

Corporate Social Responsibility, Taxation and Aggressive Tax Planning¹



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Abstract: Society expects companies to take into account the economic, environmental, and social effects of their operations and activities. The concept of corporate social responsibility (CSR) refers to the operations or actions of companies that are above or independent of the limits or minimum requirements set by legislation.

The economic purpose of a company and its responsibilities towards shareholders and debtors, first and foremost, is a natural starting point in reviewing the responsibilities. Also other stakeholders such as employers or public entities as tax collectors have economic requirements and expectations. Responsibility in the context of tax issues has become the topic of greater attention, with a number of stakeholder groups actively reviewing the approaches that companies take to their tax strategies and tax planning activities.

In this article CSR is reviewed especially in the context of taxation. Does CSR have any significance and importance in the context of tax law and especially income taxation? Does CSR set limits on the tax planning of companies, or is there an obligation to pay any more taxes than what has to be paid according to the law and the tax treaties? While the concept of CSR is not a legal one, neither is the approach for these questions in this article only a legal one.

Attitudes towards taxes are often contradictory. On the one hand, taxes are like any other costs for a company, but on the other hand, they are an economic contribution to the society in which the business is conducted.

1. The article is based on the author's book "Verotus ja yrityksen yhteiskunta-vastuu" (2014).

The phrase “aggressive tax planning”, as opposed to regular or “acceptable” tax planning, has been used on several occasions recently. Taking a purely technical approach to tax planning is unlikely to protect companies from charges of irresponsibility and associated reputational damage. Aggressive tax planning can be characterized, for instance, by an intensive use of legal and financial tools, establishments in foreign tax havens, unbalanced capital structures and transfer prices, or a disingenuous use of tax treaties.

Still, aggressive tax planning is not a legal concept so there is no legal definition for it. Instead, the question is more or less about where to draw the line of moral acceptability, which runs on the inside of the tax planning area. From the CSR point of view, aggressive tax planning can be defined as actions taken by taxpayers which are in the line of requirements of tax law, but which do not meet the reasonable and justified expectations and requirements of the stakeholders.

Keywords: Corporate social responsibility (CSR), tax morality, tax planning, aggressive tax planning, tax reporting

1. Introduction

The importance of corporate social responsibility (CSR)² is increasing all the time. Traditionally, three dimensions have been indicated in the concept of CSR: economic, environmental, and social. In other words, society expects companies to take into account the economic, environmental, and social effects of their operations and activities. Still, corporate social responsibility is to some extent a controversial concept.³

For a long time, the environmental and social issues were dominant in the CSR practices, assessment and reporting but recently, a lot of the public discussion has focused on the companies’ responsibility to pay taxes and, specifically, about the tax planning of multinational enterprises (MNEs) in the international context. Responsibility in the context of tax issues has become the topic of greater attention, with a number of stakeholder groups actively reviewing the approaches that companies take to their tax strategies and tax planning activities. It is not, however, necessary to see taxation as a completely new dimension and, instead, we can see it as part of economic responsibility.

The other way to look at CSR is to analyse how imperative or binding its norms or expectations are. According to *Carroll*, to fully address

2. The term “corporate social responsibility” is more often used even though the term “corporate responsibility”, which is sometimes also used, perhaps better covers all the aspects of the concept.
3. CSR has been seen as controversial especially in the United States. However, within the European Union, there seems to be an increasing awareness of CSR, and the EU and its member states are – at least generally – supporting the idea.

the entire range of obligations that business has towards society it must embody the economic, legal, ethical, and discretionary categories of business performance.⁴ In other words, the social responsibilities can be categorized into four groups: economic responsibility, legal responsibility, ethical responsibility, and discretionary responsibility. The social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of companies and other organizations at a given point of time.⁵

The economic purpose of a company and its responsibilities towards shareholders and debtors, first and foremost, is a natural starting point in reviewing the responsibilities. In Finland, for instance, the Limited Liability Companies Act states that the purpose of a company is to generate profits for its shareholders, unless otherwise provided in the Articles of Association.⁶ Also other stakeholders such as employers or public entities as tax collectors have economic requirements and expectations.

Of course, to be responsible, a company must always obey the law as it tries to achieve its economic objectives. However, this is not always enough. The concept of CSR refers to the operations or actions of companies that are above or independent of the limits or minimum requirements set by legislation. Society expects companies to act in socially responsible ways. In other words, society sets expectations for businesses to reflect its ethical norms.

CSR has been defined in many different ways, but there are some common features in the given definitions.⁷ First, the obligation must be voluntarily adopted; behaviour influenced by the coercive forces of law is not voluntary as such.⁸ Second, the obligation is a broad one, extending “beyond the traditional duty to shareholders to other societal groups”, or stakeholders, such as customers, employees, and suppliers.⁹ Third, CSR requires openness and transparency; a responsible company reports its businesses and activities in public, and thus pro-

4. Carroll (1979), pp. 499-500.

5. Carroll (1979), p. 500. See also Oxford Handbook (2008), p. 33.

6. Limited Liability Companies Act 21.7.2006/624 (*osakeyhtiölaki*, OYL), Chapter 1, Sec. 5.

7. About the different definitions, see Carroll (1999).

8. However, “voluntary” can sometimes be almost compulsory, if the pressure from customers and/or social media is strong enough. See also Porter – Kramer (2006), p. 80: “Heightened corporate attention to CSR has not been entirely voluntary. Many companies awoke to it only after being surprised by public responses to issues they had not previously thought were part of their business responsibilities.”

9. Jones (1980), pp. 59-60.

vides the general public with an opportunity to assess its activities.¹⁰ Finally, CSR is responsibility *within* the day-to-day business operations and activities – not something which is occasional or separate of the business.¹¹

In this article, I am going to review CSR in the context of taxation.¹² Does CSR have any significance and importance in the context of tax law and especially income taxation? If the answer is ‘yes’, what are the implications, for instance for tax planning and the other tax related activities of the companies? Does CSR set limits on the tax planning of companies, or is there an obligation to pay any more taxes than what has to be paid according to the law and the tax treaties?

Before we continue, it is important to emphasize one thing. While the concept of CSR is not a legal one, neither is the approach for these questions in this article only a legal one. In addition to the legal aspects of the issue, also the aspects of business management and business ethics are involved.

Attitudes towards taxes are often contradictory. On the one hand, taxes are like any other costs for a company, but on the other hand, they are an economic contribution to the society in which the business is conducted. It is very natural that companies are trying to minimize their taxes. However, if a jurisdiction has a consistent tax system reflecting the economic reality, the companies actually make every effort to maximize their corporate taxes, as high taxes are the outcome of high returns. Furthermore, there are some MNEs which declare that they conduct their business activities in an environmentally and socially responsible manner. At the same time, they engage in aggressive tax planning and exclude tax matters from CSR reporting.

Why, then, do we use and count on a voluntary responsibility instead of compulsory or legal responsibility? The exact legal regulation (“hard law”) is not always the best way to solve a patchwork of different kinds of everyday problems. Sometimes – not always – companies themselves are better at assessing what is relevant and what is not, and at finding out the proper approach and the solutions for everyday problems. Especially MNEs face the situation where laws vary in the different countries and jurisdictions that they operate in. Laws

10. Earlier, companies mainly used to report on their environmental impact. Later on, reporting started covering also other dimensions of CSR.
11. In addition, it is possible for a company to engage in pure discretionary activities, such as charity. When it comes to pure discretionary activities, perhaps it may be inaccurate to call these expectations responsibilities because they are at the business’s discretion. See Carroll (1979), p. 500.
12. See also Knuutinen (2013), pp. 177-191, where the issue of tax minimization and CSR is reviewed more generally.

are typically local and the principles of CSR are global, so they work better as a form of “soft law”.¹³

2. Does a corporation have social responsibility, generally or especially within taxation?

2.1. Law, justice and morality

First of all, there is the basic question to be answered: Does a corporation have *any kind* of social responsibility at all, apart from its legal obligations? In this chapter, we study this question from several points of view. We start with the moral and ethical approach.

While CSR – by definition – means responsibility on a voluntary basis, it is not a legal concept. Rather, it concerns morality and ethics. Some moral and ethical questions, like the question about justice and equity, are both ancient and eternal, and the relation of law and justice has been discussed for over two thousand years. *Aristotle* argued that justice in society can be based either on nature or on law.¹⁴ The justice based on nature is valid everywhere, independent of anyone’s views and opinions, but regarding the justice based on law, it is irrelevant what people think about it – the statutes are binding. According to *Aristotle*, justice was mainly based on nature.

Historically, the law – *lex divina* or *lex naturalis* – was the “law of God”. This meant that there could not be any discrepancies or tension between law and justice. Natural law grounded law on universal and eternal moral principles discovered by human reason. Later, also people started to make laws – *lex positiva* – themselves. This was necessary as more detailed and exact norms were needed in society. In the 19th century, natural law as a legal source was removed, leaving only positive law.¹⁵ Some basic ideas of natural law may still be seen as alive. Human beings can, at least in some situations and to some extent, distinguish between right and wrong. I argue that the idea of CSR has some common features with the idea of natural law.

