# Unavoidable: tackling the ethics of taxation

## Dr Liz Ellis, IDEA Centre

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| **18:00** | Introduction by Dr Jim Baxter<br>Professional Ethics Development Officer |
| **18:05** | Presentation by Elizabeth Ellis |
| **18:30** | Group Discussions |
| **19:00** | Conclusions |
| **19:30** | Wine Reception and Dinner |

## Abstract

"What exactly is tax avoidance? Is it always morally wrong or can it be morally justified in certain circumstances?"

Recent tax avoidance scandals, including Amazon, Starbucks and Jimmy Carr, have brought ethics to the forefront of financial debates. Presented by Dr Liz Ellis, this event brings arguments from the philosophical literature to the public debate in an attempt to shed more light on the issues. There will also be an interactive case study session where everyone will get a chance to have their say!

### *About the presenter*

Elizabeth is a Teaching Fellow and Consultant in Applied Ethics, and divides her time between teaching and undertaking external consulting in applied ethics. She is interested in all areas of applied ethics and political philosophy but her particular research interests are just war theory, collective responsibility and the ethical issues surrounding punishment and coercion.

Elizabeth's undergraduate teaching includes business ethics, environmental ethics and corporate social responsibility. At postgraduate level, she teaches on the Centre's MA in Biomedical and Health Care Ethics (online and campus) and MA in Applied and Professional Ethics (online), as well as teaching professional ethics on MA programmes in the business school.

Before taking up her post at the IDEA Centre, Elizabeth completed her PhD in Applied Ethics at the University of Edinburgh. Her PhD thesis concerned the ethics of economic sanctions and addresses the issue of how we can justify imposing (or not imposing) economic sanctions in various different contexts.

# <u>Tax Avoidance Case Studies</u>

According to HMRC:

"Tax avoidance involves bending the rules of the tax system to gain a tax advantage that Parliament never intended.

It often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage. It involves operating within the letter, but not the spirit, of the law."

https://www.gov.uk/guidance/tax-avoidance-an-introduction

**Case 1: Children's Clothes**

You have a friend who is a petite size 8. She tells you she often buys children's clothes to wear because they are cheaper since there is no VAT on children's clothes.

Q: Is this tax avoidance? Is it morally wrong? Why/Why Not?

**Case 2: New York City Tax**

Part 1

The following case, taken from the New Yorker, relates to billionaire, Julian H. Robertson, Jr.

"Since New York City tax laws don't apply to people who are deemed to be nonresidents, even if they own a residence in the city and work there, Robertson was allowed to spend no more than half a year—a hundred and eighty-three days—in New York City. This exile was self-imposed. If he had paid New York City tax, which in the top bracket reaches a rate of 3.6 per cent of taxable income, he could have spent as much time in the city as he wished…

But in 2000 Robertson was determined to stay outside the city for at least a hundred and eighty-two days, and thereby avoid New York City income tax…

This was nearly a full-time job. One of Robertson's assistants, Julie Depperschmidt, scheduled his appointments and maintained a contemporaneous computerized record of his whereabouts, carefully distinguishing between "NYC days" and "non NYC days.…

Friday nights were particularly risky, since Robertson or his wife often had social events scheduled in the city. In order to "earn a tax day," as he put it, he usually left town on Friday before midnight, even if his wife stayed at the apartment. Robertson's driver had to be on alert: as long as they crossed the Queens border en route to Locust Valley by midnight, Robertson didn't have to "waste" a Saturday as a New York day. Even one minute of a day spent in the city counts as a day of residence. … Robertson said he never missed the midnight deadline, although when he couldn't get his driver or a limousine service in time he occasionally had to hail a cab. On one occasion, Robertson came back from a trip and found himself crossing into Manhattan at 11:45 P.M. That mistake cost him a full New York City day, which he could have avoided by whiling away fifteen minutes at the airport."

*James B Stewart, Tax Me if You Can, New Yorker Magazine, 19th March 2012. URL = https://www.newyorker.com/magazine/2012/03/19/tax-me-if-you-can*

Q: The writer of this article believes this behaviour is tax avoidance. Do you agree? Why/Why Not? Is this behaviour morally wrong? Why/Why Not?

