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Paying a fair share of tax and aggressive tax planning ð A tale of two myths

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Abstract

This article critically evaluates calls by the Australian Taxation Office (ATO) for directors of corporations to ensure companies pay a ófair share of taxô or act as a ógood corporate citizenô or not embark on óaggressive tax planningô schemes. The author concludes the first two terms mean whatever the speaker wishes them to mean and introduce an emotive and subjective element into the determination of a companyôs tax liability. Although tax regulators have attempted to define what

the goals of the corporation can be achieved. The predominant way of measuring success is the level of post-tax profits derived by a company. Tax must be calculated and accurately reflected in companiesô financial statements.[5] The greater the profit derived by a company, the greater the ability of the company to achieve its goals and act for the benefit of its shareholders and other stakeholders. A loss-making company is generally unable to pay dividends and loses value. In the past corporations could only pay dividends from profits but since the incorporation of section 254T into the *Corporations Act* in 2010 corporations can now pay dividends if: the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend; the payment of the dividend is fair and reasonable to the company's shareholders as a whole; and the payment of the dividend does not materially prejudice the company's ability to pay its creditors.[6]

Tax is an unavoidable expense of the company in its search for profits and directors need to devote time to formulating tax strategies both to ensure a corporation complies with its tax obligations and to limit its liability for tax. Corporations generally strive to achieve a competitive effective tax rate. Owens states:

> So what are the aims of the tax directors today? Clearly, an overriding objective continues to be to minimise tax liabilities so as to produce a competitive effective tax rate. But this desire to minimise tax will normally be tempered by the need to achieve a stable and sustainable tax rate. Achieving this should reduce the amount of time that senior management has to spend on resolving tax disputes with the revenue bodies.[7]

Not everyone holds that a lower effective tax rate is advantageous. Thomas and Zhang contend that, although a tax expense is deducted from pre-tax profit when computing net in[illegible] undet[illegible] unexpect[illegible] in [illegible] ed by [illegible] profi[illegible] this [illegible] in [illegible] company [illegible] in [illegible] t owing to a [illegible] ngein the tax [illegible] use [illegible] cting

> interests of the corporation. But if they conflict, the directorsô duty is clear ð it is to the corporation.[9]

Australian common law has the same principle.[10]

It follows that tax minimisation policies that do not breach the anti-avoidance rules should be considered and adopted if they lead to greater profits being available for investment, distribution or the attainment of other goals of the corporation and are in its best interests.

In addition to the common law duty to act in the best interests of the corporation, there are a number of statutory duties imposed under the *Corporations Act*. From a tax perspective, the statutory duties of care, diligence,[11] good faith and to act in the interests of the corporation[12] are arguably the most important although the latter duty they did not have a duty to lookò.[18] Directors must be familiar with the fundamentals of the business in which the corporation is engaged (including risk management) and must keep themselves informed about the activities of the corporation.[19] This oversight function includes establishing a system to prevent, detect and correct any wrongdoing with reference to tax. This rule is applied in the US. In *Daniels* the majority were of the opinion that directors must ensure they have available ñmeans to audit the management of the company so that it can satisfy itself that the company is being properly runò.[20] A bpo aÁ oA P ɣ ӿ Ï iP

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The inevitable consequence of the foregoing is that corporations are entitled to arrange their affairs to pay only such tax as the law requires. The Commissioner acknowledges ñ[t]ax planning is a key feature of any tax landscapeò.[33]

Notwithstanding the foregoing it would appear that the ATO believes that corporate entities should pay what is described as their ófair share of taxô or take the interests of the community into account when determining their tax liability and act as a ógood corporate citizenô. For example the Commissioner said:

> Compliance is a rather strong sounding word. Perhaps it is better to think in terms of fairness, for that is what compliance with our tax laws is all about. It is about people paying their fair share as set by our laws.[34]

The Commissioner reverts to this theme on numerous occasions.[35]

The acceptance by the Commissioner that tax planning is legitimate is somewhat contrary to calls for companies to pay a ófair share of taxô or to act as a ógood corporate citizenô. The tension between these two positions is discussed in the next section which is divided into two parts. The first considers the concepts of a ófair share of taxô and ógood corporate citizenshipô whilst the latter reviews CSR.

