The Ethics of Tax Avoidance and Tax Evasion

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Introduction
More than ever, the world’s technology is bringing individuals and information together almost instantly. Any mistake a company or individual makes is publicly communicated all over news sources and social media outlets almost as soon as it occurs. Due to this, it is more important than ever that companies ensure that their employees are working in a manner that the outside world would view as both ethical and within the law.

The topic of ethical behavior has grown increasingly important in business in recent years. Individuals are evaluated thoroughly on the bases of skills, experiences, and ethical record by a company before they are offered a job, with even one occurrence of unacceptable behavior capable of being the deciding factor of employment.

It is also important for individuals to maintain a strong moral compass once on the job. It is collective ethics of individuals that will create the ethical environment of the company. A behavior on the part of individuals that is viewed as unethical or immoral, could permanently damage the reputation of the company. One particular area that requires ethical decision making is that of tax practices, especially those related to differentiating between tax avoidance and tax evasion. This paper will examine such practices, and evaluate the severity of the ethical issues that surround them.
Examples of Tax Practices Requiring Scrutiny

In a recent Wall Street Journal article, author Strasburg examined the strategy of dividend arbitrage. Dividend arbitrage is explained as a strategy that is, “run largely from London, where the banks temporarily transfer ownership of a client's shares to a lower-tax jurisdiction around the time when the client expects to collect a dividend on those shares” (Strasburg, 2014).

The savings from this maneuver are then split between the bank and the clientele. This strategy may allow clients to reduce their taxes on dividends from 50 percent down to 10 percent (Strasburg, 2014). In some cases, companies may end up avoiding tax liability altogether.

This strategy is very popular. Certainly, while some may question the legitimacy of this tactic, these transactions have been found legal- at least for now. In recent months, Bank of America has been questioned by federal regulators about their involvement in such practices. This questioning suggests a foreshadowing of upcoming “legal and reputational risks,” that may develop from using this strategy (Strasburg, 2014).

Banks dealing with “hedge funders and broker-dealers” (Strasburg) will certainly be examined in a similar fashion in coming months. One manager of a financial firm noted that “from a financial point of view, it is a beautiful strategy, from a public point of view; no one wants to draw down the ire of a government” (Strasburg, 2014).

The grey area that arises from an action like this is whether or not this “dividend arbitrage” strategy should be seen as tax avoidance (taking extraordinary and complex measures to avoid tax payments), or tax evasion. Understanding this difference must be part of a company’s tax planning. Tax planning is defined as the strategy of “logical analysis of a financial situation or plan from a tax perspective, to align financial goals with tax efficiency planning. The purpose of tax planning is to discover how to accomplish all of the other elements of a financial plan in the most tax-efficient manner possible” (Investopedia, n.d.).

The line between planning and evasion is a fine one- and one rarely agreed upon in recent history. According to Back, it is proposed
that “tax avoidance, while legitimate, can be seen as aggressive when it involves using financial instruments and arrangements not intended as, or anticipated by, governments as a vehicle for tax advantage” (2013).

This point of view clearly opens up the debate to whether or not dividend arbitrage can be seen as ethical. Although it is legal as currently defined, it is obvious that companies and banks are using “financial instruments and arrangements” that were not intended to be used for such purposes; what is legal may not be ethical (Back, 2013).

**Ethics of Tax Practices**

Since the majority of these transactions take place in London, it is relevant to get the public’s perception regarding such actions. “In a 2012 Institute of Business Ethics survey carried out by Ipsos MORI, tax avoidance was the second most important ethics issue that the British public thought business needed to address” (Back, 2013). Many individuals pointed out that the practice of tax avoidance, although within legal guidelines, can be perceived as evidence of greed.

Such a perception can hurt a company’s public image and, consequently, end up harming the company’s overall success. The debate in the eyes of the public centers on the question of what a company’s responsibilities are. Many feel that a company has a social responsibility to contribute to society as indicated through tax law. To the contrary, management may argue that it has a responsibility to return the highest possible amount of value to their shareholders, a responsibility to which such tax strategies contribute.

