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The Ethics and Business Diplomacy of MNE Tax Avoidance

Duane Windsor

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Abstract

Purpose — This chapter examines the ethics and business diplomacy of legal tax avoidance by multinational enterprises (MNEs).

Design/methodology/approach — The methodology assembles the relevant literature and examines alternative interpretations of corporate tax strategy. Key topics include business ethics and responsibility, business sustainability, economic patriotism and corporate inversions, tax havens, and possible solutions.

Findings — The debate concerns whether legal tax avoidance is unethical and/or poor business diplomacy. There are three possible strategies for MNEs. One strategy is intentional tax avoidance. Another strategy is business–government negotiation concerning tax liability. Another strategy is business diplomacy aimed at maximizing the social legitimacy of the firm across multiple national tax jurisdictions.

Social implications — The chapter assesses four possible solutions for corporate tax avoidance. One solution is voluntary tax payments beyond legal obligations whether out of a sense of ethics or a strategy of business diplomacy. A second solution is international tax cooperation and tax harmonization in ways that minimize opportunities for tax avoidance. A third solution is increased stakeholder pressure emphasizing business diplomacy and tax cooperation and harmonization. The fourth solution is negotiated tax liabilities between each business and each jurisdiction.

Originality/value — The chapter provides an original systematic survey of the key aspects of corporate international tax avoidance in an approach in which business ethics and business diplomacy are better integrated. The value of the chapter is that

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it provides information and assembles relevant literature concerning corporate international tax avoidance, and addresses possible solutions for this problem.

Keywords: Corporate inversion; corporate tax responsibility; economic patriotism; tax avoidance, tax havens, tax minimization

Introduction

This chapter examines the ethics and business diplomacy of tax minimization through tax avoidance or tax sheltering by multinational enterprises (MNEs). This focus excludes state-owned enterprises (SOEs) and purely domestic businesses. The chapter uses the terms business and corporation interchangeably for MNEs. Also, business diplomacy and corporate diplomacy are basically the same; business ethics and corporate ethics are basically the same. Ethics denotes a rationale for accepting a moral obligation not required by law. (There is a general moral obligation to obey the law, but civil disobedience doctrine provides a basis for disobeying immoral laws.) Acceptance might be strictly voluntary, in the sense that executives and directors wish to be ethical, fair, and just; or responsive, willingly or grudgingly, to stakeholder and social expectations, in the sense of corporate social responsiveness. A growing body of literature calls for nonavoidance behavior by businesses on ethical or responsibility arguments. That is, ethical and responsible businesses willingly should pay taxes beyond legal requirements. The usual rationale is the desperate social need for tax revenues. This set of arguments will be termed corporate tax responsibility (CTR), as a special category within business ethics and corporate social responsibility (CSR). Business diplomacy involves a broader commitment to the public good. In addition to assessing the ethical and responsibility literature on nonavoidance behavior, this chapter explores the business diplomacy strategy of nonavoidance behavior.

In general terms, business diplomacy in an international business environment of multiple stakeholders, of variable power and importance to an MNE, concerns maximizing corporate legitimacy through responsiveness to social public demand in order to improve the public good (Ordeix-Rigo & Duarte, 2009; Wolters, 2012). Stakeholder views of tax policy and tax compliance involve variable conceptions of fairness and burden (Chittenden & Foster, 2008). As a result, an optimal outcome in which all affected stakeholders are reasonably satisfied voluntarily seems unlikely, but not strictly impossible.

To address the ethics of tax avoidance in a business diplomacy strategy, the chapter will examine tax avoidance, tax minimization, fairness, burden, corporate citizenship, economic patriotism, and related concepts (including especially CSR and business diplomacy strategy). The chapter will link this conceptual examination to the ongoing efforts at improved tax coordination in the European Union (EU) and across multiple countries. The issues of corporate inversions and tax havens will be discussed.

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This examination includes descriptive (what is), instrumental (how to), and normative (ought to) dimensions. While business diplomacy can be a purely instrumental strategy to maximize a MNE's social legitimacy in relationship to social public demand/expectations, ethics adds a normative dimension to strategic judgment. A prescriptive theory of CTR combines instrumental and normative considerations. Shareholders of MNEs have a strong financial interest favoring reduction of avoidable tax liabilities, so that increasing voluntary tax payments may or may not be the obvious choice. Tax minimization can occur through legal tax avoidance or illegal tax evasion. "Loopholes" – even if obtained by corporate lobbying or close tax code interpretation – are legal devices. A tax code is a purely positive enactment, although theoretically resting on normative conceptions of fairness concerning progressivity and relationship of benefits obtained to taxes paid. Various MNEs may be structured intentionally and legally for global tax minimization through "tax avoidance in every jurisdiction" (Christensen & Murphy, 2004, p. 37). A carbon tax for reducing climate change effects may become part of the tax environment for MNEs.

