

Aggressive Tax Planning and Corporate Social Responsibility in Israel

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Introduction

Until recently, advancing issues concerning the welfare of the general public was considered to be mainly the responsibility of the state. In the era of globalization, however, it has been increasingly accepted to focus attention on large business corporations as well because of their growing economic and political power. The position according to which it is not sufficient for corporations to increase their shareholders' profits but they must act with social responsibility toward all their stakeholders has been gaining ground. Although the limits and scope of this new concept of responsibility are still ambiguous, it is generally agreed that it requires corporations to address at least some of the ramifications of their business activities by making adjustments to their production, distribution, employment, and other processes. The premise of this concept is that by assuming responsibility for the effects of their conduct, corporations can minimize the damage they cause to important issues of public interest and contribute to the creation of a more equitable, just, and sustainable society.

This paper focuses on the relations between *aggressive tax planning practices* and *corporate social responsibility* (CSR). It argues that contrary to the standard understanding of the concept of corporate social responsibility, practicing responsible tax policies must be part of what we consider to be

socially responsible conduct. The paper establishes this claim both theoretically, by reference to the idea of the social contract, and practically, by highlighting the potential harm caused to the state treasury by aggressive tax planning undertaken by large Israeli corporations.

More specifically, the paper argues that full payment of taxes is a key part of the "social contract" between the state and its citizens. This is a corollary of the doctrine stating that tax funds are at the basis of the infrastructure and of the provision of appropriate services to the public, and an important component in the reduction of economic and social disparities. Therefore, even if aggressive tax planning does not violate the letter of the law, it certainly violates its spirit. Because the issue of corporate social responsibility is viewed as pertinent to areas that go beyond compliance with the law, corporations are expected not to deviate from the boundaries of the "social license" granted to them and to avoid such planning.

In the first section we review of the provisions of Israeli law with regard to tax planning, focusing on the distinction between aggressive, illegitimate tax planning on one hand, and legitimate tax planning practices on the other. In the second part we discuss the theoretical relations between tax payment and corporate social responsibility by describing the current position of CSR theory, which does not include tax planning practices as part of CSR demands. Next, we argue that a proper understanding of the idea of the social contract requires that corporations claiming to be committed to CSR use honest and straightforward tax practices. The section concludes with a review of possible critiques of linking tax practices to CSR policy and our response to such criticism, and with a short review of the practical reasons of *business* profitability for avoiding aggressive tax planning. The third section provides practical justifications for considering corporate tax policy as a component of socially responsible behavior and examines the extent to which the declarations made by corporations concerning their commitment to social responsibility are consistent with their activities in the field of taxation. To this

end, we conducted a study to examine the effective tax rates paid by the largest public companies in Israel (listed in the TA-25 index of the Tel-Aviv Stock Exchange) between the years 2006-2009, in relation to the statutory tax rates applicable to them. The resulting *tax gap* was compared with the amounts that the surveyed companies invested in philanthropic contributions during the same years. The main argument of the present paper is that the tax gap demonstrates the incompatibility of practicing aggressive tax planning and at the same time declaring a commitment to social responsibility.

1. The Right to Tax Planning: Legitimate and Aggressive Tax Planning

1.1 *The right to tax planning and the justification for limiting it*

It is usually acknowledged that taxpayers have the right to plan their business moves in such a way that leads to a minimal tax liability, as long as they do so by legal means.¹ Many tax systems, including the Israeli one, recognize this right.² Tax planning practices undertaken by the taxpayer are often based on complex legal and business transactions that result in a reduction of tax liability, at times leading to its elimination.³

Although recognition of tax planning as a legal right is controversial,⁴ some consider it a basic constitutional right, a part of the constitutional protection of

¹ D. Glicksberg, *The Limits of Tax Planning: reclassification of transactions for tax purposes* (1990) (hereinafter: "Glicksberg"), pp.28-30.

² For the legal right for tax planning in the U.S. see *Gregory v. Helvering*, 293 U.S. 465; *Superior Oil Co. v. Mississippi* 280 U.S. 390, 395-6; *Ayrshire Pullman Motor Services v. I.R.C.* 14 T.C. 754. For the recognition of this right in Israel see: *Miscellaneous appeals 367/77*, *Itzhak and Amos Bukra Contractors Ltd. and others v. Director of Property Tax*, P.D.A. 10: 323, 326; *Civil appeal 171/54*, *Estate Manager, Southern District v. Nechama Gotlieb*, P.D.I. 9:347, 357.

³ The most obvious, and perhaps most simple example of tax planning is possibly the choice between forms of legal incorporation, that is, the choice to conduct one's business as a company or partnership, a choice that may dramatically alter the tax liability on what may be the same type of business activity. Another example is the choice between performing a transaction in one step or in several steps (for example, by transacting a sale in installments or as a conditional sale, relying on accounting rules that may lead to losses recognized for tax purposes).

⁴ As noted, there is a disagreement among tax scholars over whether tax planning should indeed be considered a right, which is a part of the right to private property. Prof. Y. Edrei, for example, argues that as long as the tax system is based on fair and

private property.⁵ In this approach, the right to tax planning derives first and foremost from the principles of personal freedom and its corollaries of private ownership and the freedom of contracts and association, but also from the democratic character of the regime and from the principles of the rule of law.⁶ The importance of tax planning for business management has been pointed out repeatedly in Israeli case law and in the legal literature. For example, Supreme Court Justice (ret.) Dov Levin noted in an article that:

It is only natural that the citizen-taxpayer, in his economic considerations and in determining his business policy, pays increasing attention to the tax burden imposed on him. Ignoring the measure and depth of taxation, and its implications for the resilience and strength of his business, is liable to result in the collapse and liquidation of the business.⁷

Nevertheless, similarly to other rights granted to individuals under Israeli law, the right to tax planning is not absolute but relative, and must be balanced with other, possibly conflicting rights and interests. Therefore, even if tax planning

proper principles, tax should not be thought of as an infringement of the right to private property. While taxes do expropriate private property, the fact that they are used as a means to distribute wealth between the individual and society, prevents it from being considered such an infringement. See Y. M. Edrei, "About declarative constitution and constitutive constitution: The status of constitutional property rights in the hierarchy of human rights," *Mishpatim* 28: 461, 522 (1997) (in Hebrew) (hereinafter: "The Status of Property Rights"). This is also the position of the European Convention on Human Right (Protocol No. 1, Article 1), according to which tax collection by the state should not be considered as an infringement of the right to private property (See at <http://echr.coe.int/NR/rdonlyres/AFE5CA8A-9F42-4F6F-997B-12E290BA2121/0/DG2ENHRHAND042003.pdf>; accessed on 30 December 2012). Prof A. Yoran takes the opposite position, as he believes that taxes should be considered as a threat to the right to private property, and therefore tax planning is every citizen's constitutional right. See Prof. A. Yoran, "The scope of constitutional protection of property and judicial intervention in economic legislation," *Mishpatim* 28: 443, 448-450, 457-459 (1997) (in Hebrew). In light of the limited scope of the present paper, we do not discuss this topic in detail and assume for the purpose of this paper that a right to tax planning does exist.

⁵ Glicksberg, *supra* note 1, p. 29

⁶ Y. Gross, "Tax evasion and artificial transactions," *Missim* 15/4 p. a-7, p. j-6 (in Hebrew), (hereinafter: "Gross").

⁷ D. Levin, "The boundary between the allowed and the prohibited in tax planning", *Ro'e Cheshbon* 39 (1990) 109, p. 110 (in Hebrew. Translation is ours).

is recognized as a right, there are various considerations that justify its restriction.⁸

First is the *social justice consideration*. According to this argument, tax planning increases the tax burden on other taxpayers. As a result, the tax rate paid across society is no longer determined only by social and economic considerations, such as the "ability to pay" principle,⁹ but it is also influenced decisively by the ability to finance a tax planning scheme (hire accountants, etc.). This circumstance can upset the relative distribution of the tax burden among citizens, as initially determined on the basis of social and economic considerations.¹⁰

A *second* consideration is an *economic* one. Tax payment is the main source for financing the state budget that the elected government uses to carry out national priorities. The use of tax planning may harm society as a whole because it leads to a reduction in the total amount of common resources held by the state. Moreover, a reduction in the financial resources of the state as a result of aggressive tax planning may lead to reliance on grants and loans from foreign sources, and thus to the renunciation of some of the government's economic and political independence.¹¹

⁸ The Israel Tax Authority, Report of the Committee on Addressing Aggressive Tax Planning, (2005) pp. 11-13 (hereinafter: the "Committee Report"), available (in Hebrew) at: <http://ozar.mof.gov.il/taxes/taxesplan07-2005.pdf>; accessed 15.11.12.

⁹ The ability-to-pay principle is a progressive taxation approach, which requires that taxes should be levied on individuals according to their ability and capacity to pay, while taking into account all the relevant characteristics (e.g. income, consumption and net worth).

¹⁰ Glicksberg, *supra* note 1, pp. 31-35.

¹¹ This phenomenon is most pronounced in developing countries, which are more vulnerable to the consequences of international tax planning. This is because in many cases the bodies governing the country do not have sufficient financial resources to investigate taxpayers who commit tax offenses (such as using fake tax invoices and false transfer pricing) and to check the validity and scope of existing tax planning. See R. Murphy, J. Christensen, S. Kapoor, Closing the Floodgates, Tax Justice Network, London (2007), p. 137, in: http://www.taxjustice.net/cms/upload/pdf/Closing_the_Floodgates_-_1-FEB-2007.pdf; accessed 15.11.12.

A *third* consideration is the *democratic* one. Tax collection is one of the pillars of democracy, being the result of a broad social consensus regarding the participation of individuals in the funding and allocation of the resources needed for the welfare of society as a whole. Because the agreed-upon tax regime is the result of a democratic social decision, tax planning, which alters this regime, can lead to the formation of a gap between the formal-legal tax system and the actual tax system arising from tax planning. The formation of such a gap results in an erosion of the social legitimacy of tax arrangements, and more generally, of the state.¹² The demonstrations and protests recently organized by the activist group UK Uncut¹³ against giant corporations operating in the UK, such as Vodafone and Arcadia Group Limited, illustrate this point. According to UK Uncut, these corporations avoided paying taxes in the hundreds of millions of pounds to the British government by relying on various complex tax planning moves based mainly on the use of tax havens. The corporations did this despite the fact that they accumulated their profits in business activities carried out in England. Note that part of the motivation for the demonstrations was fueled by significant cuts in public services and resources that the British government began implementing following a reduction in the tax base and the 2008 financial crisis. Inspired by UK Uncut, similar protest groups have recently formed in the USA (under the name US Uncut¹⁴) as well as in other European countries (e.g., Portugal Uncut¹⁵ and Take VAT¹⁶). Moreover, in June 2010, a coalition of large non-government and international organizations, including Oxfam, Action Aid, and Christian Aid, began a joint initiative to apply public pressure on the G-20 Conference with the aim to eradicate financial confidentiality and the massive worldwide use of

¹² Glicksberg, *supra* note 1, p. 66.