One feature of positive law is that in it, law and morality is distinguished from each other. Legal positivism makes a separation between law and morality; law is an autonomous normative order. Nat-

13. However, there are many different opinions on this issue. Some criticism has been voiced that CSR is only a means for corporations to avoid binding legal regulations.

14. *Aristotle: Nicomachean Ethics*, Book V, Chapter 7.

15. See *Letto-Vanamo* (2008), pp. 64-65. Around the same time, a discrepancy between positive law (*Recht*) and justice (*Gerechtigkeit*) became visible. See also *Knuutinen* (2009), pp. 302-303.

urally, law can be in line with the views of morality, equity and justice. However, to be a valid norm this kind of relation is not necessary. Regarding tax law, it is quite common that people have very different kind of views of equity, especially regarding vertical equity. There is no scientific answer to the question, for example, whether taxation should be progressive or not.

Tax laws are often compromises of different views and opinions, which reflect the spectrum of values and moral considerations. However, after a tax statute has come into force, it is only the statute itself which has relevance in the application of the law. Consequently, the question is, do moral issues have any relevance within taxation?

Some legal writers do not accept the view that there could be a total separation of law and morality. Fuller stated that there is a necessary connection between law and morality.¹⁶ However, this connection is not direct, but procedural, referring to the process how the law is prepared and enacted. The outcome is that any good and proper law also has moral content – a kind of internal morality of law.¹⁷

This relationship is very easy to find in tax law, as well. When the statute is prepared and enacted, justice is one of the main purposes to be achieved. However, it is the legislator who decides the extent to which these kinds of moral elements become part of the tax law, as there are also other aims and conditions that must be taken into account. There is always some internal morality in tax laws. However, these moral qualities are not decisive when the law is applied. This may, in turn, have an impact on the taxpayers' moral views and assessments.

Another important issue raised by Fuller is the distinction between the morality of aspiration and the morality of duty.¹⁸ *The morality of aspiration* starts at the top of human achievement. It is the morality of excellence or of the fullest realization of human powers. The morality of aspiration refers to the characteristics and actions which are above the minimum level. *The morality of duty*, instead, starts at the bottom. As Fuller put it, the morality of duty lays down the basic rules without which an ordered society is impossible, or without which an ordered society directed toward certain specific goals must fail of its mark. The question is about the basic requirements of social living.¹⁹ The morality of duty – a kind of basic morality – is negative in nature; it focuses on things you should not do.²⁰

16. *The Morality of Law* (1964).

17. See Fuller (1964), pp. 4 and 42-43.

18. See Fuller (1964), p. 5, referring largely to other legal writers as well.

19. Fuller (1964), pp. 5-6.

20. See Fuller (1964), p. 42.

In the common law tradition, concerning forbidden actions, a distinction has been made between *malum in se* and *malum prohibitum*. The point here is the background and the moral content of the norms. *Malum in se* refers to an act or crime which is "wrong in itself" because it violates the natural, moral or public principles of a civilized society. A classic example is murder. *Malum prohibitum*, on the other hand, refers to an act or crime which is created by statute, "wrong due to being prohibited". Something is forbidden because it is forbidden. In a *malum prohibitum* situation it may be enough that we obey the law only as much as is necessary – the *letter* of the law – and not more. On the other hand, in a *malum in se* situation the norm has a strong moral content, so it is important to follow the *spirit* of the law.

Ostas makes a similar distinction between the concepts of *compliance and cooperation*:

Yet, compliance embodies a less expansive duty than does cooperation. At its heart, the distinction highlights the difference between the letter and the spirit of the law. One complies with the letter of the law; one cooperates with the law's spirit.²¹

Furthermore, Ostas states that in the context of tax law the *malum prohibitum* views are often dominant:

In fact, when it comes to tax law, it seems likely that a businessperson could ethically defend most decisions to exploit tax loopholes, to take an "aggressive tax posture" interpreting ambiguities in light of the businessperson's private interest, and to lobby for reduced levels of taxation. When it comes to tax, and possibly other matters that constitute *malum prohibitum*, the societal norm seems to be "comply," not "cooperate".²²

Taxpayers often justify and defend their actions by referring to the fact that they have acted according to the law and regulations, which means first and foremost referring to the letter of law. However, for society this is not always good enough; it is expected and required that the spirit of the law is followed, referring to the aim and purpose of the tax law.

One concrete issue is the loopholes in the tax legislation: it is appropriate to use them or is it a kind of moral duty to refrain from exploiting them? From the moral point of view it would be natural to argue that exploitation is inappropriate. However, it is not always easy to see the rationality of the tax laws, as they are often arbitrary and include a wide range of distinctions. Furthermore, especially in

21. Ostas (2004), p. 566. See also SustainAbility (2006), p. 5, where the parallel terms "passive tax responsibility" and "active tax responsibility" are used.

22. Ostas (2004), p. 577.

the international context, the issue will be the fact that tax laws of different jurisdictions do not constitute a rational and coherent whole. On the contrary, states engage in tax competition, also within the European Union.

Taxation is based on statutes enacted by the parliament (the principle of legality). Companies, unlike human beings, are also creations of law and statutes, like the Companies Act in Finland. The morality of taxation is essentially law-bound, but this does not mean that it is only the letter of the law that matters. Instead, the spirit or purpose of the law has to be taken into account.

2.2. Historical perspectives

CSR has been discussed in business economics and social sciences since the 1950s and during the last few decades, CSR has become a global theme, both academically and in practice. However, looking more closely at economic history, it is easy to come to the conclusion that social responsibility in business is a much older phenomenon.

For this analysis, I studied a few company cases during the phase of industrialization in the 19th and 20th centuries in Finland, leaning on secondary sources like biographies or histories of the company. At that time, the common approach to ownership and management was “patriarchalism”, which referred to the father-like role of the business owner who often was responsible for his employees in quite a holistic way.

The entrepreneur was obliged to provide his employees and their families housing, health care, education for children, and also a wide range of recreational activities. This was not only philanthropy; it was *necessary* for pure business reasons. Without this kind of actions it would not have been possible to get workers and personnel to the new mills and factories built in the middle of nature. At the same time, these services were not *only* provided for pure business purposes. Rather, they were also measures of a sort of economic-social responsibility for the community, which, in many cases had been established and developed around the mill of factory itself. Many communities were formed in the middle of nature; close to forests to get raw materials and close to streams to get energy. The entrepreneur was the “Father” of the developing community.²³ At this time, there was also a kind of traditional understanding that the business is in charge of the employees and their families.²⁴

Although many businesses were responsible as regards their employees and the community, several examples show that they were al-

23. For instance, Serlachius in Mänttä in Central Finland.

24. See Kaitila (1947), p. 9 and Mönkkönen (1998), p. 182.

so trying to minimize their taxes to be paid to state or to the municipalities, even though the enterprises could at the same take care of some public tasks and responsibilities.²⁵

In Finland the major change from this traditional way of managing business and employees took place only in the 1960s and 1970s, when many companies more or less systematically wanted to get rid of the responsibilities described above. This was partly due to return requirements of banks and other financiers. Also, it was due to the development of the social security system and the new social responsibilities of the municipalities – in short, the Nordic welfare state model. This process and change can be described in the following figures:



Figure 1: Ownership and management structures in the 18th and 19th Centuries (“patriarchalism”)

During the age of patriarchalism, ownership, management (control) and local economic-social responsibility was one and the same (Figure 1).

25. See e.g. Lehto (1996), p. 107 and Mönkkönen (1998), p. 236.

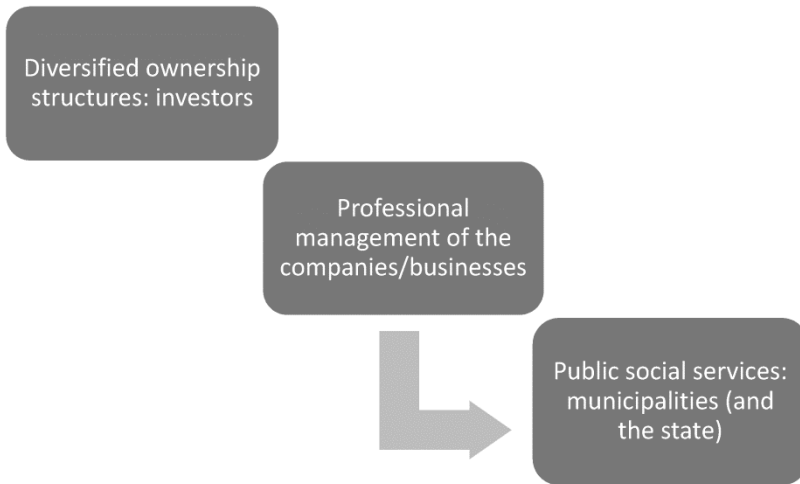


Figure 2: Current ownership and management structures; the municipalities are in charge of public social services

Nowadays, ownership is differentiated from the management (Figure 2). The primary task of the professional management is to increase shareholder value; investors have diversified portfolios and the ownership structures and relations are fragmented. The municipalities are in charge of the public social services, for which they get funding from the state as well. The arrow describes the corporate income (and other) taxes.