Although an adequate return to shareholders is a responsibility for publicly held firms, there are other stakeholders, including society as a whole. A company that loses the public’s trust regarding its ethics may well suffer permanent damage— even fatal damage— to its ability to operate. Thus, there is an operational argument, grounded in ethics, for paying one’s fair share of taxes.

Back offered advice to companies that participate in such actions with, “rather than hiding behind the business case for tax avoidance, businesses need to be transparent about their tax practices”
Both companies and government must pay more attention to communicating their positions on tax planning techniques and the law, and operate with transparency. Such transparency could help restore public trust and bring more certainty to business planning (Back, 2013).

To better understand the ethical side of this argument, a 1997 publication in the European Review highlighted the topic in *The Ethics of Tax Planning*. In defining tax planning, the authors write that “when taxation and its planning are discussed the immediate interpretation of their meaning is that they relate to a degree of evasion or avoidance. By definition, evasion is illegal and hence unethical. In the main, avoidance is acceptable, as it reduces tax liability by whatever legal means possible and therefore is basically perceived as ethical” (Stainer et al., 1997).

This gives a definition of the ethics of tax planning but illustrates the fine line between avoidance and evasion. Regardless, however, the authors admit that the ultimate effect of such planning is “the inevitable loss of revenue to the tax authorities and consequently to society at large” (Stainer et al., 1997). The conclusion of this writing is that if loopholes leading to tax avoidance practice are available, they will be taken advantage of and so it is the duty of legislators to remove them. In a 1996 publication *An Introduction to Business Ethics*, the author draws the same conclusion that, “if there are legal loopholes overlooked by the legislators, it is their job to remove them and that there is no need for honest business people to feel any obligation to call attention to these loopholes” (Jackson, 1996).

One of the causes of avid seeking of loopholes and consequent tax avoidance behavior may be high tax rates. “There are many reasons why tax avoidance and tax evasion take place, including high tax rates, imprecise laws and lack of deterents. With higher tax rates, organizations or individuals may find it worthwhile to spend more time and money on advice, perform more complex maneuvers and take greater risks, in order to avoid or evade tax liabilities” (Stainer et al., 1997).

Although lowering tax rates could have some effect on tax practices, it is not likely to prevent all tax avoidance behavior as new loopholes are always being discovered and there is likely to be
motivation to reduce liability for any tax rate higher than zero. It seems to be a behavior that could be minimized, but not eradicated. This raises the question of whether eradication would be of benefit to society.

Several legal cases have examined this over the years. Although older cases, they set the precedents for the legal view of tax practices. One example was the 1936 case of IRC vs. The Duke of Westminster, the court stated that “every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax” (Likhovski, n.d.).

In more recent cases, companies like Google and Facebook have drawn negative attention for diverting their profits to “tax havens.” This practice enables them to move their revenues to areas that will allow them to pay less tax. There is a tactic called the double Irish. “The double Irish involves forming a pair of Irish companies to turn payments on intellectual property into tax-deductible royalty payments. The U.S. parent company forms a subsidiary in Ireland. The parent signs a contract giving European rights to its intangible property to the new company. In return, the new subsidiary agrees to market or promote the products in Europe. Thus, all the European income—that previously would have been taxed in the U.S.—is taxed in Ireland instead. Then the Irish company changes its headquarters to Bermuda. No Irish tax, no Bermuda tax, and no U.S. tax” (Wood, 2014).

A source of disgust and annoyance in the United States, this tactic is also disliked in the United Kingdom (UK). George Osborne, a British Conservative Political Party leader, was quoted as stating that, “while we offer some of the lowest business taxes in the world, we expect those taxes to be paid - not avoided.” He went on to explain how such actions could lead to distrust of the British people for the companies involved, a consequence discussed earlier in this review.