¹³ For more information on UK Uncut, see: <http://www.ukuncut.org.uk>; accessed 18.11.12.

¹⁴ For more information on US Uncut, see: <http://www.usuncut.org/>; accessed 18.11.12.

¹⁵ See in <http://portugaluncut.blogspot.co.il>; accessed 18.11.12.

¹⁶ This group was formed in order to raise awareness of companies that avoid paying VAT. For more information see <http://www.guardian.co.uk/uk/2011/feb/10/vat-protest-group-targets-avoiders>; accessed 18.11.12.

offshore tax havens. Among other actions, the coalition called on the public to send letters of protest to the G-20 summit and to participate in propaganda campaigns organized by the coalition.¹⁷

A *fourth* consideration for restricting the scope of tax planning as a right is *legal*. It rests on the doctrine of good faith (*bona fide*) and on the principle of non-abuse of legal rights. Both doctrines, central to Israeli private law,¹⁸ have acquired binding legal status under the Law of Contracts, which establishes good faith as a general principle applicable to all areas of the law.¹⁹ According to these two doctrines, individuals are expected to treat each other with respect and dignity, and have one other's interests at heart while conducting business. The implication of these doctrines for tax policy is that the right to plan one's taxes must be exercised harmlessly, without taking advantage of the resources that society places at the disposal of all.²⁰ According to Prof. David Glicksberg, a leading Israeli tax expert, the principle of good faith must be viewed as part of the general anti-planning norms in Israeli law. It is therefore possible to disallow certain tax planning moves even in the absence of a specific fiscal anti-planning norm, if these moves are deemed to be undertaken in bad faith.²¹

1.2 Distinction between legitimate and aggressive tax planning

On several occasions the Israeli Supreme Court has declared that although it may be legitimate to plan one's taxes under Israeli law, this is not always the case: "A person may take advantage of any provision of law that exempts or

¹⁷ <http://www.endtaxhavensecrecy.org/en/about-us/>; accessed 15.11.12.

¹⁸ The Good Faith doctrine was declared in Israeli case law a "majestic" doctrine. See for example, HCJ 1683/93 Yavin Plast Ltd. v. The National Labour Court, 47(4) PD 702, 708; FH 7/81 Pnidar v. Castro, 37(4) PD 673

¹⁹ Through applying section 61(b) of the Contracts (General Part) Law, 1973, that states as follows: "The provisions of this law will, as far as is appropriate and *mutatis mutandis*, apply also to legal acts other than contracts and to obligations that do not arise out of a contract."

²⁰ Glicksberg, *supra* note 1, pp. 39-40.

²¹ Gross, *supra* note 6, p. 17.

relieves him from taxes, as long as he does not try to distort by his actions the intention of the legislators or to act illegally in order to become eligible for an exemption or relief that was not intended for him."²²

Given the profound social aspects of the tax liability, the legal delimitation of the tax planning domain is of great importance. This can be achieved both by subjecting a portion of tax planning practices to criminal norms, and by anti-planning norms that disallow certain tax benefits at the fiscal-civic level.²³ Tax planning aimed at tax evasion or tax avoidance, and involving the use of illegal means, falls within the criminal domain of the tax law. By contrast, other tax planning methods that lead to tax avoidance but are carried out by *legal means* should be addressed under the civil domain. Some of these methods raise questions about the legitimacy of tax planning.

Thus, the first distinction that Israeli tax law makes is between illegal or criminal tax evasion and legal or non-criminal avoidance of tax. The difference lies in the measures undertaken to achieve the goal of reducing the tax burden. Whereas the tax avoider minimizes or avoids tax payment by legal means only and makes full and truthful disclosure of all the relevant facts, the criminal tax evader achieves the same goal by concealing and misrepresenting facts.²⁴

Within the category of non-criminal tax planning, Israeli law further distinguishes between *aggressive tax planning*, to which it refers as illegitimate in a fiscal context because it deviates from accepted norms and from the intention of the legislators, and *legitimate tax planning*, to which the anti-planning norms do not apply. Chief Justice (ret.) Aharon Barak explains this distinction in the *Rubinstein* case:

²² Civil Appeal 4639/91 Director of Land Betterment Tax v. Chazon David and Elsa, Lifshitz David and Chana, Mor Uzi and Bat-Sheva, Missim 8/3 (June 1994), 95, p. 104 (paragraph 10 of Chief Supreme Court Justice (ret.) M. Shamgar).Emphasis added.

²³ Glicksberg, *supra* note 1, pp. 30-31.

²⁴ Criminal Case 55/96 State of Israel v. Promedico Ltd., P.M. 1997, p. 384 (hereinafter: the "Promedico case").

*An artificial transaction does not mean an illegal transaction. For the most part, this is a legal transaction, but for some reasons the law regards it as an illegitimate transaction in the fiscal context. **The tension, therefore, is not between legal and illegal; the tension is between legitimate and illegitimate from the point of view of the tax laws;** the tension is between a transaction that reduces taxes legitimately and a transaction that reduces taxes illegitimately. The dilemma involves delineating the boundary between legitimate and illegitimate tax planning. We wish to delineate this boundary line and balance the right of the taxpayer to plan the tax by taking legitimate advantage of the various tax laws with the public interest in collecting taxes and maintaining a just and equitable tax system.*²⁵

Establishing the boundary between legitimate and aggressive tax planning is a complex task and a source of many disagreements between taxpayers and the tax authorities. Thus, in 2004, the Israeli Tax Authority appointed a committee for handling aggressive tax planning. Below is the definition of the main characteristics of aggressive tax planning, as it appears in the report:

- *The main purpose of the activity or activities that are the object of tax planning is to avoid paying taxes or to lower taxes significantly, and the commercial reason for that activity, if any, is marginal.*
- *The tax planning relies on technical adherence to the letter of the law, but deviates from the intention of the law and the purpose of the legislation.*
- *The tax planning contradicts, at times, generally accepted economic patterns.*
- *In most cases, the tax planning is complex and relatively sophisticated.*
- *It is reasonable to assume that if the tax authorities were aware of the tax planning they would not approve it.*²⁶

Additional elements that usually characterize aggressive tax planning, according to the Committee, are the intensive use of legal and financial tools, such as offshore tax havens, and treaty shopping.²⁷

²⁵ Civil Appeal 3415/97 Ministry Assessor for Large Enterprises v. Yoav Rubinstein et Co. Construction Development and Finance Company Ltd., Missim 17/4 (August 2003), e-59, e-64 (hereinafter: "The Rubinstein case"). Emphasis added.

²⁶ Committee Report, supra note 8, p. 22.

1.3 Anti-planning norms applicable to aggressive tax planning under Israeli law

As is the case in many other countries,²⁸ Israeli law chose to limit the right to plan one's taxes in cases of aggressive planning, by "anti-planning" provisions, found both in legislation and case law. These norms are aimed at delineating the boundary between permitted and the prohibited areas of tax planning. Some provisions of the legislation are general, as is Article 86 of the *Income Tax Ordinance [New version] 1961* (hereinafter: "Income Tax Ordinance"), which grants the tax assessor the authority to ignore a transaction if he believes that it is artificial or fictitious, and that it may reduce the amount of tax paid by the taxpayer, or if one of its main purposes is tax avoidance or inappropriate tax reduction.²⁹ Other anti-planning norms, included in specific legislative provisions, are, for example, Section 75B of the *Income Tax Ordinance* which imposes tax on the controlling shareholder of a "controlled foreign company". The essence of this provision is to impose tax on the controlling shareholder in cases where a foreign company is owned by a resident of Israel, if most of its income is passive or most of its profits are derived from passive income. This is accomplished by considering the controlling shareholder of the controlled foreign company, which has passive income that has not yet been distributed, as if that income had been distributed to the controlling entity as dividends. The practical implication of this provision is taxation of the controlling shareholder, based on the accrual of

²⁷ Ibid., p. 10.

²⁸ For instance, in the U.S., as of 2003, Section 1.6011-4 of the Treasury Regulations identifies six categories of reportable transaction that are subject to disclosure requirements due to a high probability of the use of abusive tax shelters. In the UK, as of August 2006, the disclosure regime was widened to the whole of Income Tax, Corporation Tax and Capital Gains Tax, and inter alia, obliges tax payers to disclose various abusive tax arrangements, as prescribed in the relevant regulations.

²⁹ The interpretation of this provision was the centerpiece of the Promedico case, which led to the prosecution of a group of people associated with *Teva Ltd.*, for presenting a fictitious transaction in order to avoid paying taxes. The court examined the contractual, criminal and the tax-related aspects of the case, and stated that the decisive question in the matter was whether the transaction was real, artificial, or fictitious. See the Promedico Case, supra note 24.

the passive income of the company, despite the fact that it has not yet been distributed in practice.

Section 5(5) of the Income Tax Ordinance imposes tax on a "foreign business corporation". Such a company is defined as the corporation of a foreign resident, under the control of five people at most, held directly or indirectly, at a rate of 75% or more by individuals who are residents of Israel.

An additional anti-planning norm is section 145a2 to the Income Tax Ordinance, added as part of Amendment 147 to the Income Tax Ordinance, which took effect on January 1, 2006. This section imposes an obligation to report the practicing of aggressive tax planning, as well as section 75c to the Income Tax Ordinance, which imposes an obligation of tax reporting requirements for trusts and trustees.³⁰ The explanatory note to the Bill clarifies the need for reporting requirements that would enable the assessor to deal with aggressive tax planning:

Unlike tax planning in the past, current tax planning is global, highly sophisticated, and makes use of legal and financial tools as well as of "tax havens", taking advantage of tax treaties. Some of the plans involve abuse of tax treaties or are based on an interpretation of the provisions of the law that distorts the intent of the legislators. Moreover, in some cases of tax planning, the taxpayer assumes that the probability that tax planning aimed at inappropriate tax avoidance or tax reduction would be discovered in the course of the audit of the assessment is low, that the taxpayer's assessment will become outdated, and at most, the taxpayer will be required to pay the tax that he would have had to pay in the first place.

The provisions of this section are intended to assist in increasing enforcement and in the struggle against such tax planning by imposing a duty to report on transactions prescribed by the Authority.³¹

³⁰ As part of the efforts of the Israeli Tax Authority to increase the taxpayers' obligation to reveal and report information, Amendment 147 to the *Income Tax Ordinance* added reporting requirements for the trustee, the beneficiary, and the creator of the trustee (all under certain conditions) as well as an obligation to submit affidavits and reports concerning the details of the trust: real identity of the beneficiaries, value of assets, date of transfer, and more.

³¹ Bill for Amendment to the Income Tax Ordinance (No. 147), 2005, sections 47 and 48. Emphasis added.