The key definitions used in this chapter are as follows. An MNE is a private business – whether publicly traded or privately owned – that operates in two or more (and typically multiple) national tax jurisdictions. A two-jurisdiction MNE could have two home countries – as illustrated by Royal Dutch Shell headquartered in the Netherlands and the United Kingdom. A multiple-jurisdiction MNE will typically have only one or two home countries, with all other jurisdictions being host countries. Operating across national tax jurisdictions, an MNE can adjust tax liabilities through various legal devices permitted by those tax jurisdictions. Tax minimization is action to reduce liabilities and payments to tax authorities. A business can minimize taxes by tax avoidance, tax evasion, or corrupt payments. Tax avoidance or tax sheltering is legal reduction of overall tax liability. Tax codes permit the adjustments involved. If jurisdiction 1 has a lower tax rate and jurisdiction 2 has a higher tax rate, and if the MNE can arrange to have tax liability shifted from jurisdiction 2 to jurisdiction 1, then the MNE is (1) minimizing tax liability, and (2) engaging in tax avoidance in jurisdiction 1. Tax evasion or tax cheating is illegal reduction of tax liability, but such evasion or cheating occurs more with individuals or businesses operating in the shadow economy. Tax evasion appears more likely with domestic businesses than with MNEs (Bordignon & Zanardi, 1997). It is not impossible that corrupt payments could be made to tax authorities. Tax cooperation is intergovernmental coordination in tax matters, such as exchange of information. Tax harmonization means identical or closely similar taxes across countries, particularly in a particular region such as the EU. There all member-states must have a standard value-added tax rate of at least 15% (there are certain exceptions for which the reduced rate must be at least 5%), essentially to avoid tax competition through rate reductions. Typically, tax harmonization involves increasing tax rates in the lower tax jurisdictions, rather than adjusting higher tax rates downward. In principle, however, tax harmonization could be reduction of higher tax rates – and that option is one possibility for addressing corporate tax avoidance. A tax haven is a jurisdiction which affords relatively low or zero taxation in order to attract businesses (or individuals), in what amounts to tax competition.

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A purely domestic business in a unitary state cannot legally make analogous adjustments. The business is either in compliance or not in compliance. Noncompliance is tax evasion. Within a federal system, such as the United States., Canada, or Australia, a domestic business might be able to adjust tax liabilities analogously across state/province and local tax jurisdictions. A purely domestic business in a federal state thus faces a situation analogous to that of the MNE: the domestic business may operate across subnational tax jurisdictions. There is thus an important broader setting for studying the ethics of tax avoidance and tax minimization, but the focus in this chapter is on tax avoidance by MNEs.

The remainder of this chapter following this introduction is organized into seven more sections. The second section provides "A Conceptual Framework for Assessing MNE Tax Strategy." The third section examines "Ethics and Responsibility in Tax Avoidance." The fourth section discusses "Business Diplomacy in Tax Contribution." The fifth section addresses "Economic Patriotism and Corporate Inversion" – with special attention to the United States. The sixth section considers the roles of "Tax Havens and Transfer Pricing Practices." The seventh section assesses "Four Possible Solutions." The concluding eighth section places tax avoidance in the broader context of what the author terms public policy avoidance through the ability of businesses to shift activities across legal codes.

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A Conceptual Framework for Assessing MNE Tax Strategy

In January 2016, Google agreed to pay about $140 million in "back taxes" to the United Kingdom calculated through a change in how the firm measures financial performance in that country. Google's European headquarters is in low-tax Ireland. Previously Google's attitude had been expressed as "Google's tax avoidance is called 'capitalism', says chairman Eric Schmidt" (The Telegraph, 2012).

Tax avoidance has been a key policy topic among developing countries, and has become a hot policy topic in the United Kingdom and Europe, and seems particularly directed at U.S. firms and certain tax havens within or near the EU (Christians, 2014; Krugman, 2013). Starbucks has been a target of expressed concerns (Fairless, 2015). Apple has been another prominent company under public scrutiny in the United States (Lochhead, 2013a, 2013b). A merger resulting in Wahlgreens Boots Alliance was highly controversial (Ethical Performance, 2013; War on Want, 2013a, 2013b). Within the EU, while not alone Ireland and Luxembourg have been under particular pressure to reform tax policies attracting U.S. companies (*Houston Chronicle*, 2014d, 2014e; *New York Times*, 2014). In the United States, corporate inversion has become a hot policy topic. There are conflicting views among politicians, pro-tax activists, anti-tax advocates, and CEOs.

CEOs assert two positions: (1) they engage in strict tax law compliance, a legal argument (Bloomberg News, 2014a); or (2) engage in fair share payment, a moral argument (Lochhead, 2013b). There is a distinction between criminal and civil laws on the one hand, and public policy on the other (Wilson, 1989). Taxation is public

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policy, backed by criminal and civil penalties for deterrence and enforcement. But defining fair taxation is quite difficult. There is a basic distinction between benefit taxation (an individual or entity pays for benefits enjoyed) and ability-to-pay taxation (one individual or entity is able to pay more for the same benefits). The case for progressive taxation, on an ability-to-pay principle, can be characterized as "uneasy" (Blum & Kalven, 1952). One can argue reasonably that businesses should pay for benefits. Tax avoidance is more typically generated by more progressive taxation policies.