3. PAY A FAIR SHARE OF TAX ¶AND ACT AS A GOOD CORPORATE CITIZEN ¶

Freedman, Loomer and Vella undertook a survey investigating the attitudes and opinions of some large businesses and Her Majestyôs Revenue and Customs (HMRC) and report that:

> All of these respondents agreed that it was acceptable for a taxpayer to implement a business-led transaction in the most tax effective manner é corporation tax is a significant cost against business profits; reducing that cost in order to maintain competitive position or enhance shareholder value was seen as a valid commercial objective in itself.[36]

A survey conducted by Rawlings indicates that there is a perception that high wealth and corporate taxpayers do not pay their proportionate share of tax.[37]

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[33] Michael Carmody Commissioner of Taxation *Managing Compliance* Address to The Tasmanian Chamber of Commerce and Industry 3 September 2003

[34] Michael Carmody, óThe State of Play Five Years Onô (Address to Taxation Institute of Australia Victorian Division 3 February 1998).

[35] See for Commissioner of Taxation, ó*Consultation, collaboration and co-design: The way forward for the tax office*ô (Address to Australian Public Service Commission SES Breakfast, Boathouse by the Lake, Canberra 21 September 2006).

[36] Judith Freedman, Geoffrey Loomer and John Vella, óMoving Beyond Avoidance? Tax Risk and the Relationship between Large Business and HMRCô in Judith Freedman (ed), *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management* (Oxford University for Business Taxation, 2008) 81, 90.

[37] Gregory Rawlings, óCultural Narratives of Taxation and Citizenship: Fairness, Groups and Globalisationô (Working Research No 52, Centre for Tax System Integrity, Australian National University, February 2004) 1.

Similar results were obtained in a survey conducted by Valerie and John Braithwaite.

for tax although it should ensure that a company does not seek to reduce its tax liability to an amount less than that required by law.

That a taxpayer acts within the law but immorally is not a basis for a court to intervene.[48]

This article argues there is no basis for the proposition that a company is obliged to pay tax in an amount other than as prescribed by law. There is no basis for assessing or calculating tax by reference to what constitutes a ófair shareô. This is so whether one states that the concept means to act as a good corporate citizen; or if the meaning is to preclude p tkя oç mq x ! e] ƨi cM ξ x u o p˥

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In making the claim for companies to act as ógood corporate citizensô the Commissioner seeks to raise some moral obligation or some form of contract in calculating and paying their taxes. The Commissioner contends large business and the ATO have mutual obligations to ensure that the compliance process is working efficiently and effectively, and to demonstrate to the wider community how it works. According to the Commissioner, the challenge for the ATO and the business sector is to facilitate and support good corporate citizenship that will strengthen the Australian economy and promote the well-being of Australian society.[53] The call here is not for the payment of taxes as mandated by the law but rather for taxpayers to consider the community in determining how to conduct their tax affairs. The Commissioner never explains the basis or foundation for this sweeping statement. The obligation of taxpayers is limited to compliance with the tax laws and paying all such taxes as required by law.

If taxpayers accede to interpretations of the law made by the Commissioner that may be incorrect, or if they do not claim deductions or other benefits to which they are entitled as a result of statements made by the Commissioner, this may give the Commissioner a de facto power to impose tax, or at least may subvert the role of the courts to resolve disputes and declare the meaning of disputed legislation. Dabner and Burton say:

> In practice, a taxpayerôs risk assessment will typically result in the administratorôs interpretation being a proxy for what is ócorrectô. To then say that the parties have a common interest to see that the ócorrectô amount of tax is paid ignores the reality that the parties have a different view of what is ócorrectô, and thus no shared vision.[54]

If the Commissioner has inadvertently or intentionally assumed the power to impose tax or negates the role of the courts, it is beyond the authority granted to the Commissioner by the tax laws.[55] It would place too much power in the hands of the regulator if taxpayers were bound by its apparent unfettered discretion to determine the meaning and operation of the law.

Pascal Saint-Amans (Director of the Centre for Tax Policy and Administration, OECD) is reported to have said:

> Policy makers cannot blame businesses for using the rules that governments themselves have put in place. It is their responsibility to revise the rules or introduce new rules to address existing concerns.[56]

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For Saint-Amans, the solution to low effective corporate tax rates is to be found in tax policy and not in rhetorical demands.

