EdenTree SRI Expert Briefing – March 2015

Tax

Introduction

Tax has emerged as an unexpected issue of note. Once confined solely to expert accountants and lawyers, the amount of tax paid by corporations is undergoing rigorous scrutiny and debate. We have sometimes been asked by clients for our views on tax, and the role of responsible investors, and so this SRI Expert Briefing sets out our current thinking on this extremely complex issue.

Q. So, why are we talking tax?

A. Tax affects us all. The State raises tax to pay for collective services that modern society demands – health, education, defence, security, welfare, access to justice, cultural pursuits and overseas aid. The environment of stability that a State creates, funded by tax, also allows business to flourish and excel.

Q. So progressive tax is a good thing?

A. Taxation and Representation are the pivots of a functioning democracy. However, modern states are complex; the UK Government is budgeted to spend £731.4bn in the 2015 fiscal year, with tax accounting for 89% or £648.1bn of it[1]. Taxation therefore remains the bedrock for funding public services, with any shortfall made up from borrowing. Because the stability provided by a fair and functioning tax regime suits business as much as its citizenry, it is in the interests of business to contribute towards society via the payment of fair taxation.

Q. How much does business contribute in the UK?

A. Corporation Tax is a direct tax charged on the profits made by companies and other corporations and makes up approximately 10% of UK tax receipts[2]. Companies registered and domiciled in the UK pay tax on profits wherever they originate. Companies not based in the UK, but with 'branches' in the UK, pay corporation tax on taxable profits that arise in the UK.

Q. But surely Government uses tax as a competitive lever?

A. Yes. The tax regime is complex; a system of capital allowances (for plant and machinery), and a suite of other deductions and reliefs obscures the *actual* tax take, which is often difficult to calculate. Tax is also one method of incentivising inward investment. The UK headline rate of Corporation Tax has fallen from 30% in 2007 to 20% from 1 April 2015 as a deliberate Government policy to encourage business inward investment. Low tax regimes such as Ireland, Switzerland and Luxembourg successfully use their low tax status to encourage companies to relocate in order to benefit from lower tax rates. The Republic of Ireland has a headline Corporation Tax rate of 12.5%[3] making it very attractive for UK companies to relocate. Conversely, jurisdictions such as the US have a higher headline rate (35%[4]), leading to US companies keeping cash offshore rather than subject it to tax upon repatriation. Applying 'inversion' whereby the US parent becomes a subsidiary of a new overseas parent, usually in Europe, in order to lower its marginal rate of Corporation Tax has also been a recent phenomenon that has attracted criticism.

Q. Doesn't this constitute tax avoidance?

A. The use of Inversion schemes may be questionable on investment and strategy grounds, but they are legal as reducing tax is not the pre-eminent reason for undertaking a merger or acquisition.

Q. Isn't tax avoidance always wrong?

A. No, not necessarily. Tax *evasion* is an illegal practice whereby an organisation intentionally avoids paying a required tax liability. This is always wrong and is usually punishable by criminal sanction. Tax *avoidance* is the minimisation of tax by legal means via prudent tax planning. Individuals that invest in ISAs or Premium Bonds are, for instance, employing legal tax avoidance schemes. Charities are legally 'tax exempt' from much activity. Tax avoidance is normally achieved through claiming permissible deductions and credits, thereby reducing the headline tax rate. Corporation Tax is a cost or charge on profits, and business has a legal right (but not a duty) to organise its tax affairs so as to take advantage of legal allowances and reliefs. As responsible shareholders we endorse prudent tax management and planning.

Q. So why has tax avoidance become such a burning issue for society?

A. The nature of globalised capital means that tax is now a matter for international agreement and negotiation. Governments have largely failed to respond adequately to the phenomenon of borderless capital, with international tax rules failing to keep up with the migration of capital and earnings. In addition, for a multinational 'virtual' company there is no easy way to decide where profits should be taken, and tax paid. We do subscribe to the view that the principle agent responsible for the setting and collecting of tax is the State, and that nationally and internationally Government needs to set the boundaries around what is appropriate, reasonable and ethical when it comes to tax.

