Tax
Research

Tax – the heart of CSR

The Coffee Tax Code

Notes by Richard Murphy BSc FCA, UK Chartered Accountant and Director of Tax Research Limited

---

Coffee is an internationally traded commodity. It is not possible for it be consumed in most countries of the world unless that is the case. This inevitably means that tax is one of the issues of concern to corporations involved in the coffee trade, and those who monitor what they do including:

- their shareholders;
- their employees;
- the host governments to the corporations involved;
- the taxation authorities of those governments;
- those who have concern for the social responsibility of the corporations in question.

It is increasingly being recognised that taxation is a key issue in the assessment of corporate risk and in the assessment of corporate social responsibility. Since international taxation planning became intimately involved with the use of tax havens during the 1980s and 1990s issues involving the use and abuse of these territories and accounting for transactions that go through them have become a part of this debate.

The nature of that debate has changed dramatically over the last few years, and principally since the OECD published its paper entitled *Harmful Tax Practices : An Emerging Global Issue* in 1998, to be closely followed by new and upgraded papers focusing on other aspects of tax haven and offshore financial centre activity issued by the Financial Action Task Force on Moneylaundering and the Financial Stability Forum.

In combination these initiatives renewed the focus of many in the corporate world and civil society. In the latter case this was particularly promoted by a paper published by Oxfam in 2000 entitled "*Tax Havens: Releasing the hidden billions for poverty eradication".* That paper made clear that there was a substantial social cost to the use and abuse of tax havens by at least some corporations.

For other stakeholders this became apparent when a wave of corporate failures hit the international commercial sector, starting with Enron, and mowing on to Worldcom and Parmalat. In each case (and others) it was clear

that an immensely complicated offshore accounting structure, partly created for tax planning purposes had facilitated a series of complex trades that were immensely difficult to understand, but which had fateful consequences for their corporations. What was learned was that a corporation pursuing aggressive taxation planning or which seeks to secure secrecy for the transactions it undertakes may at the same time expose its shareholders to considerable financial risk, including the loss of their investment.

When matched with the rising call for corporate social responsibility the result there has been the creation of a previously unprecedented common ground for considering how best corporations might report on their activities to all their stakeholders in ways that reassure them all that the actions they are taking are:

1. legal;
2. transparent;
3. acceptable to taxation authorities;
4. socially responsible.

Perhaps the most developed example has been the *Extractive Industries Transparency Initiative(EITI)* launched by the UK Prime Minister, Tony Blair, at the World Summit on Sustainable Development, in Johannesburg, September 2002. This proposal is now supported by 20 governments[1]. Voluntary participation has been secured from most of the major oil and mining corporations in the world[2]. There has been significant NGO involvement[3] and support has also come from the IMF, NEPAD, OECD, UNDP and the World Bank.

The EITI, in its own words "encourages governments, publicly traded, private and state-owned extractive companies, international organisations, NGOs and others with an interest in the sector to work together voluntarily to develop a framework to promote transparency of payments and revenues." What this means in practice is that:

1. each corporation will for each country in which it operates eventually report the value of the resources traded in that territory, and
2. will report the payments they make in that territory to its government, whether as taxes or in some other way, license fees being common in the sector.

---

[1] Azerbaijan, Belgium, Democratic Republic of Congo, Equatorial Guinea, France, Germany, Ghana, Indonesia, Italy, Japan, Kazakhstan, Mozambique, Netherlands, Nigeria, Norway, Sierra Leone, Timor-Leste, Trinidad and Tobago, United Kingdom and the United States
[2] AngloAmerican plc., Areva, BG Group, BHP Billiton, BP, Chevron Texaco, ConocoPhillips, De Beers, ExxonMobil, Newmont, NNPC, Repsol YPF, RioTinto, Shell, SOCAR, Sonangol, Statoil and Total
[3] African Network for Environmental and Economic Justice, CAFOD, CARE International, Global Witness, Human Rights Watch, Open Society Institute, Publish What You Pay coalition, Save the Children Fund and Transparency International

The EITI "recognises that there will be transparency and accountability issues in other sectors that may be addressed using the approach developed under the EITI." The importance of the approach is that it recognises that "all stakeholders have important and relevant contributions to make - including governments and their agencies, extractive industry companies, service companies, multilateral organisations, financial organisations, investors and nongovernmental organisations."

The Coffee Tax Code that this paper puts forward recognises the foundations that this initiative is laying. If it is possible for the extractive industries to work towards transparency then so too must it be possible for the coffee industry to do the same. The suggested Coffee Tax Code is a basis for that cooperation in the interests of the industry as a whole and those who engage with it. In suggesting it we have recognised that there are issues of transparency which the coffee trade shares with the extractive industries, but that there are additional issues to be considered as well because, unlike many extractive industries, the coffee industry has a strong retail dimension.

At its core the Coffee Tax Code has two components:

1. **the tax dimension** outlines the practice that participants in the industry should adopt if they wish to demonstrate their corporate social responsibility with regard to tax

2. **the corporate dimension** suggests practice that participants in the industry should adopt if they wish to demonstrate that their corporate structures are transparent and accountable.