Also the nature of many businesses has changed dramatically in the past few decades. In the old days, it was easy to say where the value was created. Nowadays there are global value chains so in some cases, even if we had all the information at hand, it would be difficult to say where the value is created. A major part of the value of the companies is based on intangible assets. As they are immaterial, is it even possible to locate these intangibles and the return on them? However, for tax purposes the “location of income” (that is, to define or agree on the relevant jurisdiction) is necessary.

Nowadays, one of the most important core structural characteristics of a business corporation is the separation of ownership and control.²⁶ However, the situation is quite different for big multinational

26. In legal theory, the relationship between owners and managers is usually described as a principal-agent relationship. About the characteristics of a busi-

enterprises (MNEs) than for small and medium-sized enterprises (SMEs). This difference may sometimes be realized in connection with tax issues, as well.

2.3. Financial theory and the company law approach: shareholder value

Portfolio investments are more and more diversified both geographically and in terms of sectors. The ownership structures of MNEs are fragmented and the mission of the corporate executives is to increase shareholder value.

In this article, two main questions regarding CSR and companies will be discussed. The first question relates to corporate responsibility in general. If corporate executives assign corporate resources to some “social objectives”, beyond their legal obligations, this means that they are imposing extra “taxes” on the shareholders.²⁷ Do company executives have the right or power to do that?

Some counter-arguments to this critical view of CSR can, however, be presented. To begin with, the issue of CSR does not disappear even if we see that corporate executives do not have the right or power to impose “hidden” taxes. This is because the shareholders themselves always have the right and power to do or accept CSR activities, although in the case of listed MNEs this approach may be only theoretical.

Moreover, several CSR activities can also be seen as useful for shareholders. This is maybe the strongest argument for CSR, and it is also the kind of argument almost everyone can accept. One of the tasks of corporate executives is to identify and eliminate all kinds of risks in the business. As of today, a lacking no CSR strategy or related activities can be considered a risk for business and for a company. Furthermore, in some cases, CSR activities can even be seen as a kind of investment or a tool for increasing sales.

The second question relates to corporate responsibility in connection to taxation in particular. If a company pays a higher tax than it would have paid had it undertaken some tax planning, it is making inappropriate use of its shareholders’ funds.

According to financial theory, the ultimate purpose of a company is to make profits for its shareholders, and the task of the management is to maximize the value of the shares.²⁸ This idea is incorporated in the

ness corporation more broadly see Armour – Hansmann – Kraakman (2009), pp. 5-16.

27. Oxford Handbook (2008), p. 59.

28. See Oxford Handbook (2008), pp. 55-62.

Companies Act, as well. According to the Companies Act²⁹ of Finland, the purpose of a company is to generate profits for its shareholders, unless the articles of association state otherwise.³⁰ From a financial theory point of view, taxes are just costs that decrease the cash flows that belong to the shareholders, and thus decrease the value of the shares. However, shareholder value theory accepts the kinds of responsibilities that are based on legal obligations or that increase the value of the shares (at least in the long run).³¹

The globalization of the capital markets and the competition for capital are likely to have led to the fact that the shareholder value theory approach is emphasized.³² The owners of the capital set up the return requirements and the corporate executives try to meet or exceed these requirements. In some cases, this has led to aggressive tax planning activities.

2.4. What is really a company or a corporation?

What is really a company? The answer to this question may have some implications for the views on CSR, as well.

According to the Companies Act, a limited liability company shall be a legal person distinct from its shareholders, established through registration. Also, the shareholders shall have no personal liability for the obligations of the company.³³ The management of the company, in turn, shall act with due care and promote the interests of the company.³⁴

Terms like company, corporation, enterprise and firm are often used quite interchangeable in our everyday language. However, there are some differences between these terms. The terms 'firm' and 'enterprise' refer first and foremost to something which is physical, like production facilities, operations, actions etc. The terms 'company' and 'corporation', instead, refer to a legal phenomenon, to something which is created by the law. *Posner* describes the difference in the fol-

29. Ch. 1, Sec. 5 of the Limited Liability Companies Act 21.7.2006/624 (*osake-yhtiölaki*).

30. The current Finnish company law is largely founded on the Anglo-American law and economics view on companies, that is, that the purpose of a company is to provide an economically efficient vehicle for business operations.

31. In the Government Bill (HE 109/2005, pp. 38-39) it is also argued that the Company Act does not require that profits are maximized in the short run. Furthermore, it is argued that profit generation also in the longer run often requires that companies follow socially acceptable practices, possibly even in situations where the law does not enforce it.

32. Vitols (2001), p. 338.

33. Ch. 1, Sec. 2 of the Limited Liability Companies Act.

34. Ch. 1, Sec. 8 of the Limited Liability Companies Act.

lowing way: “The firm is a method of organizing production; the corporation is a method, like a bond indenture, for attracting capital into firm. The typical large business is both firm and corporation.”³⁵

The difference between firm and corporation is connected to various dimensions of CSR, as well. The environmental and social responsibilities are connected to the *operations* of a firm. The economic responsibility, on the other hand, relates broadly to a company; its shareholders, other financiers, and the public sector as the tax collector. The economic requirements and expectations of these stakeholders are also conflicting: the amount of taxes paid decreases the residual cash flow to the shareholders. Economic responsibility is, therefore, a contradictory concept.³⁶

Furthermore, people have different kinds of views of the nature or the essence of the company or the corporation. According to *Avi-Yonah*, three different kinds of approaches exist:

Historically, three views of the corporation have emerged and rotated in cyclical fashion. The first is the view that the corporation is primarily a creature of the state (the “artificial entity” view). The second is that the corporation is an entity separate from both the state and from its shareholders (the “real entity” view). The third is that the corporation is merely an aggregate of its individual members or shareholders (the “aggregate” or “nexus of contracts” view).³⁷

Avi-Yonah argues that these different views may be crucial in terms of how we see CSR issues, as well. Under the *artificial entity view*, the corporation owes its existence to the state and the corporation is granted certain privileges in order to be able to fulfil the functions that the state would like to achieve. Engaging in some forms of CSR is part of the corporation’s mission, and paying corporate tax is one way of fulfilling the corporation’s CSR obligations.³⁸ A corporation could not operate without the protection of property ensured by the law, public order and infrastructure. Therefore, under the artificial entity view, corporations have an affirmative obligation not to engage in aggressive tax planning designed to reduce their tax burden. The state created the corporation and the conditions for its operation in the market; in return, the state may legitimately expect corporations not to impose additional burdens on it. The state can also expect the corporations to

35. Posner (1992), p. 409.

36. See also SustainAbility (2006), p. 1: “We concluded that the economic dimension of the CR agenda is the least understood, the least explored and with the most potential to really challenge existing business models.”

37. Avi-Yonah (2006), pp. 2-3. See also Millon (1990) and Avi-Yonah (2005), p. 771.

38. Avi-Yonah (2006), p. 3.

contribute their fair share to the ability of the state to fulfil its obligations to its citizens.³⁹ It is also good to remember that the limited liability of the shareholders protects the assets of the shareholders from the claims of the company's creditors. This is a privilege the corporation is granted by the law.

According to the *real entity view*, on the other hand, the corporation is similar to an individual. It is an entity made up of corporate managers and employees that is separate from both the state and from its shareholders.⁴⁰ According to Avi-Yonah, the implication for CSR is that our view of CSR activities that are unrelated to the corporation, but beneficial to society at large, should be the same as our view of such behaviour by individuals. It should not be legally required, but it is praiseworthy and should be encouraged when it happens.⁴¹ As for taxes, just like an individual citizen, a corporation is legally required to pay its taxes, and is also expected not to engage in over-aggressive tax planning to minimize its tax obligations.

Finally, the corporation can merely be seen as an *aggregate* of its individual members or shareholders, as a "*nexus of contracts*". As Jensen and Meckling describe it:

Contractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, etc. [...] It is important to recognize that most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals.⁴²

This view is parallel to the shareholder value approach, which means it sees CSR as an illegitimate attempt by managers to tax shareholders without their consent, leading to managers being unaccountable to the shareholders that elected them.⁴³ Instead, it could be argued that the management has a responsibility to maximize the shareholder profits by minimizing corporate taxes. According to this view, CSR can only be seen as legitimate if, in the long run, it increases the value of the company shares.