The confusion between tax that is imposed by statute and some imprecise moral imperative has important consequences for the manner in which the media and others treat companies in relation to their tax affair.[57] For example, in evidence before the UK Parliamentôs Public Accounts Committee, the chair, Margaret Hodge, in a question to Matt Brittin, vice-president for Google Incorporated (Google) in northern and central Europe, said ñ[w]e are not accusing you of being illegal; we are accusing you of being immoralò.[58] What Hodge appears to be saying is that the UK would like Google to pay more tax than that required by UK law. If this inference is correct then politicians such as Hodge are assuming an unlegislated entitlement on the part of the UK tax aumʿ r tatl p

As Friedman stated:

> There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.[63]

Heard believes paying a ‘fair share of tax’ and CSR distorts allocative efficiency.[64]

The foregoing authors concur that it is the function of a company to maximise shareholder wealth. Although disagreeing with Friedman's reasoning, Bainbridge is of the view that the function of a director is to maximise shareholder wealth,[65] which is usually achieved by increasing after-tax profits. In compliance with their obligations to act in the best interests of the corporation, directors must ensure they maximise the advantages and minimise the risks of the corporation.

It is apposite to conclude this section by referring to what Sir Anthony Mason says on this topic: ‘as a taxpayer can't be expected to pay tax when it is not g g re u corporation cannot perform certain functions that are the exclusive preserve of the state is not a basis for requiring corporate taxpayers to pay an indeterminate amount to the revenue. If this latter argument had any validity, all taxpayers would be required to pay more tax than provided by law in some amount that is incapable of determination. Thirdly, compliance with the law does not mean that a corporation must voluntarily pay more tax than required by law.

Pekka comments on the views of Avi-Yonah as follows:

> We must firstly keep in mind that paying taxes has not been recognized as a primary CSR obligation and I am not sure if it is even a secondary one. Secondly it should be noted that tax planning or strategic tax behavior are normally considered problematic by the state only (the one losing cash flows from taxes) and other stakeholders seldom react to it. Thirdly this means that it is extremely difficult to claim that a company is promoting the enlightened value maximization by voluntarily paying taxes as it is quite difficult to see the connection between short-term cost and expected long-term profit. Instead, taxes are treated as standard costs which companies should minimize whenever that is possible by legal means.[68]

Other than possibly preserving a companyôs reputation, or achieving a trouble-free relationship with the ATO there appears to be no apparent advantage in paying more tax than required by law. Naming and shaming should not occur if corporations have paid all tax required by the law. Not minimising tax, on the other hand, may be a breach of the duty of directors to act in the best interests of the company.

There is no limit to the power of Parliament to enact taxation laws, provided they meet the constraints prescribed by the *Constitution*.[69] If the state requires M l e M q daily expenditures. Thirdly, altruistic CSR forces stockholders to sacrifice part of their income so that managers can be generous with shareholdersô funds. Lantos accepts that being socially responsible does not mean that profits will decline. They might rise because of favourable publicity. Moreover, enhanced employee morale might lead to greater productivity and less government intervention. However, if a business prospers, this is because of strategic, not altruistic, CSR.[71] Strategic CSR is appropriate even if the gain is not immediately visible in a companyôs financial statements.[72] There is nothing wrong with doing well simultaneous to doing good deeds.[73] In these circumstances, directors are acting in the best interests of the corporation. By contrast, it seems that making a gift to the revenue by paying more tax than prescribed by law is not such a good deed.

The ATO incorrectly operates on the implicit assumption that the law is constant and known to all.[83] The complexity of the tax laws makes it difficult for the regulator to justify such an approach. As Picciotto states:

> Various players may have different and genuinely-held understandings of a ruleôs meaning, and may each consider theirs the correct and clear meaning. As such, people who regard themselves as compliant based on their understanding of the regulatory requirements may, from the regulatorôs viewpoint, be avoiders or game-players.[84]

Valerie Braithwaite, Reinhart and McCrae view game playing as an attempt to cheat the system to limit the amount of tax paid.[85] Arranging a corporationôs affairs to reduce its tax liability to no more than is prescribed by law is not cheating. Some taxpayers may attempt to cheat the system, but in such circumstances, there are myriad provisions (civil and criminal) in both the *Corporations Act* and tax laws to address such conduct. The majority of companies seek to comply, but may be faced with the dilemma postulated by Picciotto above.

