

Topical Essay Nr. 3 of the Research Project on „Tax Justice & Poverty”

Corporate Social Responsibility & Corporate Tax Strategies: Contradiction or Complementarity?

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1 Luxembourg Leaks

Leaked documents discovered by the International Consortium of Investigative Journalists give an insight into the working of a tax haven, specializing on corporate issues¹: The documents show that 340 international companies have secured secret tax deals from Luxembourg that allow them to lower their global tax bills without or with only little presence in the country itself. That means, the corporations are moving their headquarters from higher-tax countries to Luxembourg, although this headquarter may often just be a so-called letterbox company. Thus they can move their profits to Luxembourg, where the corporation receives a favourable tax treatment through tax rulings – also called ‘comfort letters’ – of which 548 were issued by Luxembourg’s authorities between 2002 and 2010, negotiated by consultant firms, like PricewaterhouseCoopers (PwC), Ernst & Young, Deloitte or KPMG. As a result, the companies, including well-known transnational corporations like Pepsi, IKEA, Amazon and Deutsche Bank, just to name a few, channel hundreds of billions of dollars through Luxembourg and save billions of taxes. The financial strategies created by the accountants are highly complicated structures – containing up to 79 steps in the case of the American ‘Abbott Laboratories’ – and often use Luxembourg in combination with other tax havens. ‘Abbott Laboratories’ included, for example, companies in Cyprus and Gibraltar. These steps have in common that their only reason is the reduction or elimination of taxable income. They involve loans among sister companies, charging for the use of intellectual property and services that are nearly impossible to verify, or funds, thus exploiting the mismatches in international tax laws.

A problem connected with such business tactics is that they are backed by politics. Thus Luxembourg’s then prime minister Juncker signed a law that allowed companies to write off 80 percent of royalty income but promised to “fight tax evasion and tax dumping” when President of the European Commission in Brussels. He stressed both the necessity to “try to put some morality, some ethics into the European tax landscape” and his belief that the country’s tax regime was in accordance with European law. It is true that tax rulings are legal in Luxembourg, but the European Commission is currently investigating whether they violate European law and constitute illegal state aid.

2 Legal – illegal – illicit

Companies which engage in tax planning strategies argue that their actions are legal and do not contradict the law. How unethical this behaviour may be remains to be discussed, but

¹ <http://www.icij.org/project/luxembourg-leaks>

strictly speaking, they are correct, because one must distinguish between tax evasion, which means illegally reducing tax payments and thus is a criminal offence, and tax avoidance, which stands for legally reducing tax payments. (Fisher, 2014, p. 339ff) (Murphy, 2007, p. 5) To understand these practices and our position towards them we need, above all, to give some thought to the distinctions between what is legal, illegal and illicit: „It is judged illicit, if it perhaps not offends against the letter, but the spirit of the law. In this case it is called ‘aggressive tax avoidance’ or ‘aggressive tax planning’” (Alt & et.al., 2015, p. 15).

Most corporate tax planning strategies could be classified as tax avoidance. They are not illegal but exploit the uncertainty, the “grey area in the Tax Code” and “navigate around the intended purpose of the Tax Code”. (Fisher, 2014, p. 341) Thereby they achieve the “payment of less tax than might be required by a reasonable interpretation of the country’s law” (Palan, Murphy, & Chavagneux, 2010, p. 10).

It is not easy to define what still lies within the law and what does not. The British legal system specifies:

A tax avoidance scheme includes one or more interlinked steps which have no commercial purpose except for the avoidance of tax otherwise payable, and can conveniently be described as artificial steps. A tax avoidance scheme does not leave the taxpayer any better or worse off but leaves the Revenue worse off.” (Lord Sydney Baron Templeton cited in (Alt & et.al., 2015, p. 13))

It thus refers to a financial transaction that cannot be linked to real economy but only serves the owner. Corresponding to this definition Christensen, Coleman and Kapoor state that transactions can be classified as tax avoidance if the main purpose is the reduction of tax and no economic reason (Christensen, Coleman, & Kapoor, 2004, p. 11). The European Commission defines these tax avoidance strategies, which it calls aggressive tax planning, as follows:

“Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability.” (European Commission, 2012a, p. 2)

It further explains:

“A key characteristic of the practices in question is that they reduce tax liability through strictly legal arrangements which however contradict the intent of the law.” (European Commission, 2012a, p. 2)

3 Corporate Tax Strategies

The OECD treats tax-planning strategies in its publication on ‘Base Erosion and Profit Shifting’ (BEPS). It shows that corporations exploit gaps and mismatches in tax rules in the

architecture of the international tax system or artificially shift profits to places where there is little or no economic activity or taxation, which leads to little or no overall corporate tax paid.