Corporate governance likely emphasizes incentives for legal tax avoidance (Armstrong, Blouin, Jagolinzer, & Larcker, 2015). One empirical study finds that tax-sheltering devices do not on average affect firm value, but do have a positive effect in the presence of good governance of the particular firm (Desai & Dharmapala, 2009). Justice Strine makes three key points. First, firms are profit-seeking organizations, staffed by profit-oriented people: "Instead of recognizing that for-profit corporations will seek profit for their stockholders using all legal means available, we imbue these corporations with a personality and assume they are moral beings capable of being 'better' in the long-run than the lowest common denominator" (Strine, 2012, p. 136). Second, the effectiveness of voluntary self-regulation is strictly limited: "In the end, policy makers should not delude themselves about the corporation's ability to police itself; government still has a critical role in setting the rules of the game" (Strine, 2012, p. 136). Third, international cooperation – of the type needed to handle tax havens and increase corporate tax payments – is difficult to achieve: "The coalition- and consensus-building required to develop an effective global (or at the least, OECD-wide) scheme of externality regulation will require enormous leadership and dedication. But it cannot even begin if we delude ourselves into believing that corporations will effectively regulate themselves" (Strine, 2012, p. 172).

Conceptually, there are three alternative tax strategies for an MNE. One can think of these strategies as lying along a continuum. At one end of the continuum is aggressive tax avoidance. An MNE operates to allocate capital and activities across national jurisdictions so as to minimize legally overall tax liability. This allocation may have to be weighed against its opportunity cost defined in terms of revenues generated in each jurisdiction. In some way, the MNE optimizes its tax strategy. At the other end of the continuum is business diplomacy tax strategy. An MNE operates to contribute to the public good in each tax jurisdiction. This contribution is something beyond the tax code, the minimum requirement being nonuse of loopholes in the tax code. The advantage to the MNE is that it maximizes its social legitimacy across tax jurisdictions. In the middle of the continuum is tax negotiation. The difficulty with the anti-tax avoidance criticism is that it (1) calls for voluntary tax payments beyond legal requirements, or (2) calls for changes in the tax code itself – such calls being political rhetoric to that purpose. The difficulty with the pro-business sustainability advocacy is that it sets no limit on the contribution. For MNEs, the middle of this continuum is negotiated tax payments with each national government. Negotiation implies that the outcome will be neither minimal (tax avoidance) nor unlimited.

Some MNEs effectively are globally footloose, meaning that there is no sense of loyalty to any home country. There is a scattered literature around the idea of globally footloose MNEs (Görg & Strobl, 2003; Van Beveren, 2007). A globally footloose MNE is one owing no loyalty to any particular sovereignty. Decentering and also what the present author will term "wandering" (from location to location) suggest that footloose MNEs will elect tax avoidance. Fiat's then CEO reportedly stated that the company is "Italian based but not an Italian company" (*Financial Times*, 2010). MNEs may have a natural tendency to "decenter" (or unbundle) for business purposes (Desai, 2009). Halliburton operates co-offices in Houston (headquarters) and Dubai (field operations).

Tax policy may be intertwined with what has been labeled corporate welfare, especially in advanced countries. The term corporate welfare, or alternatively crony capitalism, implies that governments subsidize businesses inappropriately and unnecessarily. Corporate welfare has been characterized as "socialism for the rich, capitalism for the poor" and more recently in connection with the 2007 financial crisis bailouts as "privatizing profits and socializing losses." One private estimate for the United States using a broad definition is some $92 billion in federal subsidies – direct or indirect – to businesses in fiscal year 2006 (Mattera, 2014; Slivinski, 2007).

Ethics and Responsibility in Tax Avoidance

Aynsley (2014) argued that paying fair share taxes is a corporate duty. This view depends on the definition of fair share and thus of fairness in taxation. A contrary view is that there is no such corporate duty and no harm in legal tax avoidance (Edwards, 2013). An appeal to superior virtue is not a demonstration that harm is occurring in legal compliance. The duty not to pay taxes greater than actual legal liability and the responsibility to help governments cope with their financial needs are in conflict, in a way that requires a sense of ethical judgment or a strategy of business diplomacy on the part of business executives and directors.

Tax avoidance means that MNEs can move across national tax jurisdictions, and tax rates vary markedly across those jurisdictions (Deloitte, 2015). The United States has a high business tax rate (combining federal, state, and local taxes). There are calls for businesses to adopt CSR standards on taxation (Christensen & Murphy, 2004). However, these calls have to invoke business transparency through publishing relevant accounting information, or business activities confined to some substantial economic purpose as distinct from profits-laundering (Christensen & Murphy, 2004; Payne & Raiborn, 2015). Strictly legal actions are ethically neutral rather than ethically suspect, although certainly not ethically superior (i.e., virtuous or just). Tax law doctrines aimed at reducing tax shelters include business purpose, economic substance, and pre-tax profit requirement (Weisbach, 2002, 2003). While such doctrines aim at increasing efficiency of the tax system, those doctrines cannot perfectly identify tax avoidance in advance. Thus, the doctrines may induce welfare distorting responses by taxpayers seeking to structure new tax shelters (Weisbach, 2002, 2003).

