

Discuss the Ethics of Corporate Tax Avoidance from the Perspective of the Corporation

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Abstract: This paper focus on the corporate tax avoidance to demonstrate the importance of corporate ethics. The thesis discusses whether this act is legal and moral from a legal and moral perspective respectively, describes the tax breaks given by Zambia and the complex tax avoidance measures taken by multinational companies such as Starbucks and Apple, and analyzes the positive and negative effects of corporate tax avoidance. In the end, the paper comes to the conclusion that corporations should take the initiative to pay their fair share of taxes to fulfill their social responsibilities, which is not only good for enterprises to establish a good public image, but also conducive to the long-term development of the company. Besides, the governments of African countries should reduce tax breaks to change the rules that govern the whole system, so as to help millions of people across the continent.

Keywords: Tax Avoidance; Transfer Pricing; Zambia Sugar; Starbucks; Apple; Corporate Social Responsibility

1. Introduction and Background Information of Tax Avoidance

“Tax avoidance may simply be defined as the reduction or minimization of a person’s tax liability by carefully arranging one’s affairs in such a way as to take advantage of loopholes in the tax law provisions. It is the intentional act of a tax payer to pay less than what he ought to pay to the tax authority. It is legal” (Obafemi, 2014, p.22). In today’s business world, tax avoidance is pervasive across all countries and has been a concern of global significance. By using tax avoidance, enterprises exploit loopholes in legal provisions to maximize the firm profit, so that they can pay less tax than the amount that they should have paid.

2. The Legality and Morality of Tax Avoidance from the Company’s Perspective

From a legal perspective, there is no doubt that tax avoidance is a legal action complying with relevant provisions of law. However, from a moral perspective, tax avoidance leads to a reduction in the tax revenue of government. If the enterprises avoid a large amount of tax bills, which is likely to be used to promote social development by government, they may be regarded as irresponsible for society and general public, and this behaviour is considered to be immoral. But we can look at this issue in another way, “Maximizing the firm value is a key goal for each company because firm value reflects the level of prosperity of shareholders” (Firmansyah and Muliana, 2018, p.644). If the managers of company do not try their best to increase wealth for their shareholders, they will be accused of violating the shareholder-wealth-maximization principle and having no sense of responsibilities for shareholders. As a result, it is very difficult for the top managers to make a decision which everyone is satisfied with. There is a trade-off between the benefits of shareholders and the social responsibilities of company.

3. The Corporation’s Employ of Tax Avoidance

Take the example of the Zambia subsidiary of Associated British Foods, which paid less than zero point five percent in corporate tax from 2007 to 2009. According to a report from the Netherlands, this company generated profits of \$123 million during this period. The reasons for this are as follows: To begin with, many countries on the African continent are very poor, and many people in these countries are unemployed and difficult to support their families. Moreover, in southern Africa, large areas of land have been severely affected by floods every year, resulting in the loss of a large number of crops. In order to create employment opportunities, a poor country like Zambia would attract investors by reducing local tax rates. In addition, part of this company’s revenue was transferred to Ireland, Mauritius and Netherlands, which have been considered as tax heavens. “Tax havens

are defined as tax jurisdictions with abnormally low corporate income tax rates or having no corporate income tax at all, which are used by corporations and individuals to minimize their worldwide income taxes” (Epstein, Holtzblatt and Jermakowicz, 2015, p.35). For this reason, lots of companies set up their headquarters in tax heavens to enjoy preferential tax policies. For example, every time Starbucks sells a cup of coffee in England, this transaction is recorded in the sales of branch company which is located in Ireland. By shifting their profits to low-tax country, Starbucks reduces its tax bills because the tax rates in England is about eighteen percent while the tax rates in Ireland is only twelve percent. And in this way of tax avoidance is transfer pricing that “is used for goods and services transferred between units and profit centers within the same company, as well as for goods and services transferred between related companies located in different countries” (Li, 2005).

