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Paying Corporate Tax – A Moral or Legal Obligation?

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A contested issue

Source: The Guardian
https://www.theguardian.com/business/2019/oct/07/corporate-tax-avoidance-climate-crisis-inequality

The debate in academia

"… based on the theories of citizenship and social contracts corporations have duties to undertake responsible taxation as a political responsibility/ imperative."

J. Moon & S. Vallentin 2019

"… I will raise critique to the view that taxation should be based on social and ethical norms …I will argue for the benefit of the rule of law basis for taxes."

R.P. Österman 2019

"Asserting literal interpretations of tax provisions so as to knowingly circumvent the economic-policy goals underlying the legislation is morally equivalent to evaiding the law outright."

A. Hilling & D.T. Ostas 2017

"… my conclusion is that taxation should not be discussed as a CSR issue… For companies, taxes are a cost and most often nothing more than costs."

P. Timonen 2008

The big question

Question

- Do companies have an obligation not to exploit gaps, loopholes, flaws and mismatches in tax legislation in order to reduce their tax burdens?
  - In other words: Should companies abstain from undertaking aggressive tax planning strategies, even if it would be in line with the applicable black-letter tax rules?

Answer: It depends…

- What is taxation (or the tax system as such)?
- What is (the role of) a company?
- What is law?

Aim and delimitations

Aim

- Provide an informed foundation for discussing whether or not paying corporate tax is (also) a moral question
  - A Nordic academic perspective

I will not discuss

- Whether corporation tax is an appropriate tool for taxation as such
- How companies practically can operate with respect to their moral tax obligations (formulation of tax strategies/policies and use of standards)

The terms “moral” and “ethical” will be used interchangeably

- Something the corporation ought to do → Right/just/acceptable behavior

What is taxation?

Three main goals of taxation (Avi-Yonah 2006)

- 1) Raising revenue, 2) ensuring redistribution, 3) regulating behavior

What is a tax (OECD standard working definition)?:

- "A compulsory unrequited payment to the government"
  - Compulsory: Not (completely) voluntary
  - Unrequited: No specific benefit in return (not a fee for a particular service)
  - Payments: In cash or in kind
  - Government: Understood in a broad sense

Rosenbloom 2009	Gribnau 2019
"Taxes are a cost, like any other cost. There is nothing magical or special about taxes as a cost, except that they are subject to adjustment by government action…"	*"Taxation sustains human beings living and cooperating peacefully – enabling them to prosper in society…Paying taxes is a moral obligation to society."*

What is the role of a company?

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Three main views (Avi-Yonah 2014)

Artificial entity view

- The state created the corporation and the conditions for its operation in the market (social contract theory) →
  - It is legitimate to expect corporations to cooperate (and not only comply) in tax matters

Real entity view

- The corporation is separated from both state and shareholders and should be considered an ordinary citizen →
  - For all citizens that are part of the democratic process it is legitimate to minimize taxes but not to avoid paying taxes

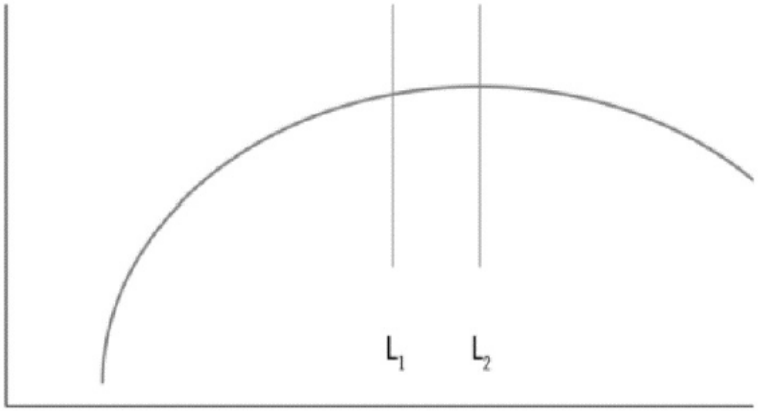
Aggregate view

- The corporation can merely be seen as an aggregate of its individual members and shareholders, i.e. a ”nexus of contracts” →
  - The sole legitimate function of the corporation is shareholder profit maximization
  - Taxes should be lawfully minimized as much as possible