The list of operations that the legislator defined as constituting tax planning and must be reported was published on December 3, 2006 as part of regulations enacted under the Income Tax Ordinance.³² These include also operations involving corporations that are offshore tax havens and operations that make abusive use of tax treaties. Failure to report an operation included in the said list is a criminal offense, even if the planning itself is eventually found to be legitimate. Some of the anti-planning norms have evolved in Israeli case law. These include, among others, the "*essence over form*" test: when the agreement is not what it appears to be, i.e., there is a discrepancy between its external appearance and its true nature, the court shall classify it based on its economic substance;³³ the "*purpose of business*" test: if the transaction lacks commercial reason or a credible reason, the court may classify it as an artificial transaction;³⁴ the "*different classification of the transaction*" test: if the court concludes that the transaction that took place between the parties is different from the external designation given to it by the parties, it shall be taxed based on its factual and legal reality.³⁵

2. Tax Payment Practices and Corporate Social Responsibility

Despite the complexity involved in determining whether tax planning practices are genuine or performed for the sole purpose of avoiding tax liability, it is clear that harsher regulative measures need to be taken to prevent them, as the economies in developed countries are plagued by aggressive tax planning practices. Various studies show that large firms invest substantial resources

³² Income Tax Ordinance (Tax Planning Requiring Reporting), 2007.

³³ Glicksberg, *supra* note 1, pp. 122-123. See also Civil Appeal 734/74 Arnold and Mor Spar v. Authority of Property Tax and Compensation, PD 30 (1) 271; Authority of Land Tax Appreciation v. Hadarey Ha'hof Co., PD 56(1) 877.

³⁴ The Rubinstein case, *supra* note 25, at p. e-65.

³⁵ See Civil Appeal 533/89 Tax Assessor for Large Enterprises v. Silberstein, 47(3) PD 376, Further Civil Discussion 3962/93 Minz and Silberstein v. Tax Assessor for Large Enterprises, 50(4) PD 817, where controlling shareholders were required to pay tax for a conceptual income, based on a loan they took from a company under their own control; see also Civil Appeal 8522/96 Rochwerger Construction Company Ltd. vs. Tel-Aviv Tax Assessor, Missim 3/11, p. 70, where the tax assessor classified management fees as dividend by means of "different classification".

into tax planning practices and that the potential harm caused by these practices to state treasuries is immense.³⁶ At the same time these harmful measures are being conducted by companies that declare themselves to be committed to acting in a socially responsible manner.

The present paper aims to expose the inconsistency of employing aggressive tax-planning practices and at the same time declaring a commitment to social responsibility. Below we illustrate that contrary to conservative conceptions of corporate social responsibility (CSR), there is a strong connection between honest and straightforward tax practices and CSR.

2.1 First and second generation CSR

CSR is an "open-ended" concept. The myriad interpretations that have been given to it (a survey conducted in 2005 found no less than 147 types of CSR activities), indicate that trying to find a single overarching definition is probably impossible. Accordingly, CSR is currently acknowledged as an "umbrella term" that covers the range of methods used to define and act upon the relations

³⁶ A study published by Oxfam in March 2009 argues that "developing countries miss out on up to \$124 billion every year in lost income from offshore assets held in tax havens". For more details see here:

<http://www.oxfam.org/en/pressroom/pressrelease/2009-03-13/tax-haven-could-deliver-120bn-year-fight-poverty>; accessed 11.11.12; according to another research, named: "False Profits: robbing the poor to keep the rich tax-free", published by Christian Aid in 2009: "Between 2005 and 2007, the total amount of capital flow from bilateral trade mispricing into the EU and the US alone from non-EU countries is estimated conservatively at more than £581.4bn (€850.1bn, US\$1.1tn)." For more details see: <http://www.christianaid.org.uk/images/false-profits.pdf>; accessed 11.11.12. A recent study (published July 2012) of Tax Justice Network (TJN), entitled "The Price of Offshore Revisited" reveals that a significant fraction of global private financial wealth, equal to at least \$21 to \$32 trillion (as of 2010), has been invested virtually tax free through more than 80 offshore secrecy jurisdictions. The study is available at:

http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf; accessed 11.11.12.

between business and society.³⁷ Defined in such broad terms, CSR is framed as an evolving field, with various actors contributing in different ways to the ongoing transformation of corporate practice.³⁸ The evolution of CSR was described by Simon Zadek in "generational terms:"³⁹ the first generation of CSR is characterized by an interpretation of the term social responsibility as mere charity and philanthropy. Corporations operating in accordance with this approach assume that by allocating a certain annual amount to public donations they act with full social responsibility. Prof. Ronen Shamir analyzed the financial statements of companies resident in Israel whose shares are traded on the Tel-Aviv Stock Exchange and concluded that "Israeli corporations perceive social responsibility as an act that supplements state welfare, as a practice of charity and community support, and as a support mechanism for the health and education systems, and to some extent as maintaining environmental quality."⁴⁰

According to Zadek's approach, the second, more advanced generation of CSR regards genuine social responsibility not as a matter of philanthropy but rather as having to do with the core business of corporate activities.⁴¹ This approach is based on the perception that corporations must take into account the social, environmental, and economic effects of their activity already at the

³⁷ Michael Blowfield & Alan Murray, *Corporate Responsibility: a Critical Introduction* (2008), pp.16, 397.

³⁸ Ronen Shamir, "Private market and public pressure: Shaping the concept of corporate social responsibility," in *Generations, Spaces, Identities: Contemporary Views of Society and Culture in Israel*, 237, pp. 238-245 (eds. Hanna Herzog, Tal Kohavi, and Shimshon Zelniker, 2007) (In Hebrew) (hereinafter: "Shamir").

³⁹ Simon Zadek, *Third Generation Corporate Citizenship - Public Policy and Business in Society*, The Foreign Policy Centre, pp.9-11 (hereinafter: "Zadek").

⁴⁰ Shamir, *supra* note 38, p.260

⁴¹ Zadek, *supra* note 39, pp.9-11; Porter & Kraemer, M. Porter & M. Kraemer, *Business and Strategy: the Link between Competitive Advantage and Corporate Social Responsibility*, *Harvard Business Review* 1 (December 2006); R. Shamir, *Between Self-Regulation and the Alien Tort Claims Act: On the Contested Concept of Corporate Social Responsibility*, *Law & Society Review*, Volume 38, Number 4 (2004); C. Parker, *Meta-Regulation: Legal Accountability for Corporate Social Responsibility*, in, *The New Corporate Accountability: Corporate Social Responsibility and the Law* (D. McBarnet, A. Voiculescu & T. Campbell (eds.), 2007).

stage of product development and service delivery. Examples of the implementation of this idea are the recycling of cell phones by cellular communication companies, the granting of preferential financing terms by banks to green investors, and so on. Transitioning from the first to the second generation of social responsibility requires that corporations adopt, among others, appropriate norms, enshrine them in ethical codes, and apply them in their routine business activities.

Given the social and economic consequences of the use of aggressive tax planning⁴² and the changing balance of power between the market and the state, various organizations and private individuals worldwide, especially in Europe, began to regard the tax issue as an integral part of the second generation of corporate social responsibility.⁴³ According to this approach, the issue of corporate social responsibility goes beyond compliance with the law and corporations must avoid aggressive tax planning, especially if they boast about being socially responsible.⁴⁴

2.2 The tax system and the social contract

Taxation is one of the foundations of democracy. It is an expression of the social contract according to which all members of society contribute to the achievement of commonly agreed-upon social and economic goals. The tax money is the blood that flows through the veins of the social contract between the citizens and the state, as the physical, social, and legal infrastructure of human society can be maintained only by means of tax collection. Without the taxpayers' money, the state cannot provide its citizens with essential services such as education, health care, security, a judiciary system, roads, water,

⁴² Aggressive tax planning practices are very common and especially vulnerable in developed countries. For further information see http://www.taxjustice.net/cms/front_content.php?idcat=104; accessed 15.11.12.

⁴³ R. Lanis & G. Richardson, *Corporate social responsibility and tax aggressiveness: An empirical analysis* in J. Account. Public Policy (2011).

⁴⁴ D. McBarnet, *Corporate Social Responsibility Beyond Law, Through Law, For Law*, in University of Edinburgh School of Law Working Paper Series (March, 2009).

sewage disposal, and so on. These service and benefits make possible an educated population, a skilled workforce, and a developed economy, all of which constitute the social capital of the state and improve its standing in the global market.

The libertarian perception that taxation is an arbitrary "taking" by the government from the citizens and a burden imposed on the shoulders of those who earn their living in the sweat of their brow reflects a very narrow understanding of citizenship and communal life.⁴⁵ On the contrary, if the tax system is generally just, when citizens evade taxation they are harming their own communities and as a result, themselves, in the long term. This is because the money "saved" by paying less in taxes is often spent on services that were formerly granted by the state, and which the state can no longer provide because of the reduced tax base. Common examples are the need to pay for private health insurance, road tolls, the education of children in kindergartens, and more.⁴⁶

Moreover, tax avoidance also increases the gap between those who can pay for the services and those who cannot pay for them. The gap is even wider when the decrease in state revenues from taxation is caused not only by a general policy of reducing tax rates but also by the use of aggressive tax planning by part of the population. Thus, those who have the ability to pay legal and accounting experts for aggressive tax planning, increase their income relative to those who do not have the means to pay for these services. This outcome erodes the foundation of the social cooperation and frustrates

⁴⁵ Edrei, *The Status of Property Rights*, supra note 4, pp. 488-490; Y. Edrei, "Taxation and the promotion of investment in financial, social, and human capital," 40 (2) *Mishpatim* (2010), 437 (in Hebrew) (hereinafter: "Social and human capital").

⁴⁶ Tax avoidance is surely not the only reason for having to privately pay for services previously subsidized by the state. Indeed, the adoption of neo-liberal ideology by the state itself, and the privatization of public services that follows from it, is a major issue. However, our argument here focuses on the significant role that tax avoidance has on the reduction of the tax base (especially by the big corporations, that amounts to billions of pounds annually), and on the shortsightedness of considering it as "money saved".

the legislative purpose underlying the determination of the tax burden. Therefore, even if aggressive tax planning falls within the letter of the law, it is in essence an unethical and unfair exploitation of its form, or as noted by Prof. Glicksberg, a modern illustration of the phrase "a villainy within the delineations of the Torah."⁴⁷

Yet another reason for considering aggressive tax planning to be contrary to the idea of social contract is that reducing the tax base in the wake of aggressive tax planning promotes the concept of "small government," which diminishes the scope of public services and considers the economic standards of the market to be the only principle that should guide society. Although this may be a reasonable account of the state, it should be decided upon through public debate rather than left to the vigilant actions of the strongest members of society. Considering the significant implications that aggressive tax planning conducted by the large corporations has on the distribution of social wealth, it must be concluded that this is an unjust practice.⁴⁸ In this context, we must also bear in mind that in democratic and liberal regimes the law is not a complete expression of the moral values espoused by society, but serves as a framework within which society can discuss the legitimate activities it wishes to encourage or discourage. Just as in sports it is possible to censure a certain type of behavior as "unsportsmanlike" and even penalize those who engage in it despite the fact that they did not act unlawfully, so it is appropriate to condemn tax planning that is harmful to society as a whole even if it does not break the law.

