

Tax Governance

The Balance between Tax Regulatory Requirements and Societal Expectations

Rossing, J. Christian Plesner; Riise Johansen, Thomas; Pearson, Thomas C.

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J. Christian Plesner Rossing, Thomas Riise Johansen, Thomas C. Pearson

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**Tax governance: The balance between tax regulatory requirements
and societal expectations**

J. Christian Plesner Rossing*
The University of Tampa
Sykes College of Business
401 W. Kennedy Blvd.
Tampa, FL, 33606
USA
Email: jrossing@ut.edu

*Corresponding author

Thomas Riise Johansen
Copenhagen Business School
Department of Accounting and Auditing
Solbjerg Plads 3
2000-Frederiksberg
Denmark
Email: trj.acc@cbs.dk

Thomas C. Pearson
University of Hawaii at Manoa
Shidler College of Business
School of Accountancy
2404 Maile Way
BusAd C-306
Honolulu, HI 96822
USA
Email: tpearson@hawaii.edu

Biographical notes:

J. Christian Plesner Rossing, PhD is an Associate Professor at The University of Tampa, Sykes College of Business, Department of Accounting. His current research interests include international transfer pricing, tax risk management and tax governance in multinationals. His research has been published in *Management Accounting Research*, *Journal of Accounting & Organizational Change*, *Journal of Accounting Education*, and *International Transfer Pricing Journal*.

Thomas Riise Johansen, PhD is a Professor at Copenhagen Business School, Department of Accounting. His current research interests include regulatory oversight and enforcement in auditing and financial reporting, audit firm governance, and the impact of social and regulatory pressures on management and reporting systems. His research has been published in *Corporate Governance: An International Review*, *Journal of Business Ethics* and *European Accounting Review*.

Thomas C. Pearson, JD, LL.M. in tax, is a Professor at the University of Hawaii's Shidler College of Business, School of Accountancy. His research interests lie in international transfer pricing, securities law, tax audits and penalties, and compliance with professional standards. He has published articles in a variety of academic and professional journals, as well as a leading textbook on Accounting and Auditing research.

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Tax governance: The balance between tax regulatory requirements and societal expectations

ABSTRACT: In October 2012, Starbucks UK branch became the subject of massive public criticism over alleged tax avoidance. Despite Starbucks arguing that its transfer pricing practices were in full compliance with regulation, public pressure led Starbucks to overpay its UK taxes on international transfer pricing beyond the regulatory requirements. This behavior contradicts the current literature in which international transfer pricing is portrayed as a tool for aggressive tax management or an exercise of regulatory compliance. It is further argued that boards and top management of multinational enterprises (MNEs) can no longer approach tax governance as a purely technical, regulation-driven discipline to be addressed only by accounting staff and tax consultants. Instead, its pivotal role in the social contract between an MNE and its stakeholders needs to be recognized.

Keywords: tax governance; international transfer pricing; tax avoidance; multinational enterprises; Starbucks; business ethics; legitimacy processes; corporate social responsibility

INTRODUCTION

This paper examines how tax behaviors of multinational enterprises (MNEs) can be influenced by stakeholder views and the way an MNE's top management may struggle to balance formal legal frameworks of international transfer pricing with stakeholder expectations of local tax payments. In recent years, the tax practices of multinational enterprises (MNEs) have attracted increased attention (BBC, 2013; Bloomberg, 2016; Financial Times, 2015). In particular, commentators have suggested that MNEs exploit their structural advantage over domestic firms for tax avoidance purposes, e.g., through the use of international transfer pricing, to

reduce the tax burden at the group level and not pay their fair share of taxes. To the contrary, MNEs have claimed that they are simply conforming to formal tax laws and that their corporate income tax payments — or lack thereof — do not reflect aggressive tax schemes. Several MNEs have been publicly exposed or “tax shamed” for their tax practices and asked to explain the low level of corporate taxes that they have paid in certain tax jurisdictions.

One such confrontation occurred at a hearing in the British Parliament where representatives from well-known MNEs, including Starbucks, were questioned about their tax practices in the UK and criticized for alleged tax avoidance through transfer pricing to reduce their UK tax burden. In the case of Starbucks, the critique did not disappear with the Parliament hearing. It subsequently escalated into public demonstrations in front of Starbucks coffee shops in the UK and on social media platforms, which ultimately placed massive pressure on the Starbucks brand (Campbell and Helleloid, 2016).

Based on the data obtained from public hearings and official Starbucks documents, this paper seeks to enhance knowledge in the domain of tax governance and transfer pricing risk management in MNEs. We note that a variety of contributions within corporate governance and corporate social responsibility (CSR) have enhanced the understanding of how contextual factors impact organizational governance (e.g. Malhotra and McDonald, 2011) and the impact from specific governance structures on organizational performance (Luxmore et al., 2012). This includes research addressing important sub-fields of the broader corporate governance umbrella, e.g. IT governance (see for example Brand et al., 2011). However, tax aspects of corporate governance in MNEs (i.e. tax governance), including the way top managements react and adapt to dynamics around the multi-faceted and vibrant pool of MNE tax stakeholders, has received very limited attention in academic literature. Instead, the interaction between an MNE and its tax environment has been treated in a rather technical manner by accounting and tax scholars, with less emphasis on how MNE tax strategies are shaped over time. Specifically,

our study explores a gap in the academic literature regarding the potential impact of public opinion on MNE tax and transfer pricing strategies, and it challenges the conventional understanding of international transfer pricing as a tool for tax avoidance. We seek to answer the following research question:

How are MNE tax practices impacted by public opinion?