Part 2

Imagine the billionaire stopped deliberately trying to stay out of New York. Instead he did whatever he wanted: left New York when it suited his work/social plans and remained in New York when it suited his work/social plans. He does, however, keep a note in his diary of whether he is in New York or not. At the end of the tax year he goes back through his diary and finds – purely by chance – that he stayed out of New York for 182 days. Therefore he has no New York City tax to pay and therefore he doesn't pay it.

Q: Is this tax avoidance? Why/Why Not? Is it morally wrong? Why/Why Not?

Part 3

Imagine you are a university lecturer who works 50/50 for two universities: one in New York and one in London. You spend 6 months in New York and 6 months in London. When your partner (who lives in New York) asks you when you are coming home for Easter, you do a quick calculation. Coming home next week will mean you are in New York for just *over* 183 days, coming home the week after next will mean you are in New York for just *under* 183 days and won't have to pay the city tax. You decide to come home the week after next for that reason.

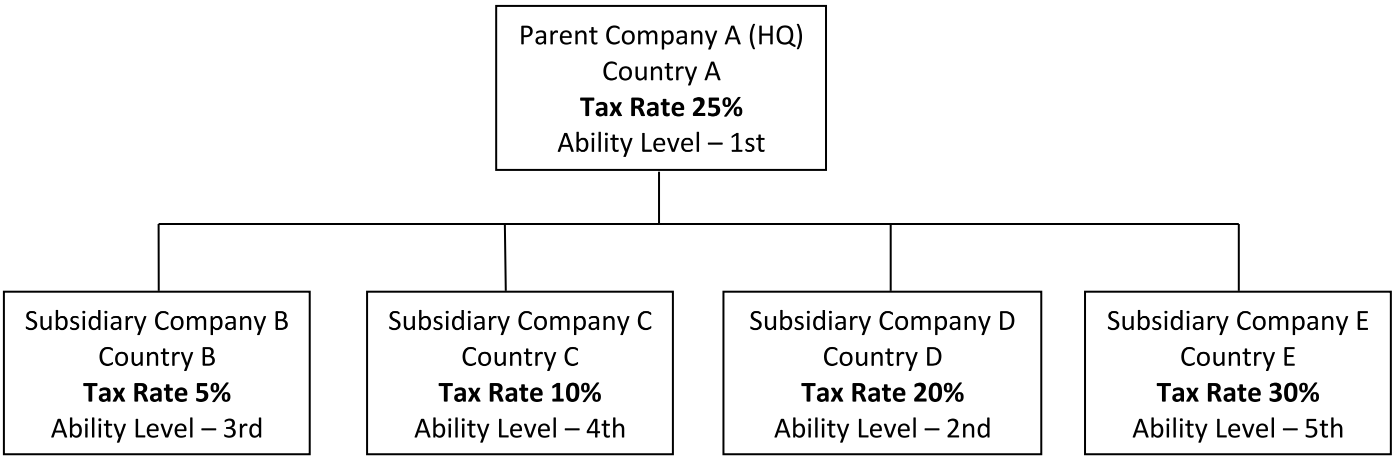
Q: Is this tax avoidance? Why/Why Not? Is it morally wrong? Why/Why Not?

### Case 3: Transfer Pricing: Sale of Goods

The Treated Timber Group (TTG), is a multinational company which manufactures high quality specially treated timber. It is headquartered in country A which has a relatively high tax rate of 25%. Company A owns various subsidiary companies which are located throughout the world. Generally speaking, TTG has a subsidiary company in every country in which it operates; the subsidiary companies employ the local staff, own and operate the local manufacturing sites etc. The Group has fallen on hard times and is loss making.

The new CEO is looking for ways to turn things around. The first thing she spots is that each subsidiary buys their own raw timber (which they then treat). This is inefficient, as one company could bulk buy on behalf of the group and save a lot of money. The bulk-buying company could then re-sell the raw timber to each of the subsidiaries in the group at a mark-up. The CEO decides that one company should take on this bulk buying task. But which one? The companies are all different sizes and have different levels of buying expertise. Company A is the most able in this regard, and company E the least (see diagram below). However, ability is not the only relevant factor here. There are tax implications too.