2.3 Aggressive tax planning and corporate social responsibility

The moral-social concept that seeks to deny the legitimacy of certain types of tax planning because of their harm to society is on an inevitable collision course with the individualistic approach, *laissez faire*-oriented, according to

⁴⁷ Glicksberg, *supra* note 1, p. 38.

⁴⁸ J. Christensen, R. Murphy, The Social Irresponsibility of Corporate Tax Avoidance: Taking CSR to the Bottom Line, *Development Journal* 47(3), (2004), p. 42.

which as long as the taxpayer's activity is not illegal, it is legitimate. This position received its extreme expression in the words of the economist Milton Friedman, according to whom the only social responsibility of corporations is to increase profits for their shareholders.⁴⁹ According to this conception, if it turns out that the corporation pays a higher tax than it would have paid had it undertaken some legal tax planning, this means that the corporation makes inappropriate use of the funds of its shareholders. This is because shareholders are entitled to decide what to do with their money and need not be subject to government decisions regarding the designation of these funds.⁵⁰ But when a corporation makes use of aggressive tax planning, the attendant moral and social implications gain even more poignant expression than when a private individual does the same. This is because society provides significant added privileges to corporations, such as limited liability and a separate legal entity, with the expectation that, in return, they do not deviate from the "social license to operate" that has been granted to them.⁵¹ The license reflects the agreement of society in which the corporation operates to use the state's territory, its natural resources, and the public services it provides (such as an educated labor force, transportation, security, etc.), all of which are financed by taxes. In return, society expects that in the course of its activities, even while aimed at increasing profits, the corporation returns its "fair share" to society. Imagine, for example, what would happen if the police did not show up when the corporate stores were looted, if the fire brigade did not arrive when a fire broke out at the factory, if the garbage collectors did not clear the trash generated by the corporation, or if there were no roads on which the corporation could transport merchandise, and so on. In this sense, it is the state, with the infrastructure and the many services it provides, that enables

⁴⁹ M. Friedman, *The Social Responsibility of Business is to Increase its Profits*, *The New York Times Magazine* (September 13, 1970).

⁵⁰ KPMG, *Tax and Corporate Social Responsibility*, (2007, UK), p.18 (hereinafter: "KPMG's Report").

⁵¹ M. Porter & M. Kraemer, *Business and Strategy: the Link between Competitive Advantage and Corporate Social Responsibility*, *Harvard Business Review* 1 (December 2006).

the proper functioning of the corporation. Therefore, as part of the social contract between the state and its citizens, the corporation is expected to pay the full tax on its earnings. From the perspective of society, the tax can be seen as a dividend that the corporation pays to society in exchange for using the resources it makes available. Thus, when the corporation evades its responsibility to pay taxes, even if it is not breaking the law, it acts unfairly, as a parasite that lives off society and prevents or delays its normal development. For these reasons, the notion that the only purpose of a corporation is to maximize shareholder profits is becoming obsolete, particularly given the fact that in recent years the public domain has undergone outsourcing and privatization, and that capital mobility, guided by considerations of profit and benefit, knows no boundaries.⁵² With the rise in the power of multinational corporations, there is also growing awareness of their extensive influence on the distribution of global resources and of their political and cultural power worldwide.⁵³ Today, in most countries corporations have the power to influence public policy, to promote or restrain social reforms, and to influence the allocation of resources in key areas such as employment, the environment, and social rights. This massive influence that corporations exercise increases social expectations from them and their responsibility toward the community within which they operate.⁵⁴

⁵² See the statement of Prof. Michael Porter, a prominent figure in the world of American management for over two decades, as published in 2011 in the *Harvard Business Review*, one of the most capitalist-oriented magazines in the U.S., in: <http://hbr.org/2011/01/the-big-idea-creating-shared-value/ar/1>; accessed 15.11.12.

⁵³ To understand the scale of this influence, note, for example, that over two thirds of global trade in goods and services is conducted by corporations and that the total annual income of the 200 largest corporations worldwide is greater than the income of each of 182 countries in which 82% of the world population resides. See Shamir, pp. 238-240. For more information see P. A. Davidsson, *Legal Enforcement of Corporate Social Responsibility within the EU*, *Columbia Journal of European Law*, 8 (Summer 2002), 529.

⁵⁴ Shamir, *supra* note 38, pp. 238-240; Clinic for Corporate Social Responsibility of the Academic Center of Law and Business, *It is Our Business: Report on Corporate Social Responsibility in Israel* (January 2010), pp. 1-4 (in Hebrew)(hereinafter: the "Clinic report 2010").

In light of this trend, there is increasing support in Western society for the notion that in addition to acting responsibly toward their shareholders, corporations must also take into account the needs and expectations of all relevant stakeholders, including employees, consumers, suppliers, authorities, and the environment. At issue are moral norms of behavior that go beyond the framework of classical market perceptions of profit and loss, and take into account the global, long-term effects associated with the business activities of corporations.⁵⁵ The field of corporate social responsibility assumes, therefore, that there is an extensive system of relationships between the corporation and the society in which it operates, and that this relationship imposes certain obligations on the corporation.⁵⁶

In our opinion, first generation philanthropy is inadequate. When a corporation contributes money to the community, there is a great likelihood that the money donated to promote a particular cause, chosen by the company according to its preferences, could be more beneficially used for the accomplishment of some other goal.⁵⁷ The state has a broader and more systemic view of the proper way to allocate resources in society than corporations do. Moreover, it is a matter of democratic principle that public funds be allocated based on the decisions of an elected government. Therefore, given that the institutions that set the priorities of the state have been democratically elected, it stands to reason to pay taxes that are allocated according to national priorities determined by state institutions.

Given the significance of tax policy for social life, the serious harm that aggressive tax planning can have on the ability of society to function properly,

⁵⁵ T. Barkai, "Social responsibility of businesses: Neo-liberalism in Zionist translation," *Teoria Uvikoret* (33), 45, pp. 48-49 (in Hebrew).

⁵⁶ Clinic Report 2010, *supra* note 54, pp. 1-6.

⁵⁷ For example, recent study of the Directory of Social Change (DSC): "The Guide to UK Company Giving", published on 2011, found that contributions in money-equivalents such as volunteering employee time and sponsorships, have in some cases impinged on the charity's own resources as they were not really needed. For further details, see: <http://www.dsc.org.uk/Publications/Fundraisingsources/@2727> ; accessed 13.9.12.

and the anti-democratic nature of "giving back to the community" by means of sporadic contributions, it is reasonable to include aggressive tax planning among objectionable practices from the CSR perspective.

2.4 Critique and Response

The following arguments could be made against the claim that there is a connection between aggressive tax planning and corporate social responsibility.

First, it may be argued that the payment of taxes is an obligation enshrined in law, and therefore as long as the corporation does not break the law, objections about the tax rate it must pay should be directed at the state and not at the corporation. Our response to this argument is that because of their growing political and economic power, giant corporations are able to influence the amount of tax they pay to the state in various ways. Indeed, quite a few countries that need foreign investment tend to negotiate with multinational corporations the tax benefits that the corporations will receive if they choose to invest in the country. Some countries are even prepared to change existing legislation for this purpose.⁵⁸ Moreover, this argument applies only to the obligation to comply with the law and ignores the position stating that the social responsibility of corporations extends beyond compliance with the law and that corporations have ethical and social obligations as well.

A second critique of the idea that taxes should be considered part of CSR touches upon the shortcomings of CSR as a voluntary area that allows corporations to declare one thing and practice a different one. Some scholars argue that even if corporations formally adopt various CSR practices with regard to tax payment, in practice they remain committed to the interests of

⁵⁸ KPMG's Report, *supra* note 50, p. 26. As explained hereinafter in footnote 116, the Israeli parliament has recently (November 2012) approved an amendment to the *Encouragement of Capital Investments Law* that grants significant tax breaks to large multinational companies operating in Israel. Among others, the amendment is a result of an extremely lenient policy towards large multinational corporations.

pure capital. As is the case of other areas of CSR, all too often economic calculations prevail, whereas social and environmental considerations are set aside.⁵⁹ In this spirit, Prof. Prem Sikka questioned the ability of CSR reports and other similar initiatives to reduce incentives for companies to report higher profits. In his opinion, this is primarily because, as opposed to financial reports, the content of CSR reports is provided by the corporations mostly voluntarily, and the corporations have no incentive to disclose the negative social and environmental consequences of their activities. They prefer instead to use corporate statements as a platform to aggrandize themselves, leaving the readers of these statements unable to substantiate their claims against the corporations.⁶⁰ If this is indeed the case, then it is clear that voluntary reports cannot be a suitable regulatory tool.

This is a significant reservation. But although we recognize the difficulty of making sure that corporations do more than merely proclaim their commitment to CSR policies regarding tax payment, we believe that it is of great importance that corporations acknowledge this connection and subscribe to it. Such a change in the stated policy of the corporation may in time trickle down to the rank and file of the organization and eventually lead to a significant change in its actual policies. Moreover, even such a simple voluntary statement can facilitate a closer public review of the practices and actions of corporations. Thus, any apparent gap between the statements and the practices of the corporation can lead to public and possibly legal scrutiny.⁶¹ The *Kasky*⁶² case illustrates the possibilities that even voluntary codes of conduct and similar instruments (such as certification standards) can open for private enforcement. The ruling in this case was that voluntary public statements made by corporations about the standards they claim to observe

⁵⁹ Prem Sikka, *Accounting for human rights: The challenge of globalization and foreign investment agreements*, *Critical Perspectives on Accounting* 22 (2011), 811, pp. 823-824

⁶⁰ *Ibid, ibid.*

⁶¹ Such was the case with regard to *Nike v. Kasky* 123 S. Ct 2554 (2003).

⁶² *Ibid,*

can constitute grounds for claims of misrepresentation and false or misleading conduct.⁶³

A third argument against the interrelations between CSR and aggressive tax planning practices could be that taxation should not be considered as part of corporate social responsibility, because the corporate taxes paid out of the profits of the corporation are not part of any commercial activity but are manifest only after the transaction has been completed.

In business practice, however, this is not true. Tax aspect is a significant consideration that affects some of the most important decisions taken by the corporation in its business activities, including the location where the business is established, the form of incorporation, and the timing of transactions.⁶⁴

2.5. Business reasons for avoiding aggressive tax planning

So far we have outlined the normative arguments that support our claim that as part of their social responsibility, corporations should avoid using

⁶³ For the dialectic relations between voluntary acts and hard law, see Ofer Sitbon and Ronit Donyets-Kedar "CSR and Clinical Legal Education: Challenging the Limits of Law", 17 *Hamishpat* (forthcoming 2012) (In Hebrew).