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The ethics of just taxation has a long history. Plato (circa 360 B.C.E.) stated in *The Republic* (Book I, cited in Rectenwald, 2012, p. 425): "... when there is an income tax, the just man will pay more and the unjust less on the same amount of income ..." From this perspective, illegal tax evasion or tax cheating is unjust. There is a theme of justice in Adam Smith's *The Wealth of Nations* (1776) (De Vries, 1989). Whether the same perspective can be applied to legal tax avoidance is more debatable. One cannot readily argue that an individual should pay more tax that is legally owed, although one can reasonably argue that the legal tax liability of an individual should be increased. Part of the debate about corporate tax avoidance thus turns on a distinction drawn between a corporation and an individual, although a corporation is an association of individuals to whom the net worth of the business belongs. Corporate tax is a tax on the owners or the shareholders.

Arguments against legal tax avoidance boil down to ethics and responsibility on a fair share basis, or appeal to the desperate financial needs of developing countries – whose governments are also often corrupt. The arguments tend to make voluntary tax contribution a minimum condition for demonstrating CSR (Dowling, 2014; Jenkins & Newell, 2013; Preuss, 2012). A study in India (Muller & Kolk, 2015) concluded that MNEs pay significantly higher effective rates than do local firms, with the higher payments found more in MNE subsidiaries known for CSR than in MNE subsidiaries less known for CSR. These findings contradict the general picture painted about tax avoidance in developing countries; although one could still argue that MNEs should pay more because they are more able than local firms. Another study isolated the ethics problem as aggressive tax avoidance (Christensen & Murphy, 2004, p. 37) illuminating the moral tone in a firm's leadership (Payne & Raiborn, 2015).

UNCTAD (2015) estimated that the foreign affiliates of MNEs contribute about $730 billion annually to the government budgets of developing countries. Systematic tax avoidance would imply that considerably more money could be contributed. But the problem is whether greater tax payments should go to developing countries or developed countries. Buried in this issue is the difficult problem of economic inequality between developing and developed countries (Garavini, 2015). An Oxfam report in January 2015 (Elliott, 2015) sates the richest 62 people hold as much wealth as the poorest half of the world's population. The UN has proposed taxing billionaires to transfer wealth to support development. The UN estimated more than 1,200 billionaires in 2012 with a combined worth of about $4.6 trillion (Krause-Jackson, 2012). A 1% levy on billionaires could raise up to $50 billion (Krause-Jackson, 2012). However, presently taxation would have to occur through national tax jurisdictions; and the issue remains why those countries should transfer wealth in this way.

CSR has received two contradictory definitions in the literature. One definition restricts CSR to voluntary altruism actions, beyond strict compliance with legal and business ethics standards. The intent of this restrictive definition is to make CSR activities appear unprofitable in any short-term time period. The definition can be relaxed somewhat through notions of strategic philanthropy, stakeholder subsidy of the firm. The other definition expands CSR to mean business ethics, legal

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compliance, and corporate citizenship (substituting for voluntary altruism). Lying between restrictive and expansive definitions of CSR is the problem of management's judgment concerning appropriate multiperiod strategy for the firm. Multiperiod strategy (including reputational effects among influential stakeholders and the possibility of changes in public policy) helps a costly CSR investment in the short term to yield either future profits or stronger reputational capital in the longer term. CSR practices can involve conflicting dimensions, such as a positive approach to communities but a negative approach to employees (Jung & Kim, 2016). Tax avoidance might indicate "bad" CTR, but not overall "bad" CSR. International taxation involves a distribution problem: between developed and developing countries, as well as between MNEs and host governments.

Business Diplomacy in Tax Contribution

Although the prevailing conception of business diplomacy is that it is distinct from and superior to lobbying or corruption of government, tax policy lies at the intersection of lobbying, business diplomacy, and business ethics (see Christians, 2014; Chu, Cheng, & Lai, 2015). Tax strategy is a test of business diplomacy, in the same sense that tax compliance is a minimum standard for CSR. Friedman (1970) argued that firms should obey laws and also basic ethical standards while lobbying government concerning beneficial public policies and eschewing discretionary (voluntary) CSR beyond legal and ethical standards. Voluntarily paying excess taxes presumably falls under Friedman's understanding of discretionary CSR. However, Friedman's conception automatically leaves discretion to management to make strategic judgments concerning how to balance competing stakeholder demands and expectations. Adam Smith (*The Theory of Moral Sentiments*, 1759) defined good citizenship as concern for community welfare beyond public policy compliance.