These arrangements are legally possible, because of an increased mobility of capital and persons, which is not yet covered by the tax laws.

A fact, which the OECD recognizes, when it says that international tax rules have failed to keep up with globalization and technological change, like the digital economy that allows companies to move themselves or their income to low-tax jurisdictions. While international tax treaties exist to avoid double taxation of multinational companies, aggressive tax planning strategies exploit them to achieve double non-taxation (for example through the use of conduit companies in third countries) (OECD, 2013b, p. 1f).

The OECD further explains the instruments used by corporate tax planning strategies in their Action Plan on BEPS:

Typical methods of tax avoidance are ‘hybrid mismatch arrangements’ which use the mismatch of the tax laws of different countries to claim multiple deductions for the same economic expense and thus cause taxable income to disappear; the creation of offshore entities to escape taxation by routing income through them; financial payments – like interest deductions – which use debt to produce tax-exempt income; or the artificial avoidance of a permanent establishment status, thus making use of the fact that some countries do not tax business profits of companies which are not permanently established in the country (ibid.).

Another important instrument of aggressive tax planning addressed by the OECD is called ‘transfer pricing’ and is defined by the OECD as “a price adopted for book-keeping purposes, which is used to value transactions between affiliated enterprises integrated under the same management at artificially high or low levels in order to effect an unspecified income payment or capital transfer between those enterprises” (OECD website, 2015b). This system is especially used for intangible goods – like intellectual property, services or risk allocation, because it is difficult to compare prices in this area – and involves transactions that would not occur between third parties (OECD, 2013b, p. 2)

Researchers, too, state the growth of a corporate tax shelter industry, including tax havens and offshore finance centres, holdings, trusts, foundations, letterbox and shell companies etc.

Markus Henn’s analysis ‘Tax Havens and the Taxation of Transnational Corporations’ gives an overview of tax planning techniques used by transnational corporations to avoid taxes: preferential tax regimes, profit shifting through transfer pricing between parent companies and affiliates in low tax countries, mismatches and derivatives (Henn, 2013, p. 2ff).

The consequences for the states, in which these taxes are avoided, are not to be neglected. At worst the state could be left without adequate resources to fulfil its functions, which has not only an effect on the government but on the whole society, because the state faces losses in tax revenue that could otherwise be spent on public services, education, health care or infrastructure – a tax gap, that is even more critical in times of national debt crisis. Consequently, the tax burden is shifted onto workers and consumers. This leads to an unfair distribution, leaving those who cannot afford to move their money to an offshore tax haven or employ a tax lawyer to pay for those who can. The problem is even more pronounced in developing countries, which, according to the OECD, rely heavily on corporate income tax from multinational enterprises and face the problem of capital flight. The assumed benefit for tax haven countries does generally not affect the indigenous population, who rather suffers from rising prices. The people who work for and benefit from the offshore financial market come from abroad and long-term investments in a tax haven country are unlikely (Fisher, 2014, p. 359) (Palan, Murphy, & Chavagneux, 2010, p. 13).

All this, in my view, contradicts CSR obligations, as will be examined more closely in the next chapter. I follow those who hold “the opinion that tax avoidance is only acceptably legal if it is demonstrably in accordance with both, the letter of the law and the intention of the lawgiver.” (Alt & et.al., 2015, p. 14)

4 Corporate Social Responsibility Concepts

In order to understand the implications of aggressive tax planning strategies, it is important to have first a closer look at the concepts of Corporate Social Responsibility (hereafter CSR) and Corporate Citizenship (CC), taking into account the different views on the nature of corporations, which then leads to the question of how to regard social activities of corporations in general. As will become clear later, these discussions are also reflected in the question whether or not companies should engage in aggressive tax planning strategies.

