# Tax Avoidance: The Good, the Bad, and the Future

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*Basic U.S. tax rules are reviewed as they relate to aggressive tax avoidance and relevant stakeholders are identified. Differences between the spirit and letter of the law are examined, and the spirit of the law is determined as the appropriate measure of morality. Several moral theories are used to make an assessment that aggressive tax avoidance is unethical. Finally, action steps that can be taken by three of the most prominent stakeholders are formulated to address the root cause of aggressive tax avoidance: the perceived overly burdensome U.S. tax rates to which corporations are subjected.*

Esteemed business ethicist Richard DeGeorge (2010) noted that the business of business is business: business exists to make a profit. All true businesses are driven by profit motive, and publicly held businesses especially want to provide the highest legally possible returns to their investors. As such, businesses will seek out mechanisms to make themselves more profitable. Most of those mechanisms are rooted in legal conduct and many are rooted in well-identified business practices such as pursuing a particular competitive advantage. However, some businesses will attempt to maximize profits by engaging in unethical or illegal conduct to maximize profit. This potential for possibly unethical and/or illegal behavior was the impetus to examine one particular path a business might take to skirt the law by not following the spirit of the law and only the letter of the law, by engaging in aggressive tax avoidance practices. Multinational entities (MNEs) have significant opportunities to report taxable income in countries with low tax rates and thereby avoid taxes in other locales such as the United States (U.S.). The question is not whether such reporting is legal, but rather whether it is ethical. This paper discusses this type of tax avoidance in relationship to ethics and social responsibility.

Several examples of recent tax savings on a monumental scale set the stage for this ethical inquiry. According to Hagerty (2014), Caterpillar shifted $8 billion in profits to a Swiss affiliate over a ten-year period to avoid almost $2.5 billion in tax payments. Engel and Lyons (2014) reported that three companies (IBM, Apple, and GE) also saved shareholders' money by shifting earnings away from the U.S. From a 10-K filing, IBM's tax note addressed the fact that it had not provided deferred taxes on $52.3 billion of undistributed earnings of non-U.S. subsidiaries as of end of year in 2013. By the end of September 2013, $111.3 billion was held by Apple's foreign subsidiaries, while GE reported $57.0 billion was held by its non-U.S. subsidiaries. The deferred tax liability of just these four exemplar companies is significant, especially in times of governmental budget tightening and growing national debt. Additionally, Hoffman (2014) indicated that Pfizer, in an attempt to take over the British firm AstraZeneca, would incur $1 billion or more in tax savings by shifting cash accumulated overseas to lower tax jurisdictions. In all, it is estimated that the largest U.S.-based MNEs have accumulated almost $2 trillion in profits outside the U.S. (Niquette, 2014).

A fiduciary duty is one of trust and confidence whereby the person acting for another is obligated to do so in a way that the one on whose behalf the actor is working can rely on as being in his best interests; he can have trust and confidence that those acting on his behalf are doing so with his best interests in mind (Cheeseman, 2016). For example, a caregiver of an elderly, infirm person owes a fiduciary duty to act in the elderly person's best interests rather than in their own self-interest. Existence of a fiduciary duty is equally true in the relationship between management and shareholders as in the previous example. Management's fiduciary duty is to act in the company stakeholders' best interest. Basic agency and corporate law indicate that management must act to preserve and pursue the rights of his shareholders (Cheeseman, 2016), but corporate leaders (or any corporate agents) cannot engage in any illegal or immoral act in the pursuit of those shareholder rights. Management may find itself wanting to act in the company's and shareholders' best interests but, simultaneously, recognize that the company, its employees, and its owners are integral parts of the society in which the company operates. The conundrum is that, while management would like to relieve the company's tax burden to the greatest extent possible, those same members of management benefit, as all of society benefits, from the payment of the very taxes that are being reduced or eliminated. The puzzle is made more difficult by the recognition that management and shareholders are not the only ones affected by the shifting of earnings to avoid tax payment; there are many stakeholders affected by this trend. Further, the clarity of the issue is muddled by the difference between legal and moral rights and responsibilities. This paper attempts to engage readers in the debate on which fiduciary duties preempt others, what stakeholders are of primary importance, and what legal or moral rules should be used to determine the question of whether aggressive tax avoidance is an acceptable business practice.

The paper is divided into several sections. First, basic applicable U.S. tax rules are discussed. Second, relevant stakeholders, both those primarily and secondarily affected by the practice of aggressive tax avoidance, are identified. Next, differences between the spirit and the letter of the law are reviewed and a determination is made that the spirit of the law is the appropriate measure of morality. Several moral theories are then invoked in order to make an assessment of whether aggressive tax avoidance is moral. Finally, after having determined that aggressive tax avoidance is unethical, action steps are formulated that can be taken by three of the most prominent stakeholders to address the root cause of aggressive tax avoidance: the perceived over-burdensome tax rates to which U.S. corporations are subjected.

## The Letter of the Law: Basic U.S. Tax Rules

The first point of information must be the definition of tax: a tax is “a compulsory levy by the government on the people’s income or wealth without a direct quid pro” (Song & Yarbrough, 1978, p. 442). Taxes can be assessed on a variety of things: earned income, capital gains, royalties, etc. Tax payment is mandated by governments to provide public goods and services to be consumed by members of that society. As Smith, Harmelink, and Hasselback (2014) noted, the increasing complexity of modern tax laws simply makes issues associated with tax much more difficult to sort out: the distinction between avoidance and evasion is fine enough without having the added burden of draconian and/or excessive tax regulations or rates.

## Tax Avoidance or Evasion: A State of Mind?

Smith et al. (2014) also asserted that it is extremely difficult to differentiate between tax avoidance and evasion. Congress first appreciated the difficulty in 1954 and in 1986, made tax evasion a felony, defining evasion as based on the willful attempt to evade or defeat any tax imposed by the tax code (26 U.S. Code §7201, 2012). Tax evasion arises with the existence of a tax liability wherein the taxpayer fails to discharge that liability. While it is not illegal to search for and embrace transactions that avoid tax liability from being accrued, it is illegal not to disclose and/or discharge an existing tax liability. An integral part of this differentiation between the legal and illegal is the purpose of the action: if the principal purpose behind the failure to disclose/pay taxes is the evasion of the payment of taxes on currently existing tax liabilities, there is illegal tax evasion. The mere consideration of ways in which to limit tax liabilities is not sufficient to meet the legal threshold of tax evasion. Intent is critically important in this review. It is well established that good faith is foundation of all legal activities (i.e., see UCC §1-304, 2001). As Smith et al. (2014) stated, “the intent to evade tax occurs when a taxpayer knowingly misrepresents the facts. Intent is a mental process, as state of mind. A taxpayer’s intent is judged by his or her actions” (p. 1-8). Bad faith, then, is a hallmark of tax evasion; “faith,” whether good or bad, speaks more to the spirit of the law than the letter of the law, leading to the assertion that it is the spirit of the law that should be considered to determine the morality of aggressive tax avoidance.

Kirchler, Maciejovsky, and Schneider (2003) noted that "tax avoidance refers to an attempt to reduce tax payments by legal means, for instance by exploiting tax-loopholes, whereas tax evasion refers to an illegal reduction of tax payments, for instance by underreporting income or by stating higher deduction-rates" (p. 2). Legal avoidance of tax payment is the arrangement of one's affairs before the tax liability has been accrued: managers organize their business activities such that income is subjected to a lower tax rate (Smith et al., 2014) or, in the case of the international movement of taxable revenue, not subject to U.S. tax at all. Tax avoidance is supported by law and practice: business people are obligated by their fiduciary duties to owners of equity to search out transactions and/or to time transactions to reduce their tax liabilities (Smith et al., 2014). Classic language in *Commissioner of Internal Revenue vs. Newman* (1947, p. 851) stated that:

> Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everyone does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced extractions, not voluntary contributions. To demand more in the name of morals is mere cant.

Kirchler et al. (2003) also found that tax avoidance was perceived as being legal and moral, while tax evasion was seen as both illegal and immoral. The concern of this paper is with tax avoidance that is so aggressive that it has become suspect on a moral plane (Cruz, Shafer, & Strawser, 2000).

## Mechanisms to Lower Tax Liabilities

The residential approach of international taxation is the form of taxation wherein the government taxes the international revenue of its residents without regard to where the income is earned, while the territorial approach to transnational income tax is founded in taxation of all parties, regardless of the taxpayer's country of residency (Czinkota, Ronkainen, & Moffett, 2011). The corporate income tax rate in the U.S. is higher than in almost 30 members of the Organization for Economic Cooperation and Development (OECD), making the U.S. rate very uncompetitive to set up operations that would bring income through the organization's tax structure into the U.S. (Myers, 2009). Not only do U.S. companies not want to have wealth reported in this very high rate venue, but this situation also makes it unattractive for other countries to invest in the U.S. Critics of the high U.S. tax rate and policies on international tax collection (Czinkota et al., 2011) have argued that "the U.S. could experience declining international competitiveness and even suffer a growing 'hollowing out' of the domestic economy because companies choose to invest and operate elsewhere" (p. 596).

Among developed countries, the U.S. imposes some of the highest effective tax rates on corporate entities. But there are also some extremely large loopholes in the tax law that allow corporations to avoid many U.S. tax consequences by using off-shore tax shelters. Weichenrieder (1996) has previously said, "in recent years, various countries have introduced incentives aimed at attracting the more mobile parts of multinationals' corporate tax bases" (p. 53). Two very important types of these incentives are the avoidance mechanisms of the "check the box" loophole and the "look-through" rule.