⁶⁴ KPMG's Report, *supra* note 50, p. 11. The large accounting firm KPMG released in recent years several reports dealing with these issues, arguing, among others, that when corporations adopt a policy of social responsibility, they should also consider the tax implications of their activities. Interestingly, in 2005 KPMG itself was sued by the U.S. government for developing, marketing and implementing potentially abusive and illegal tax shelters that U.S. taxpayers might otherwise have been unable to employ, costing the U.S. Treasury billions of dollars in lost tax revenues. KPMG admitted in court it committed fraud in designing the tax shelters and in trying to conceal the shelters from the Internal Revenue Service. As part of this prosecution, KPMG agreed to pay \$456 million as part of a Differed Prosecution Agreement, in order to avoid criminal prosecution by the U.S. government over abusive tax shelter. For more information regarding KPMG's prosecution, see: <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aplebPwsO81k&refer=us>; accessed 21.6.12. For a critical analysis of the involvement of KPMG and other Big 4 firms in facilitating the handling of illicit financial flows, see Moran Harari, Markus Meinzer and Richard Murphy, *Financial Secrecy, Banks and the Big 4 Firms of Accountants* (October 2012) Tax Justice Network, in http://www.taxjustice.net/cms/upload/pdf/FSI2012_BanksBig4.pdf; accessed 15.11.12. In light of this information, KPMG's recommendation not to practice aggressive tax practices is therefore rather ironic.

aggressive tax planning. In addition to these arguments, however, there are also practical business reasons for avoiding aggressive tax planning on the basis of sheer business profitability. Just as more and more corporations are trying to integrate philanthropy into the core of their business based on a growing perception that "charity is good for business",⁶⁵ it is our position that they should also stop the use of aggressive tax planning because of the business risks involved, as detailed below.

A *first* business consideration for adopting a responsible tax policy is the growing importance that civil society attaches to the issue of taxation, which may harm the public image of corporations that adopt aggressive tax planning, and lead to negative media coverage. For example, the giant corporation *Google* was required to provide explanations to the public when newspapers worldwide published the fact that in 2007 its British branch avoided paying 110 million pounds in taxes through the use of offshore tax havens.⁶⁶ *Barclays Bank*, one of the largest banks in England, recently drew sharp public criticism when it was reported that in 2009 it paid a corporate tax rate of only 2.4% (on a profit of 4.6 billion pounds that year),⁶⁷ and that hundreds of its branches are taxed in offshore tax havens, such as the Cayman Islands, Jersey, and the Isle of Man.⁶⁸

A *second* consideration is that complex tax planning can produce litigation costs related to the interpretation of the tax statutes. Reviewing the annual reports of corporations traded as part of the TA-25 index of the Tel-Aviv Stock Exchange reveals that in recent years many corporations were involved in

⁶⁵ Shamir, *supra* note 38, p. 252.

⁶⁶ See <http://taxjustice.blogspot.co.il/2009/04/google-avoids-100m-uk-tax.html>; accessed 21.6.12.

⁶⁷ BBC News Business, *Barclays UK Corporation tax bill of 2009 was £113*, (18.2.2011, UK), BBC website, available at <http://www.bbc.co.uk/news/business-12511912>; accessed 15.11.12.

⁶⁸ Editorial, *Corporate Tax Avoidance - Impoverishing the public* (19.2.2011, UK), *The Guardian*, available at <http://www.guardian.co.uk/commentisfree/2011/feb/19/taxavoidance-barclay>; accessed 15.11.12.

legal proceedings because of disputes regarding the payment of taxes. According to Israeli law, corporations are not obligated to publish the fees they pay to their attorneys, and it is therefore difficult to estimate the amounts they paid to their legal advisors. But in view of the type of procedures listed and of their duration, it is likely that these costs are considerable.

Third, the more companies are taking advantage of loopholes in the law in order to create complex aggressive tax planning schemes, the greater the likelihood that the authorities will consider it appropriate to enact additional anti-planning norms. It is reasonable to assume that legislation of this type will create new complexities for the tax reports, which will encumber the business activities of corporation, in addition to creating new financial costs.

Fourth, the use of aggressive tax planning may damage the trust the authorities have in the corporation, and have a negative effect on the good relations between the corporation and the authorities. As a result, the corporation may lose contracts and be subject to various restrictions on its participation in tenders conducted by the government.

A *fifth* business consideration for adopting a responsible tax policy is the uncertainty with regard to the response of the authorities to tax planning by the corporation, and the possibility that the tax liability of the corporation will end up being higher than what has been paid in practice, may result in uncertainty for investors regarding the value of the shares of the corporation.⁶⁹ For example, in 2005 the British company *Vodafone* dropped a place to fifth in the FTSE100 following an announcement by the company that contrary to previous forecasts (which were based on tax planning conducted by the company), it will likely have to pay £5 billion in taxes for the years 2005-

⁶⁹ SustainAbility, *Taxing issues - Responsible Business and tax*, p.3 (hereinafter: "SustainAbility") in http://www.taxjustice.net/cms/upload/pdf/Sustainability_taxing_issues.pdf; accessed 15.11.12.

2008.⁷⁰ Such a drop in the price of the shares can also lead to a situation where company shares continue to be traded at a lower value than their true value, if only because of the fear that in the future there will be some further uncertainty about the tax payments of the company.

Based on these considerations, corporations should weigh whether in the long term it is profitable for them to undertake aggressive tax planning.

3. From Theory to Practice: The Problem of the "Tax Gap"

Below we presents the findings of a study that compares the actual tax payments made by leading corporations in Israel with the statutory tax rates for these companies and with their philanthropic donations. Our aims are to (a) point out at the low rate of corporate taxes paid by leading Israeli corporations, partly because of tax planning practices that are not socially responsible, and (b) illustrate that the potential tax loss caused to the state as a result of aggressive tax planning far exceeds the benefits to the public from corporate philanthropy. The results presented below overwhelmingly support our conclusion that the tax policy adopted by a corporation should be regarded as an integral part of its social responsibility.

3.1. Study Findings: Aim and Method

The study focused on the list of corporations traded as part of the TA-25 index of the Tel-Aviv Stock Exchange.⁷¹ Our aim was to test whether a general

⁷⁰ A. Hawkes, *Vodafone Shares Sink Under Tax Bill*, *Accountancy Age* (24 November 2005) in <http://www.accountancyage.com/aa/analysis/1749363/vodafone-shares-sink-tax>; accessed 15.11.12. See also: R. Murphy, *Vodafone's tax case leaves a sour taste*, *Tax Research UK* (23. October 2010) in <http://www.taxresearch.org.uk/Blog/2010/10/23/vodafones-tax-case-leaves-a-sour-taste/>; accessed 15.11.12.

⁷¹ The index is updated twice a year, on the 15th of June and December. The study we conducted was based on the corporations included in the index following the June 15, 2010 update. The list of 25 corporations examined: *Discount Bank, Bezeq, Bank Hapoalim, Osem, Cellcom, Partner, Mizrahi Tefahot, Harel, Perrigo, Strauss Group, Discount Investment Corporation, Elbit, Nice, Paz Oil, Chemicals, ORL, Teva, Delek*

tendency can be observed according to which the annual tax rate paid by these leading corporations is different from the statutory corporate tax rate. The gap between the *effective tax rate* (tax rate consisting of tax expenditures actually paid by the corporation, as well as the book entry for the deferred taxes of the corporation) and the statutory corporate tax rate is hereinafter referred to as the "*tax gap*." To determine the tax gap, we used the financial statements that corporations are required to publish. The reports were found on the website of the Tel-Aviv Stock Exchange. As of today, Israeli law does not require that corporations publish in their annual papers the tax rates paid by their affiliates in each country where they are taxed. Only a fraction of the corporations we surveyed did so. This is one of the reasons why we were unable to know whether and to what extent corporations that we surveyed use aggressive tax planning and sophisticated accounting practices in order to reduce their tax liability. Given this non-transparent state of affairs, we resorted to using a rough estimate: We examined the overall effective tax rate that corporations paid on their profits. It should be emphasized that the tax gap may also (or only) be the result of reasons unrelated to aggressive tax planning, such as tax benefits that the corporation receives from the state (for example, by virtue of the Israeli Law for Encouragement of Industry or the Israeli Law for Encouragement of Capital Investment)⁷², timing differences, differences between tax rates in different years, and so on. Nevertheless, due to the lack of transparency, as noted, our objective was restricted to verifying the existence of a tax gap (without specifically determining its origin for each company) and to indicate the resulting potential financial damage caused to the state. Our initial assumption was that none of the corporations that we surveyed undertakes tax planning that would establish any type of criminal grounds against it.

Group, Israel Corporation, Gazit Globe, Leumi, MA Industries, Ormat Industries, Delek Drilling, and Avner Oil and Gas Explorations.

⁷² *Encouragement of Capital Investments Law, 1959* (refers mainly to R&D grants for Approved Enterprises) ; *Encouragement of Industry (Taxes) Law, 1969* (refers mainly to Industrial Enterprises).

To produce as reliable results as possible and to minimize annual distortions (due to a gain or loss caused to the corporation in a given year), we checked the effective tax rate paid by the above corporations over four tax years, between 2006 and 2009.

The data were collected only from the consolidated financial statements of the corporations, as published on the website of the Tel-Aviv Stock Exchange, as part of the mandatory duties imposed on public corporations. The calculation of the effective tax rate consists of the expenditure on taxes actually paid by the corporation and book entries for the deferred taxes. To calculate the effective tax rate, we examined the amount of "tax expenditures" declared by the corporation each year, and divided it by the amount of profit earned by the corporation in the same year. Regrettably, given the scope of the present study, and due to the aforementioned lack of transparency, we could not isolate from the amount of tax expenditure the amount of deferred tax attributable to each year. As a result, it must be taken into account that the effective tax rate shown does not reflect accurately the current tax rate actually paid by the corporation in the relevant years.⁷³

To obtain an average effective tax rate paid by the corporations in this period, a *weighted average* was obtained between the tax rates paid by each corporation in each of the four years (in such a way that the years in which a higher or lower tax rate was paid we assigned a different weight from that

⁷³ We sent the data we collected to the corporations by e-mail and asked for their response. With a significant number of corporations we encountered serious difficulties in locating the person in charge of social responsibility affairs of the corporation and to whom we needed to send the letter. In cases in which there was no information about social responsibility on the website of the corporation, we called up the corporation and asked to talk to the person in charge of the matter. As a result, we spoke with various officials and were transferred numerous times between the departments of Human Resources, Welfare, Customer Relations, Culture, and Public Relations. Regrettably, from among the 25 corporations to which we sent requests for comment, only 10 corporations responded. As a result, for the remaining 15 corporations we were unable to verify that the data accurately reflect their books. The comments we have received from the 10 corporations were integrated into the study's findings.

assigned for other years). This is because standard averaging is liable to result in a certain deviation relative to the overall amount of tax the corporation paid out of its total profits.