National tax codes can be riddled with so-called loopholes (i.e., technical exceptions). Tax policy lobbying obtains these loopholes. A "loophole" is commonly defined (Investopedia, n.d.) as "a technicality that allows a person or business to avoid the scope of a law or restriction without directly violating the law." Imperfect tax codes, riddled with loopholes or technicalities and varying globally by jurisdiction, permit persons or entities to minimize tax payments. A tax code is a set of detailed rules, rather than a set of guiding principles. Dworkin (1978) distinguishes among policy, principle, and rule. There is no economic advantage for a person or an entity to pay any tax beyond legal liability. While a person or privately owned entity might view overpayment (or overcompliance) as a virtue, in a publicly traded entity the notion of fiduciary responsibility to shareholders (whatever its inherent defects) must arguably be strongest in tax decisions. The decision to pay taxes voluntarily appears to rest on business diplomacy as a strategic orientation.

Legal lobbying is necessary in constitutional democracy both as protected free speech and as provision of essential information to public officials (Jindal, 2008;

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Loomis, 2006). Legal lobbying is a prerequisite condition and as such ethically neutral. Indicting public policy avoidance as unethical requires a standard for fair taxation or just compliance (Aynsley, 2014; Mankiw, 2007; Weiss, 1993). Proposed standards are typically political claims in moral clothing. There is an allegation that an organization such as the American Legislative Exchange Council (ALEC) prepares legislation proposals for businesses (American Association for Justice, 2010).

Kaufmann and Vicente (2011) argue that legislatures determine what forms of corruption are legal or illegal. Firms can also make choices with respect to corruption practices. "When faced with a regulatory constraint, firms can either comply, bribe the regulator to get around the rule, or lobby the government to relax it" (Harstad & Svensson, 2011, p. 46). Harstad and Svensson find that at lower levels of country development firms tend to bribe, switching at higher levels of country development to lobbying. The corporate benefits and ethics of lobbying (Susman, 2009) are debated topics featuring inconclusive findings on the whole.

One author proposes, for the United States, that certain tax subsidies be disallowed to business corporations that spend more than some minimum amount (say $1 million per year) on nondeductible lobbying and other political activities (Seto, 2010). One estimate is that in 2008, there was more than $3 billion in U.S. lobbying activity (Alexander, Mazza, & Scholz, 2009, p. 401). Alexander and his colleagues estimated a one-time 22,000% return ($62.5 billion in 2008 benefits, $282.7 million in lobbying cost during 2003–2004, and $220 per $1 lobbying) based on the tax holiday on repatriated earnings authorized by the American Jobs Creation Act (AJCA) of 2004. The AJCA permitted a one-time-only repatriation of foreign earnings at a reduced 15% tax rate. Generally, corporate tax returns are confidential. Under the AJCA, the benefits were publicly disclosed in audited financial statements. The authors collected lobbying data from a number of sources. The study identified 496 repatriating firms, of which 476 provided information on repatriation amount ($298 billion in aggregate) and resulting taxes. Of this set, 93 firms engaged in lobbying for the AJCA and repatriated in aggregate $208 billion (70% of the total repatriation). Regression analysis, including a variety of controls, found that lobbying was highly associated with amount repatriated. Several firms borrowed funds to repatriate as "earnings." Industry and firm size were the best predictors of repatriation; profitability was not, although repatriating firms were more profitable, and cash was not.

Farrell (2011) points out that the Alexander study provides no evidence that any votes were changed as a result of the lobbying activities of the 93 firms. The legislators might have voted the same way, on ideological grounds. Rather the study's finding was that lobbying firms benefited more than nonlobbying firms. Farrell points out further that larger firms likely had more funds to spend on lobbying. However, Farrell concedes that in theory lobbying has some benefit, or firms would not lobby; his point of criticism is that the estimated rate of return is far too high. One might interpret the action of the lobbying firms as something like a hedge: better to put up $282.7 million (some of which might have been spent anyway on lobbying) just in case (and in a successful hedge subtracted from the resulting benefits).

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Economic Patriotism and Corporate Inversion

Minimizing tax liability in the home jurisdiction involves the issue of economic patriotism, which can be defined as practicing proper corporate citizenship at home. Minimizing tax liability in a host jurisdiction involves the issue of proper corporate citizenship abroad. A "footloose" MNE effectively accepts no moral allegiance (patriotism) to a home jurisdiction in the conventional sense. A broader context for CSR occurs when a jurisdiction's governmental/political system is corrupt in forms of illegal bribery and extortion.

The rhetoric of economic patriotism has appeared in both the United States and Europe (Clift & Woll, 2012; Obama, 2012). Obama used the term in the 2012 presidential campaign (Bump, 2014; Croucher, 2015). The notion of "economic patriotism" or "corporate citizenship" as a true citizen of a home country is in conflict with realities of global business opportunities (Foroohar, 2012; Shapiro, 2012). It remains debatable whether a concept of economic patriotism can be applied effectively to an MNE (Yosifon, 2016).