The ATO appears to try to persuade taxpayers not to venture into areas of uncertainty, or to develop structures that take advantage of these uncertainties, even where there is

> the test of whether tax planning is óacceptableô should be what the legislation says as interpreted by the courts and not what the tax authorities suppose it was intended to say.[96]

Broad and vague definitions only make an already complex area of law even more difficult.

McBarnet describes avoidance as ócreative complianceô, whereby taxpayers find ñ[w]ays to accomplish compliance with the letter of the law while totally undermining the policy behind the wordsò.[97] There are objective factors that must be met before a company falls foul of the anti-avoidance rules and particularly the GAAR. Policy does not play a significant role here.

McBarnet says: ñA tax planning device may fail in court without being branded a tax fraud. It is an essential element ð and attraction ð of creative compliance that it can claim to be ónot illegalô, to be quite distinct from non-complianceò.[98] Avoidance is neither criminal nor compliance; it falls between the two. The anti-avoidance rules provide that if the criteria they prescribe are met, certain consequences follow.

McBarnet also suggests that economic elites with the resources to buy legal creativity can also buy immunity from the law.[99] That a corporation can afford to pay for advice on structuring transactions in the most tax effective way is not the problem. The only issue is whether all tax required by law is paid. It is not immoral, unethical or illegal to structure a transaction to ensure no more tax is paid than is prescribed by law. To argue that paying for advice to ensure one complies with the law is in some way reprehensible is unfounded.

Fraser notes that the line between that which is and is not taxable is an intellectual boundary; however, in the absence of a relevant judicial decision, there may be no consensus as to where that line lies.[100] Fraser continues:

> [T]he taxpayerôs only legitimate expectation is, prima facie, that he will be taxed according to statute, not é a wrong view of the law é Why then should the expectations of the taxing authority be relevant to directorsô behaviour, to the point where the disappointment of such expectations might be regarded as giving rise to some kind of sanction?[101]

Fraserôs view appears to be a correct reflection of how directors should approach decisions relating to tax. Taxpayers should not have to pay more tax than is provided by law to comply with what may be an improper demand or an incorrect view of the law by the regulator unless it is in the interests of the corporation to do so.

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The ATO appears (in principle) to acknowledge the validity of Fraser's view. Hamilton says:

> One experienced tax auditor said to me that a number of large clients appear to 'sit just behind the dam wall'. We can usefully think of that dam wall as the bar or line where acceptable tax planning becomes unacceptable tax avoidance, where tax positions transit to become more 'highly contestable'. Clients, advisers and the regulator may have very different views on where that line is.[102]

The above passage acknowledges the distinction between tax planning and avoidance and that there may be different but legitimate views of how the law operates or whether the boundary to avoidance has been crossed. A contestable arrangement may not be capable of successful challenge by the Commissioner, but companies may nevertheless be persuaded from entering into such transactions. This suggests that the Commissioner seeks to maximise the collection of revenue. Hamilton notes that in cases of two different but reasonably arguable positions owing to ambiguity in the legislation, the ATO will choose an interpretation that lowers taxpayer compliance costs.[103] This intimates that a correct view of the law may not always be the approach followed.

The Privy Council in *O'Neil* notes that referring to something as 'tax mitigation' or 'avoidance' is unhelpful because this "describes a conclusion, rather than providing a signpost to it".[104] An answer may well depend on which fact or facts the court considers to dominate a particular matrix of facts.[105] As the Privy Council in *Peterson* notes, "not every tax advantage comes within the scope of the section; only those which constitute tax avoidance as properly understood do so".[106] This principle is of application to Australia.

The views of Fraser and the Privy Council in *O'Neil* and *Peterson* are accurate expositions of the problem faced when considering the distinction between tax planning (whether it is aggressive or otherwise) and avoidance. Since the decision in *Spotless*, it has been accepted that taxpayers can arrange their affairs to minimise the extent of their tax obligations, provided their actions do not bring them within the ambit of the anti-avoidance rules.[107]

Even if a tax mitigation scheme is incapable of successful challenge by the Commissioner, the reduction in tax must be greater than the direct and indirect costs of implementing the scheme. These costs include any potential costs of litigation with the ATO, possible reputational damage, possible civil or criminal penalties and what Sartori describes as 'implicit taxes'.[108] Implicit taxes emerge when, after having minimised the tax rate, the rate of return of investments is lower than would have been the case with the higher tax rate. Tax mitigation should not reduce the net after-tax return of a transaction.

Aggressive tax planning suffers from the same problems. It is a conclusion which