By Re_Generation

Business Ethics

3.2 Corporate Taxes

Description

Researchers at the International Monetary Fund estimate that overall losses to governments as a result of corporate tax abuse amount to well beyond $1 trillion per year. Although the sum is difficult to calculate, the estimated total of global wealth that is held privately in offshore tax havens numbers a staggering $24-36 trillion as of 2015, a quantity which grows at a rate of 14% per year. As the leak of the Pandora Papers demonstrated, a global tax avoidance industry of banks, law and accounting firms, and specialist providers have designed a complex labyrinth of secret offshore structures and low-tax jurisdictions that compete with one another to facilitate the private hoarding of wealth by corporations and high net-worth individuals. Glaring loopholes in the law have made tax avoidance a significant problem for Canada; analysis by the Canada Revenue Agency of 2014 corporate taxes suggested that Canadian corporations avoid paying between C$9.4 and C$11.4 billion in tax each year, which is almost 30% of the total corporate tax bill. To learn more about how firms should be disclosing their tax payments, and reforming their accounting practices to ensure fair taxation, continue reading this PDF guide.

Acknowledgements

Written by Gareth Gransaull, Associate Director of Re_Generation, with review by some of Canada and North America's most influential sustainability leaders.

About Re_Generation

Re_Generation is a Canadian youth movement that seeks to build a regenerative, sustainable, and just economy. We aim to reimagine our schools, repurpose our careers, and remodel our companies to be aligned with regenerative principles. In particular, we provide resources for individuals to launch impact-driven careers and advocate for change within their companies and schools. We also aim to advance public policies that promote regenerative and sustainable business practices.

Our successful 'Our Future, Our Business' Manifesto campaign received the support of 65 youth organizations, 130 high-level executives, and 100 civil society organizations recognizing the need for reform in business education on sustainability. After three years of existence as the Canadian Business Youth Council for Sustainable Development, we have changed our name to Re_Generation to become more inclusive of all youth, not just business youth.

We believe that the ideal society is a **regenerative** one. Regeneration to us means putting human and ecological **well-being** at the centre of every decision. It means restoring relationships, both within nature and within society, while helping all communities to thrive. Read more about our history and vision at our **About Us** page.

Issue Summary:

When it comes to the issue of corporate action on sustainability, tax avoidance by major multinational corporations can be seen as an elephant in the room. Large businesses routinely espouse prosocial goals regarding worker's rights, education, and climate action, and yet remain unwilling to pay their fair share of taxes in order to enable public investment in common sense solutions. In fact, some research shows that companies with higher CSR ranking **pay less taxes on average**, highlighting the fact that many firms do not see paying corporate taxes as complementary to CSR activities.

Researchers at the International Monetary Fund estimate that overall losses to governments as a result of corporate tax abuse amount to **well beyond $1 trillion per year**. Although the sum is difficult to calculate, the estimated total of global wealth that is held privately in offshore tax havens numbers a **staggering $24-36 trillion as of 2015**, a quantity which grows at a rate of 14% per year. As the leak of the Pandora Papers demonstrated, a global tax avoidance industry of banks, law and accounting firms, and specialist providers have designed a complex labyrinth of **secret offshore structures** and **low-tax jurisdictions** that compete with one another to facilitate the private hoarding of wealth by corporations and high net-worth individuals. By secretly **sheltering these illicit financial flows**, such '**treasure islands**' are complicit in enabling "a criminogenic hothouse for multiple evils including fraud, tax cheating, escape from financial regulations, embezzlement, insider dealing, bribery, money laundering, and plenty more."

Glaring loopholes in the law have made tax avoidance a significant problem for Canada. Analysis by the Canada Revenue Agency of 2014 corporate taxes suggested that **Canadian corporations avoid paying between C$9.4 and C$11.4 billion in tax** each year, which is almost 30% of the total corporate tax bill. During the 1950s, corporations and individuals contributed roughly equal amounts in tax, as compared with the 2015 fiscal year, when Canadians paid $145 billion in income tax and corporations paid only $41 billion. The financial sector accounts for more than two-thirds of this tax avoidance; pre-tax profits in the banking sector as a whole soared by 60% from 2010-2015, and Canada's banks benefit from the lowest tax rate in the G7. In total, the corporate abuse of tax havens has **risen 634% since 1999**.