CSR and tax

Corporate Social Responsibility (CSR)

- CSR: Operations or actions that are above or independent of the limits or minimum requirements set by legislation.
- Justifications for CSR are:
  - Moral obligation
  - License to operate
  - Sustainability
  - Reputation



Knuutinen 2014

The aggregate view

- Only (very) limited room for CSR in tax matters (Friedman doctrine)

The artificial and real entity views

- CSR should (also) have a role to play in tax matters

CSR and tax – Concerns

Österman 2018

The legal order and the rule of law create an obstacle to power holders of society

- Taxes are not voluntary → Protection of the individal (corporation) is important
- Taxation is a complex balancing act → Needs to be carried out in a transparent democratic order
- Equal treatment of taxpayers → Presupposes a legal standard to meet some form of clarity
- Objectivity → Requires legal norms to exclude private, subjective perceptions (reducing arbitrariness)
- Procedural justice → Involves independent judicial review

CSR & tax – Criticism

Brederode, 2020

- Murder has always been considered wrong, even before written down in law → a moral obligation *in se* not to murder

- Taxes are imposed on members of society by law → An obligation *in legem*
  - The duty to pay taxes is derived directly from the law
  - Without a legal obligation, there is no moral obligation to pay tax
  - The moral and legal standard must be the same
  - An additional moral standard cannot exist outside the law that created the obligation in the first place

- According to Brederode, contributing to society is a moral obligation *in se*
  - But the elements fulfilling the obligation, including paying taxes, are not

What is law?

Shapiro 2011

- “Legal philosophy is not lexicography. It is not an elaborate attempt to contribute to the Oxford English Dictionary but rather an effort to understand the nature of the social institution and its products…”

Wendel Holmes 1887

- “… law, properly conceived, is simply a prediction of what courts will do, nothing more, nothing less.”

What is law?

Philosophy	Description	CSR
Legal positivism	The law as laid down should be kept separate, for the purpose of study and analysis, from the law as it ought morally to be. The validity of any law should be traced back to an objectively verifiable source (e.g. “grundnorm” or “rule of recognition”)	☹
(Scandinavian) legal realism	Preoccupied with separating law from “metaphysics” (no conflation of law and morality).Valid law means the abstract set of normative ideas that are effectively followed because they are experienced and felt to be socially binding by the judge and other legal authorities applying the law.	☹
Natural Law	Law has an “inner morality”, i.e. the legal validity of a norm depends on its substantive moral qualities. When law and morality diverge, morality should be followed.	☺
Legal pragmatism	Law is an instrument of social policy. Legal pragmatism emphasizes judicial awareness of and concern for consequences. It exhibits an understanding for the need to ground judgements in facts and consequences, and it appreciates reasonableness as an important part of adjudication.	☺

Inspired by Hilling and Ostas 2017, p. 73-83

What is law?

However…

- Other branches of legal philosophical schools exist
- The borders between and within the various branches are not clear-cut

- E.g. legal positivism is not “one thing”
  - Hard positivists (Austin)
  - Soft positivists (Hart)
  - Law as plans (Shapiro)

My view

- Claims that ”businesses should pay their fair share” are too vague
- The tax base is determined by law for good reasons
- But! The bonus pater business manager still should include CSR/moral reflections when deciding on the use of tax planning
  - Reputational risk
  - Shareholder welfare vs. shareholder value (O. Hart & Zingales 2017)
  - Other groups may view the role of companies/tax/law differently
  - Consistency

Schmidt 2015/2019/2020

”We find consistent evidence that corporate social responsibility is negatively related to five-year cash effective tax rates and positively related to tax lobbying expenditures. Our evidence suggests that, on average, corporate social responsibility and tax payments act as substitutes…”

Davis et al. 2016