Q. So if tax is a legal requirement, surely it can't be thought of as a matter of ethics?

A. Arguably so. We have argued that prudent tax management is legal and legitimate. However, within the definition of tax avoidance, the view has emerged that some specific mechanisms designed to reduce or almost eliminate tax are unethical. The term 'aggressive tax avoidance' has been coined to refer to these schemes. By and large these may refer to contrived, artificial or synthetic schemes that serve no purpose other than to effect a reduced tax outcome or advantage. In short, whilst these schemes may not be illegal, they are perceived as contravening the spirit of the law. Structures that deliberately circumvent or seek out loopholes in the law with the specific aim of lowering the corporate cost of tax, employ tax havens or undue secrecy or employ complex intra-business transactions that lower the assessment of profitability have therefore come under close scrutiny. We take the view that aggressive tax planning increases risk, financially and particularly reputationally, that may be to the detriment of creating long-term shareholder value. We therefore support companies that use legitimate allowances to plan their tax prudently without resorting to aggressive withholding structures.

Q. What can responsible investors do, and what should they look for?

A. Debates around tax have been useful in shining a light into a complex, little understood area of corporate finance. However, as we have argued, tax planning per se should not be viewed as pernicious or wrong. Given there is increasing scrutiny being placed on companies to be transparent in their tax affairs, we endorse the view that companies can and should do more to make their tax affairs better understood through improved disclosure and governance. This could usefully include:

- Creating and disclosing a corporate tax policy that sets out the general criteria for corporate tax planning
- Ruling in (or out) specific forms of more 'aggressive' tax planning
- Disclosing the principles for negotiating tax concessions, especially in weaker (developing) tax regimes
- Assigning Board oversight and accountability for corporate Group tax policy
- Considering greater tax transparency in the reporting of tax paid including achieving the 'fair tax' kite mark (EIM has endorsed the EITI – Extractives Industries Transparency Initiative which is a useful model)

The EdenTree SRI Team

We have a specialist in-house Socially Responsible Investment (SRI) team who carry out thematic and stock-specific research to identify ethically responsible investment ideas for our range of **Amity Funds**. Headed up by our Senior Investment Analyst Ketan Patel, CFA, and Neville White, Head of SRI Policy & Research, the team is also responsible for creating an on-going dialogue with companies, allowing us to engage on a wide variety of ethical and socially responsible investment concerns. For investors, it's an added layer of assurance that client money is being invested in companies that are operating in a responsible and sustainable way. Our ethical and responsible investment process is overseen by an independent Amity Panel that meets three times a year, and comprises industry and business experts, appointed for their specialist knowledge.

EdenTree - Ethical Investment Specialist

WINNER SIX TIMES
Investment Life & Pensions Moneyfacts Awards 2009-2014
Best Ethical Investment Provider

WINNER
Investment Life & Pensions Moneyfacts Awards 2014
Best Ethical Investment Provider

Since launching the **Amity UK Fund** in 1988, EdenTree has taken a leadership role in managing ethical investments through our research, engagement and strong fund performance. Consequently, we were delighted to receive the Moneyfacts Award for Best Ethical Investment Provider 2014, the sixth consecutive year of winning this award. We were particularly pleased to win as it is voted for by the Adviser community. In 2013, the **Amity UK Fund** was rated 'Highly Commended' in the Investment Week Climate Change and Ethical Investment Awards. We were also awarded Money Observer Best Ethical-SRI Bond Fund for the **Amity Sterling Bond Fund**; the **Amity UK Fund** won Best Equity Fund in the 2014 Money Observer Ethical/SRI category, and we were nominated for an award in the category of Best Thought Leadership Paper on Sustainable Investing, in the Investment Week Sustainable Investment Awards 2014. Today we offer six SRI funds under our Amity brand, four retail funds and two for charity investors, covering the major markets and investment classes.

Further information

For further information on EdenTree's SRI range of Amity Funds please contact your EdenTree Business Development Manager, visit www.edentreeim.com or call our IFA support team on 0800 011 3821.

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Notes

[1] http://www.ukpublicspending.co.uk/

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/356099/Corporation_Tax_Statistics_September_2014.pdf

[3] http://www.revenue.ie/en/tax/ct/

[4] http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx