax planning" is in most cases illegal.

⇒ Based on secrecy provisions, trusts, etc.

⇒ white-collar crime

⇒ criminal charges should not be excluded

CSR and "corporate tax planning"

Under the current web of bilateral tax treaties: companies "shop" for the lowest tax burden

⇒ Compatible with the letter of the law, but not with its spirit

⇒ Companies caught between respecting the spirit of the law *versus* giving in to the imperatives of competition

⇒ respect of minimalist CSR possible but unlikely

CSR and the "tax planners"

Who are the tax planners?

⇒ The big four accountancy firms; law firms, banks

How do they promote tax avoidance?

⇒ by selling tax advice

⇒ by creating the legal foundation for the laws, trusts, offshore special purpose vehicles and so forth that make tax avoidance possible

⇒ by promoting bank secrecy

Two lessons:

1) lip-service to corporate social responsibility by these companies is hypocritical
2) for companies engaged in these activities, respecting even a minimalist CSR seems inconceivable

Some solutions

1) Country by country reporting
- multinationals have to provide information on economic activity, financial performance, sales, labour costs, etc. for each country
- potential: reveal illegal tax avoidance (though transfer mispricing, etc.)
- advantages: information available internally for most companies already; no international tax treaties necessary

2) 'Formulary Apportionment' in corporate taxation:
- attribution of the right to tax corporate profits on the basis of a formula including one or more of the following factors - sales, payroll, property in the country in question
- advantage: some versions circumvent collective action problem
- potential drawback: distributive impact = ?

Firm *versus* state: questions of governance

Two points:

1) The argument of corporate efficiency *versus* state wastefulness is no longer convincing (if it ever was)
2) None of the reform proposals mentioned would eliminate all tax competition

⇒ Both corporate and political governance need an effective system of checks and balances to prevent excesses

Conclusions

A sceptic view on CSR:

1) In a competitive environment where some degree of tax avoidance is the norm, taking the moral high road of tax compliance may simply not be an available option of many multinationals
2) Even if it is, it seems naïve to expect them to choose it
3) As for companies who sell tax planning services, respecting the minimalist CSR outlined here seems inconceivable

⇒ A reminder of the necessity of regulation and the role of the state