Influential lobbying groups in Canada, such as the **Canadian Chamber of Commerce**, consistently advocate for tax cuts on the spurious premise that they will increase innovation and economic growth. However, analysis by Statistics Canada shows that **drastic cuts to the corporate income tax rate over the last 20 years have not stimulated new investment**. Between 1997 to 2016, Canada's corporate income tax rate was cut almost in half, from 43% to 26.7%, and yet investment in machinery and intellectual property is still below the 1997 level as a percentage of GDP. Instead, there has been an explosion in activities that are hard to classify as 'productive', such as share buybacks, large increases in executive compensation, and a huge increase in merger activity. At the same time, tax decreases caused enormous social externalities, including a 40% cut in hospital beds between 1952 and 2018, social housing units being cut by the thousands, and underinvestment in public infrastructure.

By far the biggest losers of this offshore scam, however, are the world's least developed countries, many of whom face egregious degrees of capital flight as the wealth of their resources is appropriated by multinational actors without proper remuneration. A system of unfair **bilateral tax treaties**, negotiated by nations of the Global North, disproportionately benefit multinational corporations by constraining the ability of developing nations to crack down on tax avoidance. The UN Convention on Trade and Development estimates that curbing illicit financial flows could **reduce the continent's annual financing gap** of $200 billion by half. In India alone, the annual sum lost to tax avoidance could cover the cost of hospital treatments for 55 million low-income patients every year. The scale of tax theft from developing countries is so large that it represents one of the largest obstacles to the achievement of the Sustainable Development Goals, and should be viewed as a major human rights issue.

Fortunately, there has been significant progress in the global movement for tax justice in recent years. 2021 in particular was a landmark year, with the publication of the FACTI Panel report that advocated for unitary taxation, a global minimum tax rate, the establishment of a Centre for Monitoring Tax Rights, and most significantly, the creation of a global UN Tax Convention which would effectively move the responsibility for setting global tax rules away from the OECD to a separate UN body. In April of 2021, the UN tax committee finalized revisions to a model tax treaty, while the G77 group tabled a proposal for an intergovernmental tax body. Perhaps most promising was the news in June that the G7 had reached an agreement for a global minimum corporate tax of 15%. With all of these proposals currently in the works, it is likely that stricter rules on base erosion and profit-shifting and corporate tax policy are just around the corner, implying that prudent corporations should consider revising their tax practices in an effort to pre-empt regulations and avoid future fines.

Key Considerations:

Analyzing tax dodging by corporate entities is made more complex by the fact that there is a significant legal grey area between what constitutes tax evasion (i.e. illegal behaviours that deliberately conceal assets or income in violation of the law) and tax avoidance (i.e. ostensibly legal behaviours that minimize the amount of taxes payable, also known as 'aggressive tax planning', in a way that violates the spirit of the law, if not the letter of the law). Although these are treated as separate legal categories, the distinctions are often quite blurred. Canada has yet to prosecute a single individual for tax evasion.

The process whereby corporations exploit gaps and mismatches in tax rules to shift profits to low or no-tax locations is known as 'base erosion and profit-shifting', or BEPS. The OECD has developed an Inclusive Framework on BEPS that includes a list of 15 actions governments should take to reduce this form of tax dodging, accompanied by an annual progress report. One key strategy by which firms engage in BEPS is price manipulation, a process by which prices are inflated at one point in a supply chain in order to reduce the profits that are eligible for taxation in the next jurisdiction. Another strategy involves companies diverting profits to affiliates in low-tax jurisdictions by selling intangible assets, the use of which can be charged back to affiliates in high-tax countries in a way that reduces the taxable profits they appear to earn on paper.

