What Stakeholders Expect from Corporations When It Comes to Paying Tax: Corporate Reputation and Optimal Tax Planning

A Summary

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Executive summary

This paper summarises the findings of an extensive research project that sought to determine stakeholder expectations and investor behaviour regarding companies’ corporation tax practices in the UK¹. The interdisciplinary study combined both qualitative and quantitative approaches.

**Key findings from the qualitative part** of the study with business decision-makers and industry representatives (‘the business community’), non-governmental organisations (NGOs) and consumer bodies (‘the public bodies’), include general agreement that the UK tax system is fair, but disagreement about whether large companies are paying an appropriate amount of tax and contribute enough to society. Respondents believe that the international tax system introduces complexity and may distort competition, and comment that there is not a level playing field between large UK companies and multinationals domiciled elsewhere. Interestingly, while respondents across stakeholder groups feel strongly that government and politicians are mainly responsible for issues of fairness regarding tax, most respondents also suggest that more communication and transparency will improve company–stakeholder relationships and the reputations of firms. However, the business community and the public body views differ in terms of who they think companies should communicate with and on what issues, and the media is viewed with scepticism from all involved parties, albeit for different reasons. While the business community looks towards government and policy makers as communication partners, viewing the public as recipients of information in need of education, NGOs and consumer bodies hope there will be a multi-stakeholder debate on corporate tax including a process of listening and informing by businesses, resulting in credible, simple and transparent communication, distributed by companies but verified by independent bodies. For companies concerned about the effects of corporate tax on reputation and stakeholder relationships, this report outlines a process that includes internal and external dialogue to encourage tax strategies that are values congruent, stakeholder relevant and evidence based.

**Key findings from the quantitative part** of the study with investors as stakeholders highlight that typical effective corporation tax rates in the UK have been at comparable levels to those in the US despite the statutory rates in the former having been lower and falling. Total (current plus deferred) corporation tax rates remained close to statutory levels throughout the period investigated. Therefore, it can be argued that historically, the widespread populist view of mass tax avoidance among UK firms cannot be substantiated. We find no discernible link between tax rates and stock returns for the UK, no matter how tax payment/tax avoidance is measured. This is true throughout the sample period and for both customer-facing and non-customer-facing companies. However, companies with lower effective tax rates have significantly higher levels of stock market risk. Firms that are reported in the newspapers in a negative way in relation to their level of corporation tax payment experience very small negative stock returns, which are fully reversed within a month. News announcements of the involvement of a firm in a potentially unacceptable tax-related activity, according to the authorities, result in steeper and much longer-lasting falls in share prices.

Combining and interpreting the insights from the qualitative and quantitative parts suggests an opportunity for better engagement and communication: while stakeholders presume that aggressive tax practices are at play, the quantitative evidence shows otherwise. However the results indicate that companies need to appreciate that communication is not only about telling your story – it is also about listening and responding to issues that matter to stakeholders, following the example approach we suggest in the process framework of this study. Furthermore, firms often view communication as linear, direct and company-centric – essentially they often see themselves at the centre of their universe. Instead, they could see their role as facilitators of conversations between groups, i.e. while NGOs may be cynical of company communication, they are keen to hear from industry bodies, consumer groups and academics and, if companies could bring these groups together to discuss independent findings, that would benefit all participants. In essence, while communication and transparency are important, companies need to think carefully about WHO is the communicator, WHAT is the message, and what is the PURPOSE of the message. Stakeholders are more likely to build trust if there are genuine opportunities to engage with multiple stakeholders and the purpose of the dialogue is well intentioned and not controlled by the firm. Companies could think in a less constrained way about communication, listening and facilitating the voices of other players who are trusted by multiple groups.

¹ A full version of the report is available from [www.henley.ac.uk/jmcr](http://www.henley.ac.uk/jmcr)
Interest in the amount of tax a firm pays has been expressed by an increasingly broad array of stakeholders, including not only shareholders and the tax authorities but also customers, suppliers, employees, NGOs and the public at large. It is clear that perceptions of the acceptability of tax avoidance have changed, perhaps permanently, so that practices which were previously deemed part of sensible planning are no longer socially acceptable in the UK. Firms that are perceived to be ‘shirking their responsibility to pay their fair share of tax’ can be subject to widespread opprobrium in the media.