The "check the box" loophole is a form of tax arbitrage (Slemrod & Yitzhaki, 2002) that allows U.S. companies to exploit differences in tax jurisdictions. The rule lets companies select how subsidiaries are classified for tax purposes and costs the U.S. approximately $10 billion annually (Drawbaugh & Sullivan, 2013). The rule, originally designed to help simplify multinational corporate tax filings, began as a compromise that allowed the U.S. to tax "passive" foreign income such royalties and interest earned, but not "active" income from normal business transactions. Companies are allowed to self-describe individual subsidiaries, including the use of a "disregarded" (or irrelevant-for-tax-purposes) entity concept. This concept allows high-volume "non-company branches" to be established in low-tax jurisdictions to absorb income from foreign operations. An Apple subsidiary in Ireland, for example, absorbs "all of the income from Apple's retail stores in Europe" (Drawbaugh & Sullivan, 2013). When attempts were made to eliminate the loophole, advocates said that U.S. MNEs would be damaged by "forcing them to pay more taxes not only in the United States, but also to high-tax nations such as France" (Drawbaugh & Sullivan, 2013). By 2004, thanks in part to the 'check the box' rule, U.S.-based multinational corporations paid an effective tax rate of about 2.3% on $700 billion in foreign earnings (Drawbaugh & Sullivan, 2013). It has been estimated that U.S. companies keep about $1.8 trillion of "unrepatriated" earnings that are not subject to tax while being held abroad (Gerth, Houlder, & Murphy, 2011).

In 2006, the "look through" rule was passed to give "corporations more latitude to move some types of income from one foreign unit to another without paying a tax" (Drawbaugh & Sullivan, 2013). The rule has been extended time-after-time, including in January 2013 in an attempt to keep the U.S. government from going off a "fiscal cliff" (Drawbaugh & Sullivan, 2013). Again, it would be hard for a profit-seeking business to ignore such legally permitted incentives to avoid taxes in light of management's fiduciary duty to serve the best interests of the shareholders. Indeed, it might be immoral to do so, depending on the aggressiveness of the avoidance. The more aggressive the tax avoidance, however, the more suspect, both legally and morally, tax avoidance becomes.

In the summer of 2013, the OECD Center for Tax Policy and Administration indicated strong support from the G20 countries to address the issue of "based erosion and profit shifting" (BEPS) so as to reform the international tax system (Goodall, 2013). According to the OECD (2013), BEPS created harm to governments, individual taxpayers, and businesses for the reasons indicated in Exhibit 1. Apple, for example, has corporate entities that pay no income tax to any taxing nation:

> Apple Inc., a U.S. corporation, has used a variety of offshore structures, arrangements, and transactions to shift billions of dollars in profits away from the United States and into Ireland, where Apple appears to have negotiated a special corporate tax arrangement of less than 2%. Despite reporting net

> income of $30 billion over the four-year period 2009 to 2012, AOI [Apple Operations International] paid no corporate income taxes to any national government during that period. Similarly, Apple Sales International [ASI], a second Irish affiliate, is the repository for Apple's offshore intellectual property rights and the recipient of substantial income related to Apple worldwide sales, yet claims to be a tax resident nowhere and may be causing that income to go untaxed. (Verschoor, 2013, p. 13)

**Exhibit 1:** *Harm from BEPS*

Governments
- Have less revenue
- Have higher cost to ensure compliance
- Have had the integrity of the tax system undermined as certain parties believe low corporate taxes unfair
- Are, in developing countries, critically underfunding public investments that could promote economic growth
- Have non-optical resource allocations

Individual Taxpayers
- Have to bear more of the tax burden because businesses are paying less in taxes

Businesses
- May face significant reputational risk if their effective tax rate is viewed as too low.
- May fail to take advantage of legal ways to reduce tax burden and thereby be placed at a competitive disadvantage
- May, if only operating domestically, be unable to compete with multinationals that can shift their profits to avoid or reduce taxes.

Source: Adapted from Organization for Economic Cooperation and Development (OECD), *Action Plan on Base Erosion and Profit Shifting* (2013, p. 8)

Regardless of the identification of problems associated with aggressive tax avoidance, some U.S. business groups, including the Chamber of Commerce and Business Roundtable, indicate a high level of concern that steps might be taken by international organizations to curb some of the aggressive tax avoidance strategies taken by companies (Houlder, Politi, & Wolf, 2013). Some of the tax strategies used by large MNEs are “increasingly politically unpalatable in some nations at a time of budget woes and persistent economic weakness,” but business groups think the opportunities are necessary to avoid double taxation and other barriers to cross-border trade and investment (Politi, 2013; Weichenrieder, 1996).

One OECD conclusion is that there is an increasing disconnect between the places where actual business activities occur and the places where profits are reported for tax purposes. Even the regulations for transfer prices are not providing much help. Even in the U.S., there is a varying tax system among the states as well as a varying jurisdictional adoption of the Uniform Division of Income for Tax Purposes Act (1957, amended 1966). If the states within one nation cannot agree, it would seem far-fetched that agreement on formulary apportionment globally could be reached. Even more unlikely would be an agreement on what constitutes “aggressive” tax avoidance, versus legitimate tax avoidance, versus the moral overtones of each kind of avoidance.

*Impact of Ethics on Behavior*

Shafer and Simmons (2007) succinctly defined the problem of aggressive tax avoidance by stating that aggressive tax avoidance, or a person's failure to pay their taxes, violates principles of social/civic responsibility. Assessments about whether legal tax avoidance is ethical or unethical must be made considering the symbiotic nature of business and society (DeGeorge, 2010; Velasquez, 1999) and the harm that could accrue to society and individual groups or members of society. To do this, one must identify the stakeholders under consideration.

## Stakeholders

Stakeholders are comprised of a diverse set of people who and entities that might be positively or negatively affected by the actions of the company engaging in a particular behavior. Wood-Harper et al. (1996) defined a stakeholder as "any individual, group, organization, or institution that can affect, as well as be affected by, an individual's, group's, organization's, or institution's policy or policies" (p. 9). Stakeholders have been deemed to have specific rights such as respect, integrity, standards, transparency, and accountability (Waddock, Bodwell, & Graves, 2003). Primary stakeholders are those without whose participation and support the organization would cease to exist, while secondary stakeholders are those that can influence the organization, but could not cause dissolution if thwarted (Gonzalez-Benito & Gonzalez-Benito, 2006). In regard to the payment of taxes, the primary stakeholders would be the corporate shareholders, employees, and the governments of the countries in which the corporation transacts business or reports profits. Secondary stakeholders would include potential investors, creditors, competitors, and society at large.

From a business perspective, ethical behavior can be viewed as morally appropriate and 'right' conduct rather than the strict definition of legally 'right' conduct. Unfortunately, each group of stakeholders may have a different perception of what is 'right' and may use different theories and cultural contexts upon which to judge conduct. However, in most situations, businesses (in the form of the people who run them) generally do the 'right' thing for one (or both) of two reasons: because the 'right' thing is the 'right' thing to do or because the 'right' thing will provide positive benefits to the organization (Baron, 2009). The right thing could be legally mandated: most laws stem from what society finds to be the right thing (Velasquez, 1999). The morally right thing might also be to breach the law, where the law itself is wrong, as in the case of slavery, which, until the Emancipation Proclamation, was legal, but which is and has always been immoral. Such civil disobedience may be morally required, but the suspect action remains illegal (Hanson, Crosser, & Laufer, 1992). In the case of aggressive tax avoidance, the right thing legally and morally is to pay one's fair share of taxes. *Bullen v. Wisconsin* (1916) ruled that "when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits. When an act is condemned as evasion, what is meant is that it is on the wrong side of the line".

Approaches to ethical decision making can be classified as either teleological or deontological (DeGeorge, 2010). The teleological framework focuses on consequences (typically using utilitarianism or egoism theories) that result from the action. Deontological frameworks (such as Kantian and Rawlsian analyses) focus on duty; an action is either innately right or wrong and the consequences resulting from the action are irrelevant. Moral pluralism is the concept that one uses multiple approaches to ethical decision making (DeGeorge, 2010). This paper applies multiple ethical frameworks to support a position that aggressive tax avoidance is unethical.

The utilitarian analysis (Bentham, 1789) suggests that an action is morally correct if it produces the greatest amount of good for the greatest number of people or, in a "no-win" situation, the least amount of harm for the greatest number of those affected. In contrast, egoism uses the same thought processes of utilitarianism, but is limited to a review of consequences only to the extent that the decision maker himself is affected. The best decision is the one that produces the greatest good for the decision maker rather than for the greatest number. One might define the 'decision maker' as either the manager engaging in the process or the entire business entity doing so. In this instance, the use of egoism is not appropriate as the number of stakeholders who can be negatively impacted by aggressive tax avoidance is large and the harm accruing significant (i.e., OECD, 2013, Exhibit 1). Thus, the broader concept of utilitarianism, wherein the effects on any number of stakeholders can be considered, is used in this paper.

The utilitarian analysis requires the decision maker to engage in five steps to achieve the morally defensible choice of action, in this case, whether to aggressively avoid taxes or not. First, the action under consideration must be identified and identified clearly. Here, the question is indeed whether to aggressively avoid tax payment when it is or may be legally permitted. The second task is the identification of stakeholders, both primary and secondary stakeholders. Third, alternatives must be developed (i.e., to avoid taxes in a more reasonable way, to aggressively avoid taxes, or to evade taxes). The next step requires an assessment of the advantages and disadvantages of each of the alternatives. Finally, the decision maker should accept as the best ethical choice the alternative that provides the greatest good for the greatest number of stakeholders, or the least amount of harm for the greatest number of stakeholders.

