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Corporate social responsibility and tax avoidance: A comment and reflection

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ABSTRACT

This paper is a response to Sikka's 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance'. We believe that 'Smoke and Mirrors' (hereafter S&M) identifies an area of considerable importance but that it is misleading and problematic for several reasons. First, it glosses over the important distinction between tax avoidance and tax evasion. Despite using the term 'tax avoidance' in the title, to establish its conclusion, the paper relies predominantly on a handful of examples involving fraud, deceit and corruption, which are behaviors usually associated with 'tax evasion'. In the context of corporate social responsibility, we explain why this distinction is crucial and offer directions for future research in this area. Second, Sikka's paper ignores voluminous extant research on tax compliance, corporate tax avoidance and its relationship with CSR. Third, the paper mis-reports key statistics on the tax gap in the UK and US, and finally, it omits a robust discussion of the considerable policy response to corporate tax avoidance, which has been promoted by numerous tax agencies and international organizations such as the OECD. In the current paper, while recognizing the merits of S&M, we highlight the problems listed above, seek to remedy them, identify additional areas of concern and encourage further research attention in this area.

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1. Introduction and motivation

This paper responds to Sikka's recent article, 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance' (Sikka, 2010; hereafter S&M), which was published in this journal. In Section 4 of S&M, it is stated that the purpose of the paper is to 'encourage research into corporate claims of socially responsible conduct by examining their tax practices' (p. 165) and that the 'payment of democratically agreed taxes represents a litmus test for claims of social responsibility' (p. 166). In Section 1 of S&M, there is a claim, which we dispute, that 'comparatively little scholarly attention is paid to the payment of democratically agreed taxes' (p. 154).

In the course of establishing what many might consider an important conclusion, that is, 'in essence, companies have developed elaborate practices to appropriate returns due to society on its investment of social capital' (p. 165), S&M describes a number of instances in which corporations and advisors have engaged in activity that falls short of the standard of behavior that society might reasonably expect of such entities. The examples adduced in S&M, including Enron, WorldCom and Deutsche Bank, are acknowledged (at p. 157) as examples of deceit, fraud and/or corruption. Many of the examples provided in S&M demonstrate various types and aspects of fraud, deceit and/or corruption that were not voluntarily disclosed by the

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companies or organization identified. Very few of the examples in S&M represent tax-related behavior that is not an instance of fraud, deceit or corruption. We suggest that these examples provide very little information or insight concerning the tax-related behavior of the majority of companies and organizations and are therefore insufficient to justify the conclusion reached on p. 165 (see above). In addition, these examples say little about the relationship between tax-related behavior and the corporate social responsibility (CSR hereafter) practices of the majority of companies and organizations and why disclosure and transparency may be important for substantiating the CSR claims of corporations. It is a great pity that S&M takes this approach. We agree with S&M that the tax-related behavior of corporations and other organizations might, in certain circumstances, act as a litmus test both when considering the CSR claims of particular companies and when addressing various scholarly debates (see Avi-Yonah, 2008; Desai & Dharmapala, 2006b; Freedman, 2008a).

However, the content and tenor of S&M, as well as the methods of reasoning and unstated assumptions that appear to us to be present in S&M, the lack of inclusion of citations to established prior theoretical and empirical scholarly literature, the use of non-peer-reviewed reports,¹ the incorrect interpretation of existing tax gap statistics and the absence of any discussion of policy response by governments and tax agencies all are severe shortcomings.

In this response, we address several aspects of S&M that, when taken together, call into question the reliability of the conclusion that is offered and suggest that the research approach employed fails to identify a number of important issues that are relevant to the discussion of these topics.

This response is organized as follows. In the next section, we highlight the importance of distinguishing between the concepts of 'tax avoidance' and 'tax evasion' as well as discuss how such a distinction might be made and the relevance of the distinction when assessing the CSR behavior of corporations. In so doing, we acknowledge the difficulties that might be associated with such a distinction. We believe that a major failure of S&M is that by occasionally eliding the two concepts of tax avoidance and tax evasion, S&M fails to establish, however tentatively, any conclusion that is generally applicable to corporate activity.

In our view, S&M also fails to identify, let alone discuss, important issues concerning the nature of certain categories of corporate behavior for which the distinction between tax avoidance and tax evasion is relevant and useful. A major reason for our view is that, while S&M identifies a handful of companies and other organizations that did not disclose their deceitful, fraudulent and/or corrupt activity, this information is of little interest. To then use these examples to draw conclusions about the tax-related behavior of companies in general is, in our opinion, unconvincing.

What S&M does not consider are the merits of tax-related behavior that is *not* considered to be deceitful, fraudulent or corrupt by democratically elected governments and tax authorities. It is in this area of behavior that the relationship between tax-related behavior and CSR, whether considered on a national basis or with respect to the cross-border activity of multinational enterprises, raises important questions and may be of most interest. Given the number of headline corporate scandals in the past few decades, it is reasonably easy to identify what can be recognized as appropriate responses to deceit, fraud and/or corruption and these responses are accepted as appropriate by many of the parties contributing to the discussions taking place on these topics.²

It is more difficult to identify an appropriate and justified response or set of responses to tax-related behavior that is not deceitful, fraudulent and/or corrupt behavior, including behavior that some have characterized as creative compliance (Farber, 1999; McBarnet, 2005; Shah, 1996). We suggest that the academy should be focusing on the identification of such a response or set of responses and how they should be reflected in CSR behavior and disclosure. As the actual title of S&M suggests, it is the relationship between CSR and tax avoidance that is interesting, not the relationship between CSR and deceitful, corrupt or fraudulent behavior that, we suggest, is commonly identified as tax evasion.

Having argued that there is a useful and important distinction between tax evasion and other types of tax-related behavior,³ we then consider S&M's approach to the distinction in Section 3, arguing that even though the distinction between tax evasion and tax avoidance is not pursued, it is pertinent to S&M's argument.

Section 4 considers, in summary form, the considerable scholarly attention paid to tax-related behavior, the payment of democratically agreed taxes and extant research (uncited in S&M) on the link between CSR and taxation. This research is wide-ranging and originates in many different parts of the academy. We believe that the omission of this literature is unfortunate and undermines claims made in S&M that imply a paucity of existing tax research, which is incorrect.

In Section 5, we consider the use that S&M makes of some of its 'evidence', particularly the relevance of the examples cited, the selective and/or incorrect citation of reports on the tax gap and the dependence of S&M on statements that appear to be without foundation. We also briefly outline the policy approach to large business compliance currently undertaken by many tax authorities around the world and the regulation of tax accountants, which are topics clearly relevant to CSR and tax avoidance yet entirely omitted in S&M. In particular, we refer to the approach adopted by Her Majesty's Revenue and Customs (HMRC) to the behavior of large UK businesses with respect to their tax planning and tax positions and to the 'Working with Tax Agents' initiative (HMRC, 2009a, 2009b).

¹ See Fuest and Riedel (2009) for an interesting review of the literature on tax avoidance and tax evasion in developing countries, including a criticism of the methodology used in arriving at such estimates by a number of non-peer-reviewed reports.

² The websites of tax administrators (e.g., IRS, HMRC and the Australian Tax Office) regularly report instances of the consequences of deceit, fraud and/or corruption in the area of taxation. The consequences often involve a prison sentence.