First some more well-known and well-established understandings of CSR:

The European Commission defines CSR in the as “the responsibility of enterprises for their impacts on society” (European Commission , 2011, p. 6). It further encourages enterprises to “have in place a process to integrate social, environmental, ethical human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders” (European Commission , 2011, p. 6).

The EU Green Paper ‘Promoting a European Framework for Corporate Social Responsibility’ (2001) is a relevant statement of the European Union on their commitment to CSR:

“The European Union is concerned with corporate social responsibility as it can be a positive contribution to the strategic goal decided in Lisbon: ‘to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’.” (European Commission, 2001, p. 3)

The paper defines “being socially responsible” as “not only fulfilling legal expectations, but also going beyond compliance and investing ‘more’ into human capital, the environment and the relations with stakeholders.” (European Commission, 2001, p. 6). It emphasizes the voluntary identification with values beyond legal obligations and the responsibility to cooperate with stakeholders to avoid a negative impact on society.

The OECD, too, claims: “We commit ourselves to promote actively internationally agreed corporate social responsibility” (OECD, 2009). Corresponding measures are the ‘OECD Guidelines for Multinational Enterprises’ which, according to the foreword of the 2011 edition of the document, want to “provide non-binding principles and standards for responsible business conduct in a global context consistent with applicable laws and internationally recognized standards” (OECD, 2011, p. 3) as well as the ‘OECD Principles of Corporate Governance’.

On its website, the OECD explains that ‘Corporate Responsibility’ refers to the actions taken by businesses to “nurture and enhance the symbiotic relationship” between businesses and society, which is seen as important because “a business sector cannot prosper if the society in which it operates is failing and a failing business sector inevitably detracts from general well-being” (OECD website, 2015a).

Consequently, it is obvious that CSR is about the relationship between business and larger society and, more precisely, the role and obligations of private business within that society, the inclusion of social and environmental concerns into business decisions and operations, and a voluntary structural and behavioural change that leads to an increased interaction with stakeholders (van Marrevijk, 2003, p. 102ff.).

The crucial problem here, however, is, that there is a strong voluntary element in it. Whatever a business decides to do is up to them to decide, there is no measure or pressure of obligation, narrowing down the degree of own discretion.

How much a business (or its owner) is willing to go on the road of voluntary CSR depends on the worldview underlying any interpretation of CSR:

Avi-Yonah contrasts different opinions towards CSR based on the different understandings of the role of corporations in society. I will further on have a look at what he calls the *aggregate view* and the *real entity view*. Besides Avi-Yonah, similar observations are stated by Ray Broomhill, who describes the existence of different schools of thought regarding CSR. His depiction of the *neoliberal perspective* concurs with Avi-Yonah's *aggregate view*. On the other hand, what he calls a *neo-Keynesian perspective* is similar to the *real entity view* (Broomhill, 2007, p. 6ff).

The *aggregate view* or *neoliberal perspective* sees the corporation as property of the shareholders. Consequently, its only responsibility is towards its shareholders, while the responsibility for social activities lies with the state. Advocates of this view generally refer to Milton Friedman who claims that: "there is only one social responsibility of business – to use its resources and engage in activities designed to increase its profits" (Friedman, 1970). Therefore social activities are regarded as illegitimate as they interfere with the company's primary purpose (Avi-Yonah, 2008, p. 184f). At best, these activities can – according to the neoliberal discourse – be legitimate only if they have a positive aspect on profit maximization in the long run. Thus they can be seen as part of the corporate strategy to avoid a negative reputation (Avi-Yonah, 2008, p. 187).

The *real entity view* or *neo-Keynesian perspective* on the other hand regards the corporation as an individual legal entity, like the citizen of a country. This interpretation is also reflected in the notion connected with the term 'corporate citizenship', which is based on the legal concept of a corporation as a 'legal person'. Consequently, like with any normal citizen, it is praiseworthy if a company engages in social activities. Although it is not legally required to promote CSR activities, companies should be encouraged to do so (Avi-Yonah, 2008, p. 184).

Supporters of the latter interpretation accordingly share the view of 'Corporate Social Responsibility' and believe that businesses not only have a responsibility towards their shareholders but have "recognized the importance of companies accommodating stakeholder interests" (Du Plessis, Hargovan, & Bagaric, 2011²), like those of society as a whole or of the government of the country they operate in.