The Tax Justice Network has identified three core principles according to which all tax systems, and all corporate tax policies, should be organized in order to reduce the propensity for profit-shifting and tax avoidance:

1. Automatic exchange of information;
2. Beneficial ownership registration (i.e. registering the identity of all individuals that de facto control or receive profits from a particular company or legal vehicle, even when the legal owner is de jure another entity);
3. Country by country reporting (i.e. disaggregating tax expenditures according to jurisdiction in order to illuminate aggressive tax planning strategies).

The third principle is of the highest importance when it comes to firm-level accounting. According to the final report of the panel on Financial Accountability, Transparency, and Integrity, in order to improve disclosure on tax expenditures all multinational enterprises should publish country-by-country breakdowns of where their business model generates value, where that value is taxed, and the taxes paid accordingly. These metrics must include disclosures of revenue, profit and loss, taxes paid, and number of employees, all disaggregated by jurisdiction.

Critical self-assessment questions when evaluating corporate tax policies include:
1. Does the firm in question pay its fair share of taxes?
2. Does the firm exploit offshore ownership structures and tax havens to reduce its overall tax burden? If so, how?
3. Does the firm use transfer pricing or the sale of intangible assets to take advantage of low-tax jurisdictions?
4. Does the firm publish public-facing records of its annual taxes paid on a country-by-country basis?
5. Does the firm disclose the beneficial owners of all of its associated legal entities?
6. Does the firm participate in lobbying activities, either directly or indirectly, that aim to reduce the overall corporate tax burden?
7. Does the firm disclose the extent to which it benefits from subsidies or any other form of industry support funded by the public?

Tools:

Recognizing the inherent relationship between corporate tax policy and the UN Sustainable Development Goals, the B Team has developed a set of **Responsible Tax Principles** that outline key indicators for businesses to implement related to accountability, transparency, and the need to support effective tax systems.

In 2021, the organization Fair Tax Mark released its first ever **Global Multinational Business Standard** for tax disclosure, which contains a list of 19 relevant questions, including:
1. Does the business make freely available, on an annual basis, a full set of financial statements (including profit or loss, financial position and cash flows)?
2. Is clarity provided on the nature of business activity?
3. Is clarity provided on the primary trading address (as opposed to a registered office address)?
4. Are the beneficial owners* of shareholdings of 5% and above disclosed? Are all related party transactions transparent?
5. Are the names and addresses of all directors provided? Is the country of residence of directors discernible?
6. Does the business publish a tax policy?
7. Has the business nominated a named board director to have responsibility for its tax policy?
8. Does the business report annually on its effective compliance with its tax policy? Does the business have a whistle-blower policy (and / or procedures) in place that explicitly covers the area of 'tax'?
9. Does the business's public tax policy explicitly embrace the following commitments:
   a. seek to declare profits in the place where their economic substance arises?
   b. not use tax havens artificially and for the purposes of tax reduction?
   c. follow the spirit as well as the letter of the law, and not structure transactions and operations artificially for the purpose of avoiding tax?
10. Does the business utilise tax havens as locations for either incorporation, subsidiaries or operations?
11. Does the business disclose a full list of subsidiaries, stating their name and place of incorporation? Is the country of tax residence of each subsidiary transparent? Is the nature of business activity of each subsidiary made clear?
12. Does the business disclose data on the net asset value for each country in which it operates? Does the business breakdown the net asset figure and disclose data on the gross assets and gross liabili-