If the sole function of corporations is profit maximization, it seems to follow that corporations should maximize profits also by minimiz-

39. Avi-Yonah (2006), p. 15.

40. As a matter of fact, a company is always separate of its shareholders.

41. Avi-Yonah (2006), p. 16.

42. Jensen – Meckling (1976/1996), p. 108. See also Prebble (1998), pp. 115-116: "A company is a convenient fiction, invented to enable people to band together for business or investment, and to enable management to be separated from capital. [...] companies are themselves already artificial, fictitious creations."

43. Avi-Yonah (2006), pp. 4-5.

ing their taxes. However, if all corporations avoid paying taxes in every possible way, the result would be inadequate revenue for the government to fulfil the obligations that under the aggregate view it bears the sole responsibility for. In extreme cases, the result is that neither the corporations nor the government are able to address social problems. With this thought and approach, Avi-Yonah seeks to argue that, even under the extreme version of the aggregate view, corporations do have an affirmative obligation to pay their taxes, so as to enable the state to carry out those functions that they themselves are barred from pursuing, as they are unrelated to the goal of shareholder profit maximization.⁴⁴ In fact, this can be seen as one justification of imposing tax on corporations: Rather than bear any social responsibility, by paying its taxes, the corporation can shift this responsibility to the state, where it according to this view belongs.⁴⁵ If this way of thinking is accepted as a starting point, aggressive tax planning or other inappropriate tax activities, despite their legality, are not acceptable:

Thus, strategic tax behavior seems to be inconsistent with *any* view of the corporation. Under the artificial entity view, it undermines the constitutive relationship between the corporation and the state. Under the real view, it runs contrary to the normal obligation of citizens to comply with the law even in the absence of effective enforcement. And under the aggregate view, it is different from other forms of shareholder profit maximization in that it weakens the ability of the state to carry out those functions that the corporation is barred from pursuing. It would thus seem that whatever view management takes of its relationship to the shareholders, to society and to the state, it is never justified in pursuing tax strategies that have as their only goal minimizing the corporation's tax payments to the government.⁴⁶

In any case, the kind of CSR which, at least in the long term, is clearly beneficial for the shareholders is justified and acceptable independent of the views of the essence and the purpose of the company.

2.5. Are taxes only transactions costs?

Taxes have a kind of ambivalent role. We can regard taxes as costs, or as transaction costs as it is sometimes expressed. Taxes reduce the shareholders' residual right to the company's profits and value. Therefore, taxes should be minimized as any other cost items. Also according to the International Financial Reporting Standards (IFRS), taxes are calculated and accrued as expenses.⁴⁷

44. Avi-Yonah (2006), p. 23.

45. Avi-Yonah (2006), p. 23.

46. Avi-Yonah (2006), p. 24.

47. Tax expense is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax. See IAS 12.

On the other hand, corporate income tax can be seen as a distribution out of the profits. Thus, what is the right way to see taxes? There is no one answer to this question. The *Tax Justice Network* argues that taxes should be regarded first and foremost as distributions:

Anti-tax lobbies seek to portray tax as a cost. This is the wrong way to see it. Tax is not a cost, but a distribution out of profits. That puts tax in the same category as a dividend – a return to the stakeholders in the enterprise. This reflects the fact that companies do not make profit merely by using investors' capital. They also use the societies in which they operate, whether that is the physical infrastructure provided by the state, the people the state has educated, or the legal infrastructure that allows companies to protect their property rights. Tax is the return due on this investment by society from which companies benefit. Moreover, tax is properly due to the state in which a company generates its profit, not to that state to which it can relocate its profit for taxation purposes.

Or should one just finally say that income taxes are neither a cost nor a distribution of profits? They are simply just income taxes, which have their own purpose, meaning and character. According to the principle of legality, taxation is based on law.⁴⁸

The cost-oriented approach can easily lead to a situation where the tax issues are not considered and treated as a part of CSR. However, if one regards taxes as a distribution out of profits, the situation is different. Some companies may also intentionally keep tax issues outside of their CSR agenda, although this is getting increasingly harder to do. Income taxes are not directly related to the businesses and operations of a firm, i.e. to the goods or services it is producing. Instead, having to pay high income taxes is the outcome of a successful business.

2.6. The framework of the European Union

In its 2011 strategy for CSR, the European Commission has defined CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis”.⁴⁹

It is worth noting that only the environmental and social responsibilities are explicitly included in this definition. On the other hand, it is stated that corporate social responsibility concerns actions by companies over and above their legal obligations towards society and the environment.⁵⁰ This phrasing could basically include tax responsibilities, as well, but the rest of the text in the CSR strategy does not support this conclusion.

48. See e.g. the constitutions of Finland (PL 81 §) and Sweden (8 kap. 3 § RF).

49. COM(2011) 681 final (A renewed EU strategy 2011-14 for Corporate Social Responsibility), p. 3, referring further to COM(2001) 366.

50. COM(2011) 681 final, p. 3.

In this strategy, the Commission argues that addressing corporate social responsibility is in the interests of both the enterprises and of society as a whole. According to the Commission, a strategic approach to CSR is increasingly important to the competitiveness of enterprises. By addressing their social responsibilities, enterprises can build long-term employee, consumer and citizen trust as a basis for sustainable business models. The Commission points out that responsible business conduct is especially important when private sector operators provide public services.⁵¹ In spite of a lot of progress,⁵² important challenges remain, as many companies in the EU have not yet fully integrated social and environmental concerns into their operations and strategy.⁵³

In its CSR strategy, the Commission puts forward a new and quite open definition of CSR as “the responsibility of enterprises for their impacts on society”. To fully meet their corporate social responsibility, enterprises should have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders, with the aim of (i) maximizing the creation of shared value for their owners/shareholders as well as for their other stakeholders and society at large, and (ii) identifying, preventing and mitigating their possible adverse impacts.⁵⁴

The Commission states that

[a]ccording to these principles and guidelines, CSR at least covers human rights, labour and employment practices (such as training, diversity, gender equality and employee health and well-being), environmental issues (such as biodiversity, climate change, resource efficiency, life-cycle assessment and pollution prevention), and combating bribery and corruption. Community involvement and development, the integration of disabled persons, and consumer interests, including privacy, are also part of the CSR agenda. [...] In addition, the Commission promotes the three principles of good tax governance – namely transparency, exchange of information and fair tax competition – in relations between states. Enterprises are encouraged, where appropriate, also to work towards the implementation of these principles.⁵⁵

It is interesting that taxation is not included in this “CSR at least covers” list above. Thus, it is difficult to avoid the impression that the

51. COM(2011) 681 final, p. 3.

52. For instance, the number of European enterprises publishing sustainability reports according to the guidelines of the Global Reporting Initiative (GRI) rose from 270 in 2006 to over 850 in 2011. COM(2011) 681 final, p. 6.

53. COM(2011) 681 final, p. 5.

54. COM(2011) 681 final, p. 6.

55. COM(2011) 681 final, p. 7.

Commission is not fully satisfied or that it possibly lacks sufficient consensus that taxation is a matter of the social responsibility agenda. However, both states and enterprises are encouraged by the Commission to work towards the implementation of the principles of good tax governance. On December 6th, 2012, a year after the strategy was published, the Commission gave a recommendation on aggressive tax planning.⁵⁶ The reporting requirements on taxes paid on a country-by-country basis have also been discussed in the European Union institutions.

3. Argumentation for CSR within taxation

3.1. Moral obligation

The arguments for CSR are well-known: moral obligation, sustainability, companies' license to operate, and the reputation of companies.⁵⁷ How relevant are these arguments in the context of taxation?

Human beings have some kind of understanding and view of what is right and what is wrong. It is often argued that companies also have a duty or *moral obligation* to be good citizens, honour ethical values and to do "the right thing". How well, then, does this kind of moral appeal, after all, fit creatures of law, like companies? Can a company have morals or morality?

A company, as such, cannot have any morality or moral beliefs. However, the owners and the management of the companies always do. Companies can have a corporate culture, which is, of course, created first and foremost by the owners and the management. In this sense, companies *are* able to honour the ethical values of the society. Furthermore, because companies are managed by natural persons, they *can* seek to be good taxpayers and to pay their fair share of taxes. Unfortunately, it is not always easy to say what this fair share of taxes should be. It is also in the nature of moral obligations to be absolute mandates while most corporate social and other choices involve balancing competing values, interests, and costs.⁵⁸

For instance, in the European Union, companies have the freedom of establishment, set out in Article 49 of the Treaty on the Functioning of the European Union (TFEU). In the EU strategy 2011-14 for Corporate Social Responsibility it is stated that the Commission promotes the three principles of good tax governance – transparency, exchange of information and fair tax competition – in the relations between

56. This will be discussed more closely in chapter 4 of this article.

57. See e.g. Porter – Kramer (2006), p. 81.

58. Porter – Kramer (2006), p. 82.

states.⁵⁹ Moreover, where appropriate, enterprises are also encouraged to work towards the implementation of these principles. If MNEs take advantage of the freedom of establishment and the tax competition, can it be immoral or irresponsible towards another Member State?