Some of the corporations showed a loss for the year 2008. Examination of their financial reports indicates that for various reasons, including the right of corporations to transfer losses to subsequent years for tax purposes, the amount of "tax expenditures" shown by these corporations had a negative numeric value, which probably represents a tax benefit. As the purpose of our examination in the present paper is only to examine the tax rate paid by corporations on their profits, receiving a tax benefit in a year in which the corporation posted a loss is not relevant for our calculation. Therefore, we decided to exclude this year from the data analysis for the relevant corporations. In other words, the calculation of the average tax rate for corporations that posted a loss for the year 2008 was based on the tax years 2006, 2007, and 2009 only.

We calculated the tax gap as follows: we compared the average effective tax rate paid by the corporation during this period with the average statutory tax rate that applied to corporations during these years.⁷⁴ We also took into account the fact that corporations defined for tax purposes as "financial institutions" (such as banks and insurance companies) pay, in addition to the corporate tax that applies, a profit tax, and therefore the average statutory tax rate that applies to them was higher in those years.⁷⁵ To discover the relationship between the rate paid by the corporation and the tax rate that applied to it, we divided the effective tax rate by the statutory tax rate applicable to the corporation, in accordance with the said classification of the corporation.

⁷⁴ The statutory corporate tax rate during the relevant years was as follows: 2006: 31%, 2007: 29%, 2008: 27%, and 2009: 26%.

⁷⁵ The statutory corporate tax rate that applied to financial institutions during the relevant years was as follows: 2006: 40.65%, 2007: 38.53%, 2008: 36.8%, and 2009: 36.21%.

The potential tax loss is the amount of money which is not collected by the Treasury each year as a result of the existence of the tax gap (which is, as noted, the difference between the effective tax rate and the statutory tax rate). For the purpose of our investigation, the potential tax loss consists of the difference between tax expenditures the corporation was supposed to pay in 2006-2009 in accordance with the statutory tax rate, and tax expenditures that the corporation declared. To calculate the amount of potential tax loss caused to the State by all the corporations traded as part of the TA-25 index during the relevant years, we summed the potential tax loss we obtained for each of these corporations.

In addition to examining the tax gap, we looked into two other variables: *contributions rate relative to profit* and *transparency with regard to tax havens*. As noted earlier, first generation CSR is characterized by philanthropy, which is voluntary, sporadic, and often regarded as an exercise in public relations. We compared these contributions with the tax payment policy of the corporations, which in our view should be considered second generation CSR. Israeli law mandates that corporations traded on the securities exchange specify in their board of directors' reports their corporate policy with regard to donations, if such policy has been formulated.⁷⁶ They are also required to state the scope of their financial contributions to the community each year.⁷⁷ Note that corporations often contribute to the community by means of "money equivalents," such as sponsorships and volunteer hours of employees, rather than by direct money donations. But because it is difficult to quantify contributions in money equivalents without uniform criteria for comparison, we chose to consider only contributions paid as money.⁷⁸

⁷⁶ Amendment (2001) to the Securities Regulations (Periodic and Immediate Papers) 1970.

⁷⁷ Securities Regulations (Periodic and Immediate Papers), 1970, section 10(b)(6).

⁷⁸ For some of the corporations that posted a loss for 2008 but chose nevertheless to transfer money for contributions, calculating the percentage that contributions represented of the amount of the loss for the year led to a negative numeric value that did not make sense. Therefore, for these corporations, we calculated the average

Regarding transparency, note that Israeli corporations are *not* required by law to publish where in the world each of their subsidiaries is taxed or the tax rate that applies to each subsidiary. Several Israeli corporations, however, chose to do so on their own initiative and published this data in their annual reports. When examining the extent to which aggressive tax planning is used, the importance of transparency in this matter applies only to corporations whose subsidiaries are not considered to be Israeli residents but are taxed in different jurisdictions worldwide, some of which may also serve as offshore tax havens.

In 2008, a pamphlet was published by the British Trade Union Congress (TUC), calculating the tax lost to the UK government from tax avoidance and tax planning. The study, conducted by a chartered accountant and economist, Richard Murphy (Director of Tax Research LLP), focused on the tax rates paid during the six years between 2000 and 2006 by the fifty largest corporations traded on the London stock exchange (FTSE 100 index).⁷⁹ Murphy identified a general tendency according to which the amount of deferred taxes that corporations listed in their annual reports increased significantly each year, reaching hundreds of millions of pounds.⁸⁰ Murphy concluded that the actual tax rate paid by the corporations that he surveyed was on average 5% lower than the effective tax rate stated by them, and which also included deferred taxes.⁸¹

amount of contributions based on the tax years 2006, 2007, and 2009 only. Similarly, for corporations that published the amounts of contributions only for some of the relevant years, we calculated the average based on the incomplete information at our disposal.

⁷⁹ Richard Murphy for Trades Union Congress, *The Missing Billions: the UK Tax Gap* (London, 2008); <http://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf>; accessed 15.11.12.

⁸⁰ *Ibid*, p.50. Murphy points to an extreme example of one of the corporations surveyed by him: Between 2000 and 2006, the average amount of deferred taxes of each of the companies included in this specific corporation increased by hundreds of millions of pounds. The aggregate amount was so high that in 2006 the total amount of deferred tax of the corporation amounted to GBP 47.7 billion, an amount greater than the total corporate tax paid by all UK corporations together in the same year.

⁸¹ *Ibid*, pp.23-29. Applying Murphy's estimate to our research means that the potential tax loss caused to the state is higher by an additional NIS 2.15 billion per year on average (although we must consider the fact that Murphy's conclusions

3.2. Data Analysis

3.2.1. We obtained the following results about the average tax rate paid by corporations in the tax years 2006-2009:

- (a) As a result of the tax gap, for each year between 2006 and 2009, the potential amount of tax loss caused to the state by the corporations we surveyed amounts on average to a total of about NIS 3.06 billion.
- (b) 17 of 25 of the corporations paid on average less than the statutory tax rate. Of these, one corporation paid an average of less than zero percent tax.⁸²
- (c) 6 of the corporations surveyed paid on average more than the statutory tax rate. The proportional part they paid in relation to the statutory tax rate ranged from 100.03% to 111.61%.⁸³

3.2.2. Regarding the disclosure of the residence of the subsidiaries and the tax rates applicable to them, we obtained the following results from the 25 corporations surveyed:

- (a) 4 corporations have no foreign subsidiaries.
- (b) 6 corporations disclosed no information about the place of residence of their subsidiaries.
- (c) 4 corporations disclosed in detail the place of residence and the tax rates applicable to each of their subsidiaries.

concerned corporation traded in England, whereas our present paper, as noted, deals with corporations traded in Israel).

⁸² The two limited partnerships on the list, Avner Oil and Gas Exploration and Delek Drilling, are not considered taxpayers according to the Income Tax Ordinance. The income and expenses, as well as the profits and losses of these partnerships are attributed entirely to the general partner (by share in the partnership) and the unit holders who are "entitled holders" based on the ratio of their partnership holdings. Therefore, we were unable to calculate the effective tax rate applicable to these partnerships. Moreover, both partnerships indicated explicitly that they had not yet adopted any contributions policy and therefore did not contribute money at all during the relevant years.

⁸³ A variety of reasons may lead a company to pay an effective tax rate which is higher than the statutory tax rate. Among these reasons are: limitations on "Loss Carrybacks" and on offsetting losses, limitations on changes in companies' holding structure and various restrictions on the deduction of financing expenses and limited possibilities on the submission of consolidated tax reports.

- (d) 11 corporations have mentioned only their *main* companies that are taxed outside Israel, or provided information only on some of the years surveyed, or noted in a clarification to the financial statements the list of companies that were part of the holding company, from which it is possible to glean the residence of most of its subsidiaries.
- (e) Some of the subsidiaries of 7 of the corporations are taxed in offshore tax havens such as the Cayman Islands, Bermuda, Switzerland, Jersey, and Guernsey.

3.2.3. Regarding payments for contributions we obtained the following results:

- (a) Total contributions paid by 15 of the 25 corporations (for which we have complete data on contributions) in the course of the four relevant years was NIS 164,294,623 on average for each of the years examined. Assuming that this figure represents the average amount of corporate contributions for the remaining ten corporations (despite the fact that the two limited partnerships stated that they did not contribute at all in these years), the total annual average contribution of all 25 corporations would amount to NIS 273,824,371.
- (b) The percentage of corporate profits (after tax) that contributions represent (including corporations for which we have partial information about donations) ranged from 0.06% to 4.08%. However, it is reasonable to assume that a significant proportion of contributions have been recognized under Article 46 of the Income Tax Ordinance as *deductible donations* that grant the company credits at the level of the corporate tax. *In these cases the contributions by the corporation represent a percentage of earnings after tax that is even lower than the one calculated by us.*⁸⁴

⁸⁴ It should also be taken into account that some of the subsidiaries of the corporations were also traded separately on the TA-25 index (e.g., Israel Corporation, ICL, and ORL). In these cases, it is plausible that the percentage of contributions made by these subsidiaries is low relative to other corporations; and by contrast, the percentage of contributions of their parent companies is high relative to other corporations.

- (c) For 8 of the corporations we were not able to locate in the financial statements the amounts donated during the relevant years, or we found data only for some of the years.⁸⁵
- (d) *The ratio between the loss of the state (caused by the tax gap left by the surveyed corporations) and the contributions made by these corporations is 11:1. i.e. the tax gap was 11 times higher than the financial contributions.*

The findings of the study are troubling: the effective tax rate of the leading Israeli corporations is significantly lower than the statutory corporate tax rate for the years 2006-2009, despite the fact that corporate tax rates in Israel have been reduced significantly in recent years (as explained below) and in 2011 were currently ranked at the bottom of the list of developed countries (with the exception of Ireland).⁸⁶ As a result of the tax gap created in these years, the treasury sustained a potential annual tax loss of at least NIS 3.06 billion on average. The tax gap far exceeds the benefit to the public from corporate donations.

3.3. Comparative Data

3.3.1. UK Study

3.3.1.1. A main inspiration for conducting the present study was the “Tax Gap” initiative of the *Guardian*, published in February 2009. Over two weeks, day after day, the *Guardian* examined the extent of tax avoidance by large businesses. As part of the initiative, the *Guardian* created an interactive database of tax data from the FTSE 100 UK

⁸⁵ As noted above, the two partnerships stated explicitly that they have not yet adopted a contribution policy.

⁸⁶ Knesset -Research and Information Center, Description and Analysis of the Consequences of the Tax Policy of the Government (12 December 2010), p. 12 (hereinafter: “Knesset- Tax policy report”), available (in Hebrew) at: <http://www.knesset.gov.il/mmm/data/pdf/m02714.pdf>; accessed 15.11.12.