³ That is, other types of tax-related behavior being referred to in this paper as tax avoidance.

Section 6 concludes and offers brief observations on three matters that we consider to be relevant to this research area: (i) the obligations of directors, which are alluded to in S&M, (ii) the purported but disputed distinction between the ‘spirit’ of the law and the ‘letter’ of the law and (iii) the human rights of companies that are found in democratically adopted laws and that are relevant to any debate on CSR, before finally identifying opportunities for further research.

2. The importance of the distinction between tax avoidance and tax evasion

S&M refers to CSR and tax avoidance, but with the exception of footnote 1 (which is discussed later), no definition or explanation is offered of what types of behavior should be categorized as tax avoidance. We believe that it is easy to assume that tax avoidance has a clear definition and such an assumption can lead to misunderstanding. Part of the purpose of this response is to offer a description of tax avoidance that can then be used in further discussion. However, any attempt to understand tax avoidance and the relationship between tax avoidance and tax evasion must accept that both are essentially *legal* concepts. Neither tax avoidance nor tax evasion could exist without the existence of tax codes, which give these concepts meaning. Some might make moral judgments regarding such behavior (Barker, 2009; Prebble & Prebble, 2010), but we struggle to see how any such moral assessment can be made without recognizing that the concepts of tax avoidance and tax evasion are legal concepts. In short, the existence of a tax code is a necessary condition for the existence of behavior that might be classified as either tax evasion or tax avoidance.

In addition, as most tax codes are large and complicated, it is suggested that without specialists to interpret the tax code, to determine its application and to identify tax-related behavior that is to be classified as tax evasion or tax avoidance, S&M would have little to say about the behavior of some companies and advisors because such categories would be bereft of content.

Although we acknowledge that our assumption might be misguided, we assume that if S&M is using definitions of tax evasion and tax avoidance that arise from the existence of a tax code, then S&M must accept that the ‘rule of law’ has societal implications and that a measure of ‘certainty’ should also be present in the legal codes (including the tax code) of a country. It is therefore a pity that S&M might be read as taking a somewhat jaundiced view of the nature of tax law and of tax lawyers; it states, ‘... lawyers ... also legitimise vocabularies and discourses that seek to normalise avoidance of taxes’ (p. 156). If the concepts of ‘tax evasion’ and ‘tax avoidance’ are to have content and are to be capable of being used to denote categories of behavior, we would suggest that lawyers and similar experts (whether tax advisors, tax administration officials or judges) and their understanding and experience of the law and its application to events are almost certainly required to assist in providing such content.

Given that any system of law is considered by most interested commentators to be normative, we find it rather puzzling that S&M appears to disparage the input of lawyers in this process without offering an alternative method, the application of which would provide content and clearly define the concepts of ‘tax avoidance’ and ‘tax evasion’. Because of the assumed importance of the ‘rule of law’ and the existence of a measure of ‘certainty’ in the tax code of a country, we would be interested to know how S&M would give content to the concept of tax avoidance without relying on the skill and knowledge of experts, many of whom would be lawyers. We therefore suggest that when considering the relationship between tax avoidance and CSR, it is important to be reasonably open-minded about the relationship between tax law, tax lawyers (and other tax experts) and tax avoidance, or if not open-minded, to make explicit the assumptions being made about that relationship.

S&M footnote 1 states (at p. 154) that ‘There are perennial debates about the meaning and significance of ‘tax avoidance’ and ‘tax evasion.’ This is true,⁴ although it should be noted that many of the debates might be founded on one or more points of confusion. S&M does acknowledge that a distinction is generally made between the concept of tax avoidance, which refers to behavior that is lawful, and the concept of tax evasion, which refers to practices that contravene the law. However, S&M then adduces evidence that in many cases requires the useful distinction between the concepts of tax avoidance and tax evasion to be more or less ignored (see also Section 5). It is thus important to address S&M’s reasons for proceeding as if the distinction between tax avoidance and tax evasion is *not* as important or as useful as many governments, scholars, international organizations, advisors and taxpayers consider it to be. These reasons are discussed in Section 3.

Although we believe that a distinction between tax avoidance and tax evasion not only exists but also is useful when seeking understanding and clarification about CSR, we acknowledge that S&M might believe that such a distinction does nothing more than ‘enable the dominant class to advance its hegemony through consent rather than brute force’ (p. 154). The distinction then becomes part of a narrative that can deceive many within society. If this is the case, it would have been helpful for this position to have been acknowledged and for the conceptual assumptions underlying the on-going debate to be rejected. We believe that a debate about the meaning of tax evasion and tax avoidance and the application of concepts such as ‘creative compliance’ is important because the outcome of the debate should inform the relationship between CSR behavior, corporate CSR disclosure and the tax avoidance behavior of corporations.

Before considering the view of S&M, it is useful to reflect, initially at a theoretical level, on the concepts of tax avoidance and tax evasion by considering the types of behavior that actors (who are at least potential taxpayers, if not actual taxpayers)

⁴ A considerable amount of research from many disciplines has been conducted on this distinction (e.g., Barker, 2009; Freedman, 2004, 2008b; Halkyard, 2004; Hoffman, 2005; Kirchler, Maciejovsky, & Schneider, 2003; McClaren, 2008; Picciotto, 2007; Schler, 2002; Seldon, 1979; Self, 2008; Templeman, 1997; Weisbach, 2002; Weisbach, 2004).

have, on occasion, the opportunity to choose between. We then consider some of the practical difficulties that arise when choosing between alternatives in circumstances where tax outcomes matter. In this paper, the term ‘actor’ is used to refer to any person or entity that is, at least theoretically, within the tax base of a jurisdiction. In the context of responding to S&M, ‘actor’ will refer to companies, but the issues raised there are also relevant to the tax-related behavior of individuals and other entities that might fall within a particular tax base.

It is undeniable that the tax code of a sovereign state⁵ is almost certainly complex and that many types of events, transactions, arrangements and activities will be identified as having consequences under a tax code.⁶ In addition, it is acknowledged that the tax code of each sovereign state is itself different and that an event that might give rise to a tax liability in one sovereign state will not give rise to a tax liability in a different sovereign state.

In addition to being complex, the tax code of a sovereign state will have many functions. Two such functions are (i) to impose a liability to pay tax if certain types of events happen, such as making a profit, and (ii) to create an entitlement to some form of tax relief or tax credit if certain other types of events happen, such as making a loss or paying interest. The tax code, being part of the overall tax system that gives effect to these functions, may be considered to consist of a large collection of democratically enacted laws for most economically developed sovereign states. A particular subset of this tax code will seek to identify a type of event, and if a token of that event occurs, then the tax consequences, as laid out within the relevant provisions of the tax code, will crystallize.

This understanding of a country’s tax code is relevant not only to many existing tax codes, which are usually rules-based and complex, but also, we would suggest, to a principles-based tax code.⁷ In less abstract terms, a provision might, for example, identify the disposal of a capital asset as possibly giving rise to a tax liability that is to be calculated by reference to the profit made on the disposal of the asset. An actor disposing of a capital asset that fell within the relevant provision might thereby crystallize a tax liability. However, before an event actually occurs, the actor might be able to choose between one event rather than another, each of which has different tax consequences. The simple and readily understood example of selecting the extent to which a subsidiary company is to be funded by debt or equity will illustrate the operation of such a choice. In many countries, the existing tax code allows a tax deduction against profits for some interest payments but not for dividend payments; therefore, choosing the split of debt or equity in a company has a direct effect on the tax position of that subsidiary company and the investors (Blouin, Core, & Guay, 2010).

For these purposes, it is assumed that any event between which the actor may choose is a real and not a sham event. That is, each of the events between which the actor may choose is neither fraudulent nor deceitful nor corrupt. Rather, each event is lawful, viable and tenable. In selecting one event rather than another, the actor will produce a state of affairs that is different from another state of affairs that might have occurred had the actor selected a different event.

In plain English, ex ante, an actor chooses between alternatives. Ex post, a tax liability or an entitlement to a tax relief crystallizes. Given the choice made by the actor ex ante, the expectation of the actor might be for a reduction in tax payable. In practice, this might mean that a choice by a corporation results in less taxable profit arising in that corporation (e.g., the firm is financed by debt rather than equity), more taxable profit arising in another company (e.g., payment for the use of intellectual property), or tax relief being available sooner rather than later (e.g., funding a leasing transaction rather than providing a loan).

Given this possibility of an ex ante choice between alternatives with different ex post consequences, we believe that a distinction can be made between tax-related behavior that is correctly described as tax evasion and ‘every other type of tax-related behavior’.

The labels that have been attached to ‘every other type of tax behavior’ are many and varied. A considerable amount of effort by academics (e.g., Barker, 2009; Freedman, 2008a; Halkyard, 2004; Kirchler et al., 2003; Schler, 2002; Weisbach, 2002), tax administrations (HMRC, 2011; OECD, 2008, 2011) and even judges (Hoffman, 2005) has been applied to distinguishing various subcategories within ‘every other type of tax-related behavior’, such as ‘tax avoidance’, ‘tax mitigation’, and ‘tax planning’, and then attaching adjectives, such as ‘artificial’, ‘aggressive’, and ‘unacceptable’.

We suggest that the important and relevant characteristics of a particular type of behavior do not change simply as a result of attaching a label. For example, to prefix ‘artificial’ before a tax avoidance arrangement might mean that the selected event is in some way deceitful or a sham (i.e., the event purports to be one thing when in fact it is another) or it might mean that the event is unusual, new, innovative and/or complex but is not deceitful or a sham. For example, to a layperson, funding capital projects through complex tax-based leasing arrangements rather than through debt finance may be considered artificial, but such arrangements are an accepted part of the commercial world.

We are also aware that tax codes and tax practice have developed differently within different countries. A label such as ‘tax avoidance’, which describes a particular type of behavior in one country (e.g., the UK), would be unacceptable as a label when used to describe a very similar type of behavior in another country (e.g., New Zealand). In New Zealand, the label ‘tax planning’ is more likely to be used even though the behavior would be essentially the same.

⁵ In this response, no detailed analysis is given of what constitutes a ‘sovereign state’. In using the term, we refer to any entity with legitimate tax-making powers, and this will include nations (such as the UK), states (such as Texas or New South Wales) and even local authorities.

⁶ Rather than repeatedly referring to ‘events, transactions, arrangements and activities’, for the sake of brevity, we shall refer to ‘events’ in this paper.

⁷ See Freedman (2010) for a discussion of the necessary qualities of a principles-based tax code.

In a similar manner, within a country, different interested parties will use a label such as ‘tax avoidance’ to denote different types of behavior. In the UK, the tax authorities use ‘tax avoidance’ to denote a specific category of behavior (HMRC, 2009b) and the denotation of that same phrase is different for many tax advisors and different again for NGOs with an interest in this topic.

We believe that it is important to strive for clarity when discussing CSR and tax-related behavior, and even if certainty is difficult to locate in some areas of tax-related behavior (see below), seeking clarity will assist in identifying such areas of uncertainty, the possible reasons for such uncertainty, and even what may be considered appropriate responses when addressing the topic of CSR behavior and corporate CSR reporting.

Whatever the labels used to describe the various categories of behavior, a necessary condition for any behavior to be classified correctly as tax evasion is that, as a result of the actions of an agent, a tax liability has been crystallized under a tax code and is not satisfied by the agent. The crystallization of a tax liability but non-satisfaction of that tax liability is a necessary condition for the existence of an instance of tax evasion, but we believe it is not a sufficient condition. A tax liability might not be satisfied for a number of reasons, including ignorance of the existence of the liability or administrative incompetence. Although some may consider the non-satisfaction of a tax liability as a result of ignorance or administrative incompetence to represent an instance of tax evasion, generally, tax administrations have not taken this stance.

Although non-payment of a crystallized tax liability is a necessary condition for the existence of tax evasion, we suggest that something more is also required. In most countries, tax evasion is usually considered to be a criminal matter,⁸ and for the non-satisfaction of a crystallized tax liability to be considered criminal, there must be some form of intentional deceit, fraud and/or corruption.

As a result, we therefore suggest that there are two necessary conditions for tax evasion: a failure to satisfy a tax liability that has crystallized and an intention, based on an event that has occurred, to be deceitful, fraudulent and/or corrupt with respect to that event. If an instance of tax-related behavior does not possess the necessary conditions, then it is not tax evasion.

The reason(s) for choosing between two or more possible events is based on an understanding of how part of the tax code of a jurisdiction (or even jurisdictions, in the case of multinational corporations) will apply to the different events between which the actor can choose.

Once the selected event occurs, it is expected that tax consequences will follow. If the expected tax outcome of the choice made by the actor does not crystallize as expected, then, in simple terms, the *ex ante* tax avoidance was not successful. It is important to note that, provided that the tax liability that does crystallize *ex post* is satisfied (i.e., the actor complies with its obligations to society under the tax code), unsuccessful tax avoidance should not be classified as tax evasion behavior (based on the description of tax evasion provided earlier). In such circumstances, even though the tax avoidance failed, the *ex ante* tax-related behavior is not deceitful, fraudulent or corrupt.

In contrast, if an event occurs and a liability to taxation crystallizes but the actor *intentionally* does not satisfy the liability to taxation, by and for whatever means, then the actor is engaged in deceitful, fraudulent and/or corrupt behavior. The intention not to satisfy a liability to taxation that has crystallized is manifested *ex post*, even if the decision not to satisfy the liability originated *ex ante*. The actor is engaging in tax evasion.

S&M glosses over this important distinction. What is more, from its general tone the view is espoused that if an actor chooses event A rather than event B and the tax position that crystallizes following event A is more advantageous to the actor, the actor is to be condemned in some manner for not selecting event B. This is so notwithstanding that in satisfying the tax liability that crystallizes as a result of event A, the actor is honoring its ‘commitment to pay tax’ (p. 166) and has made the ‘appropriate returns to society’ (p. 165) as required by society under the tax code. The actor is not appropriating ‘returns due to society’ (p. 165) because the amount of tax due to be paid is actually paid. The actor is tax compliant. This reference to a non-existent counterfactual in order to provide a standard by which the actor’s tax-related behavior is to be judged is puzzling.