The Kantian analysis (Kant, 1964) can be simplified in three simple questions that, if all are answered in the positive, a moral duty to act (or not to act) is imposed. A precursor to the application of Kant's Categorical Imperatives is the requirement that the decision maker be in a rational state when making decisions as to the ethical nature of an action. In this instance, again, management is seeking the ultimate in rationale: they would like to limit to the greatest extent possible, legally and, hopefully, morally, the tax liabilities the firm accrues on behalf of their shareholders. Thus, the requirement that the actor is rational is met: management is indeed acting rationally to explore ways to limit their tax liabilities and maximize profits thereby.

The next step of the Kantian analysis is the posing of the three questions that are deemed to be Kant's Categorical Imperatives. First, the action should be universally consistent; that is, one must choose to act such that all will be treated the same and such that the actor would submit to that treatment. Second, the action must respect individuals as inherently or innately valuable, apart from any benefit that they might provide the actor. Third, the action must acknowledge and respect the autonomy of all rational beings. The Kantian analysis has been described simply as the idea that people should do unto others as they would have others do unto them (the Golden Rule).

The action of engaging in legal tax avoidance would be universally consistent in that any company engaging in such behavior would not be prosecuted; every company would be treated the same by the law and no company would be favored or singled out for prosecution. However, there is a difficulty in this philosophy relative to the particular issue of aggressive tax avoidance. All companies are not able to shelter their profits by taking advantage of tax arbitrage because some companies may have limited ability to establish subsidiaries that fit the check-the-box loophole. Further, tax avoidance, in and of itself, is valuable only for the benefits that will accrue to the acting company; aggressive tax avoidance does not treat as valuable or worthy of respect any stakeholder adversely affected by the constricted availability of tax revenues for a government's provision of public goods and services. Finally, individuals will generally agree that legally avoiding taxes is a rational process chosen by freely acting decision makers, but there is a question of whether those individuals would agree that the structure by which this legality has been designed is appropriate. The process has been specifically entitled a 'loophole' and many individuals would not agree that the use of 'loopholes' is entirely ethical. Many individuals might not want tax laws to be written so that certain companies (or individuals) are able to take advantage of a loophole, while others would not be free or otherwise able to similarly participate. Thus, legally avoiding taxes because of loopholes does not seem to be consistent with an ethical designation under Kantian analysis.

The Rawlsian analysis (Rawls, 1958, 1971) is considered a deontological theory based in the concept of justice. Principles of justice should be decided behind a "veil of ignorance" of one's position in society. If the decision maker is behind a veil of ignorance, in the "original position," he has no knowledge of his own characteristics, attributes or station in life, economically, politically or socially. By making decisions in this manner, based on Rawls' three Principles of Fairness, the rules determined should be fairest to everyone because everyone would be accorded liberties that were as great as everyone else's and societal opportunities would be equally available to all. These principles are designated the Principle of Equal Liberty, the Difference Principle, and the Principle of Fair Equality of Opportunity.

Under the Principle of Equal Liberty, everyone would be free to do what they felt was most important individually, to the extent that their freedom is constrained by others' freedoms. Under the Difference Principle, everyone would choose rules that would protect each person from being treated as the least important person in society. Under the Principle of Fair Equality of Opportunity, everyone would make rules that protect their own interests if they ultimately are found to be most talented or deserving. To illustrate, an ethical decision maker would not make rules that would allow discrimination based on gender or race under Rawlsian theory because (given the "veil of ignorance") that decision maker would not rationally subject himself/herself to personal discrimination.

The use of Rawlsian analysis to assess tax avoidance through tax shelters would quickly disenfranchise the notion of ethicality. If someone adopted a 'veil of ignorance' and was asked whether some companies should be able to obtain tax benefits because of a loophole in the tax law, that person would likely and adamantly answer in the negative. Such a benefit would be discriminatory to those unable to fit into the loophole. Companies with the financial resources to employ tax-savvy accountants and attorneys who are able to structure activities in avoidance of paying taxes that less aggressive interpretation of the law might mandate are "more" equal than companies with fewer financial means. The use of tax loopholes deprives those unequally disadvantaged, those without sufficient means to avoid tax payment, of the ability to avoid taxes. Moreover, Rawls' principles are violated from the perspective of the rightful provision of public goods and services: those with greater ability to pay taxes are the same ones with the ability to avoid the payment of their fair share of taxes.

## Corporate Tax Avoidance Actions and Ethical Behaviors

Apple, Google, Microsoft, and Hewlett-Packard are among the largest U.S. corporate entities that are taking advantage of the "check the box" loophole. Companies are also avoiding taxes through legitimate transfer pricing structures, tax rate negotiations, and domicile location. It seems that there are only a few questions to be asked to determine the morality of aggressive tax avoidance, utilizing any of the three ethical frameworks described above. For example, using the utilitarian analysis, which stakeholders benefit and which stakeholders are harmed by engaging in tax avoidance strategies that are so aggressive that they might be found to be illegal after the fact?