On September 22, 2014, in announcing new rules aimed against inversions, Treasury Secretary Jacob Lew stated: "These transactions may be legal, but they're wrong" (Davis, 2014, p. D1). On September 22, 2014, Treasury Secretary Jacob Lew announced rules intended to reduce or eliminate the economic incentives for inversions (Davis, 2014). Reported pinion among corporate advisers was that the effect would be to make inversion deals less lucrative rather than to halt deals (*Houston Chronicle*, 2014b). In a letter to the Congress which is available online for ready access, Lew (2014) wrote: "... these firms are attempting to avoid paying taxes here, notwithstanding the benefits they gain from being located in the United States." He characterized the attempt as "effectively renouncing their citizenship to get out of paying taxes" and articulated the notion of economic patriotism: "What we need as a nation is a new sense of economic patriotism, where we all rise or fall together."

In September 2014, five liberal U.S. Senators (four Democrats and one Independent) sent a letter to the CEO of Burger King opposing the move of its corporate headquarters to Canada from Miami. The letter reads in part: "We believe you will find that turning your back on your loyal U.S. taxpaying customers by renouncing your corporate citizenship is not in the best interest of Burger King or its shareholders." The letter also accuses Burger King in the words of a news report "of trying to avoid paying its fair share for roads and other public services it receives in the United States" (*Houston Chronicle*, 2014a). The letter contains the following notions: loyalty, corporate citizenship, best interest, fair share, and corporate benefit ("roads and other public services").

In a corporate inversion, a firm merges with or acquires a smaller firm in a different country and relocates its legal business address to the other country for the purpose of shifting legal and tax residence (Freedman, 2014). It is not strictly established that tax breaks drive corporate inversions (Hall, 2014). Corporate inversion is just one form of tax avoidance. Other forms include for example "transfer-pricing, re-invoicing, offshore 'special purpose vehicles', ... dubious charitable trusts ..."

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(Christensen & Murphy, 2004, p. 37). Senator Charles Schumer (D-NY) called for Congressional legislation to stop "earnings stripping" in which a parent company loads a U.S. subsidiary with tax-deductible debt (Davis, 2014, p. D6). In so-called "dividend arbitrage" operating mostly through London banks may temporarily transfer ownership of client shares to a lower tax jurisdiction when a dividend is expected.

The U.S. Congressional Research Service (Marples & Gravelle, 2014) reports that 75 U.S. firms have made inversions over the past two decades (Freedman, 2014). Recent inversions include pharmaceuticals AbbVie (Chicago) and Mylan (Pittsburgh) shifting to Europe (Freedman, 2014). Accenture, once Andersen Consulting, went to Bermuda in a 2001 inversion and is now incorporated in Ireland (Bump, 2014). Certain oil field services providers originally headquartered in Houston moved early (Freedman, 2014). Transocean moved to the Cayman Islands (1999), and then to Switzerland (2008). Noble Corp. moved to the Cayman Islands (2002), then to Switzerland (2009), and then to London (2013). Weatherford International moved to Bermuda (2002) and then to Switzerland (2008) (Eaton, 2014a). The three firms saved an estimated $2.923 billion in taxes during 2002−2009 (Freedman, 2014). A corporate inversion both saves taxes and facilitates repatriation of foreign earnings to the United States (Freedman, 2014).

There appear to be three kinds of corporate inversions: (1) to please host-country regulators; (2) to reduce aggregate tax liability; (3) to take advantage of regulation havens. Burger King's shift to Canada appears to be an instance of pleasing Canadian regulators concerning acquisition of a Canadian firm rather than (2) or (3).

The most general approach to altering economic inversions would be to reduce corporate tax rates and go to residence-neutral taxation so that location is irrelevant. Public policy solutions may tend to create new loopholes. A 2004 law attempted to reduce inversions by requiring a 20% threshold: former U.S. shareholders must own less than 80% of the merged company (Freedman, 2014). Firms introverting prior to the law are not affected by the requirement (Freedman, 2014), and presumably not by new requirements

The recent rise in corporate inversions in the pharmaceutical industry likely reflects high profitability such that there are significant tax advantages (Professor Mark V. Pauly, quoted in Knowledge@Wharton, 2014). One proposed policy option is to reduce the U.S. corporate tax rate and tax code complexity. The Obama administration proposes requiring shareholders to own 50% of the new entity, and a so-called "smell test" in which companies operating primarily in the United States would be treated for tax purposes as U.S. corporations (Freedman, 2014).

Tax Havens and Transfer Pricing Practices

Tax havens, and similarly special purpose entities operated abroad, are a tax avoidance opportunity provided by a host national government. Transfer pricing is an internal business choice, subject to home-country and host-country regulations.

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Corporate tax strategy can be separated into two different kinds of problems. One problem, discussed earlier, involves jurisdictions that are less "developed" and sometimes markedly corrupt. The other problem involves tax havens among jurisdictions that may be comparably "developed" economically and politically. The EU is trying to address certain tax havens allegedly operated by certain member-states. Tax havens typically offer reduced tax rates to attract MNE activities (Gravelle, 2013; Redinova & Smrcka, 2013).

A study of firms headquartered in Bermuda and the Cayman Islands – which are offshore finance centers (OFCs) – found a significant discretionary between tax avoidance behavior and use of formal tools to profess CSR (Preuss, 2012). The author characterizes this discrepancy as duplicity.