From a tax point of view, it will be best if company B buys the timber. Country B has the lowest tax rate. When company B re-sells the treated timber to the other subsidiaries it makes a profit but this will be taxed at a very low rate (5%). The other subsidiaries have to pay for the timber and this expense reduces their profits, saving them tax that would have been paid at much higher rates. The higher the mark-up charged by B, the more tax the Group will save as a whole. Unfortunately for TTG, there are limits on how much mark-up B can charge which are set by the Office for Economic Co-operation and Development (OECD). The OECD "arm's length" rules state that the price charged by B must be the same as the price which an unrelated third party would charge. This rule exists precisely to prevent the tax advantage TTG are considering. However, there is no obvious third party market price for this rare type of timber. The CEO estimates that a third party seller would charge somewhere between £20 and £50 per tonne. She is pushing for the £50 level in order to maximise the tax benefits.



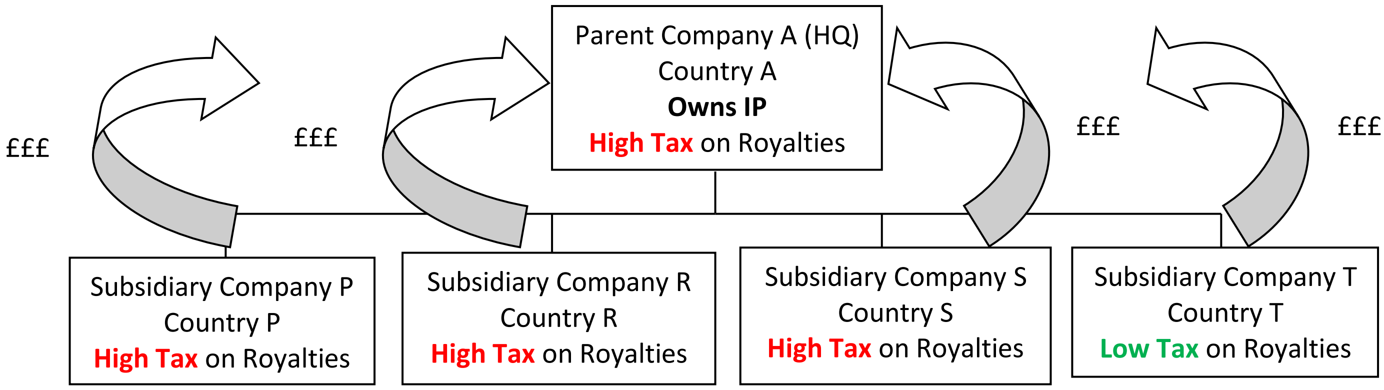

Q: Is the CEO's plan tax avoidance? Is it morally wrong? Why/Why Not?

Q: Which country do you think should procure the timber on behalf of the group? How much should they re-sell it for? Or should they just continue as they are?

Q: D and E are developing countries. Does that make any difference to your answer?

**Case 4: Research and Development**

The new CEO of a multinational technology company has decided the company is paying too much tax – far more than its competitors. This is mostly due to the way the company organises its research and development (R&D). Currently all R&D facilities are located in country A, the country where the company is headquartered, and all R&D takes place there. Company A therefore owns all the intellectual property (IP) rights to any useful technological discoveries. The subsidiary companies pay royalties to company A in order to exploit the new technologies, e.g. by incorporating them into the products they manufacture to be sold in their local markets. However, country A taxes royalties received heavily and this is contributing to the large tax bill.




The CEO suggests three methods of reducing the company's tax burden…

Option 1: The company is planning to open a new R&D facility next year as part of a strategic drive to innovate more quickly. The CEO proposes that the new facility be located in country T which has very low taxes on royalties. The other facilities in country A will continue to operate as normal.

Option 2: The entirety of the company's R&D function should be relocated to country T on a permanent basis; this means all new intellectual property created post-move will be held by subsidiary company T. The move will involve relocating key people, recruiting new staff in country T and making others in country A redundant. It will also involve finding new premises in country T and shutting down those in country A. Long term the tax benefits will outweigh this expense.

Option 3: As in option 2, the entirety of the company's R&D function should be relocated to country T on a permanent basis. This means that all new intellectual property created that point onwards will be held by subsidiary company T. The CEO also argues that going forward, subsidiary company T ought to charge a higher amount for royalties than A has charged in the past, an amount comparable with competitors. This will reduce the group's overall tax bill because royalties paid by the other companies reduce their profits (and therefore their tax) yet the additional royalty income earned by company T will be taxed at a very low rate. At this point, the CFO notes that competitor companies have been accused by the media of tax avoidance for setting their royalty payments so high.

Q: Which options, if any, are tax avoidance? Which, if any, are morally wrong? Why?

Q: What is the relevance of the company's competitors being involved in similar practices?