Perhaps the most high-profile illustrations of the extreme negative publicity that can result from alleged tax avoidance relate to large US companies. Some of these companies have suffered significant reputational damage resulting in customer boycotts, prompting one to deliberately increase its UK corporation tax payments and to relocate offices to the UK. Although the short-term media furore over these companies has died down, corporate tax has become an issue that refuses to go away, partly perhaps as a result of the dawning realisation that fiscal austerity is set to remain for the foreseeable future. There is a prevalent popular belief that if firms paid more tax, fiscal deficits could be reduced and/or spending cuts avoided.

Viewed from the outside, it seems possible to think of the payment of corporation tax in a particular country as a choice variable for a multinational firm, which can opt to pay more or less as it feels appropriate. At the same time, the scope for firms to discreetly reduce their tax bills through avoidance measures while remaining under the radar is declining. Widespread use of social media means that any corporate transgressions, or perceived transgressions, can result in almost instant adverse publicity. In order to meet with societal expectations, it may be that firms need not only to pay any taxes that are legally required, but also to act within the spirit of the relevant legislation.

Arguably, all stakeholders have lost out in the war of words over corporation tax. From the ‘big business’ perspective, the burden of dealing with tax risk and controversy is growing and many firms have increased their tax function, although even this resource may be insufficient. Concern within the business community over media coverage of taxes has heightened, and some firms argue that the more general anti-corporate sentiment the debate has engendered may damage the business case for locating in the UK, despite its stable and predictable tax regime. Contrary to popular opinion, the total value of corporation tax paid is growing but represents less than a quarter of the total taxes paid by big UK businesses.

The strength of public concern around corporation tax has motivated us to conduct the present study. We summarise our methodology and key findings below. A full version of the report is available from www.henley.reading.ac.uk/jmcr.
Stakeholder expectations of corporations when it comes to paying tax

The qualitative part of this study utilised a detailed survey of 61 representatives from four stakeholder groups to understand expectations regarding companies’ corporation tax practices in the UK: industry representatives, consumer bodies, NGOs, and business decision-makers from FTSE 100 & 250 companies. In general there was broad agreement on the majority of issues between business decision-makers and industry representatives (‘the business community’); there was also considerable agreement between NGOs and consumer bodies (‘the public body’).

Methodology

The structured survey asked respondents in 30–60 minute telephone interviews a range of questions concerning their views on the fairness of the tax system, whether large UK-based companies pay an appropriate amount of tax, whether they believe there to be a link between corporate tax rates and competition, how they consider big business is perceived in society, what could be done to build trust, who should be involved in designing a firm’s planning process and what should such a process look like. There was an overwhelmingly positive response to participating in the study by all stakeholder groups, which demonstrates the relevance of the debate and the keen interest by all players to have their views heard. The findings of the study are discussed in five sections below, from perceptions of fairness of the UK tax system overall, to views of large UK companies, contribution to society and guiding approaches and a way forward for companies on tax issues.

1. Perceptions of fairness of the UK tax system

Overall, the UK tax system is perceived as reasonably fair, with business decision-makers being the most positive (M=7.5 on a 10-point scale; where M is the mean (arithmetic average), 1 indicates ‘very unfair’ and 10 indicates ‘very fair’), followed by industry representatives (M=6.5), then NGOs (M=5.7) and consumer bodies last (M=5.0). Reasons for lower scale ratings are based on perceived issues of wealth inequality, a disparity between personal and corporate tax rules, perceptions that some tax rules lacked transparency and clarity and were constraining by nature, while comments accompanying higher scale ratings suggest that the system is progressive and fit for purpose. Respondents from all stakeholder groups are almost unanimous that government and politicians are predominantly responsible for issues of fairness regarding tax, as shown in Figure 1.

‘Based on work I’ve done with other tax systems, I think the UK tax system and HMRC try to be as fair as they can within the constraints placed around them… It could never be completely fair, but it’s not bad.’

Industry representative

‘The choice not to pursue large corporations vigorously for tax leaves people feeling that it is unfair.’

Consumer body

‘Tax is as it is. I think it is madness to talk about fair tax. There is nothing I object to, I think it does penalise banks but doesn’t set out to penalise other particular groups.’