Of the stakeholders mentioned earlier, the corporation's shareholders and employees receive the most benefits. The value of corporate stock increases because the reduced taxes generate higher profitability. Employees benefit through bonus and incentive plans, higher wages, or greater job security (because of corporate financial success); lower taxes result in higher cash flows that, in turn, may more easily allow creditor payments or organizational growth in jobs.

In contrast, the greatest harm is done to the countries that are not receiving what may be perceived to be an 'equitable' share of profits in the form of taxes. Additional harm can be attributed to competitors who either do not have the multinational presence or taxation expertise to engage in sheltering tactics. Harm may come to members of society-at-large because a greater tax burden is placed on all non-MNEs (from individuals to small businesses to purely domestic companies) to provide the resources needed to support governmental services.

Because of the difficulty of measuring benefits and costs, a comprehensive assessment of whether legal, though aggressive, tax avoidance in these instances is ethical cannot be made. However, if one believes that the societal harm (because of reduced tax collections and governmental provision of benefits) is greater than the benefit provided to an individual company engaging in such actions, then utilization of tax shelters as previously discussed would not meet an ethical determination under utilitarianism. Thus, the second question posed is would legal tax avoidance, again, though perhaps suspiciously aggressive, be considered as meeting the 3 Kantian conditions?

The action of engaging in legal tax avoidance would be universally consistent in that any company engaging in such behavior would not be prosecuted; every company would be treated the same by the law and no company would be favored or singled out for prosecution. However, the difficulty in this philosophy relative to this particular issue has already been alluded to. Firstly, all companies are not able to shelter their profits by taking advantage of tax arbitrage because there may have been limited ability to establish 'subsidiaries' that fit the "check-the-box" loophole. Secondly, tax avoidance, in and of itself, is valuable only for the benefits that will be provided to the acting company, not the others that would be affected by the avoidance. Finally, while individuals could agree that legally avoiding taxes is a rational process chosen by freely acting decision makers, there is a question of whether those individuals would agree that the structure by which this legality has been designed is appropriate. The process has been specifically entitled a 'loophole' and many individuals would not agree that the use of loopholes is entirely ethical. Why would we adopt a law by which only some entities similarly situated are benefitted, but not others? Thus, legally but aggressively avoiding taxes because of loopholes does not seem to be consistent with an ethical designation under a Kantian analysis.

The use of Rawlsian analysis to assess tax avoidance through tax shelters would quickly disenfranchise the notion of ethicality. If one adopted a veil of ignorance and were asked whether some companies should be able to obtain tax benefits because of a loophole in the tax law, one would likely and adamantly answer in the negative. Such a benefit would be discriminatory to those unable to fit into the loophole. Table 1 is a depiction of the application of ethical principle to the practices of tax avoidance through legal loopholes and tax evasion.

**Table 1:** *Application of Ethical Principle to Tax Avoidance, Aggressive Tax Avoidance and Tax Evasion Practices*

| Ethical Principles | | Tax Approach | | |
|---|---|---|---|---|
| **Framework** | **Principles** | **Tax Avoidance** | **Aggressive Tax Avoidance** | **Tax Evasion** |
| **Utilitarianism** | **Social Utility** | Ethical and legal | Not ethical, but possibly legal | Not ethical or legal |
| **Kantian** | **Golden rule** | Ethical and legal | Not ethical, but possibly legal | Not ethical or legal |
| **Rawlsian** | **Justice** | Ethical and legal | Not ethical, but possibly legal | Not ethical or legal |

*Fixing the Problem*

Use of the "check-the-box" loophole to avoid tax payments is believed by corporate managers to be in the best organizational interest. Most members of society and most businesspeople today recognize the need for some level of government services and, to support such services, some level of taxes (McGee, Nickerson, & Fees, 2005; McGee, 2006; McGee, Ho, & Li, 2008).

In light of the incentives various governments have provided in the form of extremely favorable tax treatment to attract big business to "their shores," it can hardly be deemed as positive that multinational business would thereafter not cavil at or hesitate to engage in tax avoidance, even aggressive tax avoidance (Weichenrieder, 1996). Thus, not surprisingly, Apple and other companies have indicated that they will not repatriate profits earned outside of the U.S. to the U.S. until corporate tax rates are lowered. Such a position could be viewed as economic extortion in that there is the threat that financial benefits will continue to be withheld from the U.S. tax coffers until the demand for tax reduction occurs.