These actions by Facebook and Google have been recently stopped. The BBC noted a source saying that “profits made in Britain
would be taxed in Britain” (Ahmed, 2014). This marks one of the better known recent examples of tax avoidance. Although this particular case has been settled, many others are likely to arise. Tax competition between countries and the search for the lowest tax liability is likely to continue to attract businesses attention.

Another recent example of tax avoidance maneuvers is the case of Apple in Ireland. Apple, which owns many companies in Ireland, had also been moving their UK revenue to Ireland, where they have been paying a tax rate of less than two percent. This behavior has saved them billions of dollars and has been going on since at least 1991 (at which point they were getting away with paying zero dollars in taxes). Many question how major corporations are able to achieve such deals and pay such low tax rates. In Apple’s case, in exchange for the lower tax rates, Ireland received intellectual property rights and other intangibles (Wood, 2014).

Although the European Union has been aggressively looking into whether or not these deals should be considered “state aid,” Apple’s Chief Financial Officer was quoted as saying, “there’s never been any special deal, and there’s never been anything that would be construed as state aid” (Ahmed, 2014). If evidence can be found to the contrary, the European Union could collect billions of dollars of lost taxes from Apple. Obviously, the problems that the Union is having in Europe related to tax practices is a pressing issue. Across the globe, more action is needed to clearly define acceptable and unacceptable tax practices. In the United States, clear inversion rules were recently released in wake of the Burger King and Tim Horton’s scandal (Strasburg, 2014).

**Effects on Government**

So how do governments go about collecting the taxes they expect? Also, who should they be focusing their attention on when it comes to tax issues? As was pointed out earlier, tax evasion is illegal, but tax avoidance is not. So far examples of questionable behavior have been presented but in order to answer questions about government choices, a more analytic approach to tax avoidance and evasion incidence is necessary to determine the relative incidence and cost of each category.
Richard Murphy is a tax expert who was named the seventh most influential person in global tax in 2013 and is an adviser to the British registered, Tax Justice Network. In response to a revelation that, of the targeted 1,165 people, only 795 were prosecuted for tax behavior in the UK, in the most recent year, Murphy has called for prosecution for the “major” players in these activities. He states, “now I am not, for one minute, arguing that there is not a problem with small traders evading tax: there undoubtedly is. Nor am I arguing that they should not be prosecuted: there is a good case for them being so. What is notable, however, is the absence of substantial prosecutions, many relating to offshore, where we are well aware that there are more significant funds involved in many of the cases addressed but which do not, however, seem to end in court action. There is a very good question to be answered as to why that is the case” (Murphy, 2014).

Murphy points out that tax avoidance is responsible for a loss of some £20 billion a year in the UK; tax evasion is responsible for some £80 billion a year (Murphy, 2014). With such numbers, most experts feel that the efforts and resources of the government should be focused on addressing the £80 billion of losses; that £80 billion is made up of tax evasion specifically and taxes that are not paid for illegal activities such as the drug trade (Murphy, 2014).

As the example in the UK makes clear, this tax behavior costs nations tremendously. If a country is losing the equivalent of billions of dollars per year due to tax evasion/tax avoidance activities there is no doubt that other government expenditures, such as those for social programs and important government investment spending, cannot be receiving the funding that they otherwise would.

**Utilitarian Ethics in Business**

According to philosopher John Stuart Mill, utilitarianism is a very clear cut moral philosophy. “Actions are right in proportion as they tend to promote happiness, wrong as they tend to produce the reverse of happiness,” according to this philosophy (Bio, 2014). Tax avoidance by definition, would go against this philosophy. Taxes are intended to help
redistribute earnings in a country by taking a portion of profits and using them to establish necessary programs that cater to the common good. When an individual or company takes away from this ability to redistribute due to their tax practices, they are acting unethically when examined through a Utilitarian lens.