With respect to tax havens (see Ali Abbas, Klemm, Bedi, & Park, 2012; Krugman, 2013), Kay (2013) has recommended a number of possible reforms: "... removing interest deductibility, introducing an allowance for the cost of corporate equity or shifting the tax base towards cash flow rather than accounting profit. ... Opportunities for tax avoidance are everywhere and always the consequence of rules that treat economically similar transactions differently." Additionally, such rules as exist are rarely enforced, as authorities prefer to negotiate (Kay, 2013). Kay advocates taxing shareholders rather than companies, and if necessary for some reason to tax companies then to tax free cash flow or economic rent (i.e., earnings in excess of cost of capital). One study (Becker & Fuest, 2010) suggests that optimal tax-enforcement policy may be difficult to design in the presence of tax havens. An empirical examination of 2,067 U.S. MNEs (1994–2009) found greater earning management if the firm operates extensively in weak rule of law countries than if the firm operates extensively in strong rule of law countries (Dyreng, Hanlon, & Maydew, 2012). The study developed a similar finding with respect to extensive subsidiaries in tax havens. However, the study also concluded that most earnings management occurred in domestic rather than foreign income.

For the period 1993–2010, generating 16,340 firm-years, tax avoidance tends to coincide with less timely annual earnings announcements operating through greater temporary and permanent book-tax differences. Tax avoidance also impacts value-relevance of earnings to investors at announcement date (Crabtree & Kubick, 2014).

MNEs may hold an estimated $2 trillion in low-tax jurisdictions (Bloomberg News, 2014b, quoting the OECD Secretary-General). Some 30% of cross-border corporate investment is routed through offshore hubs before reaching a final destination (UNCTAD, 2015). One estimate is that tax revenue losses for developing countries linked to offshore hubs total $100 billion annually (UNCTAD, 2015).

Transfer pricing is one of the approaches used to control tax jurisdiction location of profits and costs (Durst, 2011; Spencer, 2012). The EU commission found that low-tax treatment for Apple in Ireland, where the firm "funnels the bulk of its international sales through subsidiaries" using "exaggerated transfer pricing" (Baetz, 2014), is state aid that may be illegal under EU law.

The transfer pricing problem lacks a widely accepted theoretical solution and is a matter of proposed norm (Baistrocchi, 2006). Problems in defining policy are that

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(1) the arms-length standard (ALS) (Rectenwald, 2012, p. 426) must be estimated as there is no external transaction, (2) there is a cycle of offshore tax deferral while waiting for a repatriation holiday (Rectenwald, 2012, p. 449), and (3) there are disagreements (such as the Irish tax haven policy) hindering intergovernmental cooperation. There are two different model tax conventions, by the UN and the OECD, which are in some tension (Murphy, 2011). A reason for this tension is that the UN tends to represent the interests of developing countries and the OECD the interests of developed countries.

Four Possible Solutions

There is a lively debate over whether corporate tax avoidance can be fixed (Knowledge@Wharton, 2013). There are four general solutions to the problem of tax avoidance for discussion. Real outcomes will likely combine all four of these solutions in variable patterns.

(1) MNE management (executives and directors) can voluntarily make higher tax payments on an ethical conception that firms should pay some "fair" tax burden not defined by tax law requirements. This solution calls on one or both of ethics and business diplomacy. Fairness is difficult to define normatively. It is not possible to satisfy all stakeholder groups, as shareholders (and possibly employees if compensation or employment level is affected) can feel "unfairly" burdened through a voluntary choice of management. Virtue or responsibility takes the form of overpayment in violation of fiduciary responsibility. Economic patriotism is meaningful for domestic firms, with no option or interest to operate transnationally. The appeal cannot have useful relevance for an MNE operating across multiple jurisdictions. Public policy is open to influence efforts by the very MNEs to be regulated; and those MNEs may have opportunities to shift activities among jurisdictions in competition with one another.

Fair Tax Mark is a private certification that a firm complies with standards for fair tax compliance. SSE plc, the second largest UK energy supplier and a FTSE100 company, has Fair Tax accreditation (Fair Tax, n.d.). SSE is the first FTSE100 firm to get accreditation (SSE trailblazes, 2014; SSE plc awarded, 2015).

A study of 3,040 U.S. firms (1991–2010, involving 16,606 firm-year observations) found that internationalization is positively related to the firm's CSR rating (Attig, Boubakri, El Ghoul, & Guedhami, 2016). The authors found a similarly positive relationship for a large sample of firms from 44 countries. The positive relationship also held for firms with extensive foreign subsidiaries in strong rule of law countries.

A study using 217 tax-avoidant and 217 non-tax-avoidant firm-year observations for 2003–2009 from the Kinder, Lydenberg, and Domini database found that more socially responsible firms display less tax avoidance (Lanis & Richardson, 2015). CSR categories for community relations and diversity were particularly important in this relationship.