Although the legitimacy of increased shareholder value by reducing taxes is a reasonable business action, perhaps the situation could be handled in alternative ways that would benefit both shareholders and the U.S. government. First, Congress should review the tax code to eliminate tax loopholes that benefit MNEs in an attempt to place all corporate entities on the same 'tax footing.' Further, acknowledgement that tax rates overseas are significantly lower elsewhere than are those in the U.S. and consideration of a phase-in for lowering those rates to make the playing field more level should be made. Second, Congress should consider what it really wants from U.S. corporations by assessing the benefits that could be provided under various options. The tax base provided by corporate entities took a downturn when they went offshore because of lower labor rates and when transfer prices were set to take advantage (to the extent possible) of tax arbitrage. Would the U.S. be better off if companies came back on-shore and created additional jobs? If so, Congress should provide tax incentives to encourage such action. Third, Congress (and other governmental entities at all levels) should find ways to entice foreign corporations to locate in the U.S. But any such enticements should not be given at the expense of 'home-grown' entities, especially those engaged in technology and other developing economic sectors that provide jobs allowing a higher standard of living. Fourth, U.S. company management needs to recognize that organizational success is made possible, in part, by the ability of the company to partake in the societal benefits that exist in this land of opportunity. The ability to provide such benefits must be supported by a healthy tax base. Therefore, giving back to the government in the form of taxes is nothing more than an ethical quid pro quo.

Fifth and finally, and this is slowly occurring, stockholders should be convinced that long-term returns on investments are more productive and socially responsible than short-term ones. Many companies are now focused on the triple bottom line of people, planet, and profits. People and planet are long-term sustainability concepts that encourage a view beyond this week's Dow Jones Industrial Average. Table 2 is a summary of how each of these suggestions meets the moral standards mandated by the frameworks of utilitarianism, Kantianism, and the Rawlsian analysis.

**Table 2:** *Application of Ethical Principle to Tax Avoidance and Evasion Practices*

| Paradigm Shift | Ethical Principles | | | Ethical Conclusion |
|---|---|---|---|---|
| **Away from Incentive to Aggressively Avoid Tax** | **Utilitarian Analysis** | **Kantian Analysis** | **Rawlsian Analysis** | **Is the action morally correct?** |
| Revision of tax code and elimination of tax loopholes | *Benefits:*<br>Increased tax revenue and/or lower rates for:<br>• Taxpayers<br>• Society as a whole<br>Reduction of benefits to special-interest groups<br>Fair payment from, and fair treatment for, all taxpayers<br>Reduction in costs of tax preparation<br>Easier for companies to repatriate profits earned overseas<br>Reduction in stakeholder accusations of tax-dodging and organizational greed<br><br>*Costs:*<br>Immediate decrease in maximization of profit<br>Possible job implications for tax professionals | Equal treatment of all firms under the law<br>Recognition of all firms as inherently valuable for the tax and employment base they contribute<br>Ability of all firms to freely pursue profit maximization without fear of being at a competitive disadvantage because of inability to shift taxable income away from the U.S. | Equal treatment among all taxpayers so that each pays his fair share, which promotes social justice<br>Social and economic inequalities would be diminished by ultimately increased tax collection to the greatest extent possible or practical, benefitting those least advantaged in society<br>Those least advantaged would have the opportunity to become less disadvantaged through fair and complete tax collection and expenditure | Yes |
| Tax base alteration to incentivize U.S. businesses return to the U.S. | *Benefits:*<br>Long-run increase in tax revenues<br>Increased employment levels<br><br>*Costs:*<br>Possible short-term tax revenue decrease | All businesses would benefit equally by incentives to come back to or stay in the U. S.; no business would be treated differently than any other<br>No business would be unfairly "used" to support societal needs, as all would be treated equally, not as an end to the government's/society's needs<br>Incentives recognize firms' freedoms to do business fairly, bearing their fair share of communal costs | More attractive for U.S. business to be able to fairly compete in its home market, which promotes social justice<br>Social and economic inequalities will be reduced as a result of increased tax income overall<br>Those least advantaged in society will be in a more favorable position as a result of increased tax revenue and expenditure to minimize social and economic inequalities | Yes |
| Tax base alteration to incentive foreign business to come to the U.S. | *Benefits:*<br>Increased tax revenues<br>Increased employment levels<br><br>*Costs:*<br>Possible short-term tax revenue decrease | Businesses across national borders are treated equally as those in the home country<br>Foreign businesses are not taxed at a higher rate than domestic firms, and thus are not used merely to further the interest of a higher tax base creation<br>Foreign firms can freely chose to locate in the U. S., a lower tax based system | Equal liberties are given to all to locate in places with lower tax rates<br>Differences among domestic and foreign firms can be reduced or eliminated, stimulating increased interest in locating in the U. S.<br>Foreign firms are granted the same access to the huge U. S. markets in which to distribute their products or services | Yes |

