Tax Avoidance Law And Its Effects

Introduction

A multitude of Multinational Companies (MNCs) across the global economy use ambiguities or loopholes in global tax laws in order to reach a desired outcome, often in the best interest of maximising shareholder and/or private corporate value through paying less tax (Contractor, 2016). HM Revenue and Customs (2016) states that such tax avoidance is often comprised of contrived, artificial transactions which lead to a tax advantage that Parliament never intended.

Types of tax avoidance strategies include the deferral of foreign affiliate income, transfer pricing, royalty payments, global cost division and inversions (Contractor, op. cit.). Multinational corporations can utilise the above strategies to reduce tax expenditure legally across a globe which is separated by varying jurisdictions in relation to taxation (ibid). Therefore, as a result of the absence of a homogenous international tax regime, such loopholes can be exploited, resulting in aggressive tax avoidance rather than simple tax planning which can have multiple adverse effects on economies and states internationally.

This essay conveys that it is not the responsibility of MNCs to pay more tax than legally required. If legal loopholes exist, then MNCs should be allowed to exploit them and any negative effects brought about by tax planning is at the fault of the law itself and its creators. It also portrays how tax competitiveness worldwide is simply a part of international economic rivalry and how the extent of MNCs' tax avoidance and self-regulation could be controlled by their view on corporate social responsibility and hence reputation. However, global cooperation on tax reform could minimise various disadvantages that arise from ambiguities in global tax laws.

This essay will analyse and critically evaluate some of the effects of tax planning and hence conclude whether such effects are advantageous and or disadvantageous with respect to various stakeholders and highly industrialised countries. Academic literature and real-life examples will be used throughout to support ideas expressed.

Governmental tax revenue reduction/ Corporate tax gain

A key result of tax avoidance, especially in highly industrialised countries, is a reduction in tax revenue collected by governments. Markle (2015) found that a substantial number of highly industrialised countries fail to tax MNCs' foreign affiliates' profits which in the US, for example, could have contributed to the estimated loss of $2.1 to $3 trillion in unrepatriated profits from US multinational foreign affiliates (Contractor, op. cit.). In the UK, recent examples include Starbucks' European business paying an effective UK tax rate of just 2.8% in the year to the end of October 2017 as a pose to the actual corporate tax rate of 19.5% (Marriage, 2018), whilst Google, despite generating £3.4 billion in UK revenues last year, only paid £20.4 million in corporate tax (Neate, 2014). Although the foreign income of MNCs is taxable in the US, a substantial loophole exists where after taxes have been paid on foreign affiliates' income in different countries, any extra profit can simply escape US tax legislation by not being remitted back to the US (Contractor, op. cit.).

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A reduction in tax revenue can be seen as disadvantageous to the Governments and citizens of the UK and US as less money is available to invest in national operations such as infrastructure, health and education. On the other hand, how negative this outcome could be depends on what and where such tax revenue would have actually been spent on and its positive effects on the domestic economy. Moreover, it could be argued that if such loopholes exist, it is a firm's legal right to retain such tax planning gains. The above sources simply convey a negative effect through figures of lost tax revenue but on the contrary, such tax gain by MNCs could be re-invested back into the country, cancelling out the negative effect of lost tax revenue. Hong and Smart (2010) suggest such tax planning opportunities allow countries to at least maintain corporate tax rates whilst still attracting foreign direct investment (FDI). Therefore, tax gain here could be seen as advantageous to a country as well as the MNC, subject to how such tax gain is spent. The positive effects MNCs can bring to nations through investment may be the reason why such loopholes still exist whilst also simultaneously attempting to prevent expatriation of key MNC operations.

Tax avoidance and its effect on MNCs' reputations and corporate social responsibility

Brennan and Atkins (2008) provide an insight into the evolution of corporate governance and how MNCs have started to shift from the agency theory where a business' processes solely account for its shareholders to a more inclusive, stakeholder-orientated approach. This elucidates how MNCs may be starting to self-regulate themselves in terms of the amount of tax they pay in order to sustain a positive reputation in society by harnessing their corporate social responsibility. Elbra and Mikler (2016) further support this in portraying corporate reputations are integral assets which can be heavily affected by not paying tax appropriately. This shows that the negative effect reputation can have on financial performance could offset the extent to which MNCs avoid paying tax. Real life instances can support this argument, for example, due to prior tax avoidance that gravitated solely towards the accountability of shareholders, Starbucks moved their headquarters from Amsterdam to London in an attempt to reprimand previous tax avoidance and showcase their acknowledgement of all stakeholder accountability and social responsibility (Marriage, 2018) . Facebook also announced they will report their revenue from advertising in UK instead of re-route through Ireland, the spokesman of the company said that this action is to show company's increasing concentration on social responsibility, and earn public trust back (The Guardian, 2017).