**The Rights Approach**

From the perspective of the rights approach, the ethical ramifications of tax avoidance get a bit blurry. According to the rights approach, “what makes human beings different from mere things is that people have dignity based on their ability to choose freely what they will do with their lives, and they have a fundamental moral right to have these choices respected” (Velasquez et al., 2014).

If an individual decides to partake in tax avoidance in a legal way, is it right to judge their actions in a negative light? If the actions being taken are not harmful to other individuals, then under the rights approach, such actions would not be deemed unethical. However, when individuals’ tax plans, as mentioned before, are taking away from the government’s ability to provide services to people it is harmful to others. Is this effect of tax practices enough to deem tax avoidance unethical through a rights approach lens as well?

**An Ideological Approach**

It depends on how an individual looks at taxes. According to Tom Cardamone, the director of Global Financial Integrity, “people see tax as a cost. It's not; it's an investment...It goes into government coffers to improve infrastructure, healthcare, etc. This is the fundamental problem in how people view tax” (Law Review, 2012). His approach to taxes alters interpretation of the ethics of tax avoidance, in addition to tax evasion.

If individuals viewed tax as an investment, it is possible that tax avoidance is ethical- so long as it occurs within the confines of the law. While legal, however, it may be socially irresponsible since it takes funds away from investment for society- though those funds may be privately invested rather than publicly.
Catholic Social Teaching
An ethical analysis of tax related behavior benefits tremendously from the conclusions arising from Catholic social teaching. It is possible to incorporate these teachings with the philosophical approaches of the Utilitarian and Rights approach; it seems appropriate to integrate and compare Catholic social teaching to these two philosophies when it comes to ethical tax behavior.

In 2013, Pope Francis gave a speech focused on the state of our worldwide economy. The Pope remarked that, “while the income of a minority is increasing exponentially, that of the majority is crumbling. This imbalance results from ideologies which uphold the absolute autonomy of markets and financial speculation, and thus deny the right of control to States, which are themselves charged with providing for the common good. A new, invisible and at times virtual tyranny is established, one which unilaterally and irremediably imposes its own laws and rules” (Winters, 2013).

The Pope’s words resemble a Utilitarian approach to the economic environment. If the resources are available for everyone to be able to maintain a suitable life, the resources should be spread around to a far greater extent. John Carr, an expert on Catholic social teaching at Georgetown University commented that “the pope’s message on the need for ethics in economic life is not conservative or liberal, but Catholic. It is not socialist or capitalist, but Christian” (Winters, 2013).

The Pope’s speech strongly urged that actions in business that are not aimed toward the greater good should be analyzed and fixed. Naturally, one subset of these business practices are tax practices; what should be examined and fixed are tax practices that are not aimed towards benefiting the common good, but rather benefit individual interests. Clearly, the Pope indicated strong feelings about redistribution of resources to the poor to create a more equal and stable society for all. His words showed strong disappointment in the current state of our worldwide economy and the kind of behavior that has resulted in such a state (Winters, 2013).
Further Ethical Concerns

Mike Lebowitz, a lawyer interviewed for the *International Tax Review* was quoted as saying that “tax is a cost to a multinational. There is a balance that you need to come to. What’s the right tax rate for a multinational that balances the legislative needs of government with the desire of a multinational to maximize profit for its investors, not just shareholders but employees too? If I’m an employee of a company that I know has more money to invest in more people, that’s an investment in my future” (Blurring lines in tax planning, 2010).

Lebowitz’s comments represent a different twist on the redistribution on funds. While the money that is being saved because of tax avoidance behavior by a company is not being redistributed through government, it is being redistributed to individuals who have interest in that company. Whether this money is used for beneficial purposes is unknown, however, the argument does comply with the rights approach in terms of stockholders, shareholders, and even stakeholders being given their rightful portion of the pie.

Stakeholders may constitute a wider range of individuals than obvious. Stakeholders are any individuals who have either a direct or indirect affiliation with an organization, and can be affected by the actions being taken by that organization. If a company is able to save money because of its tax avoidance maneuvers, it is possible that the money that was saved could go towards things that benefit communities in which the company is located, for example. If a company places value on corporate social responsibility, it may use its saved resources for the general good. This relates to corporate culture, values, and mission.