Business decision-maker
2. Views of large UK companies

The business community holds a much more positive view than the public body on the question of whether large UK companies pay an appropriate amount of tax. Many respondents believe that there is not a level playing field between large UK companies and multinationals domiciled elsewhere, and that the international tax system introduces complexity and potential unfairness. Representatives from both the business community and the public body recognise a number of steps that have begun to be taken in the UK and internationally to change the tax system, e.g. GAAR (General Anti-Abuse Rule) and BEPS (Base Erosion and Profit Shifting), but comments regarding the impact of such efforts are inconclusive at present. Respondents name a range of activities that companies should start and stop doing with regard to tax issues, some of which are illustrated in Figure 2.

Figure 2: What large UK-registered businesses (FTSE 100 & 250) should start and stop doing

‘Where should you pay tax? Where you make the money and have a lot of your business or a lot of branches – where the profit is coming from, even if your head office is registered somewhere else, you should be making contributions in the country the profit is coming from.’
(Consumer body)

‘It’s one of the areas which we’ve been asked to provide some guidance on as it sort of raises its head in the media as an issue. It’s also come up very high in the various topics that the man in the street, in the surveys we do, says needs attention. So we have been asked about it. In particular, we have been giving guidance about what you might put in your code of business ethics about your approach to taxation. More and more companies are beginning to see that it’s required, not least in the way in which the general public look at them.’
(Industry representative)
3. Contribution to society

While most respondents agree that large firms provide useful employment and are essential to the UK being internationally competitive, the public body view rates them much lower than the business community on issues related to societal impact (see Figure 3).

**Figure 3: Support for statements about large UK-registered businesses (FTSE 100 & 250)**

Respondents indicate that they believe the UK public to be concerned about the extent of corporate contributions to society and trust in companies is perceived to be relatively low, particularly regarding multinationals operating in the UK but not domiciled here. The business community thinks that a general climate of negativity is based on a lack of understanding and bad press coverage, while the public body view is that companies have yet to engage in the tax debate in a meaningful way, need to listen more closely to stakeholder views and adopt more transparent communication about tax.

4. Guiding approaches for companies on tax issues

In terms of guiding approaches that companies could adopt in respect of tax, the top choice among business decision-makers and industry representatives is for companies to engage with industry bodies and politicians to develop new tax legislation. In contrast, consumer bodies would prefer companies to engage proactively with the general public in the UK to deliver on societal expectations regarding company tax, and NGOs favour companies making an effort to operate within the spirit and letter of the law as their top choice. The majority of respondents in this survey agree that businesses should work further on creating a greater degree of transparency and improving clarity in communication about what they are paying and their profits. A summary of the top choices by stakeholder group between guiding approaches is in Figure 4.
Figure 4: Guiding approaches that companies could adopt in respect of tax

Respondents were presented with four different ‘guiding approaches’ that companies could adopt in respect of tax
(Scale from 1–10, where 1 means ‘disagree completely’ and 10 means ‘agree completely’; M is the mean score)

Top choice among NGOs (M=8.4)
Making an effort to operate within spirit AND letter of the law

Top choice among consumer bodies (M=7.4)
Engaging proactively with the general public in the UK to deliver on societal expectations regarding company tax

Top choice among business decision-makers (M=8.3)
Engaging with industry bodies and politicians to develop new tax legislation

Top choice among industry representatives (M=8.3)
Making a conscious effort to minimise tax costs for their firm

The various stakeholder groups suggest a number of potential solutions or strategies to build the public’s trust, as illustrated in Figure 5. Indeed, issues of transparency and communication emerged as strongly overlapping key drivers to build public trust in the eyes of most respondents.

Figure 5: Key drivers of restoring the public’s trust in large business and tax

5. A way forward

Key differences exist in respondents’ views on who companies should engage with on tax issues and how future communication should be motivated and disseminated. The business community wishes to prioritise communication with government and policy makers and views the public as often uninformed and in need of education about tax. NGOs and consumer bodies, on the other hand, long for a multi-stakeholder debate on corporate tax and express a desire to be listened to by business, which they hope will result in credible, simple and transparent communication about tax, distributed by companies but verified by independent bodies. Integrating both groups’ perspectives, Figure 6 outlines a process that includes internal as well as external dialogue to encourage tax strategies that are values congruent, stakeholder relevant and evidence based. Please refer to the full report for a number of academic references that further underpin the development of this process framework.