Index Series,⁸⁷ the 100 largest companies in the UK. The database compared the tax paid as a percentage of pretax profits by each of the 100 companies (i.e., the effective tax rate) during the years 2004-2007 with the statutory corporate tax rate.⁸⁸ The *Guardian* also created a Tax Gap blog that enabled readers to suggest their own initiatives and to post relevant comments and discoveries.

3.3.1.2. Using the *Guardian* database, we calculated the tax gap of the largest 25 corporations listed in the FTSE 100 for the years 2004-2007. We found the relevant data on the financial contributions of the 25 corporations for the years 2004-2007 in their financial reports. In general, we referred only to contributions paid as money and ignored money equivalents (including volunteer hours of employees, sponsorships, etc), but five of the corporations provided only the total amount of contributions for both types.

Our calculations produced the following results:

- The potential amount of tax loss caused to the UK government by these corporations (excluding Shell and Vodafone as outliers) amounted to approximately GBP 4 billion per year.⁸⁹
- 20 of the corporations paid on average less than the statutory tax rate, and the remaining five paid the statutory tax rate or more.
- Excluding one company, all the companies reported the location of their subsidiaries. Nine companies reported having subsidiaries in offshore tax havens such as the Cayman Islands, Bermuda, Jersey, and Guernsey.

⁸⁷ The interactive database created by the Guardian can be found here: <http://www.guardian.co.uk/business/interactive/2009/feb/02/tax-database> ; accessed 15.11.12.

⁸⁸The UK statutory tax rate in the years 2004-2007 was 30%.

⁸⁹ At the time of collecting the comparative data, "Prudential" and "Glencore" were listed on the biggest 25 corporations. However, Glencore was not listed in the FTES 100 during 2004-2009 and for Prudential there was not enough data. Therefore, BT and Centrica were analyzed instead as they were next on the list.

- Corporate contributions (including by corporations for which we have only partial information about donations) represent 0.17% to 2.46% of corporate profits (after tax).
- The ratio between the financial contributions and the tax gap of these corporations was approximately 7:1, i.e., the tax gap was 7 times higher than the financial contributions.

3.3.2. US Study

In the present paper we do not provide calculations of the tax gap created by the 25 largest U.S. corporations, but some U.S. studies have reported noteworthy findings in this regard.

A study, published by Martin Sullivan in 2011 reveals that in recent years, despite the fact that the statutory corporate tax rate has remained constant at 35%, the effective tax rates paid by the most profitable U.S. companies have declined.⁹⁰ According to the Congressional Research Service of the U.S., the decline can be explained by various factors, mainly increased international activity and lower foreign tax rates.⁹¹

A 2012 study by the Congressional Budget Office reveals that in the fiscal year of 2011 the effective corporate federal tax rate fell to 12.1%, the lowest level since 1972. This figure seems radical, especially comparing with the 25.6% that companies paid on average between 1987 and 2008. Apparently, the main reason for the low rate was the "bonus depreciation" tax break that allowed companies to write off investments in the year in which they were bought rather than over time.

Another study, published in 2011 jointly by Citizens for Tax Justice and the Institute on Taxation and Economic Policy in the U.S., examined the effective

⁹⁰ Martin Sullivan, *Corporate Tax Reform: Taxing Profits in the 21st Century* (New York, NY: Apress, 2011).

⁹¹ Congressional Research Service, *The Corporate Income Tax System: Overview and Options for Reform* (September 2012), p.10.

tax rate paid during the years 2008-2010 by 280 of the largest corporations listed in Fortune 500: Annual ranking of America's largest corporations. The report reveals, among others, the following:

- Although the statutory company tax rate in the U.S. was 35%, the average effective tax rate for all 280 companies was only 18.5%.
- 30 companies paid less than 0% over the three years, resulting in an effective average tax rate of minus 6.7%.
- 25% of the 280 corporations paid on average over the three years an effective tax rate of 32.3%.

Research conducted in 2011 by the Committee Encouraging Corporate Philanthropy in the U.S. examined the donations paid in the year 2010 by 184 leading companies, including 63 of the top 100 companies on the Fortune 500 list.⁹² The study reveals that the median cash donation rate as a percentage of the pre-tax profit of these corporations was 0.66%.⁹³

4. Rethinking Tax Policy and CSR

In many countries, including Israel, corporate tax rates have been declining significantly in recent years. In Israel, the corporate tax rate was reduced from 61% in 1985 to 25% in 2010, and plans to further decrease it to 18% in 2016 were shelved only following public protest. Reasons for the decline in tax rates are, among others, the desire to attract investors into the country, the mobility of capital, and the assumption that low taxes encourage honest tax payment. In addition to the decline in tax rates, the government granted large tax benefits to encourage industrial development and capital investment, including benefits under the Law for Encouragement of Capital Investment, the Law for

⁹² Committee Encouraging Corporate Philanthropy, *Giving in Numbers: 2011 Edition* (2011). (hereinafter: "CECP"). In fact, 184 companies were surveyed, but for one of the companies, the study did not incorporate data.

⁹³ Note that as opposed to the American Study conducted above by CECP, the financial contributions of Israeli and UK companies were calculated as a percentage of *after* tax profits.

Encouragement of Industry, and the granting of “participation exemptions.”⁹⁴
All these contribute to the decline of the tax base of the country.⁹⁵

Despite the steady decline in corporate tax rates and despite increasing tax benefits, corporations *de facto* continue to seek creative ways to reduce their tax payments, and the extent of their use of aggressive tax planning continues to rise. The resulting tax loss leads to a dramatic deviation in the distribution of tax rates in society, an issue related to social justice and to the responsibility of both the corporations and the government for the standard of living of the general public.⁹⁶

Importantly, we are acutely aware of the significant profits that corporate investments yield to the state. These gains include, among others, development of infrastructure and technology, jobs, decrease in unemployment benefits and other transfer payments, collection of additional taxes on the salaries of employees, attracting investments by other companies as a result of existing investments, and the like. Nevertheless, in our opinion, given the rate of potential tax loss, and in light of the normative considerations presented above, new conclusions must be reached. First and most important for the purposes of this paper, we believe it is imperative to include abstaining from aggressive tax planning practices among the demands of CSR. Second, we strongly advise that the state reconsider the implications of the reduction in the overall tax base that follow from the granting of tax benefits and of reduced tax rates.

CSR is a dynamic field, and the demands it imposes on corporations are constantly evolving. Including tax policy among the demands of CSR could be

⁹⁴ The exemptions were added in 2006 as part of Amendment 147 to the *Income Tax Ordinance* and are incorporated in article 67 to the *Income Tax Ordinance*.

⁹⁵ Social and human capital, *supra* note 45, pp. 47-48.

⁹⁶ Tax Justice Network, *Mind the tax gap: How companies can beat poverty*, (2006) p. 12, (hereinafter: “Mind the tax gap”), available at: http://www.taxjustice.net/cms/upload/pdf/Mind_the_Tax_Gap_-_final_-_15_Jan_2006.pdf; accessed 11.11.12.

achieved by public pressure. One of the most significant factors in the increase of public awareness of "fair trade" has been the social pressure exerted on corporations by activists and NGOs worldwide. This pressure was manifest, among others, in demonstrations and propaganda campaigns, consumer boycotts, the sale of stocks and pressure on institutional investors to divest, public shaming, and lawsuits. In a similar way it may be possible to raise awareness of the importance of preventing the use of aggressive tax planning among corporations. The culture of tax avoidance by companies must be condemned, and it is imperative to explain how payment of full taxes is a significant act of social responsibility and even of patriotism.⁹⁷ Furthermore, public pressure must be exerted on corporations to increase transparency with regard to the amount of tax paid by their subsidiaries in the countries in which they are taxed on their profits. The greater the pressure the public exerts on this issue, the more corporations will seek to adopt a responsible tax policy as part of their social responsibility.⁹⁸

The present paper also draws attention to the need to take into account the *overall "tax gap" picture* when granting tax benefits and reducing tax rates, including aggressive tax planning practices. We especially advise to reconsider the argument in favor of the reduction of tax rates as a mechanism for attracting investment. Empirical findings support the conclusion that the reduction of corporate taxes encourages foreign investment only in the short and intermediate terms, and that in the long term prolonged and consistent tax rate reduction can have disastrous consequences.⁹⁹ For example, tax reductions in Ireland, which initiated a most aggressive international tax competition, indeed produced in the beginning great economic growth. Over time, however, the social gaps widened, violence intensified and became a significant social issue, and growth rates began to fall even before the eruption

⁹⁷ SustainAbility, *supra* note 69, p. 29.

⁹⁸ For Examples of public pressure put by various organizations and coalitions around the world in this regard, see in p.5 above.

⁹⁹ Social and human capital, *supra* note 45, pp. 47-48

of the global economic crisis. Tax scholars have concluded therefore that neglect of the social capital at the expense of encouraging financial capital did not increase the welfare of the residents of Ireland.¹⁰⁰ A similar conclusion was reached by Christensen and Kapoor,¹⁰¹ who showed that the main considerations underlying investor decisions about the location where a manufacturing or industrial enterprise is to be established are the presence in the country of physical and social infrastructure, an educated workforce, and political and economic stability. By contrast, the weight investors assign to incentives such as tax benefits and lower tax rates among their general considerations is not high.¹⁰² Note that strong infrastructures are primarily the result of high tax payments. Professor Reuven Avi-Yonah argued that it is reasonable to assume that states would prefer to stop lowering the tax rates and granting tax benefits if an international agreement existed stipulating that states should avoid taking part in tax competition.¹⁰³

Note further that a tax policy report submitted to the Finance Committee of the Israeli Parliament in December 2010, found that continued reductions in direct taxes could lead to increasing social gaps, which are already considered to be high relative to other developed countries. It was also noted that such reduction may shrink the "security cushion" of the Israeli economy, especially needed for financial coping in times of emergency such as prolonged war or another global crisis.¹⁰⁴ Similarly, the Bank of Israel noted in its annual report for 2010 that the continuation of the planned tax cuts could jeopardize the two

¹⁰⁰ *Ibid, ibid*. See also SustainAbility, *supra* note 69, p. 16.

¹⁰¹ J. Christensen and S. Kapoor, *Tax Avoidance, Tax Competition and Globalisation: Making Tax Justice a Focus for Global Activism*, paper given at Tax and Development Conference (2004), Helsinki, Finland.

¹⁰² The OECD, *Economic Survey of Israel 2009: Assessing the macroeconomic policy framework* (2010, Paris).

¹⁰³ R. Avi-Yonah *Globalization, Tax Competition and the Fiscal Crisis of the Welfare State*, *Harvard Law Review* (2000) vol. 113:1573. Prof. Edrey adds that the international tax competition is indeed "a race to the bottom that places in jeopardy the accomplishments of the welfare state and is liable to lead to its end," in *Social and human capital*, *supra* note 45, pp. 47-48.