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(2) All tax jurisdictions might adjust taxation codes in some way that makes tax liability shifting infeasible. Tax avoidance might be reduced by coordinated tax policy changes. This solution requires difficult tax policy coordination, although initial efforts are underway (within the EU and across multiple countries) to do so. A fundamental difficulty in tax coordination is that (a) some jurisdictions will prefer higher tax rates and some jurisdictions will prefer lower tax rates, and (b) some jurisdictions may see incentives to "cheat" on the coordination. Shareholders may complain about tax policy, but not about management compliance with tax policy. Tax coordination involves division of a fixed pie, together with the dynamics of how tax rates influence economic growth and thus tax yield over time. An international tax organization (Horner, 2001) may not be able to cope with the distributional politics of this division.

While better international coordination might reduce location advantage with respect to tax liability, there may be other location advantages, as reflected in Burger King's decision to relocate to Canada. An alternative to international policy coordination is parallel domestic tax reform in enough countries so that the problem of international cooperation does not arise.

A simpler approach is international cooperation rather than tax coordination (Bank, 2013). OECD is working on plans for exchange of information concerning corporate tax avoidance strategies (Bloomberg News, 2014b). In late October 2014, 51 countries signed an accord to combat tax evasion through automatic exchange of tax information from 2017; however, Switzerland and the United States were not signatories. Switzerland maintains marked banking system secrecy; and the United States has opted to pursue its own strategy (Smale, 2014). The 51 signatories are members of the 123-country Global Forum organized by Germany and the United Kingdom to address tax evasion and fraud (Smale, 2014). The broader policy problem is to coordinate tax policy as distinct from tax enforcement through information exchange.

(3) Stakeholder groups may possess, or develop, sufficient "power" to influence MNE and tax policy choices. Politician "jawboning" (as in the United Kingdom recently) and media criticism are instances of such influence efforts. Responsiveness, of which tax compliance is a subcategory, can be to pressure by public officials, media, and/or stakeholders (external or internal).

Medtronic is acquiring Covidien, Ireland, for $43 billion to invert. In August, Medtronic disclosed its intention to reimburse its CEO for a $24.8 million inversion-generated tax bill. The 2004 law imposed a 15% tax on stock and option awards given to personnel of inverting companies (Knowledge@Wharton, 2014). While the new Treasury rules apparently halted a Salix Pharmaceuticals merger with an Italian drug firm's subsidiary, Medtronic disclosed in September that it will borrow part of the funds for the Covidien acquisition (*Houston Chronicle*, 2014c).

MNEs can lobby, or help corrupt, national governments. Lai (2014) added interest group influence into the standard tax competition model. A finding was that smaller countries do not necessarily set lower capital tax rates relative to larger countries. Rather the smaller country weighs political effect from

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lobbying against efficiency effect of lower tax rate. If the smaller country faces less lobbying effort, then it may set a higher tax rate than the larger country. In this approach, the tax rate partly depends on lobbying effort.

(4) Tax liability might be negotiated by MNE management with each tax jurisdiction in order to reduce likelihood of increase in formal taxation codes and to reduce stakeholder pressures. A possible difficulty in negotiation is that whether voluntary tax payments to corrupt governments have an ambiguous status under anti-corruption accords and statutes. This issue requires further investigation.

The difficulty is that negotiating power may lie with firms rather than with countries. In the period preceding the Scottish (referendum) vote on September 18, 2014, on independence from the United Kingdom, some important businesses expressed opposition to independence. Standard Life insurance stated that it might shift operations and legal entities (Rankin, Carnell, & Mongahan, 2014). Royal Dutch Shell and BP warned against secession because of reported concern regarding the prospect of increased oil-production taxes levied by Scotland (Eaton, 2014b). Two leading banks warned they would move corporate headquarters (Royal Bank of Scotland, which is majority owned by UK taxpayers following the 2008 government bailout) or legal entities (Lloyds Banking Group owner of Halifax and Bank of Scotland) to England (Hui & Kelbie, 2014).

Conclusion: The Broader Context of Public Policy Avoidance

There are four corporate approaches to managing business−government relations along a continuum from strongly ethical to strongly unethical: (1) strict compliance with public policy; (2) legal lobbying to change public policy; (3) public policy avoidance by shifting in some way; and (3) illegal corruption to change public policy. Compliance is strongly ethical. Legal lobbying and public policy avoidance are ethically neutral. Illegal corruption − typically bribes and improper donations − is strongly unethical.

As CTR is one dimension of CSR, so tax avoidance is one dimension of an expanded notion of public policy avoidance (Leitzel, 1996−1997). The broadest scope of this chapter becomes the question of public policy avoidance (in any form) by MNEs having the ability to move legal jurisdiction or shift activities. The essential question concerns whether and if so why virtuous behavior, good citizenship, and justice theory reach a limit when applied to legal tax and regulatory avoidance. A general conception of public policy avoidance includes instances such as corporate inversion, other tax avoidance, and regulatory haven decisions. These instances are legally permissible choices, but subject to moral and political criticism intended to promote voluntary self-regulation and changes in public policy strengthening regulatory controls. Economic patriotism and CSR arguments call for voluntary self-regulation by companies in advance of public policy changes.

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