In the context of taxation, morality is very much connected to the tax systems created and decided in the political process. That is, the nature of tax law is largely positive law. In this respect there are some differences to some other areas of CSR, for instance, some of the social responsibilities which are connected to human rights. In taxation, the requirements of the society are based above all on law. *Honoré* put the idea this way:

The need for determinants of morality is particularly clear as regards obligations owed by members of a community to their community. Taxation affords a good example. [...] So members of a community have in principle a moral obligation to pay taxes. But this obligation is incomplete or, if one prefers, inchoate, apart from law. It has no real content until the amount or rate of tax is fixed by an institutional decision, by law. What amounts to a reasonable contribution is not otherwise determinable, since what is required is a co-ordinated scheme which can be defended as fair not merely in the aggregate amount it raises but in its distribution. Taxpayers cannot settle it for themselves, as people can within limits settle for themselves, say, the proper way of showing respect for the feelings of others. Apart from law no one has a moral obligation to pay any particular amount of tax.⁶⁰

On the other hand, one of the basic principles in international taxation is that the taxes of MNEs should be paid where the economic value is created, and the directors of MNEs more or less *do* know where the value of its products or services is created. "Active tax responsibility" would require that this value creation is taken into account in the context of taxation as well and also that the purpose or the spirit of the tax law (not only the letter of law) of each operating state is followed.⁶¹ Companies should cooperate, not only comply, with the law. More-

59. COM(2011) 681 final (A renewed EU strategy 2011-14 for Corporate Social Responsibility), p. 7.

60. *Honoré* (1993), p. 5.

61. See also OECD Guidelines for Multinational Enterprises (2011), p. 60: "In particular, enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate. Complying with the spirit of the law means discerning and following the intention of the legislature. It does not require an enterprise to make payment in excess of the amount legally required pursuant to such an interpretation. [...] An enterprise complies with the spirit of the tax laws and regulations if it takes reasonable steps to determine the intention of the legislature and interprets those tax rules consistent with that intention in light of the statutory language and relevant, contemporaneous legislative history."

over, in situations where the law is ambiguous or includes loopholes, the cooperation approach is particularly needed.⁶²

3.2. License to operate

The notion of *license to operate* derives from the fact that every company needs tacit or explicit permission from governments, communities, and other stakeholders to do business.⁶³ A company is created by the law and has to be registered somewhere, although as a non-physical legal phenomenon, it cannot have a physical presence. A company owes its existence to the state and is granted certain privileges in order to be able to fulfil those functions that the state would like to achieve.⁶⁴

Companies have the privilege to run their businesses in an organized society, which means, *inter alia*, infrastructure, public order and the legal system. The state bestows various legal advantages on the companies, such as legal personality and limited liability. Therefore, it is considered fair that companies pay corporate taxes, as well, as they are the price companies pay for this partnership. Furthermore, we can also argue that because of this partnership, companies have to take into consideration the moral and ethical values and expectations of the society, also regarding the tax issues. Since the corporate existence is derived from the state, it is argued that an implicit contract can be inferred that the corporation will help the state in mitigating the harms that it causes, even in the absence of legal responsibility.⁶⁵ From this can be concurred that companies should also not engage in aggressive tax planning.

It is increasingly the case that both businesses and individuals can choose where to locate and invest. The national states often rely on tax competition in order to attract companies to establish or invest in their jurisdiction instead of somewhere else. Independent of the level of tax competitiveness, however, all the states presumably expect the companies to pay their taxes as the law requires. Governments expect that taxpayers do not engage in tax avoidance or other artificial tax behaviour.

3.3. Sustainability

The most well-known definition of *sustainability* was developed in the 1980s by the World Commission on Environment and Development, headed by Norwegian Prime Minister Gro Harlem Brundtland: "Meet-

62. See Ostas (2004), p. 568.

63. See Porter – Kramer (2006), pp. 81-82.

64. Avi-Yonah (2006), p. 3.

65. Avi-Yonah (2006), pp. 8-9.

ing the needs of the present without compromising the ability of future generations to meet their own needs.”⁶⁶ Sustainable development implements fairness between generations.

Sustainability is usually connected to environmental development, and sometimes also to social development. Consequently, companies should operate in ways that secure long-term economic performance by avoiding short-term behaviour which is environmentally wasteful or socially detrimental.⁶⁷ Sustainable development is also related to taxation; tax havens, for instance, distort the inter-nation equity⁶⁸ as well as threaten the financial base and the funding of public services in other countries. Based on Brundtland’s definition of sustainability, also fairness and justice between generations is important. That is, equity and justice in taxation should not only be assessed in one place and at one time.

3.4. Reputation and shareholder value

Finally, *reputation* is used by many companies to justify CSR initiatives and action on the grounds that they will improve a company’s image, strengthen its brand, and even raise the value of its stock.⁶⁹ However, there are basically two aspects with regard to the reputation: (i) acts or omissions that have a negative impact on the reputation, and (ii) the activities that contribute positively to the company’s reputation.

Aggressive tax planning can have a negative impact on the reputation of a company. With aggressive tax planning, a company can achieve short-term economic benefits but the situation may be reversed in the long run. However, it should also be emphasized here that any company *may* and even *must* carry out normal and appropriate tax planning.

It is, of course, clear that if the company pays taxes more than the law requires, then this comes out of the cash flows which belong to the shareholders. Also, the company cannot in general claim to be particularly responsible if it pays its taxes in accordance with the law – after all, this is what all companies are expected to do. However, the company can describe the principles of its tax planning and tax management in its CSR reports, as well as give some relevant numbers about the taxes paid, possibly on country-by-country basis as well.

On the negative side, the effects of irresponsible tax behaviour are more easily realized. If a company engages in aggressive tax planning

66. World Commission on Environment and Development: Our Common Future.

67. Porter – Kramer (2006), p. 82.

68. See Musgrave – Musgrave (1972), p. 63.

69. Porter – Kramer (2006), p. 82.

or other inappropriate tax behaviour which the clients, media and the society as a whole do not accept, this can have effects on customer behaviour and sales. Media coverage of the tax issues has increased significantly in the last few years. This can also have an effect on investors which stress ethical or responsibility considerations in their investment decisions. Therefore, in some cases this can even decrease the value of a company.

According to financial theory, the value of a company (or a share) is the sum of (the) future cash flows (CF), discounted with an appropriate rate of interest (i) to the present value:

$$PV = \sum_{n=0}^N \frac{CF_n}{(1 + i_n)^n}$$

Cash flows can be viewed either before taxes or after taxes:

$CF = CF^\circ - T$, where

CF° is the cash flow before taxes

CF is the cash flow after taxes (i.e., the net cash flow which increases the shareholder value)

T is the income tax of the company.

When a company engages in normal and appropriate tax planning and tax management activities, the cash flows after taxes ($CF_1, CF_2 \dots$) increase because of the tax savings. Therefore, the shareholder value increases. There is nothing wrong or inappropriate with this.

However, if a company engages in aggressive tax planning or other inappropriate tax behaviour which is not accepted by the relevant stakeholders, this can decrease the cash flow before taxes. The effective tax rate of the company is maybe lower, but the overall effect on net cash flows can be negative as a result of these actions and reactions.

In this kind of framework, two further levels could be discerned: First, there is the point at which *some* of the stakeholders will react to the inappropriate tax behaviour of the company. However, the amount of taxes saved by the actions exceed the effect of these negative reactions. This is marked with line L_1 in Figure 3 below. Second, at one point the reactions are strong enough to exceed the savings from the inappropriate tax behaviour. This is marked with line L_2 in Figure 3.

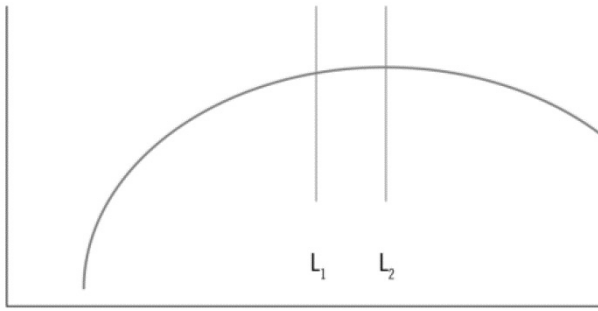


Figure 3: Appropriate tax planning and tax management, aggressive tax planning, and the shareholder value.

Basically, a company can – and it can be argued that in the interests of shareholders it also should – engage in tax planning and tax management activities, up until point L_1 in the picture, but it should *not* cross the line L_2 . We can call the area between the line L_1 and the line L_2 the *critical area*, where a company has to monitor and listen carefully to its stakeholders. However, as noted earlier, companies are in very different kinds of situations depending, for instance, on the industry and the client base. Therefore, the curve above is company-specific.