ties for each country in which it operates?
13. Is data on the revenue and net profit / loss before tax provided for each country in which it operates?
14. Does the business disclose the total tax charge, current tax charge, deferred tax charge and cash taxes paid for each country in which it operates?
15. Does the business disclose the number of employees, together with a note on the basis of calculation used, for each country in which it operates? Is the aggregate gross remuneration of employees disclosed, together with a note on the basis of calculation used, for each country in which it operates?
16. Does the business provide a numerical reconciliation of its actual current tax charge, and compare this with the current tax provisions that might be expected if the headline tax rate in the parent entity's local jurisdiction were to be applied to the business's accounting profits? Does the business reconcile its actual current tax charge with its total tax charge for the year, by offering a reconciliation that explains the deferred tax provision for the year and other items that make up the difference?
17. Does the business provide a narrative explanation as to why its actual current tax charge differs from the provisions that might be expected if the headline tax rate in the parent entity's local jurisdiction were to be applied to the business's accounting profits?
18. Does the business provide a deferred tax note that:
    a. explains the deferred tax balance with significant precision such that the cause of at least 75% of the underlying asset and / or liability is clearly described?
    b. states clearly when the underlying assets and / or liabilities are likely to have an impact on the business's tax bill, or a statement that this is not known because it is more than five years after the balance sheet date?
    c. discloses the existence and numerical value of any uncertain tax positions that may exist, and the process of determination?
19. What was the business' average tax rate (in terms of cash taxes paid) over the last five years?

The UN Principles of Responsible Investment identifies **corporate tax policy as a relevant ESG issue**, and has developed a **framework for disclosure** that highlights relevant indicators relating to policy, governance, risk management, and performance. It includes, among other criteria, a requirement for country-by-country reporting details, including a list of all subsidiaries and their business nature, as well as the primary drivers of the gap between the effective tax rate and the weighted average statutory rate based on the firm's geographic sales mix. The framework expects businesses to provide an explicit overview of their tax structure and strategies, including how transfer prices are set within the group and how tax havens are used, if applicable.

In 2019, the Global Reporting Initiative (GRI) released its first ever **global standard for tax transparency**, one that requires organizations to disclose their tax strategies, the governance body that formally reviews the strategy, the frequency of this review, their approach to regulatory compliance, and the relationship between their tax strategy and their overall sustainable development strategies. As with the PRI framework, the GRI expects businesses to provide transparency into tax havens, transfer pricing, and other tax incentives. The GRI expects firms to disaggregate their tax expenditures according to the following criteria:
1. Names of resident entities;
2. Primary activities of the organization;
3. Number of employees, and the basis of calculation of this number;
4. Revenues from third-party sales;
5. Revenues from intra-group transactions with other tax jurisdictions;
6. Profit/loss before tax;
7. Tangible assets other than cash and cash equivalents;
8. Corporate income tax paid on a cash basis;
9. Corporate income tax accrued on profit/loss;

10. Reasons for the difference between corporate income tax accrued on profit/loss and the tax due if the statutory tax rate is applied to profit/loss before tax.

The Shift Project has recognized aggressive tax minimization strategies as a risk to human rights around the world, particularly with respect to corporate operations in developing nations. They have developed a **framework for due diligence** that identifies relevant questions to ask when evaluating the impacts of tax policy on human rights and sustainable development. Particularly regarding the role of extractive firms in resource-rich developing nations, the **Publish What You Pay** campaign has developed a set of principles for **revenue transparency** that aims to help governments calculate the royalties they should be receiving from foreign-owned firms. For information about the implementation of the Extractive Industries Transparency Index, see **this link**.

Case Studies:

There are a few standout examples of corporations that have become leaders in tax transparency. Allianz, a major international financial services company, **aims to be a responsible taxpayer** by refusing to engage in aggressive tax planning or artificial structuring, refraining from exploiting tax havens, and avoiding 'discretionary tax arrangements'. Additionally, Allianz has adopted a comprehensive **Standard for Tax Management** which stipulates that the corporation's tax planning must be premised on valid business reasons.

Similarly, Vodafone has been a leader in **publishing tax reports on a country-by-country**, actual cash-paid basis, since at least 2013. The Danish company Maersk began including taxation in their sustainability report as of 2016, and has **initiated implementation** of the B Team Responsible Tax Principles.

Organizations/Initiatives:

For further information about the globally pervasive problem of tax dodging (including both evasion and avoidance), check out the following organizations:

- **TaxCOOP**
- **Canadians for Tax Fairness**
- **Publish What You Pay Canada**
- **Tax Justice Network**
- **Global Alliance for Tax Justice**
- **Global Financial Integrity**
- **Resource Movement**
- **Americans for Tax Fairness**
- **Financial Accountability, Transparency, and Integrity Panel**