All this makes clear that tax avoidance cannot be definitely determined to be unethical, when motives are unclear, the use of savings unknown, and compliance with law apparent. Also clear is that there needs to be a set of rules with which everyone feels comfortable. Such rules would have to be based on an acceptable balance between an individual’s right to benefit from their work and the utilitarian concept of sharing some of the wealth. This kind of common ground could also appeal to those who view taxes as social investment and saved taxes as potential employee investment.
Combating Unethical Tax Avoidance

While the discussion of the ethics of tax avoidance is uncertain and dependent on many variables including philosophy, use of savings, and others, tax behaviors that lay outside the law are clearly unethical. Measures are being taken globally to put an end to these behaviors- or at least limit them.

In the European Union several groups have been established to discuss and monitor some of the practices previously detailed in this paper. An example is The Code of Conduct on Business Taxation group in which UN countries “assess each other’s tax regimes to identify harmful tax measures. This group enforces the commitment of Member States to abolish existing harmful measures and refrain from introducing new ones” (A huge problem, n.d.).

Also designed to combat tax problems is The Tax Policy Group, “where personal representatives of EU finance ministers discuss issues such as double taxation and tax avoidance” (A huge problem, n.d.). With such groups in place, it is obvious that measures are being taken to resolve the problems.

However, with the number of dollars of lost tax revenue that has been described (£80 billion a year in the UK alone), it does not seem that the policies in place currently have been effective. Although governments are at the forefront of addressing these issues, it is also important to educate individuals in business about illegal and unethical behaviors related to tax practices.

If employees are sufficiently educated about the ethical issues of tax behaviors, those employees may behave in more responsible ways. This educational task is the responsibility of management. This means that individuals at the management level must receive proper training, and must be held accountable for their behavior and that of their employees.

How Big a Problem is Tax Evasion?

There are large figures given out as estimated losses due to tax evasion. According to the International Tax Review, however, corporate tax,
in developed economies, amounts to just eight percent to ten percent of total tax receipts. It could be argued this percentage is becoming increasingly “disproportionate” (Blurring lines in tax planning, 2010). Relative to the use of resources, this number seems relatively low.

The government usually has the upper hand in situations that relate to tax avoidance practices. It is government that has the ability to set or revise tax law; it is government that has the ability to audit any company felt not to be complying. One government cannot force other governments to come to agreement, however.

Theo Keijzer, chairman of the Taxation Commission of the International Chamber of Commerce, has stated that “it is my belief that change has to come. If not, in 10 years’ time, the corporate tax system could come to a grinding halt. Society is spending so much effort on corporate tax, both authorities and companies, you really ought to question whether the global welfare would not improve by redirecting this effort to something more advantageous for the world at large” (Blurring lines in tax planning, 2010). Regardless of the stand one takes on corporate taxation, it seems that this problem of defining, managing, and enforcing corporate tax compliance could remain a never ending battle until guidelines are put in place that are ethical and consistent for all players- domestically and worldwide.

**Conclusion**

Legally, it has been understood that most tax avoidance practices are indeed “legal,” unlike tax evasion. However, it is important when examining tax practices, to take a step back and analyze all of the issues related to tax planning and management- both legal and ethical. The reasons behind corporate decisions and the impact of such decisions on all of their stakeholders must be considered.

Simpler is the distinction between tax avoidance and tax evasion; where tax evasion certainly crosses the line into illegal behavior. From a management perspective, the safest tactic when managing tax policy is not to test the limits of the law. From a larger, social perspective, the ongoing fight against unlawful and unethical
practices will be won when the costs to corporations for behaving in such ways are greater than the benefits of such practices. Guidelines must be clear, universal, and the cost of noncompliance must be great. Until this happens, tax avoidance and tax evasion will continue to be a hot topic for business.
References