"The main argument advanced [...] by advocates of corporate social responsibility is that the company does not exist solely to maximize profits for the shareholders,

but also to serve the society on which it depends for its existence” (Mujih, 2012, p. 202).

The definition given by the European Union quoted above shows this belief, taking a real entity perspective on corporations and their social commitment.

5 Corporate Citizenship Concepts

Keeping this in mind we have to ask what difference there is between CSR and the concept of ‘corporate citizenship’ (CC) mentioned above (cf. Rieth, p. 67). The origins of the term lie in the USA in the 1950s as Carroll points out. He also explains that “corporate citizenship addresses the relationship between companies and all their important stakeholders [including the community in which the business is located], not just employees” and further on confirms that “just as private citizens are expected to fulfill these responsibilities [to contribute to the whole] companies are as well.” (Carroll, 1998, p. 1)

The EU also defines the concept of Corporate Citizenship in its Green Paper ‘Promoting a European framework for Corporate Social Responsibility’ as “the management of the totality of relationships between a company and its host communities, locally, nationally and globally” (European Commission, 2001, p. 24).

In Germany, the concept of Corporate Citizenship was defined by the Commission of Enquiry concerning the future of Corporate Citizenship of the German parliament, who sees CC as an aspect of CSR². The two terms are also often treated as synonymous in literature. ‘Corporate Citizenship’, as mentioned before, stresses the concept of a corporation as a legal person, a citizen of a community. The enquiry commission emphasizes the public spirit that makes a corporation take over the role of an active citizen. (Habisch, 2003, p. 52ff). Consequently, the term CC is frequently used in a more limited sense than CSR, to show the commitment of the corporation to solve social problems in its local environment (Rieth, 2009, p. 67). However, as the definition of the EU Green Paper shows, the environment in which a company is located can also mean a global community with a multinational corporation.

While some regard CC as being predominantly about philanthropy, Habisch and Rieth both dispute this notion. They state that CC activities can be seen as philanthropic actions as they underline the unselfish character of activities that have no evident economic motives. However, Habisch emphasizes the win-win situation for corporation and society that results

² cf. Enquete-Kommission Zukunft des bürgerschaftlichen Engagements (2002)

from investment in social capital and can lead to a better economic competitiveness and productivity of the region (Habisch, 2003, p. 53ff) (Rieth, 2009, p. 66f).

What is more, Rieth explains that the purpose of CSR exceeds philanthropic actions. The corporation should integrate the CSR activities into its core business. That means, on the one hand it can apply its competence for CSR projects and let the community profit from it, on the other hand it has to incorporate socially responsible behaviour into its own day-to-day business activities (Rieth, 2009, p. 65f) like tax strategies.

Thus, companies invest in the community they operate in and take a share of political responsibility.

However, the problem with these qualifications remains the same as we stated already with the concepts of CSR: In the end, it is up to the business concerned whether it is willing to accept the tradeoff between a certain (short term) profit arising from tax avoidance or Habisch and Rieth's view that a moral and generous behavior will indeed result in a win-win situation, leading to more business turnover and higher profit.

It is to be hoped that clarifying implications arising from the debate of CSR and CC and implications resulting from the importance of underlying worldviews and interpretative frameworks may contribute to a better understood CSR and CC concept leading to a real appreciation of the relationship between CSR and tax obligations.

To put it differently: Right now and at first sight nobody will question that legal persons (businesses) and natural persons ('ordinary citizens') have taxpayers' obligations towards the state in which they produce and/or have habitual/main residence. Nevertheless, up to recently it was far more acceptable for businesses to be engaged in (aggressive) tax avoidance because of the businesses' alleged obligations towards shareholders, investments, the requirement to keep equity because of liquidity, because of jobs... The recent discussion regarding underlying assumptions increases the awareness that paying taxes, also for businesses, is more than a mere obligation which in the end benefits all, e.g. because of a well-educated work force, modern infrastructure, social stability etc. This growing awareness of the link between CSR, CC and the wider "utility" of the payment of taxes should contribute to the gradual replacement of aggressive tax avoidance by tax compliance, not just orientated towards the minimal necessity, but following the letter and spirit of the law, serving the common good of all. This growing awareness will put increasing negative and positive pressure upon

businesses, thus moving them, their leaderships and owners to a more generous interpretation of tax compliance.