However, what happens in practice may be unclear. Defining a distinction between tax evasion and tax avoidance on a theoretical basis is all very well, but actual decision making in certain cases can be difficult, and such difficulty is relevant when considering the relationship between CSR and tax avoidance.

We believe that a major cause of the difficulty that can arise in some circumstances is due to the uncertainty that can exist concerning the tax consequences of a particular event. Tax advisors, tax administrators and tax courts can agree on the manner in which the tax code applies to an event in most cases; it is when there is a measure of uncertainty concerning if and how the tax code applies to a particular event that the distinction between tax avoidance and tax evasion might appear to be difficult to discern.

Such uncertainty can arise for many reasons. The relevant area of the tax code can be complex, and neither the tax advisors nor the tax administrators can be certain whether the event is taxable or whether relief is available. More often, the tax administrators have an understanding of the tax code that suggests an event should be taxable or no relief should be available, yet the tax advisors disagree because their understanding of the tax code is different.

⁸ In some countries, tax evasion does not fall within the scope of the criminal law but is considered to be a civil matter.

We do not believe that CSR absolves decision makers in corporations from assessing the available information and reaching their own conclusions. Virtuous CSR behavior and compliance does not require decision makers to accept the opinion of tax administrators in an uncritical manner, even if tax administrators would prefer that to be the case. In the context of making decisions that have tax consequences, this is an important aspect of the ‘rule of law’ and, as will be suggested in Section 6, a corollary of some corporations falling within and hence being protected by human rights legislation. Such disagreements can lead to the courts deciding the extent to which, if at all, the relevant tax code applies to that particular event. History indicates that neither tax administrations nor tax advisors are always correct in their understanding of how the tax code applies to a particular event.

We suggest that in such circumstances of uncertainty, it is still possible to make a useful distinction between tax evasion and what has been described as every other type of tax behavior that we identify as tax avoidance. However, we suggest that one area that may be of interest when considering CSR behavior, corporate CSR reporting and tax avoidance is the distinction between the tax-related behavior of agents based on uncertainty and tax-related behavior based on certainty. A detailed analysis of this distinction, including identifying the reasons for the uncertainty/certainty and the degree of uncertainty, considering the process by which the relevant part of the tax code is applied to a particular type of event and assessing the relevant factors external to the tax code is beyond the scope of this paper. However, it is possible to identify a number of important and related factors that may be used to distinguish between various types of tax-related behavior, and such distinctions are, we believe, relevant to understanding the relationship between CSR behavior, corporate CSR reporting and decisions that are tax-related. The proposed factors are as follows:

- *Intention of the actor.* As discussed above, an intention to be fraudulent, deceitful and/or corrupt is a necessary condition for any behavior to be classified as tax evasion, but it is not a characteristic of tax avoidance.
- *Knowledge or appreciation of how the tax code applies to the events being considered.* Relevant to CSR behavior and reporting is the extent to which the agent has diligently sought to understand how the tax code applies to an event.
- *Propensity of an actor to comply with the tax code and in so doing, make full and truthful disclosure of all tax-relevant matters associated with the event.*

Using these three factors, tax evasion can be described as requiring an intention to be fraudulent, corrupt and/or deceitful under circumstances in which knowledge or appreciation of the tax code is not considered duly important and a propensity to comply with the tax code is minimal or lacking. In contrast, everything else, which we have called tax avoidance, would lack an intention to be fraudulent, corrupt and/or deceitful. Depending upon the degree of knowledge or appreciation of the application of the tax code and the extent to which there is a propensity to comply, corporations could be assessed in relation to their CSR behavior and corporate CSR reporting.

With respect to the broad category of tax avoidance (everything that is not tax evasion), ex ante choice based on diligently acquired knowledge in combination with full and truthful ex post disclosure should, from a CSR perspective, be considered differently than any ex ante choice based on ignorance in combination with negligent disclosure. Both categories of behavior should be considered different from tax evasion. S&M fails to make such distinctions.

3. The approach to the distinction between tax evasion and tax avoidance in S&M

Having offered what we consider a viable distinction between tax evasion and tax avoidance and suggested a number of concepts that might be useful in any future discussion of the relationship between CSR behavior, corporate CSR reporting and tax avoidance, we now evaluate the S&M approach to the distinction, which appears to rely on three separate strands.

First, S&M notes that ‘... in practice the distinction is no[t] (sic) so clear-cut.’ (p. 154). However, simply stating that the distinction is not clear-cut is not a sufficient reason for subsequently acting as if the two concepts can be linked together in an uncritical manner. As outlined earlier, tax beneficial ex ante behavior (which can be termed ‘tax avoidance’) is not tax evasion, and even ineffective ex ante tax avoidance behavior is not usually considered to be tax evasion provided the relevant actor does not intentionally fail to satisfy any liability to taxation that crystallizes.

One response supporting the S&M position could be summarized as follows: ‘because the distinction between tax avoidance and tax evasion is occasionally not clear-cut, it can be ignored’, and such a response might find support in the uncertain aspects of a tax code that have been identified above. For an actor (e.g., a parent company of a multinational group) to seek an advantageous tax position based on such uncertainty is a sufficient reason to call into doubt any purported distinction between tax avoidance (which, based on the analysis above, is an ex ante choice) and tax evasion (which is an ex post choice). In short, the tax consequences of a particular event occurring may be so uncertain that it is not possible to categorize such behavior as either tax avoidance or tax evasion; therefore, the distinction is wholly redundant. Based on our identification of the necessary conditions for any behavior to be classified as tax evasion, we maintain that it is possible, in theory and in practice, to justify the distinction between tax evasion and tax avoidance.

It is undeniable that difficult cases exist. However, it is acknowledged by taxpayers, tax administrators, lawyers and judges around the world (Freedman, Loomer, & Vella, 2009 and previous references) that difficult cases do not necessarily justify the disregard of a very important and useful distinction, particularly because S&M supposedly (p. 153) aims to reveal the difference between what is said and what is performed by companies (‘organised hypocrisy’) and to call for additional research into the tax avoidance aspects of CSR (rather than the tax evasion aspects of CSR). However, to answer this call,

a distinction between various concepts, one of which is the distinction between tax avoidance and tax evasion, is almost certainly required.

To illustrate, consider a situation in which, when asked, it is difficult for an individual to say whether a particular ceramic tile is blue or green. The color is greenish-blue. This difficulty does not prevent the individual from successfully identifying other items as being either blue or green in color. A difficulty that might exist in some circumstances does not prevent the distinction between the colors blue and green from being useful and relevant.

However, the distinction between the concept of tax avoidance and the concept of tax evasion is far more robust than the distinction between blue and green. In the case of colors, there can be circumstances in which different individuals will disagree as to whether the color being viewed is the color blue or the color green. In the case of tax avoidance and tax evasion, these are not only legal concepts with a meaning and denotation that is framed by the system of law in which they exist; there is also a mechanism available under which it is possible to determine whether a particular instance of behavior is one that is appropriately described as tax avoidance or tax evasion.