**Table 2:** *continued*

| Paradigm Shift | Ethical Principles | | | Ethical Conclusion |
|---|---|---|---|---|
| **Away from Incentive to Aggressively Avoid Tax** | **Utilitarian Analysis** | **Kantian Analysis** | **Rawlsian Analysis** | **Is the action morally correct?** |
| Management recognition that there is a symbiotic relationship between business, government and society | *Benefits:*<br>More positive firm image with many stakeholders<br><br>*Costs:*<br>Potential short-term angst by stockholders demanding profit maximization | Management from all firms will be treated equally, as a partner in the provision of goods and services to society, to whom they already have a working/business relationship<br>Management will recognize that firms and society cannot merely use each other as means to an end, but that these parties have common ends, benefitting each other<br>Management freely engages in business transactions with society, who freely engages in that business, to the betterment of both | Management from all firms are treated equally by governments and society<br>Social and economic inequality are recognized by management to exist and management recognizes a duty to address these inequalities as part of the symbiotic relationship with business, thus also aiding in the creation of a society that values granting opportunities to those most in need | Yes |
| Stockholders' recognition that there is a long-term, ongoing symbiotic relationship between business, government and society | *Benefits:*<br>Paying one's fair share and associated virtuous feeling<br><br>*Costs:*<br>Potential short-term angst by shareholders demanding profit maximization | Stockholders from all firms will be treated equally, as a partner in the provision of goods and services to society, to whom they already have a working/business relationship<br>Stockholders will recognize that firms and society cannot merely use each other as means to an end, but that the parties have common ends, benefitting each other<br>Stockholders freely engages in business transactions with the firms' in which they hold stock and with society, who freely engages in that business, to the betterment of both | Stockholders from all firms are treated equally by governments and society<br>Social and economic inequality are recognized by stockholders to exist and they recognize a duty to address these inequalities as part of the symbiotic relationship with business, thus also aiding in the creation of a society that values granting opportunities to those most in need | Yes |

## Future Research

A major question related to reducing the U.S. income tax rate is the extent to which the government's revenues would be reduced. For example, in early 2015, Rand Paul suggested a flat-tax rate of 17% on business income and said that would reduce government inflows by $700 billion. Paul later suggested a 14% flat-tax which would obviously have a more extensive governmental revenue impact (Sahadi, 2015; Kohlhepp, 2015). Numerous other tax reduction proposals have been made, including a FairTax Plan that would tax only consumption (Baron, 2015). Although any tax rate reduction would slash government inflows, research needs to be performed as to the level of administrative and compliance costs that such a policy might also reduce. Additionally, the total potential positive impact of benefits from economic growth, unemployment drops, elimination of loopholes, and repatriation of overseas funds should be estimated. In other words, the net positive or negative impact on U.S. society should be disclosed in a clear and transparent manner.

As Huneycutt (2009) asserted, stock trading fees plummeted and trading could occur at the mere click of a computer key, "[s]tocks slowly morphed from a form of ownership of real companies and into a form of abstract profit-making… [and] the majority of the market participants arguably were ignoring the fundamentals behind the companies they were investing in. Investing became about psychology and little more" (p. 1). Additional research should be obtained on ways to integrate a longer-term investment mentality into investors as well as a better understanding of the global benefits of the utilization of the triple bottom line as a corporate performance measurement.

## Conclusion

In 2014, a Congressional Research Service tax expert testified that U.S. corporations were reporting profits in Bermuda that likely exceeded that country's GDP by approximately 1,000% (Gravelle, 2014) and that consisted of only one small country measured in a single year. The situation of tax avoidance through tax loopholes provides an unadulterated example of the difference between what is legal and what is ethical. Legality tends to conform to current societal norms rather than reflecting the totality of morality. In other words, there is a 'spirit of the law' (morality) and a 'letter of the law' (legality). Legitimizing a 'wrong' act because of circumstances or societal mores does not make that act any more moral (Raiborn & Payne, 1990). Table 3 presents the conclusions as to the ethical and legal natures of aggressive tax avoidance and tax evasion.

**Table 3:** *Conclusion of Ethical and Legal Conundrum of Aggressive Tax Avoidance and Tax Evasion*

| Tax Avoidance and Evasion: Legal and/or Ethical? | Ethical | Unethical |
|---|---|---|
| **Legal** | Fair payment of taxes to legitimate governmental ends of provision of public goods and services | "Extreme" tax avoidance: making a legal interpretation of tax law that espouses only the letter of the law, while ignoring the spirit of the law |
| **Illegal** | Civil disobedience in the refusal to pay taxes legally owed, but which are disproportionate or unfairly burdensome taxes to a corrupt government | Tax evasion: the failure to pay legally owed taxes that are fairly assessed to support good faith, legitimate governmental interests to provide for the provision of public goods or services |

This circumstance highlights why companies need to be aware of whether their managers are walking the walk or merely talking the talk. Leo Martin, director of GoodCorporation business advisers, sums up the reality of such activity: “Leaders need to show that they are prepared to give up moneymaking opportunities, if there is a risk that values might be compromised” (Newing, 2013, p. 6). The fact that the tax code allows a legal loophole does not mean that the ethical behavior of paying one’s fair share should be ignored.

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