‘Try to explain the tax charge better, not just to the financial markets but to the general public. But that in itself is very problematic because of the complexity and confidentiality.’
(Industry representative)

‘Offer some education, because my view is that the public perception is based on what they read in the newspapers, which is probably an inaccurate portrayal of the facts. So by explaining how the tax is calculated, what reliefs you get and why those reliefs have been put in place by governments.’
(Business decision-maker)
The process requires companies to first acknowledge tax as an issue of public interest that justifies senior management attention and warrants dedicated resources and reputation management strategies (step 1). To create alignment and consensus on the issues of taxation, the process suggests the engagement of internal stakeholders on how corporate tax relates to the vision and values of the firm (step 2), before consulting a wider external audience on stakeholder knowledge, behaviour and current/future support of corporate tax strategies (step 3).

Insights created in both internal and external stakeholder dialogues then allow companies to identify potential gaps and issues that a focal company may choose to champion and pioneer in going forward (step 4). Consultation with policy makers, government, advisory bodies and special interest groups presents a logical next step for companies to promote progressive ideas on corporate tax and to co-create solutions for the future (step 5), while adopting a more transparent and simplified communication style on tax issues would demonstrate a values- and/or stakeholder-led, evidence-based approach and could acknowledge the needs and expectations of different stakeholder audiences. Importantly, companies may want to consider how stakeholders communicate among each other, who listens to whom, and how networks of influence and dialogue may be created and facilitated. Finally, companies should usefully measure, monitor and benchmark stakeholder opinion and behaviour in relation to changes made to corporate tax strategy to establish the value added and reputational benefits created (step 6).
Turning now to the quantitative part of the study, this focused on investors as stakeholders and applied various empirical econometric models to a sample comprising all firms that were part of the FTSE All-Share index, spanning the 1991 to 2014 period. There were on average 450 firms per year in the sample, making a total of 10,729 firm-years. The mean cash effective tax rates (CETRs) show that UK firms paid a high percentage of their profits as current taxes for all years until 2004 inclusive. If we consider the total effective tax rate, known as the GAAP effective tax rate (GETR), which includes deferred as well as current tax, the figures indicate that in fact the rates of tax paid by UK firms have not fallen by more than the statutory tax rate – and, in particular, barely declined at all during the 2007–10 period. Figure 7 illustrates clearly how the CETR and GETR diverged at this time while the latter remained roughly at the statutory tax level.

Figure 7: The profile of the average of the cash and total effective tax rates 1991–2014 against the statutory rate

Our key finding from these regressions is that none of the tax variables that we use to measure the extent to which firms pay or avoid tax are remotely close to statistical significance at conventionally adopted levels despite the large sample size, indicating that effective tax rates are not priced in stock returns. Thus, in sum, investors appear to be unconcerned with corporate taxes when making stock purchase and sale decisions, or alternatively it is possible that different groups of investors have specific preferences but on aggregate these are either inconsequential (swamped by the other factors they take into account) or they cancel each other out. We also observe that the lack of a link between stock returns and tax payments holds throughout the sample period on a year-by-year basis and on separating firms by their industrial sector so that there is not a bigger impact on consumer-facing firms (e.g., retailers) compared with business-to-business firms.

We then move on to consider whether there is a link between the firms effective tax rate and the riskiness of its stock and we find that firms with lower rates of effective corporate tax (higher book tax differences) have significantly higher measures of risk.

Can corporation tax rates explain the cross-sectional variation in stock returns?

Are investors concerned with the rates of corporation tax paid by the firms in which they own shares? If, for example, investors believe that tax-avoiding firms are more likely to be the subject of an investigation by the tax authorities, or are more likely to be the focus of negative media scrutiny or a consumer boycott, demand for the shares will be lower than for those of otherwise equivalent companies and investors will only be willing to hold them if they command a premium. We address this by running a set of panel regressions where a tax-related measure is an explanatory variable and the dependent variable is a set of firm-monthly returns. For easier comparison with existing studies, we also employ a ‘time-series of cross-sections’ approach.

Does tax-related media coverage affect share prices?

We perform a search for news items over the January 1991 – October 2014 period where the name of a specific firm is linked with corporation tax avoidance using the UK Newsstand database. We adopt an event study methodology, investigating abnormal share price movements and relating these to the news stories using a 61 trading-day window (approximately three calendar months) from -30 to +30, where T=0 is the date on which the news story appears.