In simple terms, it is ultimately the role of judicial systems to determine the tax and other legal consequences of a particular instance of behavior (i.e., the selection of one event rather than another) when there is a disagreement between a potential taxpayer and a tax authority. Indeed, the courts of many countries have, over the decades, developed sophisticated methods and tests for making the distinction; for example, the concept of 'economic substance' is used in the US (however, we obviously do not know of any 'court' of color determination).

Simply because there may be some dispute or a measure of uncertainty as to whether a particular event (or collection of events) is to be described as tax avoidance or tax evasion is, we suggest, not a sufficiently robust reason for ignoring the distinction between the two concepts. This is particularly true if the concepts are being used to make a distinction between categories of behavior that are of significance.

In essence, actors who are tax evaders do not pay the tax that is due under the law and engage in deceitful, fraudulent and/or corrupt behavior. In contrast, tax avoiders pay all of the taxes that crystallize as a result of entering into a particular event (Hoffman, 2005). The tax avoider will have exercised choice between alternative courses of action, but the tax avoider (not the tax evader) fulfills all obligations and satisfies all 'democratically agreed taxes' (pp. 154, 165) imposed by society. We have difficulty appreciating the merit of any argument or conclusion based on ignoring this difference.

Second, S&M refers to several 'promoters' who have described the strategies they offer as avoidance strategies, which S&M claims ex post are concluded to have been evasion strategies, but no direct reference or justification for this claim is offered (p. 154). It is to be assumed that the examples provided later (e.g., the references to KPMG and Ernst & Young) are instances of such behavior. However, as the examples used in S&M demonstrate, the activities of these particular advisors proved to be cases of 'tax fraud conspiracy' (p. 160), an instance that we have argued is tax evasion.

The fact that a promoter labels an event that proves to be a case of tax evasion as 'tax avoidance' reveals very little about the importance of the distinction between tax avoidance and tax evasion; however, it does reveal a considerable amount about the promoter. Likewise, describing a ceramic tile as being blue in color when it is actually green does not diminish the importance of the distinction between blue and green.

Finally, S&M suggests that some events entered into by companies have a certain outcome under the tax code (e.g., the event delivers a tax benefit in accordance with the relevant part of the tax code), but entering into such an event is not acceptable on ethical or moral grounds. We assume that it is the act of entering into the event that is immoral or unethical, not the event itself. For example, if it is necessary to craft a loan agreement or incorporate a subsidiary as part of an event, the purpose of which is to provide some form of tax benefit, the loan agreement or subsidiary is morally and ethically neutral, provided that such legal events and/or arrangements are real and not fraudulent, deceitful or a sham. However, S&M does not address the distinction between what may be called the intention of the actor and the 'tools' required to give effect to the intended event, and we accept that S&M might wish to argue that the 'tools' used to give effect to certain events are themselves immoral or unethical. For example, one might consider a company incorporated under the laws of a tax haven to be an immoral or unethical 'tool' but a company incorporated under UK law to be an acceptable 'tool'. S&M is silent on this point, yet if such a distinction is important, identification and discussion would have been illuminating.

It is important to acknowledge that neither S&M nor this response seeks to provide an argued justification, one way or the other, for an ethical description of tax-related behavior that is not tax evasion.⁹ Tax evasion, based as it is on fraud, deceit and/or corruption, is taken to be unethical and/or immoral. Even so, without venturing too far into this ethical area, we will make an observation about democratically enacted tax law and the relationship between such tax law and the event entered into by actors, which is a relationship that we consider pertinent to S&M's position.

It is undeniable that corporate activity exists in many forms. The company law code, contract law, and property law of a sovereign state provide the framework within which such corporate activity can take place, whether the sovereign state is a small offshore island (which may be referred to as a tax haven) or one of the largest developed countries in the world. Additionally, there are many purposes to which the corporate structure is put. A company may do nothing more than lend money and receive interest. Alternately, the assets and other resources of a company may be used, for example, to build airplanes, invent drugs, write software, provide social housing, or alleviate poverty.

⁹ For our purposes, as summarized earlier, tax evasion is an ex post intention (which may have been formed ex ante) and does not occur to satisfy a liability to taxation that has crystallized under part of the tax code as a consequence of an event occurring.

A sovereign state is able to identify certain corporate activities and declare that if such activities occur, then certain tax consequences will follow. This is the case whether the tax code is based on rules or principles and includes, for example, providing incentives to encourage corporate behavior that is of benefit to wider society. Tax will be levied or tax reliefs will be granted as a result of the corporate activities occurring. A sovereign state will have many reasons to adopt such tax laws, not only to raise income but also to encourage and support economic activity considered to benefit the citizens of the country (HM Treasury, 2010) and to redistribute income.

It is reasonable to accept that under a democratic system that is subject to the principles of the rule of law and seeks to provide a measure of certainty in the laws that exist, if the sovereign state declares, for example, that tax is to be levied on a certain class of corporate activities, then corporate activities that fall outside that identified class of activities are not subject to that particular type of taxation. Thus, it can be said that there are limits or boundaries (see Shaw, Slemrod, & Whiting, 2010, p. 1118) to the tax base or even various types of tax bases that are identified and described by the democratic sovereign state. Corporate actors choosing to enter into activities that fall outside the identified and described tax base, by definition, will not be subject to the tax consequences attaching to these activities.

Equally, corporate actors may choose to enter into activities that do fall within the identified and described tax base. When the consequences of such actions are confirmed as falling within the relevant tax base, either by clear application of the tax code or by the tax authorities or by the judicial process, such actors are entitled under the tax code declared by the democratic sovereign state to benefit from any tax relief that is made available by that part of the tax code.

Given that the type of activity selected by a corporation has been identified by the democratic sovereign state and thus results in an identified tax consequence, the moral or ethical qualities of intentionally acting such that (i) part of the tax code of a democratic sovereign state does not apply to a particular event because the selected event is not within the tax base created by the tax code or even that (ii) part of the tax code does apply (and a tax relief is available) are not obvious.

It is possible for most men and women of good will to recognize and accept that certain corporate activities and decisions could justifiably be called immoral and unethical. One only has to consider cases involving the exploitation of workers, suppliers and customers by corporations to accept that some behaviors and decisions are immoral and unethical. However, with tax-related behavior, the matter may be somewhat different. If the tax code, the judicial system and, indeed, the tax administration accept that choosing event A rather than event B has the expected beneficial tax consequence, in what manner is the chosen event unethical or immoral?

It appears that S&M would have it otherwise, that is, a selected event can be viable and tenable, have the expected tax consequences and yet be considered unethical by certain interest groups (unethical in this context perhaps means nothing more than 'disapproved of' by that group). By taking such an approach, the distinction between tax avoidance and tax evasion is undermined to such an extent that the distinction is not relevant to any investigation into the relationship between tax-related behavior and CSR.

We fear that the tenor of S&M is that tax avoidance activities and tax evasion activities are both tarred with the brush of immorality, and thus, companies engaging in tax avoidance activities are no different from companies engaging in tax evasion. Whereas we believe that there are circumstances in which not to select event A ex ante, an event that is expected to result in a more favorable tax position than an alternative event B would itself be immoral. More tax would be paid than need have been, and the resources of the corporation are consequently reduced, which may have an impact on employees, suppliers, customers and the future viability of the enterprise. In failing to clearly elucidate the moral concerns that underlie S&M, a position is built, and conclusions are offered based on premises that are not clear. As a consequence, the important issues that arise in this area of research are somewhat obscured.

