Corporate Social Responsibility and Strategic Tax Behavior – Comment on the paper by Reuven S. Avi-Yonah

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Professor Avi-Yonah addresses two questions:

“First, from the perspective of the corporation, should the corporation cooperate and pay the corporate tax, or should it engage in ‘strategic’ tax behavior designed to minimize or eliminate its corporate tax burden?

Second, from the perspective of the state, should the state use the corporate tax just to raise revenue, or should it also try to use it as a regulatory tool to steer corporate behavior in directions that it deems beneficial to society?”

This comment is only directed towards the first question – which really is an important and highly topical question in global commercial environment. 1

This became an issue for states and their treasuries as soon as it became possible for companies to exploit as well regulatory and tax competition between nation states as different regulatory structures of tax legislations and it has become even more relevant as it has become evident that the “world is flat” 2 and it is possible to place either operations or at least organizations in whichever part of the world you like. However, it might be useful to test if we have any common understanding about the “strategic” tax behavior or if we are able to make a distinction between acceptable and unacceptable tax strategies. This is however outside the scope of this comment so I won’t even try. 3

I am not quite sure, whether we should agree with professor Avi-Yonah when he states that “if engaging in CSR is a legitimate corporate function, then corporations can also be expected to pay taxes to bolster society as part of their assumption of CSR.” It is by no means self-evident that paying taxes is an elementary part of the CSR and even less self-evident that companies should voluntarily pay anything they are not obliged to pay. Therefore, I do find – despite this skepticism – it justified to

1 Due to this there is no need to raise questions connected to the second question, e.g. concerning distributive taxation or a need to find some welfarist approach or other possible justifications for the use of taxes. A comprehensive overview of the welfarist approach is KAPLOW/SHAVELL, Fairness versus Welfare (2002).

2 The concept is from FRIEDMAN, The World Is Flat (2005).

3 As an example it may be noted that some Finnish companies have subsidiaries in the Netherlands with their only task to own real estates or other commercial premises in Finland. These premises are leased to the parent company or to some other subsidiary within the group. The economic rationale behind this is that Dutch taxation has had much more favorable treatment for profits from real estate sales. This is not considered an aggressive tax planning but a routine arrangement to save company and its shareholders from taxes.
say “that the answer depends on our view of CSR” but I still have some doubts if this view really “depends on our view of the corporation”.

I hope I am not too cynical when I ask if corporate social responsibility really is justification for companies to be “happy taxpayers” (which is quite a rare phenomenon in commercial community). Besides that I must say that as much I appreciate professor Avi-Yonah’s analysis of the three competing (or sometimes completing) views of the corporation they do not get much attention on the management floor or in the boardroom where the relevant decisions are made. Sometimes it is even questionable if the CSR gets enough attention there but my understanding is that companies do not really see taxation as a CSR issue. Instead, taxes are recognized merely as a standard cost related to profits, the specialty of which is that it is sometimes avoidable or at least possible to reduce by tax planning.4

This being so, the question for management and for board members is, why should we give shareholders money to the state if we have a legal way to operate without doing so and if we can minimize the tax burden without taking too much risk. From the boardroom point of view this is far from being a simple “transfer value from the state to our shareholders’”-scheme as the board faces a question of acceptable ways to make profit and risks related to them. There are several types of risks (litigation, reputation, financial and criminal sanctions, etc.) connected to aggressive tax planning and every board has to balance the pros and cons when adopting strategic tax decisions. A workable starting point for this discussion is: if you are not ready to disclose it and make it absolutely transparent you usually shouldn’t use it. If tax designing seems to require exemptions from standard financial reporting the company is quite certainly on the grey area and it should just step back and accept taxes as a standard cost.

1. Our Understanding of CSR

Even though corporate social responsibility as such has been a subject of discussion from early 1960s only,5 the phenomenon as its self is much older. As soon as large industrial companies begun to emerge, they took some concern for the living conditions of their staff. Although we may have doubts if this really was concern for the welfare of the staff or concern for the availability of the staff, it appeared in forms which are common for genuine social responsibility. Companies or their owners built houses, schools and hospitals, hired teachers and nurses and so on. Sometimes this was based on pure economic rationales as it was the only way to guarantee the availability of the workers, sometimes it was real paternalism of socially-aware or

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4 Tax liabilities are in most cases among the three or four largest groups of operational costs of companies and all tax-related information is hence essential for shareholders, creditors and investors to understand the performance of the company. This being so, the disclosure and transparency of tax-arrangements are essential from the corporate governance point of view but this does not as itself justify any CSR-related obligation e.g. to avoid aggressive tax planning.

5 See FRIEDMAN, Freedom and Capitalism (1962). Paradoxically enough from our present viewpoint, Friedman only recognized one social responsibility for the corporations: to generate profits for the benefit of shareholders.