Our presumption was that such news reports will be negatively viewed by investors and therefore demand for the shares and share prices will fall around the date of the appearance of the news story (before if there is leakage of the news or after if there is a delayed reaction). A negative abnormal return might be expected for various reasons: the firm’s costs may increase if they are subject to back-payment requirements, fines or interest penalties, and revenues may fall if disaffected customers take their business elsewhere. The news may also be viewed by investors as a signal of managerial incompetence in letting such stories become public in the first place.
The cumulative abnormal returns are negative (see Figure 8), suggesting that revelations regarding a firm being involved in tax avoidance are viewed somewhat negatively, although the magnitudes are very small and none are statistically significant. There is a sharp reversal in the following days, however, as cumulative abnormal returns are a positive and marginally significant 0.8% for the two trading-week period following the news story. The latter may result from the positive effects on share prices that arise from any kind of news (both good and bad) in putting the stock ‘on the radar’ of prospective purchasers. In that sense, any news is good news as it increases demand for the firm’s shares, especially among retail investors. It may also arise as a result of heightened public relations efforts by those firms affected, which more than cancel out the effects of the bad publicity.

We also find that news stories engender greater shareholder reactions when they reveal potentially more serious misdeeds that could affect a firm’s profitability directly (Figure 9). To establish these companies, we search for the name of the firm linked with corporation tax and terms such as ‘investigation’, ‘fine’, or ‘lawsuit’, where increased tax avoidance might bring with it increased risks of penalties and back-payment demands, as well as risks of interest costs from the tax authorities if the firm is caught and punished. Although the eventual rebound for firms reported in potentially culpable stories is slightly stronger in the longer term than is the case for firms where the stories are weaker, it is clear that overall investors do view these in a more negative light as one might anticipate. At its lowest point, the share price falls for such firms by around 2% and it typically remains in the doldrums for a further month after the story breaks and thereafter there is only a muted, partial recovery.
Conclusions

The survey results discussed here confirm a perception among consumer groups that firms have been engaged in far-reaching tax avoidance on an industrial scale. However, the actual figures do not support this view. UK-based firms’ total corporate tax rates have remained at roughly the statutory rate since the early 1990s, indicating that the suggestion that tax avoidance is endemic and part of the culture of business is unfounded. It is plausible that the wider public sees media reports of foreign firms appearing to pay almost no tax in the UK and they are too hasty to tar UK-based firms with the same dirty brush.

As far as investors are concerned, senior managers choosing to avoid taxes more or less aggressively are unlikely to affect stock prices one way or the other, even in the short term, provided that they remain well within the realms likely to be deemed acceptable by the revenue authorities. However, all else being equal, companies that have high effective tax rates will be perceived as less risky investments by shareholders.

A key message arising from our findings is perhaps that firms must acknowledge the plurality of their stakeholders and may need to reconcile the potentially mixed signals arising from the various groups. Being labelled as a tax avoider may cause reputational damage among some stakeholder groups, and is most likely to be frowned upon by NGOs and consumer bodies, but equity investors are typically ambivalent. While government and politicians are seen to be mainly responsible for setting appropriate rules and policies, there is much interest by a range of stakeholders in having their views heard. As such companies have a unique opportunity to reach out to the public and to demonstrate that stakeholder views do matter in business. Against the background that almost all respondents named more transparency and better communication on corporate tax as desirable goals for the future, companies that decide to proactively take the lead on educating and informing others about corporate tax are likely to derive positive reputational benefits.

Interestingly, in terms of guiding approaches that companies may want to adopt in the eyes of stakeholders on issues of tax, business decision-makers and industry representatives favour close collaboration and engagement with policy makers and government, while NGOs and consumer bodies hope that companies would engage in a wider public debate with consumers, special interest groups and local communities. However, all respondent groups agreed on the notion that more transparency, clarity and better communication are key for the future. Building on the insights generated from the stakeholder survey, the study outlines a six-step process that companies and advisory bodies may wish to follow when choosing to engage internal and external stakeholders in taxation issues.
This study has been conducted by a group of academics from Henley Business School at the University of Reading. Founded in 1945, Henley was the first business school to be established in the UK and is one of the oldest and most respected schools in Europe. It is consistently ranked among the world’s top 50 business schools by the Financial Times and The Economist. It is among an elite group of business schools – the top 1% in the world – to be triple-accredited for the quality and capability of its faculty and output.

As part of the University of Reading, Henley operates within an academic institution that is placed within the top 1% of all universities globally.

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