In sum, rather than dispelling the smoke and mirrors that are suggested to exist in this area of corporate activity, S&M may be adding to them by not making important distinctions between different categories of behavior and not identifying the motives for such behavior.

4. S&M omits extant research literature on corporate tax compliance (and CSR)

As mentioned in our opening paragraph, S&M states that 'comparatively little scholarly attention is paid to the payment of democratically agreed taxes' (p. 154). Although S&M only cites two relevant articles from scholarly journals, as opposed to citing numerous reports from vested interest groups (i.e., Lyssiotou, Pashardes, & Stengos, 2004; Sikka & Hampton, 2005), there is compelling evidence of a considerable scholarly literature on tax-related behavior and on the payment of taxes. The extensive literature on tax compliance appears in mainstream accounting journals, such as *Accounting Forum*, *The Accounting Review*, *Accounting, Organizations and Society*, *Contemporary Accounting Research*, and the *Journal of Accounting and Economics*, as well as in other disciplines, such as economics, law, sociology, and, of course, tax journals.¹⁰

The purpose of this response is not to provide a full literature review, but to point readers to review articles, such as Jackson and Milliron (1986), Andreoni, Erard, and Feinstein (1998), Hasseldine and Li (1999), Richardson and Sawyer (2001), Shackelford and Shevlin (2001), Stewart (2005) and Hanlon and Heitzman (2010), and to books by Braithwaite (2003a,

¹⁰ Examples in top mainstream accounting journals include Dyreng, Hanlon, and Maydew (2008), Erickson, Hanlon, and Edwards (2004), Frank, Lynch, and Rego (2009), Mills (1998), Phillips (2003) and Rego (2003).

2003b), Kirchler (2007) and Torgler (2007). Taken together, these reviews cover hundreds, if not thousands, of peer-reviewed theoretical and empirical studies.

While we do acknowledge that much prior work on tax compliance has focused on individual tax compliance rather than corporate tax compliance, which is more difficult to model (Slemrod, 2004b), over the last decade, the situation has changed considerably. Although early corporate work examined companies' effective tax rates (e.g., Holland, 1998; Zimmerman, 1983), current quantitative work focuses explicitly on tax avoidance and related consequences, such as firm value (Desai & Dharmapala, 2006a, 2009), ownership structure (Chen, Chen, Cheng, & Shevlin, 2010) and earnings management (Hanlon & Maydew, 2004). This literature even suggests that tax avoiding firms can be penalized in equity markets relative to other firms that presumably avoid less tax (Hanlon & Slemrod, 2009), although they interestingly find evidence of cross-sectional variation. Some work (e.g., Hanlon, Mills, & Slemrod, 2007) has even used datasets of corporate taxpayer audits to determine which factors are associated with (non)compliance.

For the last several years, qualitative research methods have also been used to study corporate tax avoidance (e.g., Freedman et al., 2009; Mulligan & Oats, 2009; Oats & Salter, 2008; Toumi, 2008) and have even been commissioned by tax agencies themselves (e.g., HMRC, 2007). The respondents of most studies stress the importance of corporate reputation, suggesting that the CSR and tax relationship is more complex than simple hyperbole or 'organised hypocrisy'.

S&M highlights the role of accounting firms (i.e., cases involving individuals from KPMG and Ernst & Young). Again, this is an area that has received attention in the literature, not only by Sikka and Hampton (2005) and Sikka (2008). By definition, accounting firms operate as intermediaries between corporate taxpayers and tax agencies (Hasseldine, Holland, & van der Rijt, 2011; OECD, 2008). Prior research suggests that accountants, acting in their intermediary role, do not just act as 'exploiters' of the tax system but have an active 'enforcer' role to play in tax systems (Klepper, Mazur, & Nagin, 2001; NAO, 2010). For instance, US research shows that tax returns prepared by certified public accountants (CPAs) are associated with fewer audit adjustments by the Internal Revenue Service (IRS) than self-prepared returns or returns prepared by non-CPA preparers (Hite & Hasseldine, 2003; TIGTA, 2008).

S&M calls for more research into the topic of CSR and tax avoidance but does not discuss the definition of CSR in any detail. We agree that CSR is an area of academic research that is still developing, but we note that it is a wide-ranging umbrella term that can be usefully extended into all areas affected by corporations (Prieto-Carron, Lund-Thomsen, Chan, Muro, & Bhusan, 2006). In fact, there are numerous relevant publications in this area that are uncited in S&M. These studies show that researchers have been investigating the moral aspects of tax compliance and corporate compliance for many years (e.g., Kaplan, Newberry, & Reckers, 1997; Roth, Scholz, & Witte, 1989; Slemrod, 1992).

The role of companies and tax-related behavior has recently received considerable attention. For example, in 2007, a conference with 130 delegates met at the Oxford University Centre for Business Taxation to debate related issues with a conference volume subsequently published (Freedman, 2008a). One participant, Avi-Yonah (2008, pp. 183–184), states, 'From the perspective of the corporation, if engaging in CSR is a legitimate corporate function, then corporations can also be expected to pay taxes to bolster society as part of their assumptions of CSR. If, on the other hand, CSR is illegitimate, there is a question whether corporations should try to minimize their tax payments as part of avoiding CSR and maximizing the profits of their shareholders.' In addition, Desai and Dharmapala (2006b, p. 4) state, 'How should corporations view their tax obligations, and should tax compliance be part of their social responsibility campaigns? Alternatively, why aren't tax payments more frequently framed within the context of the social responsibility of corporations?' We refer readers to the interdisciplinary volume edited by Freedman (2008a) as a useful first step in accessing this literature.

Work in tax and social responsibility is not restricted to the US or UK; the Centre for Tax System Integrity at Australian National University has been exclusively focusing on tax compliance for several years with an interdisciplinary social science team. Much of their work is related to social responsibility and responsive regulation (see, for example, Braithwaite, 2003a, 2007; Braithwaite, Pittelkow, & Williams, 2003; McBarnet, 2003). Finally, from a socio-legal perspective, McBarnet, Aurora, and Campbell (2009, p. 52), note that 'It is not surprising that tax avoidance has caught the eye of critics geared to CSR. In terms of its consequences . . . [i]t is also, of course, a challenge for business in that it goes to the heart of the issue of profit maximisation . . .'

By failing to refer to the ongoing and lively debate that is taking place on the topic of CSR and tax, S&M is revealing, inadvertently perhaps, a lack of understanding of the issues considered important by scholars already operating in this area. Clearly, our response is not a literature review in itself, but interested readers are directed to the references listed in this section.

5. Examples, statistics and omission of any discussion of policy responses in S&M

We believe and have argued that when considering CSR behavior and reporting, important distinctions are to be made between tax evasion and other types of tax-related behavior that we refer to as tax avoidance. Based on the three important factors of (i) intention, (ii) knowledge or appreciation of the tax code and (iii) propensity to comply with the requirements of the tax code, various categories of tax-related behavior can be identified.

We consider it unfortunate that S&M did not consider making such distinctions or make a more clear distinction between tax avoidance behavior (however, that is understood in S&M) and tax evasion behavior. There are too many examples to cite in S&M of tax avoidance being bracketed with tax evasion but, for example, the following occurs on p. 154: 'large scale tax

avoidance and evasion', 'tax avoidance and evasion' and 'devise schemes to avoid/evade taxes'. This bracketing occurs throughout S&M and does not assist clarity when considering CSR and tax avoidance.

With regard to the examples used in S&M to illustrate 'organised hypocrisy', the concern is that many of those examples are instances of fraud, deceit and/or corruption, descriptions that are closely linked to tax evasion but, as has been argued, are not linked to tax avoidance. For example, in connection with Enron, S&M contains the following: 'under the weight of frauds by senior management, Enron collapsed' (p. 158, our emphasis); 'Many of Enron's transactions had *no economic substance*' (p. 158, our emphasis); major transactions 'involved deceptive financial structures' (p. 158, our emphasis); 'transactions appear to have had no business purpose other than to enable Enron to engage in *deceptive accounting* . . . or *deceptively reduce its tax obligations*' (p. 158, our emphasis).

In a similar manner, when referring to WorldCom's tax avoidance strategy, S&M quotes from the report of the insolvency examiner who concluded that KPMG 'failed to explain the true nature' (p. 159) of one major arrangement, an approach that is anything but a propensity to comply. S&M uses KPMG and Ernst & Young as evidence to support the contention of 'organised hypocrisy'. Again, however, the less than wholesome aspects of the behavior of these firms are highlighted: 'advised its employees . . . to make misleading statements' (p. 159, our emphasis), 'phony losses', 'defraud the United States Treasury', 'evade taxes', 'false tax returns' and 'illegal tax shelters' (all p. 160 and all our emphasis). The list could continue, as S&M also refers to companies, international firms of accountants and international banks (UBS and Deutsche Bank). In each of the examples used in S&M, reference is made to activities that are deceitful, corrupt and/or fraudulent. We are not sure what relevance such examples have in the connection between CSR behavior, corporate CSR disclosure and tax avoidance and a conclusion that charges the majority of companies with 'organised hypocrisy', companies that we believe do not engage in fraudulent, deceitful and/or corrupt tax-related behavior (Freedman et al., 2009).

We also suspect that S&M does not fully understand some of the tax arrangements that are discussed. For example, in the context of discussing the behavior of Walmart, S&M refers to the use of a REIT by Walmart, which is identified as a 'Reinvestment Trust'. In the US and the UK, a REIT is usually understood to refer to a 'Real Estate Investment Trust' rather than a 'Reinvestment Trust', which is a different arrangement. Such fundamental errors in S&M are disappointing.

S&M states that 'the US Treasury estimates that it may be losing over \$345 billion each year due to a variety of tax avoidance/evasion schemes' (p. 154). We agree that the US gross tax gap is indeed \$US345 billion.¹¹ However, we believe that this statistic is selectively reported. Of the \$345 billion tax gap, only a little over seven percent (less than \$25 billion) is attributable to large corporations. The remainder involves non-filing, under-reporting of tax owed and underpayment, primarily by individual taxpayers and not necessarily as part of any tax avoidance planning. In fact, the non-compliance rates of US large companies, which are approximately 13 percent, according to Hanlon et al. (2007), are substantially less than the non-compliance rates of small businesses (Slemrod, 2004a), which are entities that are notorious for their non-compliance with tax laws, especially where there are structural opportunities to evade tax (e.g., cash industries).

In relation to the UK, S&M states that '£40 billion of tax revenue is lost each year' (p. 154). Again, in the context of the original focus on CSR and tax avoidance, it seems useful to investigate this statistic more closely. HMRC (2010, p. 7) reports that the amount of the £40 billion tax gap attributable to tax avoidance by large businesses is only £2.9 billion. It should also be noted in this context that HMRC uses the phrase 'tax avoidance' to mean entering into an arrangement under which the tax policy and understanding adopted by HMRC (which may be different from the enacted tax code) is considered by HMRC to give rise to a tax liability. Whether such an arrangement does in fact give rise to a tax liability actually depends upon the content of the tax code, not on the content of HMRC tax policy. S&M makes no mention of this aspect of the UK figures and the specific meaning of 'tax avoidance' in this context.

A further and important point is that no discussion of CSR and tax avoidance would be complete without considering the administrative and tax policy response to avoidance and the attitude toward the role played by external tax advisers (e.g., whether, and if so, how they should be regulated). In terms of the administrative response, there is a general trend toward 'co-operative compliance' arrangements in terms of the relationship between tax agencies and taxpayers (Braithwaite, 2003b; Hasseldine, 2009). This co-operative approach has permeated into how large businesses are treated by specific tax agencies (e.g., HMRC, 2006; Oats & Tuck, 2008), although we note that not all scholars believe in the full adoption of co-operative compliance models (Burton, 2007).

One example of a policy response is the use of 'disclosure initiatives' (OECD, 2011) that can bolster other enforcement methods such as auditing. Since 2004, HMRC has operated a 'Disclosure of Tax Avoidance' regime whereby tax avoidance arrangements must be reported to HMRC (Oats & Salter, 2008). This has been viewed as remarkably effective, with 2928 schemes (2035 relating to direct tax) disclosed as of 31 March 2010 and over £12 billion in tax avoidance opportunities cut off (OECD, 2011). In this context, the question arises as to whether the legal obligation to disclose tax avoidance arrangements to the tax authority is a powerful CSR tool. Assuming that a corporation does not intend to act fraudulently, corruptly and/or deceitfully, any UK company disclosing in its CSR report that it complies with all relevant tax legislation might be doing all that is necessary from a CSR perspective.

Another tool widely used overseas, in countries such as Australia, Canada, Germany, New Zealand and South Africa, is the general anti-avoidance rule (GAAR). Freedman (2008a) provides further evidence and expansive discussion of international

¹¹ Note that the net tax gap is \$290 billion, which takes into account payments of that year's tax liability that come in later either voluntarily or as a result of IRS enforcement action.

experience. Finally, the role of intermediaries such as banks is viewed as important (OECD, 2009). A UK Code of Practice for banks states that *'The Government expects that banking groups, their subsidiaries, and their branches operating in the UK, will comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament'*. Following pressure from the Chancellor of the Exchequer, the top 15 banks operating in the UK have agreed to this 'voluntary' Code of Practice on Taxation (Osborne, 2011). We return again to this subject (i.e., the 'spirit' of the law) in our concluding remarks.

While citing the cases of individuals from KPMG and Ernst & Young, S&M is notably silent on the debate regarding the regulation of tax preparers. In the US, there have long been rules (recently tightened) in Treasury Department Circular No. 230 governing practice before the IRS, and the regulations are even more stringent in the states of Oregon and California, as noted by GAO (2008) and McKerchar, Bloomquist, and Leviner (2008). In Australia, a federal *Tax Practitioner Registration Board* was established in 2010 to replace six state-based tax agents' boards. Tax agents are required to meet a 'fit and proper person test' as well as minimum educational qualifications and relevant experience requirements to provide tax agent services. Meanwhile, in the UK, there is no explicit requirement for becoming a tax agent. However, following a report from the National Audit Office (2010), more attention is being given to the role of tax agents, and new legislative powers involving sanctions and access to tax agents' working papers are being introduced via the operation of the Consultative Committee on Powers, Deterrents and Safeguards (HMRC, 2009a).