Here, the ambiguities in global tax laws can be seen to regulate themselves and the MNCs utilising them, through reputation and corporate social responsibility, showing how such ambiguities can be advantageous. However, the extent to which this supposed trade-off is reached could still mean a significant amount of tax avoidance is carried out, again creating the disadvantages aforementioned through a reduction in government tax revenue. Moreover, despite Brennan and Atkins (2008) suggesting a trend in MNCs behavior, this doesn't prove all MNCs are doing the same which can create significant inequalities in the amount of tax being paid by different firms. On the contrary, if it is the choice of the firm to exploit legal loopholes in the law then equally, it is the choice of the firm to realise its corporate social responsibility and act on it. Therefore, if a MNC does not correlate their brand value with their social responsibility, they are unlikely to voluntarily pay tax, negating the potential for such positive effects from existing ambiguities in global tax laws.

Global tax competitiveness

Ambiguities in global tax laws create international tax competitiveness which has the potential to fuel the global economy. For example, Neate (2014) conveys how the double Irish loophole allows multinational US companies to funnel a substantial amount of their income through Ireland to reduce their national tax bill by paying a corporate tax rate of 12.5% or less. O'connor (2014) highlights how Ireland's low corporate income stance can encourage labour supply and demand whilst simultaneously incentivising FDI. Here, ambiguities in global tax laws are shown to benefit Ireland but also in this example disadvantage the US through reduced tax revenue. This is a prime example of tax competitiveness and shouldn't discourage Ireland's tax policies but yet exist as just one part of a competitive global economy.

A study by Deloitte (2014) which involved 800 corporate executives in 20 jurisdictions discovered that corporate taxation policy and transfer pricing abilities were of upmost importance for MNCs when making key FDI decisions. This further highlights how tax competitiveness brought about by global ambiguities in tax laws is fundamental in MNCs' decision making. Therefore, a country's tax policy can be either advantageous or disadvantageous depending on the stance of the policy towards MNCs and hence attracting FDI. This relates back to international economic rivalry stated in this paper's thesis statement; it is ultimately at the choice of the MNC where to base and transfer operations and finance and therefore at the choice of government tax policies to incentivise such.

On the other hand, Elbra and Mikler (2016) point out that the tax competition global ambiguities create can be detrimental and have the ability to actually distort trade and investment whilst diminish national tax bases. This is not necessarily true as those countries with high tax-rates such as the UK and US are already global hubs for investment and trade which is why they are able to charge such high corporate tax-rates. Therefore, the tax avoidance incurred in such highly industrialised countries by large MNC's can be offset by not only the sheer scale of investment and trade but also the high levels of income tax and corporate tax of solely national operating firms.

In addition to this, Contractor (2016) states that's many executives of MNCs in highly industrialised countries like the UK and US already think taxes are too high and in turn suffer a competitive disadvantage, especially against rival MNCs which operate in countries with less rigorous tax laws. I believe global tax competition resulting in less after-tax income for MNCs can also be disadvantageous to their domestic economies and stakeholders. For example, suppliers who rely on large MNCs can be heavily affected if stringent tax laws are enforced on their biggest customers. Moreover, customers of the MNCs themselves get less benefit from new, innovative and better quality products due to a lack of research and development which could have been funded by corporate tax deductions.

Conclusion

In conclusion, whilst loopholes in global tax law exist, I believe MNCs should be allowed to exploit them as long as doing so is legal. The disadvantage of reduced tax revenue for governments through tax planning in highly industrialised countries could be offset by re-investment back into the country whilst on the other hand, if not re-invested, the extra tax revenue could have been invested by the government into integral infrastructural projects. This

brings about the question of whether the money will be spent better in the hands of an MNC or a government which can be extremely subjective and depends whose interests are most regarded. To ensure such tax gain is spent effectively, global laws could be implemented to guarantee that any tax gain by MNCs is spent through FDI and/or product/service research and development.

Corporate social responsibility and reputation can act as an effective form of self -regulation, highlighting further that ambiguities in global tax laws won't be exploited indefinitely by most MNCs. Moreover, through obvious exploitation of such ambiguities and MNCs stating it is their legal right to do so, they are potentially exposing themselves to international re-regulation which could alleviate any disadvantages at present. Palan and Wigan (2014) state the success of a global tax reform simply depends on sustaining international cooperation whilst Sharman (2006) believes it is a near impossible task due to global economic competitiveness and national sovereignty.

I believe Fischer's theory used by economists to manage foreign exchange risk can be applied to ambiguities in global tax laws so that firms, through the implementation of a global tax rate, cannot benefit through the channelling of funds to tax havens or the stockpiling of assets in shell companies.

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