¹⁰⁴ Knesset- Tax policy report, *supra* note 86, p. 13.

most important macro-economic objectives of Israel: reducing the budget deficit and reducing the national debt.¹⁰⁵ The Bank of Israel noted further that:

“Of all the tax rate reductions, the reduction of the corporate statutory tax rate was the sharpest and most prominent... At the beginning of the decade the statutory tax rate in Israel was higher than the average for OECD countries. As a result of the sharp reduction, tax rates in 2010 were similar, and it is expected that in 2016 tax rates in Israel will be lower than the average in OECD countries.¹⁰⁶ It is important to note that in OECD countries the reduction in tax rates was carried out together with an expansion of the tax base, with more rigid restrictions on authorized tax deductions, and therefore during this period... the gap between the statutory tax rate and the effective tax rate was reduced, and the latter was also calculated into the tax base. By contrast, in Israel... no significant change was made to the tax base during this period.”¹⁰⁷

Prof. Joseph Edrey, a leading tax scholar, recently expressed his opinion about this reduction, voicing a "serious concern for the economic and social strength of the country as a result of joining the ' tax competition' that many countries are engaged in, mostly developing countries. This competition courts the financial capital and neglects the human and social capital in Israel. Thus our policy makers ignore the many dangers, economic and especially social, associated with this competition, and demonstrate a lack of confidence in the economic might and strength of the country and in the ability of the social capital and human capital to attract the financial capital.”¹⁰⁸

¹⁰⁵ The Central Bank of Israel, Report for 2010 (April 2011), pp. 193-214 (in Hebrew), (hereinafter: "The Central Bank 2010"); See also M. Arlozorov, *This is how Israel holds two contradictory records in the area of taxes*, The Marker (6.4.2011), available (in Hebrew) at <http://www.themarker.com/news/1.619540>; accessed 15.11.12.

¹⁰⁶ As mentioned in p.37 of this paper, following public protest in summer of 2011, the government decided to stop the gradual reduction of corporate tax rate to 18% as initially planned, and even to increase it to 25%.

¹⁰⁷ The Central Bank 2010, supra note 105, pp. 206-207.

¹⁰⁸ Social and human capital, supra note 45, p. 87.

Indeed, the overall tax policy of the state, which includes corporate tax rates, tax benefits to corporations, and a lenient attitude towards aggressive tax planning practices, leads to a significant potential tax loss caused to the state. This tax loss is reflected in a decline in services and in various resources that the state finances for its citizens. It leads to a dramatic deviation in the distribution of tax rates in society, and it must be regarded not as a purely economic-professional matter but as an important aspect of social justice policy and of the responsibility of the government for its citizens' standard of living.¹⁰⁹ Moreover, it is important to note that the resulting reduction in the tax base leads to further strengthening of the corporations at the expense of a reduction of the public sector, and is one of the main reasons for the formation of the problem referred to as the "short blanket" syndrome in the allocation of the budget, as well as for the ongoing "drying out" of public services. In addition to a shift in the state's attitude towards corporate tax payments, all this mandates that we adopt a more robust conception of corporate social responsibility, to include corporate tax policy within its domain.

Conclusion

The purpose of this paper was to examine the theoretical and the practical implications of aggressive tax planning for CSR. We began by discussing the right to plan one's taxes under Israeli law and the restrictions imposed on this right. We then demonstrated the ***theoretical grounds*** for limiting aggressive tax planning practices, mainly on the basis of the idea of the social contract. More specifically, we explained that aggressive tax planning impairs the ability of society to function properly, is detrimental to social equality and to the implementation of social or economic policy by means of the tax system, and imposes an added economic burden on those who do not or cannot undertake such planning. For these reasons, we argued that aggressive tax planning should be considered unethical and illegitimate, even if it is strictly speaking in

¹⁰⁹ Mind the Tax Gap, supra note 96, p. 12.

compliance with the letter of the law. Furthermore, we argued that refraining from aggressive tax planning should be part of CSR. After reviewing possible critiques of our approach and responding to them, we offered ***practical reasons*** for considering tax policy a matter of CSR. Our argument here relied on our own small-scale study, inspired by other studies conducted in the UK, according to which aggressive tax planning practices potentially cost the state treasury much more than it gains from philanthropic corporate gestures that characterize first generation CSR.

The second part of the paper examined the effective tax rate paid by corporations listed on the TA-25 index during the years 2006-2009. Our aim was to learn about the tax policies of leading Israeli corporations and about their practices reflecting social responsibility. The findings show that the tax gap between the effective tax rate and the statutory tax rate paid by the surveyed corporations in the years 2006-2009 results in a potential tax loss to the state of NIS 3.06 billion on average each year. It is important to note again that although the scale of the study is not large enough to warrant far-reaching conclusions, it is nevertheless sufficient to point to a general trend according to which the actual tax rates paid by most of the leading corporations in Israel are significantly lower than the statutory corporate tax rate. The study further showed that this potential loss far exceeds the sum of donations made by these corporations to Israeli society.

The study presented in this paper was made public in Israel in 2011 under the title: "The Israeli Missing Billions." Upon its release, the findings were reported on the front page of leading financial daily in Israel, *The Marker*. The news report also included commentary by two corporations that did not agree with our findings.¹¹⁰ The conference at which the report was first presented was attended, among others, by Finance Minister Yuval Steinitz, prominent academics, the President of the Institute of Certified Public Accountants in Israel, the Chair of the Ethics Committee of the Israeli Bar Association, and the

¹¹⁰ See <http://www.themarker.com/markets/1.641294>; accessed 15.11.12 (in Hebrew).

Deputy Director of the Tax Authority. The findings of the report were mentioned and discussed in the media and debated in the Knesset (the Israeli parliament).¹¹¹ They were also presented to the Trachtenberg Committee, established by the Government following the Israeli "occupy" protests of the summer of 2011.¹¹²

Publication of the report triggered a thorough debate on the tax payment policy of large corporations. MK Galon, for example, revealed that whereas nine tenths of Israeli companies paid a 25% corporate tax rate, as required by law, companies in the upper one tenth tier paid on average only 19.2%; companies in the upper 1% tier paid on average an even lower rate of 17.5%; and companies that received tax breaks on the basis of the Law for Encouragement of Capital Investment paid on average a corporate tax rate of 3.3%.¹¹³

The media debate surrounding the findings of the report was one expression of the influence of the "court of public opinion" over the CSR discourse.¹¹⁴ In the course of the debate over corporate tax planning, the overall spirit of the

¹¹¹ See <http://www.haaretz.co.il/hasite/spages/1228022.html?more=1>; accessed 15.11.12 (in Hebrew); <http://www.globes.co.il/news/article.aspx?QUID=1056,U1307683741695&did=1000652696>; accessed 15.11.12 (in Hebrew); <http://www.themarket.com/markets/1.655013>; accessed 15.11.12 (in Hebrew).

¹¹² The report has continued to feature in media coverage in the following months as well and was covered also by global civil society media. See <http://taxjustice.blogspot.com/2011/06/israels-missing-billions-new-study-of.html>; accessed 15.11.12; <http://www.business-humanrights.org/Links/Repository/1006246/jump>; accessed 15.11.12.

¹¹³ See <http://www.themarket.com/markets/1.1786337>; accessed 15.11.12 (in Hebrew). Interestingly, 72% of the NIS 5.6 Billion tax breaks given by the Law for Encouragement of Capital Investment, were distributed to only 5 large multinationals (Intel, Teva, Amdocs, CheckPoint, Iscar). Furthermore, these tax breaks were 2.2 times higher than the tax payments paid by these corporations (including the income tax paid by their employees). See <http://www.themarket.com/markets/1.1719110>; accessed 15.11.12 (in Hebrew).

¹¹⁴ Doreen McBarnet, *Corporate Social Responsibility Beyond Law, Through Law, For Law*, in *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Doreen McBarnet, Aurora Voiculescu & Tom Campbell (eds.), 2007) 9.

coverage was extremely critical of the perceived disregard by corporations for the spirit of the law, and corporate conduct was deemed socially irresponsible.

All these have resulted in slow but important changes in government tax policy with its endorsement of the tax recommendations in the Trachtenberg committee report. First, the government decided to cancel the planned reduction of corporate tax to 18% by 2016, and even raised it by 1% to 25%. Second, the government established two special committees: one for handling aggressive tax planning of shell companies and another for handling "black" money. Last but not least, the government decided to add 750 new employees (an addition of 14.3% to current positions) to the tax authorities in order to exercise closer supervision and enforcement, especially of aggressive tax planning.¹¹⁵

While the Israeli public opinion has undoubtedly become more alerted by tax justice issues in the last two years, there is still a long way to go. Thus, for example, in November 2012 the Israeli parliament approved an amendment to the Israeli Law for Encouragement of Capital Investment which grants significant tax breaks to Israeli multinational corporations, following a lenient legislative and enforcement policy.¹¹⁶ We nonetheless believe that tax justice

¹¹⁵ See the interview with Doron Arbeli, head of the Israeli Tax Authority, available (in Hebrew) at: <http://www.themarket.com/law/1.1826017>; accessed 26.12.12.

¹¹⁶ The legal arrangement in effect before the new amendment, allowed corporations, subject to certain conditions, to have their profits taxed only after they had been distributed as dividends. To avoid the tax payments, most companies refrained from distributing their profits and as a result billions of NIS were accumulated by the companies without the state being able to collect tax payments. When a treasury deficit became imminent, the government started renegotiating with the corporations on the terms of taxation of these so-called "restricted profits." As a result, in November 2012, amendment 69 to the Encouragement of Capital Investments Law was approved by the Israeli Parliament. The amendment allows these corporations to pay corporate taxes at rates of 40% to 70% lower than what they would have paid otherwise if the money is paid by the end of 2013 and subject to the obligation of the companies to invest at least half the amount of the dividend in Israel. Eventually, the demand that the money be invested in Israel was abandoned. The total value of the restricted profits is estimated by the treasury to be NIS 120 billion and the waved tax revenues are estimated to be close to NIS 30 billion. For the full version of amendment number 69 to the Encouragement of Capital Investments Law, see:

issues will remain on the Israeli public agenda in the future. Indeed, and like many other countries that face recession and budget cuts, the money Israel loses every year as a result of tax evasion and tax avoidance, will inevitably force it to search for ways for closing the floodgates, and the sooner- the better.

<http://www.justice.gov.il/NR/rdonlyres/87E79A0A-2224-4944-B26F-191E7D7E5F62/38579/2385.pdf>
; accessed 26.12.12 (in Hebrew); For relevant media coverage on the “restricted profits” see www.haaretz.com/business/steinitz-expects-nis-8-9b-from-trapped-profits-law.premium-1.475465; accessed 11.11.12;
www.jpost.com/Business/BusinessNews/Article.aspx?id=290946; accessed 11.11.12.