6 Discussion: Are Corporate Tax Strategies part of Corporate Social Responsibility?

Many scholars, mostly from a neoliberal background, dispute the claim that corporate tax strategies should be regarded under the label of corporate social responsibility, by arguing, like Pekka Timonen, that taxes are a legislative issue and are calculated by corporations as a “standard cost related to profits” (Timonen, 2008, p. 200). The OECD, however, states that “corporate citizenship in the area of taxation implies that enterprises should comply with both the letter and the spirit of the tax laws and with regulations in all countries in which they operate”. They should further “co-operate with authorities and make information that is relevant or required by law available to them” (OECD, 2011, p. 60). This proclamation shows that the OECD sees the company’s attitude towards taxation as a vital part of the CSR agenda. Other researchers, like Fisher, consider the moral aspect. While tax avoidance is not illegal, it can be seen as immoral, as illicit.

If CSR means to minimize any harmful effects and maximize the long-run beneficial impact of corporations on society (Fisher, 2014, p. 354), and if one takes into account that tax payments are important for the well-being of the public, for example, with regard to the fair distribution of the tax burden within the community or the government revenue that could be spent on social development and infrastructure, then one should see tax in context of CSR programmes.

A view also shared by the Tax Justice Network: “Paying taxes is perhaps the most fundamental way in which private and corporate citizens engage with broader society” (Christensen, Coleman, & Kapoor, 2004, p. 9). They conclude furthermore, that the

“CR agenda is driven by demand for an ethical approach to doing business. It is not possible to be ethical in one area of business conduct and to act otherwise in another area, and companies that function in this way reveal a disconnect in their core organizational values” (Christensen, Coleman, & Kapoor, 2004, p. 10).

Therefore, it is right to argue that tax avoidance is not good corporate citizenship (Christensen, Coleman, & Kapoor, 2004, p. 8ff).

Another issue to be taken into consideration is the fact that paying taxes is regarded as social responsibility by the public (Fisher, 2014, p. 348), so that tax related behaviour – as it is the case with CSR – may have an impact on reputation (Fisher, 2014, p. 353ff). Aggressive tax strategies and their exposure to the public through the media could harm the company’s

reputation. What has intensified this threat since the publication of Fisher's essay is the increased public sensibility to the topic as a result of the Luxembourg Leaks affair. Now a company will readily be labelled a poor Corporate Citizen, like it was the case with Starbucks (Fisher, 2014, p. 353ff). On the other hand, if a responsible corporate tax strategy is perceived as positive by consumers, it will be rewarded by long term financial gains and competitive advantages (Fisher, 2014, p. 353) (Mullerat, 2010, p. 29), thus creating a win-win situation for society and the corporation, which is, as stated by Habisch, an important aspect of Corporate Citizenship.

Consequently, responsible Corporate Tax Strategies can be successfully integrated into corporate communication activity, like the CSR report or an advertising campaign and be used to enhance trust among consumers.

Considering this, some, like radical political economists, are sceptical of voluntary CSR policies. They accuse companies of deflecting attention from socially and environmentally destructive activities by emphasizing their CSR activities in order to avoid social criticism and stricter laws by defining the extent of their commitment themselves (Rieth, 2009, p. 65).

7 Conclusion

As Avi-Yonah demonstrated, a lot depends on one's view of the nature of a corporation – like the attitude towards CSR as a whole. This concurs with the position of this research that tax related issues cannot be discussed separated from underlying worldviews and their implied conclusions.

While supporters of the aggregate, neoliberal opinion, like Timonen, will argue that taxes are to be seen as a standard cost, that is – according to the company's purpose of profit maximization – to be held as low as possible (Avi-Yonah, 2008, p. 193ff), followers of the real entity view may claim that corporations should behave like ordinary citizens, i.e. try to comply with tax laws to their best ability. They may be allowed to try and minimize taxes within the spirit of the law, but not to engage in deliberate strategic tax behaviour (Avi-Yonah, 2008, p. 191ff). Avi-Yonah supports the real entity view and consequently criticizes the aggregate view as illogical: If neoliberals say the state has all the responsibility for social activities, it has to raise taxes to fulfil this obligation. If the corporation now avoids paying taxes to maximize its profit, the state has no adequate revenue to fulfil its obligation (Avi-Yonah, 2008, p. 186 and 195).