The tax code suggests:

1. That the corporation avoid using tax havens. Unless a trade genuinely originates in a tax haven (and in the coffee industry that is almost without exception not the case) the only reason for using a tax haven state is to reduce the overall tax charge within a supply chain. Since this is done by shifting profit away from one territory and towards another more lowly taxed one this is not seen as an indication of social responsibility.

2. The corporation does not artificially price the transfer of products from one state to another so that profit is mainly or solely earned in those states where there are low tax rates. "Transfer pricing" is necessary in any multinational corporation where commodities have to be transferred from one jurisdiction to another. Rules published by the OECD, the UN and others suggest arms length pricing should be always be used i.e. the price should be that which would have been paid between independent parties even though they are not. Setting such prices is, however, hard in some cases and provides opportunities for abuse. Good practice would suggest that such abuse is not a part of corporate social responsibility and as such should not be done.

3. It is not uncommon for many corporations to now register their patents, trademarks and industrial processes in tax havens and then have operating corporations in relatively high taxed (and often developed states) pay royalties for the use of this intellectual property to a corporation they own in a tax haven, so shifting profits into a low tax area. This is likely to be of particular interest to retail corporations in the coffee trade. In addition it I not uncommon for multinational corporations to run their currency and some financial operations from offshore centres. These are now the most common forms of transfer pricing abuse as it is difficult to prove any fair market price for the trades involved. It is therefore recommended that a corporation that wishes to act in accordance with the highest standards of conduct avoid this activity.

4. Many countries in the world offer incentives for foreign corporations to invest. If these are universally available it is reasonable that a corporation take advantage of them. But when, as is also commonplace, large corporations seek to trade one possible investment off against another by seeking additional tax advantages from the country in which they might invest the practice begins to undermine the revenues of the host government of the country in which they place their business. At that point the activity ceases to be socially responsible and as such is not recommended practice.

5. It is now fairly widely recognised that a corporation can choose its attitude to the tax legislation which governments seek to impose upon it. They might:

   a. be compliant with the law
   b. seek to mitigate their tax but only using openly disclosed schemes and arrangements, or;
   c. aggressively seek to avoid liability by use of artificial structures and transactions, non disclosure of the true nature of transactions and by pushing the boundaries of law beyond reasonable limits of interpretation.

   Although the last practice is clearly illegal many governments do not have the resources needed to tackle such abuse. This does not legitimise it though and as such it is to be discouraged.

6. Taxation liabilities owed by many corporations in many states extend beyond those due on their profits. They also have to comply with sales taxes, laws on taxing their employees, local and regional taxes and so on. As with the law on the taxation of profits a corporation has a choice as to how it might approach compliance with these laws. Since they are enacted by most governments in the best interests of their populations and are used by them to provide social and other services compliance with these laws is seen to be as much a part of corporate social responsibility as is compliance

with the laws on the taxation of profit and corporations that seeks to be corporately socially responsible must seek to conform to best practice in these areas.

The corporate dimension is essentially involved with issues concerning transparency, as follows:

1. It must be possible to identify all corporations involved in a trade and who owns them.

2. If a corporation is part of a group the group structure must be transparent.

3. Many trading relationships are now complex and involve joint ventures, associated parties and other organisations that are not obviously related to each other but in practice have significant commercial interests in common. If a trading group is to be understood the related parties to it must be disclosed and transactions with them must be transparent.

4. Transparency is not possible, of course, if good quality accounting information is not produced. Since that information must be comparable it is also important that recognised accounting rules are followed.

5. Auditors have been much criticised of late, and sometimes rightly so. Few however doubt that good quality audit procedures contribute significantly to good corporate reporting and this is why audited data is an essential part of any consideration of transparency.

6. By definition the consolidated accounts of group corporations do not disclose the payments made between group corporations. However, in many cases the whole issue of transparency necessitates the disclosure of such payments or it is not clear where a supply chain starts, through which territories it is routed, where value is added on the way and who benefits from it. Proposals have now been made that in the interests of transparency, for the reduction of risk and for the benefit of stakeholders inter group trading should be disclosed and this is suggested in the Coffee Tax Code, not least because it also helps a tax authority understand where it fits into the overall taxation structure of a corporation.

7. As has been noted above, it is generally felt that a corporation can take one of three approaches to tax planning. It might be compliant, or it might seek to mitigate tax whilst clearly acting within the law, or it can be aggressive in testing the law to its limits with the inevitable associated risk that it will on occasion overstep that mark. This will almost certainly be reflected in the charge to tax shown in its profit and loss account. However, it is also important to compare that

charge with the actual tax paid as it is often the case that tax declared to be due in the profit and loss account is not actually paid due to opportunities to defer the liability being taken. The hope is that in the deferral period the liability might reduce. This form of tax planning does, therefore, also have to be considered when reviewing accounting disclosure.

8. A major focus of many accounting initiatives that focus upon corporate social responsibility has been the disclosure by a corporation of all the payments it makes to governments wherever they might be in the world. This requirement is, for example found in the EITI and the Global Reporting Initiative and is also reflected in this proposal.