It may be necessary to stress that the picture above is only a description of a *theoretical* way of thinking, not something which is empirically tested. The companies are in very different positions regarding the potential reactions. Also, this thinking model does not yet give any answers to the question of where and how to draw a line between appropriate tax planning and aggressive tax planning in practice, an issue which is discussed later in this article.

Reputation is maybe the strongest argument for CSR while all the previous arguments are to some extent dependent on moral or other subjective views. Every firm should consider the facts which affect its reputation. However, none of the mentioned arguments offer sufficient guidance for all the difficult and practical choices corporate leaders must make. As *Porter and Kramer* put it, the views of stakeholder groups are obviously important, but these groups can never fully understand a corporation's capabilities, competitive positioning, or the trade-offs it has to make.⁷⁰ This is very much true for tax issues, as well.

70. Porter – Kramer (2006), p. 82.

4. Aggressive tax planning

4.1. Tax evasion, tax avoidance, tax planning

The different ways to minimize taxes can be divided into three basic levels:⁷¹

Tax evasion is the general term for any kind of efforts by taxpayers to evade taxes by *illegal* means. This can mean, for example, incomplete or false tax reporting or otherwise acting in a fraudulent manner. In income taxation, this means declaring either less income (or profits or gains) than actually earned or overstating deductions. Thus, the tax evader tries to achieve his goal by concealing facts and misrepresenting them. Tax evasion (or tax fraud) is criminalized, and it is obvious that tax evasion efforts are not socially responsible activities. However, with large multinational enterprises, illegal abuse is the exception rather than the rule; their tax strategies and tax behaviour usually comply with the *legal* requirements of the countries involved.

A distinction must be made between *illegal* (criminal) tax evasion and *legal* (non-criminal) tax avoidance. Tax avoidance means the legal utilization of the tax regime to one's own advantage in order to reduce the amount of tax that is payable, by means that are within the law, or at least within the *letter* of the law. The tax avoider makes – at least formally – full and truthful disclosure of all the facts. In tax avoidance, legal formalities are used to get tax advantages. Tax avoidance transactions are either mainly or only made for tax purposes. Tax avoidance transactions are often artificial, lacking valid business reasons. Thus, the question is not about the disclosure of the facts; instead, the question is often the purpose and real substance of the actions or transactions. Despite the fact that these transactions are formally legal and that they are also fully and truthfully disclosed, they go against the *purpose* of tax law. Although the actions taken are formally presented to the tax authorities, the ultimate purpose or the real economic significance of the actions is often hidden.

It is very difficult to give an exact definition of tax avoidance.⁷² Also, it is important to notice that tax avoidance is not criminalized and, as a matter of fact, the difficulty to give an exact definition is the core

71. See also Knuutinen (2013).

72. See e.g. OECD (Centre for Tax Policy and Administration): Glossary of Tax Terms (www.oecd.org): "A term that is difficult to define but which is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that, although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law it purports to follow."

of the problem. If tax avoidance could be exhaustively defined, it could also be criminalized.

In any case, we can still generally describe and characterize tax avoidance. Furthermore, in the tax legislation of many countries, for example in Finland and Sweden, there is a general anti-avoidance provision (or act), for which purposes there has to be some kind of legal definition for tax avoidance.⁷³ As we know, however, these legal definitions are often somewhat ambiguous.

As tax avoidance is against the purpose of tax law it is quite obvious that tax avoidance efforts are not socially responsible activities, either. However, it is not always easy for taxpayers to know in advance what behaviour is tax avoidance and what is not, although according to the principle of legality, taxpayers should know their legal position beforehand.

The line between tax evasion and tax avoidance is easy to draw conceptually, but the line between tax avoidance and tax planning is quite difficult.

Tax planning (or tax mitigation) often refers to the transactions of taxpayers which are not, per se, against the purpose of the tax law. At least in the framework of the national tax system, the legislator has explicitly or implicitly accepted this kind of actions for tax purposes. The choice between forms of legal incorporation (e.g. to conduct one's business as a company or as a partnership) is, for instance, acceptable tax planning even though it may dramatically alter tax consequences.

Despite the fact that tax planning is acceptable it sometimes raises a number of concerns. Opportunities for tax planning vary for different kind of taxpayers. Therefore, tax planning can also lead to an unjust distribution of the tax burden, as well as to inefficiencies in the economy if the taxpayers make decisions they would not make in a tax-free economic situation.

Income tax systems are not usually consistent and coherent; on the contrary, they include different kinds of distinctions and discontinuities, with no relevant equivalences in the economic reality. These features are used both in tax avoidance and in tax planning. Different kinds of distinctions and discontinuities are especially common and

73. In Finland, Sec. 28 of the Act on Assessment Procedure 18.12.1995/1558 (*laki verotusmenettelystä*). This general anti-avoidance provision may be applied in the case of any arrangement with a clear tax avoidance purpose. Based on the general anti-avoidance provision, it is possible to deny any tax benefits that would not have been available had the taxpayer used the form of an arrangement or a transaction that corresponds to the actual nature of the arrangement or transaction. The general anti-avoidance provision applies both to domestic and cross-border situations.

troublesome in the international framework, that is, between different tax systems.

The phrase “aggressive tax planning”, as opposed to regular or “acceptable” tax planning, has been used on several occasions recently.⁷⁴ Aggressive tax planning can be characterized, for instance, by an intensive use of legal and financial tools, establishments in foreign tax havens, unbalanced capital structures and transfer prices, or a disingenuous use of tax treaties. Still, aggressive tax planning is not a legal concept so there is no legal definition for it. Instead, the question is more or less about where to draw the line of moral acceptability, which runs on the inside of the tax planning area.

Moral views often vary between individual people and also over time. In the first place, taxpayers themselves have to draw the line between acceptable and unacceptable tax planning activities. However, it is often more crucial where this line is drawn by the different stakeholders and the whole surrounding society: media, customers, investors, etc. Taking a purely technical approach to tax planning is unlikely to protect companies from charges of irresponsibility and associated reputational damage.⁷⁵

In sum, from the CSR point of view, aggressive tax planning can be defined as actions taken by taxpayers (i) which are *in the line of requirements of tax law*, but (ii) which *do not meet the reasonable and justified expectations and requirements of the stakeholders*.

There are, however, some differences between the perspective of the managers and that of the tax authorities when evaluating aggressive or improper tax behaviour. For the tax authorities, only the distinction between tax planning and tax avoidance – that is, the legal distinction according to the tax legislation – is relevant. For the companies, also the distinction between aggressive tax planning and regular tax planning – that is, tax planning based on and linked with proper and acceptable business reasons – may be relevant. The distinction between tax planning and tax avoidance is, of course, important for the managers as well, but it is not the whole story. They have to think about what kind of tax planning is acceptable from the CSR perspective, as well.

4.2. BEPS (Base Erosion and Profit Shifting)

Through aggressive tax planning, MNEs in particular are able to shift their (untaxed) business profits to other jurisdictions, also to tax havens. The OECD has emphasized that there is a growing perception that governments lose substantial corporate tax revenue because of

74. See also <http://www.oecd.org/ctp/aggressive/>.

75. SustainAbility (2006), p. 2.

tax planning aimed at shifting profits to locations where they are subject to a more favourable tax treatment, resulting in an eroding taxable base.⁷⁶

Aggressive tax planning and the tax havens issues are related to the question of inter-nation equity. OECD has been concerned about the erosion of the corporate tax base in OECD member countries and non-members alike. Some non-governmental organizations (NGOs) have emphasized that the question of equity and justice in taxation should be evaluated especially as a comparison between the rich industrialized countries and poorer developing economies.

The tax systems are local but the businesses are often global. The increasing globalization and the amount of cross-border business have made local taxation of companies more difficult, especially when it comes to large MNEs. This dilemma is described by the OECD as the following:

Domestic rules for international taxation and internationally agreed standards are still grounded in an economic environment characterized by a lower degree of economic integration across borders, rather than today's environment of global taxpayers, characterized by the increasing importance of intellectual property as a value-driver and by constant developments of information and communications technologies.⁷⁷

The OECD argues that there are several studies and data indicating that there is increased segregation between the location where actual business activities and investment take place and the location where profits are reported for tax purposes.⁷⁸ It is possible, for example, to be heavily involved in the economic life of another country through the Internet without having a taxable presence there.⁷⁹ The economy has, to some extent, become detached from the physical conditions.

Such aggressive tax strategies and activities may distort the fair distribution of tax revenues between states. Profit shifting may give multinationals an unfair competitive advantage against small and medium-sized enterprises (SMEs) which, on the average, carry their business at the more local level. In addition, profit shifting may lead to an inefficient allocation of resources and generally undermine voluntary compliance by all taxpayers.⁸⁰

Most "Base Erosion and Profit Shifting" (BEPS) strategies used by multinationals are based on the interfaces and differences of the tax

76. OECD (2013a), p. 13.

77. OECD (2013a), p. 5.

78. OECD (2013a), p. 15

79. OECD (2013a), p. 7.

80. See OECD (2013a), p. 8.

systems in the different states. In cross-border tax arbitrage the taxpayers rely on conflicts or differences between the tax rules of two countries to structure a transaction or entity with the goal of obtaining tax benefits. That is, with cross-border tax arbitrage, the taxpayer is utilizing incompatibilities and inconsistencies between different tax systems and the outcome can be either a reduced or a no-taxation situation.⁸¹

The OECD has identified problems first and foremost in the following areas:

- international mismatches in entity and instrument characterization, including hybrid mismatch arrangements and arbitrage;
- application of treaty concepts to profits derived from the delivery of digital goods and services;
- the tax treatment of related party debt-financing, captive insurance and other intra-group financial transactions;
- transfer pricing, especially in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents;
- the effectiveness of anti-avoidance measures, in particular general anti-avoidance rules (GAARs), controlled foreign corporation (CFC) regimes, thin capitalization rules and rules to prevent tax treaty abuse;
- the availability of harmful preferential regimes.⁸²

Technically, many of these tax planning actions are typically acceptable from the viewpoint of the national tax laws of each country. However, when taking two or more tax systems into consideration, these systems do not work together in such a way that their basic objectives would be realized in an appropriate manner.

4.3. The European Commission

As noted earlier, the European Commission only says a few words about tax issues in its CSR strategy, but in December 2012, it gave a recommendation concerning aggressive tax planning.⁸³

In its recommendation the Commission finds as follows:

81. About the cross-border tax arbitrage, see Ring (2002).

82. OECD (2013a), p. 6. See also “Action Plan on Base Erosion and Profit Shifting” (OECD 2013b) with some proposed actions to solve these problems.

83. Commission recommendation of 6.12.2012 on aggressive tax planning, C(2012) 8806 final (Brussels, 6.12.2012).

- (1) Countries around the world have traditionally treated tax planning as a legitimate practice. Over time, however, the tax planning structures have become ever-more sophisticated. They develop across various jurisdictions and effectively, shift taxable profits towards states with beneficial tax regimes. A key characteristic of the practices in question is that they reduce tax liability through strictly legal arrangements which however contradict the intent of the law.
- (2) Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. Aggressive tax planning can take a multitude of forms. [...]
- (3) Member States find it difficult to protect their national tax bases from erosion through aggressive tax planning, despite important efforts. National provisions in this area are often not fully effective, especially due to the cross-border dimension of many tax planning structures and the increased mobility of capital and persons.
- (4) [...]
- (5) [...]
- (6) [...]
- (7) [...]
- (8) As tax planning structures are ever more elaborate and national legislators are frequently left with insufficient time for reaction, specific anti-abuse measures often turn out to be inadequate for successfully catching up with novel aggressive tax planning structures. Such structures can be harmful to national tax revenues and to the functioning of the internal market. Therefore, it is appropriate to recommend the adoption by Member States of a common general anti-abuse rule, which should also avoid the complexity of many different ones. In this context, it is necessary to take account of the limits imposed by Union law with regard to anti-abuse rules.⁸⁴

Finally the Commission notes that to preserve the autonomous operation of the existing Union acts in the area concerned, this recommendation does not apply within the scope of directives in the field of direct taxation.⁸⁵

84. C(2012) 8806 final, pp. 2-3.

85. However, the Commission stated that a revision of these directives with a view to implement the principles underlying the recommendation was currently being considered by the Commission. In November 2013, the Commission gave a proposal for a directive amending Directive 2011/96/EU on

The formulation and the conditions for the application of the proposed General Anti-Abuse Rule are discussed hereinafter in the recommendation.⁸⁶ However, when looking at these formulations and conditions, it is difficult to say whether the question, under these prerequisites, is about tax avoidance or aggressive tax planning, after all.⁸⁷

As is well known, the recommendation is not binding law, but it could be regarded as a forecast of the direction in which the European tax law is developing in the long run. Also, it gives MNEs some guidance on what kinds of expectations there are regarding their tax behaviour.

The Commission has also taken other steps against aggressive tax planning. In April 2013, it set up an expert group, known as the Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation.⁸⁸ According to the decision, the term good governance in tax matters covers transparency, exchange of information and fair tax competition.⁸⁹ Members of the Platform represent the Member States' tax authorities as well as business, civil society and tax practitioner organizations.

4.4. Tax competition

It is clear that tax avoidance is not acceptable from the EU perspective.⁹⁰ As the EU Court has stated, nationals of a Member State must not improperly or fraudulently take advantage of the rights created by the Treaty and of the provisions of EU law, nor circumvent their national legislation.⁹¹ Still, the usage of the EU fundamental freedoms is not tax avoidance or improper use as such. On the contrary, creat-

the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. COM(2013) 814 final (25.11.2013). The proposal focuses on hybrid loans arrangements.

86. See C(2012) 8806 final, pp. 4-5.

87. See also C(2013) 2236 final, p. 2: "According to the Recommendation on aggressive tax planning, Member States should adopt a general anti-abuse rule under which they would ignore artificial arrangements carried out essentially for tax avoidance purposes and apply their tax rules instead by reference to actual economic substance."

88. Commission decision of 23.4.2013 on setting up a Commission Expert Group to be known as the Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation. C(2013) 2236 final (Brussels, 23.4.2013).

89. C(2013) 2236 final, p. 3.

90. This is supported also by the fact that the aim of preventing tax avoidance is included in many EU directives. See Weber (2005), p. 174.

91. See C-196/04 *Cadbury Schweppes*, Para. 35, with many references there to earlier case law.

ing internal market and cross-border activities between Member States are some of the main objectives of the EU.

MNEs have the freedom to establish new companies also in those Member States where the corporate tax rate is low, such as Ireland, or locate to and manage their intangibles in the Netherlands, for example, where taxes on royalty payments are very low. From the perspective of other Member States, however, these kinds of tax competition activities may understandably be undesirable. The European Commission promotes the principles of good tax governance – transparency, exchange of information and fair tax competition – in the relations between states. In addition, enterprises are also encouraged, where appropriate, to work towards the implementation of these principles.⁹² It is, however, difficult to draw the line between fair and unfair tax competition.

Multinational enterprises face the same demarcation problem. Can it be irresponsible, or classifiable as aggressive tax planning, to make use of the differences in tax systems within the European Union? Which is the society to whom a MNE should be responsible?

5. Reconciliation of the requirements of tax law and CSR

5.1. Tax planning – acceptable and necessary as such

As such, there is nothing wrong with tax planning, on the contrary, companies have to manage their taxation and perform the necessary tax planning activities, e.g. to avoid double taxation situations. The tax laws often offer alternative ways in which real economic transactions can be structured, and the options often have different tax consequences.⁹³ These options can, naturally, be used to one's advantage. The management of a company shall act with due care and promote the interests of the company, including tax management and tax planning.

Considering taxation as a CSR issue does not mean that more taxes must be paid than the law requires. Nor does it mean that tax planning should cease.⁹⁴ CSR must not create obstacles to the normal and appropriate tax planning activities. A very large part of corporate tax planning is appropriate and necessary, but in some cases and in some respects tax planning can be inappropriate from the stakeholders' point of view. Therefore, CSR can be seen to set some limits to and requirements for the tax planning activities.

92. COM(2011) 681 final, p. 7.

93. SustainAbility (2006), p. 2.

94. SustainAbility (2006), p. 2.

5.2. Aggressive tax planning and CSR

Previously, we defined aggressive tax planning, from the CSR point of view, as actions taken by taxpayers which are in line with the requirements of tax law, but do not meet the reasonable and justified expectations and requirements of the stakeholders. All considered, how can a company get to know what those reasonable and justified expectations and requirements of the stakeholders are?

The European Commission gives the following answer regarding CSR, in general:

For companies seeking a formal approach to CSR, especially large companies, authoritative guidance is provided by internationally recognised principles and guidelines, in particular the recently updated OECD Guidelines for Multinational Enterprises, the ten principles of the United Nations Global Compact, the ISO 26000 Guidance Standard on Social Responsibility, the ILO Tri-partite Declaration of Principles Concerning Multinational Enterprises and Social Policy, and the United Nations Guiding Principles on Business and Human Rights. This core set of internationally recognised principles and guidelines represents an evolving and recently strengthened global framework for CSR. European policy to promote CSR should be made fully consistent with this framework.⁹⁵

Many of the internationally recognized principles and guidelines above do not handle tax issues at all. The OECD Guidelines for Multinational Enterprises are, however, an exception. Some guidance is given in the Commission recommendation on aggressive tax planning, as well.⁹⁶

5.3. OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises are far-reaching recommendations addressed by governments aimed at MNEs operating in or from adhering countries. The guidelines provide voluntary principles and standards for responsible business conduct in areas such as human rights, employment and industrial relations, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. The Guidelines provide non-binding principles and standards for responsible business conduct in a global context that are consistent with applicable laws and internationally recognized standards.⁹⁷

95. COM(2011) 681 final, pp. 6-7.

96. C(2012) 8806 final.

97. See OECD (2011), p. 3. The OECD Guidelines were first adopted in 1976 as part of the OECD Declaration on International Investment and Multinational Enterprises. They have been reviewed five times since; the most recent update took place in 2011. All 34 OECD countries and also 11 non-OECD countries, namely Argentina, Brazil, Colombia, Costa Rica, Egypt, Latvia, Lithua-

Taxation is dealt with in a specific section of the Guidelines, where the following points are mentioned:

It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate. Complying with the spirit of the law means discerning and following the intention of the legislature. It does not require an enterprise to make payment in excess of the amount legally required pursuant to such an interpretation. Tax compliance includes such measures as providing to the relevant authorities timely information that is relevant or required by law for purposes of the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.

[...] Enterprises should treat tax governance and tax compliance as important elements of their oversight and broader risk management systems. In particular, corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated.

[...] Corporate citizenship in the area of taxation implies that enterprises should comply with both the letter and the spirit of the tax laws and regulations in all countries in which they operate, co-operate with authorities and make information that is relevant or required by law available to them. An enterprise complies with the spirit of the tax laws and regulations if it takes reasonable steps to determine the intention of the legislature and interprets those tax rules consistent with that intention in light of the statutory language and relevant, contemporaneous legislative history. Transactions should not be structured in a way that will have tax results that are inconsistent with the underlying economic consequences of the transaction unless there exists specific legislation designed to give that result.

[...] Enterprises' commitments to co-operation, transparency and tax compliance should be reflected in risk management systems, structures and policies. In the case of enterprises having a corporate legal form, corporate boards are in a position to oversee tax risk in a number of ways.

[...] A member of a multinational enterprise group in one country may have extensive economic relationships with members of the same multinational enterprise group in other countries. Such relationships may affect the tax liability of each of the parties. Accordingly, tax authorities may need information from outside their jurisdiction in order to be able to evaluate those relationships and determine the tax liability of the member of the MNE group in their jurisdiction. Again, the information to be provided is limited to that which is relevant to or required by law for the proposed evaluation of those economic relationships for the purpose of determining the correct tax liability of the member of the MNE group. MNEs should co-operate in providing that information.

[...] Transfer pricing is a particularly important issue for corporate citizenship and taxation. The dramatic increase in global trade and cross-border direct investment [...] means that transfer pricing is a significant determinant of the tax lia-

nia, Morocco, Peru, Romania, and Tunisia, adhere to the Guidelines. See Annual Report on the OECD Guidelines for Multinational Enterprises 2013, p. 11.

bilities of members of a multinational enterprise group because it materially influences the division of the tax base between countries in which the multinational enterprise operates. [...] Application of the arm's length principle avoids inappropriate shifting of profits or losses and minimises risks of double taxation. Its proper application requires multinational enterprises to cooperate with tax authorities and to furnish all information that is relevant or required by law regarding the selection of the transfer pricing method adopted for the international transactions undertaken by them and their related party. It is recognised that determining whether transfer pricing adequately reflects the arm's length standard (or principle) is often difficult both for multinational enterprises and for tax administrations and that its application is not an exact science.⁹⁸

The guidelines use the term "corporate citizenship" which in this context means more or less the same as corporate social responsibility.

These recommendations seem to set very strict and high standards for multinationals. *If* all MNEs and all countries actually followed the guidelines, many problems discussed in this article would already be solved. However, this is not the case in practice.

5.4. Reporting requirements

The reporting requirements of tax payments have been discussed on many occasions lately. Many companies have voluntarily started to report their tax payments on a country-by-country basis in their sustainability or CSR reports. Within the European Union, there has been much discussion about whether this kind of reporting even should be compulsory for bigger companies,⁹⁹ as the International Financial Reporting Standards (IFRS) do not require country-specific reporting.

Corporate responsibility reporting is, by definition, not limited by geography. There are many different kinds of standards for CSR reporting and the application of these standards is, at least in principle, voluntary. In practice, large companies may have to follow them because of the expectations of their stakeholders.

The *Global Reporting Initiative* (GRI) are the most popular corporate responsibility reporting guidelines. According to these guidelines, a sustainability report conveys disclosures on an organization's impact, be they positive or negative, on the environment, the society and the

98. OECD (2011), pp. 60-62.

99. See Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC. See also COM(2013) 207 final (Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups).

economy.¹⁰⁰ The new G4¹⁰¹ has an increased emphasis on the need for organizations to focus their reporting process and final report on the topics that are *material* to their business and their key stakeholders. This materiality focus will make reports more *relevant*, more credible and more user-friendly.¹⁰²

The present GRI G3 version does not say much about taxes,¹⁰³ but the new G4 version deals with tax issues more clearly:

All organization taxes (such as corporate, income, property) and related penalties paid at the international, national, and local levels. This figure does not include deferred taxes because they may not be paid. For organizations operating in more than one country, report taxes paid by country. [...] ¹⁰⁴

Relevance is emphasized throughout the guidelines. How, then, can companies evaluate what is relevant? As the purpose of reporting is to inform stakeholders about the organization's impact on the environment, society and economy, perhaps it is best to discuss with them what the most relevant information is. In the end, relevant information is whatever the stakeholders need to assess the implementation of corporate social responsibility.

The term "tax footprint" is sometimes used referring to country-by-country reporting. However, I argue that the term *tax contribution* is more suitable in this context. Taxes are *positive* for society while carbon dioxide emissions, for instance, are not.

On the other hand, tax contribution in country-specific numbers alone does not always give stakeholders enough information to assess whether the distribution of tax revenues implements inter-nation equity between states. To make this kind of an assessment one should know much more about, for example, the financial structure of the group or the transfer pricing practices.

100. GRI G4, Part 1 (2013), p. 3.

101. Reports published after 31 December 2015 should be prepared in accordance with the G4 Guidelines. See GRI G4, Part 1 (2013), p. 14.

102. GRI G4, Part 1 (2013), p. 3.

103. GRI G3 does not even mention the term "tax". Instead, the term "payments to government" is used. See GRI G3.1, p. 26: "EC1 Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments."

104. GRI G4, Part 2, pp. 69-70.

6. Conclusions

Whether or not taxes belong to the CSR agenda has been somewhat ambiguous. As a matter of fact, the role of economic responsibility as a part of CSR is a bit obscure. This is due to the fact that the Companies Act quite clearly indicates the actors to whom a company first and foremost has an economic responsibility.

Although in connection with CSR all three areas, the *triple bottom line*, are usually discussed, in practice the ecological and social responsibilities have received most of the attention. This is reflected, for example, in the definitions of corporate responsibility, the ISO standards, and CSR reporting. At the same time, it is clear that a company needs economic success in order to take care of any kind of responsibilities. Without companies or enterprises, there is no corporate responsibility.

Lately, many signs have indicated that taxes are a CSR issue, regardless of what companies themselves think about the fact. The stakeholders seem to expect that companies report on their taxes, tax strategies and tax activities more than the law or the IFRS require. There are mixed views, however, as to whether these increasing expectations or requirements on reporting should be enacted in the law or whether it is better if companies can do it on a voluntary basis. By definition, CSR operates on a voluntary basis. In principle, the voluntariness and flexibility of the reporting requirements also makes it possible for companies to focus on relevant issues in their reporting. (It would be a different matter altogether if all companies would report on their relevant tax issues just on a voluntary basis.)

One of the drivers for the increased attention to tax matters has been the fact that the public finances in many countries have suffered due to the financial and debt crisis since 2008. The changes can be seen in the public opinion and in the media attention, but also in the actions of the states competing for the tax revenues. This competition takes place, in the first place, with regard to tax policies. Lately, there have been many signs that also the tax authorities in many countries have activated their defence of the local tax base. At the same time, digital services and e-commerce have fundamentally changed the structures of the economic activities and value chains of international business. As OECD states, there is increased segregation between the location where the actual business activities and investments take place and the location where the profits are reported for tax purposes.

In addition to all the issues discussed above, tax havens bring their own additional questions. Tax havens are definitely a big global problem. However, it is not easy to draw a line between countries that are tax havens and those that are not. The Netherlands and Luxembourg,

for example, also offer some tax benefits for multinational enterprises but maybe still should not generally to be considered tax havens.

All of the above considered, from the viewpoint of a single welfare state, it is quite obvious that responsibility with tax matters is desirable. Corporate social responsibility but also responsibility and fairness in tax competition is needed for the implementation of inter-nation equity.

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