And this method is also used by Apple. Apple Sales International (hereafter this text will be abbreviated as ASI), an Apple subsidiary based in low-tax Ireland, which is responsible for receiving all sales revenue of Apple outside the United States and enjoy the Irish corporate income tax rate of 12.5%. However, the 12.5% tax rate is still a bit high for Apple compared to the tax breaks offered by some other tax havens, and Apple’s ultimate goal is to transfer most of its international business income to another tax haven and enjoy a lower tax rate. Ireland’s special tax law is a charter for Apple company. According to Irish tax law, even if a company registered in Ireland, as long as its headquarters or parent company is located in another country, it is regarded as a foreign corporation, which means it does not have to pay tax to the Irish government. Apple Operations International is such a foreign company (hereafter this text will be abbreviated as AOI) set up by Apple in Ireland, with its headquarters in the famous tax haven, the Caribbean Islands. In this case, what Apple needs to consider is how to transfer the revenue from ASI to AOI at the lowest cost. For this purpose, Apple set up a third subsidiary in the Netherlands - Apple Operations Europe (hereafter this text will be abbreviated as AOE). In Ireland, any direct transaction between ASI and AOI is taxed by the government. Nevertheless, if the transaction takes place in the Netherlands, Apple could further reduces the tax it has to pay. According to the Dutch tax law, the nationality of a company depends on the place where the company is registered rather than where it is headquartered. As a result, AOI, headquartered in the Caribbean Islands, is considered an EU company because it is incorporated in Ireland. Ireland and the Netherlands both stipulate that transactions between companies from EU member states could be exempted from income tax, so three subsidiaries of Apple in Ireland and the Netherlands are recognized as EU companies in the Netherlands and do not have to pay income tax. Then Apple chooses intellectual property to act as a medium for transferring funds. Apple in the United States first authorizes its intellectual property assets (services provided by the software, etc) to AOI, then AOI leases it to AOE in the Netherlands, and finally AOE authorizes it to ASI for sale. Therefore, when users outside the USA buy Apple’s application services in the iTunes market, the cash paid by the user first goes into the ASI account, then paid by ASI as the income of intellectual property patent royalties to AOE in the Netherlands, and then transferred to AOI through AOE. And eventually AOI transfers the money as internal funds to its headquarters in the Caribbean islands, so as to avoid regulatory hurdles. Throughout the transfer process, Apple only has to pay an extremely low transaction tax to the Netherlands and a low income tax to Ireland. It is reported that the net income of AOI is thirty billion dollars between 2009 and 2012, but this offshore subsidiary refused to declare its place of residence, did not submit the enterprise income tax return, and did not pay the enterprise income tax to any government within five years. “It is as though a bunch of alien techies arrived from Mars, sold us \$30bn (£19.6bn) worth of smartphones and laptops, and then took all the moolah up to the stratosphere, where they simply circled the earth” (BBC, 2013). Yet it is not unusual for this to happen. Amazon earns 130 billion dollars a year without paying a cent in taxes. Google finds legal loopholes in national and international laws and uses sophisticated accounting methods to avoid tax of at least 3.2 billion pounds from 2006 to 2011. It is eye-popping! In a word, multinationals pay a much lower proportion of public sector costs in all developed economies around the world.

4. The Positive and Negative Effects of Corporate Tax Avoidance

There are both advantages and disadvantages in using tax avoidance. On the one hand, a variety of methods used for tax avoidance expose the imperfections of the current tax laws. According to these methods, the tax authorities are able to find the defects of law, so as to take corrective measures to improve tax system. On the other hand, the revenue generated from taxation is tend to be used to promote the economic development and social equity and justice. Nevertheless, the increasing rate of tax avoidance made it more difficult for government to collect taxes. The Zambia Sugar Company I mentioned above caused the loss of twenty seven million dollars in Zambian public services due to its tax avoidance, and the amount of loss is enough to help forty eight thousand children to have educational opportunities. What is more, it was reported that the loss of tax revenue in tax heavens was fourteen times the amount the United Kingdom gave Zambia to fight against hunger and food insecurity. Besides, a Reuters report in 2012 showed that “Starbucks had paid no corporation, or income, tax in Britain in the past three years and had paid only 8.6 million pounds since 1998. Over this period it sold 3.1 billion pounds worth of coffee, prompting criticism from politicians and

media commentators” (Bergin, 2012). Such a large quantity of tax revenue avoided is extremely bad for the economy and the enterprise has no sense of social responsibility in my opinion. Last but not least, tax avoidance may increase the difficulty of making financial statements, and finally affects the future cash flows.

5. Conclusion and Recommendation

To sum up, tax avoidance not only brings the enterprises huge profits, but also help the tax authorities to improve the tax system. But at the same time, it has many adverse effects, for example, it is not conducive to economic development, the performance of social responsibility and the increase of transparency of financial report. As far as I am concerned, if the enterprises only pay attention to their own benefits, they will not have long-term development because they can not get support from the general public. On the contrary, if the company not only focus on its own interests, but also takes into account the interests of the society at the same time, it will has a good public reputation, which is very beneficial to the future development of the company. Further more, I believe that corporations have real responsibilities to play for countries like Zambia, and multinational companies like Apple should stop conducting these artificial transactions abroad and pay its fair share of taxes where its profits are made. And the best way to ensure these multinationals pay full taxes is that African politicians are willing to take action. Zambia should stop giving too many tax breaks that do not fundamentally solve the problem. Because in the long run, it is necessary to significantly increase government tax revenue and use it to help millions of people across the continent.

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