6. Concluding remarks

Before concluding, there are three topics that we consider relevant to research in the area of tax avoidance and CSR, only one of which is briefly mentioned in S&M. The first is that of the duties of directors. The assets and other resources of any company are ultimately under the control and direction of the directors of that company and, at least in theory, when exercising that control, the directors must do so in accordance with their legal obligations.¹²

S&M states, 'There is no legal or moral compulsion for company directors to indulge in tax evasion or avoidance.' (p. 165); 'There are no laws which require directors to specifically increase profits by avoiding taxes.' (p. 155); and finally, 'The use of strategies for tax avoidance/evasion is primarily a matter of executive discretion rather than any legal or moral compulsion.' (pp. 155–156). S&M demonstrates an unfortunate lack of appreciation of the duties of directors, the relationship that directors have with their company, the importance of recognizing that a company is created under a particular body of company law, and that these aspects differ from sovereign state to sovereign state. This paper does not provide a detailed analysis of the content of the corporate codes of various countries,¹³ however, as noted in S&M (p. 155), Section 172 of the UK Companies Act 2006 requires a director of a company incorporated in the UK to act *'in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole'*, taking into account various matters including the interests of other stakeholders. It should be noted that the company law codes in the UK were recently reconsidered, and it is not readily apparent whether the company law codes of all countries will impose such obligations on directors.

Moreover, given the obligation each director has, situations will arise that present each director and the directors collectively with a choice between event A and event B such that the ex post tax position under event A is more beneficial to the company. In such circumstances, with all other things being equal, it is difficult to see how the director(s) do not have a legal obligation to choose event A under the assumption that, if the directors have a moral obligation to fulfill their duties under democratically enacted UK law, the directors would also have a moral obligation to choose event A.

On the other hand, another aspect that be considered relevant to the debate regarding tax avoidance and CSR is that directors have no obligation, legal or even moral, to select the event (out of a choice of more than one) under which their company will pay a maximum amount of tax and, importantly, that democratic societies do not insist that they do make such a choice. These are matters that are ignored or glossed over in S&M.

The second observation is that on occasion, when the relationship and distinction between tax avoidance and tax evasion is discussed, a distinction is made between the 'letter' of the law and the 'spirit' of the law. The purpose of this distinction is to identify a class of tax-related behavior that, although complying with the 'letter' of the law, does not comply with the 'spirit' of the law (McBarnet, 2003; McBarnet et al., 2009; Picciotto, 2007). Instances of tax-related behavior that only comply with the 'letter' rather than the 'spirit' of the law are condemned as being unacceptable. The 'spirit' of the law is often closely linked with what is referred to as the 'intention' of the lawmaker, in the case of the UK with the intention of Parliament.

There are significant difficulties with this approach that need to be addressed when considering the relationship between CSR behavior and tax avoidance. Making reference to the 'spirit' of the law implies the existence of some form of shadowy parallel tax code to which only a privileged few have access while everyone else has to make do with the 'letter' of the law. Suggesting that the 'letter' of the law is distinct from the 'spirit' of the law, particularly in the context of the tax code (see the next observation), appears to ignore the purpose of the tax code, which among other purposes, is to identify in a reasonably clear manner events that are to be taxed or events that lead to a tax benefit or credit. To have a set of events that cannot be

¹² We are aware of the issues that arise when considering matters associated with directors considered as agents, but a discussion of these issues is beyond the scope of this paper.

¹³ For a useful discussion on this topic, see Kraakman et al. (2009).

identified by the application of a reasonably clear tax code but that can be identified by those who have access to the 'spirit' of the law requires a view of a democracy operating within the rule of law that may not be as democratic as we would wish.

We would suggest that there is nothing beyond the tax code. There is no need for a distinction between the 'letter' of the law and the 'spirit' of the law because there is no need to look any further than the actual legislation. It is almost certain that to look for an 'intention' that lies beyond what is to be found in the enacted tax code is a fruitless exercise. This position is elegantly expressed in the words of Hoffman (2005): 'The only way in which [the lawmaker] can express an intention to impose a tax is by statute, which means that such a tax is imposed. If that is what [the lawmaker] means, the courts should be trusted to give effect to its intention'.

The final observation relates to the protection provided to the property and resources owned by companies under human rights legislation. Under both the 'Convention for the Protection of Human Rights and Fundamental Freedoms' (as amended) and the UK Human Rights Act 1998, a company 'is entitled to the peaceful enjoyment of his (sic) possessions' (Protocol 1, Article 1), and this peaceful enjoyment of possessions, which includes using the possessions in accordance with the wishes of the company, cannot be interfered with except as set out in law. There is nothing under this human rights legislation that prevents a sovereign state from enacting tax laws that are considered to be for the benefit of the citizens of the country (in the 'public interest' or the 'general interest') but under which a company can be 'deprived of his (sic) possessions'. Given the importance of the principle of the rule of law for democratic countries, as has been suggested, there is an assumption that the tax laws that impose tax will be more or less certain. The protection offered to companies under this human rights legislation means that subject to the confines of the general law, companies incorporated in countries that have adopted such human rights legislation almost certainly have a right to arrange their affairs as each company sees fit. In addition, given that the tax code of a sovereign state is enacted to identify certain classes of events and distinguish between classes of such events, such companies might well be considered to have rights that are protected by human rights legislation and that allow them to engage in tax-related behavior that seeks to reduce the amount of tax payable should the companies so desire. There is nothing sinister in this approach. Tax law offers incentives in the form of lower taxes to encourage particular activities, and companies are free to avail themselves of such incentives.

In summary, we are concerned about weaknesses in the argument of S&M, whose approach seems to include (i) arguing that because some companies engage in tax evasion (i.e., the companies and advisors are deceitful, corrupt and/or fraudulent), all companies who engage in tax avoidance are suspect; (ii) failing to distinguish between tax evasion and tax avoidance; (iii) relying on non-peer reviewed literature; (iv) misrepresenting official statistics; and (v) ignoring extant scholarly literature and policy responses both within the UK and in the international tax community.

However, like Avi-Yonah (2008) and others, we clearly believe that understanding the relationship between CSR and tax avoidance is important and worthy of ongoing scholarship and debate, but in addition to more empirical research, we suggest that a conceptual framework is also required because there is an element of confusion regarding the definition of tax avoidance. Although provided in a simplified form, we have proposed a set of three factors that may be applicable to tax-related behavior and that might assist in future discussion in this area. The conceptual framework will have to consider not only the different types of tax-related behavior but also the various rights and obligations to which a director is subject as well as the relationship between a democratically enacted tax code and the transactions and arrangements to which such a tax code applies. When considering CSR behavior, a crucial issue is the nature of the activities that a company can undertake or should undertake, where such activities can be labeled 'tax-related behavior'.

We believe that future research should not gloss over existing compliance-related research and should take into account policy and administrative responses by governments and national tax agencies (e.g., HMRC, IRS, Australian Tax Office). We hope that this response to S&M will assist other researchers in their future endeavors to investigate the relationship between CSR and tax avoidance.

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