A final note should be made regarding the position of the Tax Justice & Poverty research that it is time for states to stop tax competition among each other but to join into cooperation

which, in the end, is the best means to stop undermining each other's tax base and to combat aggressive tax avoidance and tax evasion.

8 Policy recommendation

Many positions exist concerning the problems illustrated above (see the chapter about Corporate Tax Strategies). In the following, some of the prominent opinions will be reviewed. On the political level, EU authorities are pushing corporate tax probes. The Commission Vice President Joaquín Almunia declares: "In the current context of tight public budgets, it is particularly important that large multinationals pay their fair share of taxes." (European Commission, 2014, p. 1)

Specific policy recommendations in order to achieve this goal vary, but what everyone agrees on is the need for global solutions as an answer to a global economy. They aim at the creation of a multilateral instrument (OECD, 2013b, p. 3) or a global tax forum (Tax Justice Network , 2003, p. 3) that would ensure an automatic exchange between all tax authorities and thus make it harder for corporations or individuals to exploit mismatches between the different tax systems. Another important aspect would be the taxation of transnational corporations on a unitary basis to avoid the shifting of profits to low-tax jurisdictions (Tax Justice Network , 2003, p. 4) and to ensure that the tax is declared in the territory where the economic benefit arose (Murphy, 2007, p. 3f). The European commission follows the same thoughts by demanding a common assessment basis for corporate taxes in the EU with regard to turnover, employees and capital, which would benefit all European countries. The OECD as well as many others support the idea of an annual country-by-country report on income, economic activity, tax obligations and tax payments by corporations (OECD, 2013b, p. 2). The Tax Justice Network wants them to give even more information, including interest, royalties and licence fees, as well as the number of employees (Murphy, 2007, p. 13f) to disclose shifting of profits to low tax countries.

These are certainly measures that would help the authorities to fight tax avoidance. On the other hand, it is also important to change not only the legislation, but also the attitude of people towards tax matters. Murphy even demands that tax evasion and supplying tax havens be counted as corruption (Murphy, 2007, p. 12).

Here, negatively, Fisher encourages the opportunity to put public pressure on companies from the media, consumers and possibly even investors in order to "shame" corporations into refraining from tax avoidance. According to her, this situation can be compared to a similar

approach that has motivated companies to engage in CSR activities before (Fisher, 2014, p. 360).

It appears unrealistic to demand that corporations do not exploit loopholes in tax laws. However, it could be possible to approach this problem by transparency. Companies should lay open their tax strategies for the public. There are examples, where corporations integrate the fact that they pay taxes in their CSR report. The American company Johnson&Johnson, for example, states in their 'Citizenship and Sustainability Report': "We are responsible to the communities in which we live and work and to the world community as well. We must be good citizens— support good works and charities and pay our fair share of taxes" (Johnson&Johnson, 2013, p. 117).

On a more positive note, also proposals exist to advance tax compliance: While tax avoidance is rarely discussed by academics in the context of CSR, according to Fisher it matches many of the characteristics that embody other socially responsible activities (Fisher, 2014, p. 365). It would help to change the attitude towards corporations regarding tax-planning strategies, e.g. to view tax avoidance as socially irresponsible activity and see anti-avoidance as a CSR "norm" (Fisher, 2014, p. 361). Fisher counts on self-regulating instead of external regulation. Murphy, too, asks for a "culture of citizenship" (Murphy, 2007, p. 4) that regards tax paying as a responsibility to the state and the society and does not see the corporation's duty towards shareholders only. Considering ethics in the relationship with all parties Murphy would help to encourage businesses to comply with the spirit of the law, and not only its letters (Murphy, 2007, p. 3), because for every new tax law corporations and tax lawyers would find a way to exploit loopholes.

Nevertheless, as important as this raised consciousness and self-regulation through voluntary tax compliance may be I think it is unrealistic to count on public pressure and a culture of citizenship only, but necessary to enforce external regulations on an international basis. Therefore, in my opinion, the creation of a multilateral tax instrument and a country-by-country reporting seem to be the most promising steps.

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