This paper shows how Starbucks UK navigated the uncertainty concerning corporate taxation, public perceptions of Starbucks' actions, and the way that international transfer pricing was used in an attempt to restore its commercial legitimacy after public critique of its tax practices.¹

In a theoretical sense, this study contributes to the understanding and explanation of legitimacy-seeking processes in MNE tax behavior, including the attempt to build social trust beyond standard laws and regulations in extreme situations. For this purpose, this study draws on legitimacy theory (Deephouse and Carter, 2005; Deephouse and Suchman, 2008; Suchman, 1995) and responds to calls for a broader understanding of tax governance in its social and institutional contexts (Avi-Yonah, 2008; Gracia and Oats, 2014; Knuutinen, 2014; Mulligan and Oats, 2016). Specifically, it illustrates how an MNE's tax behavior — in this case, Starbucks' international transfer pricing approach — is not strictly a matter of tax compliance or optimization within the boundaries of certain regulatory standards. Instead, it appears to be dependent on the public perception of tax *outcomes*, even when the MNE claims that its original transfer pricing approach is in full compliance with formal laws and regulation.

This 'beyond compliance' case (Gunningham et al., 2004) suggests that tax governance and specific tax affairs are not purely technical regulation-driven areas that concern only accounting and tax experts. MNE boards and top management teams must pursue a balance beyond the tax regulatory environment, including the development of appropriate response

¹ This paper neither condemns nor commends Starbucks' tax practices.

strategies towards public questioning of tax governance practices. Thus, the knowledge that constitutes compliant tax behavior is not only a neutral body of knowledge that is defined by legal regulations and tax professionals; it is also a social construction (Mulligan and Oats, 2016; Picciotto, 2007) that is shaped and challenged by external stakeholder pressures and needs to be analyzed in that context.

The paper responds to recent calls for studies into the increasingly important role of tax risk management and international transfer pricing in MNEs (Cools and Emmanuel, 2007; Cools et al., 2008; Cools and Slagmulder, 2009; Jost et al., 2014; Plesner Rossing and Rohde, 2014; Wunder, 2009). Different from most research on transfer pricing and corporate taxation, this study seeks to enhance the current understanding of the forces that may escalate legitimacy/reputational risks when coalitions of NGOs, politicians, consumers, and the media question MNE tax behavior. Theory development in MNE accounting and taxation, which has been historically driven by a technical analysis of MNE tax practices (Armstrong et al., 2012; Borkowski and Gaffney, 2012; Hope et al., 2013; Klassen et al., 2016; Lo and Wong, 2011; Richardson et al., 2013), must consider alternative contextual factors to explain MNE behavior. This includes creating awareness of the complex strategic dimensions in which top management teams should become involved and avoid the current tendency toward ‘tax decentralization’ where a pool of staff and consultants perform technical silo work detached from commercial operations and top management involvement.

This paper is structured as follows. The next section reviews the literature on corporate tax avoidance and international transfer pricing. This is followed by an outline of the theoretical frame of reference for this study. The research method is then described, followed by the case analysis. The final section provides an overview of the contributions from the analysis.

LITERATURE REVIEW

Corporate Tax Avoidance

The literature on corporate tax avoidance studies its measurement, magnitude, and specific determinants. Establishing a formal definition of tax avoidance is a fundamental issue because many perceptions of its meaning have emerged in the literature. Hanlon and Heitzman (2010) suggest defining tax avoidance as ‘the reduction of explicit taxes’ because this definition is sufficiently broad to capture direct tax avoidance activities and targeted tax benefits from lobbying activities.

The measurement of tax avoidance has been subject to intense debate. Much of the literature has used either tax information from financial statements or tax return data to estimate different forms of effective tax rates as proxies for tax aggressiveness. Examples of measures that have been used in the literature include GAAP effective tax rates (ETRs) (e.g. Armstrong et al., 2012), cash-based ETRs (Brown, 2011; Brown and Drake, 2013), unrecognized tax benefits (Blouin et al., 2010) and book-tax differences (Blaylock et al., 2012). Each of these measures have specific abilities to capture the various types of corporate tax avoidance; see Hanlon and Heitzman (2010) or Lisowsky et al. (2013) for a review of different proxies. Moreover, when criticized on one of these measures, MNEs often argue that corporate tax only measures a fraction — in some cases, a relatively low fraction — of the total tax contribution that they provide because it does not capture other taxes that are paid by the MNE, e.g., Value Added Tax (VAT), custom duties, and payroll taxes.²

Another stream of the literature attempts to identify the determinants of corporate tax avoidance, including specific firm characteristics that can predict this behavior. Rego (2003) found that the extent of international activities is associated with lower GAAP-based ETRs. This result fits well with recent political initiatives that argue that MNEs hold a structural

² For example, Vodafone argues that “...corporation tax is only one of 60 different types of taxation paid by Vodafone’s operating businesses every year” (Vodafone, 2015).

benefit compared with their domestic counterparts that provides for substantial tax avoidance schemes (e.g. OECD, 2013). However, the results are mixed in this research domain. For example, Markle and Shackelford (2012) found little difference between the ETRs of MNEs compared with domestic-only firms. In fact, Dyreng et al. (2015) found contradictory results that indicated that US-based MNEs in recent years have faced higher ETRs than their domestic counterparts.

In general, the vast majority of the tax avoidance research is based on quantitative analyses that predict the tax avoidance behavior that is linked to certain MNE structures, accounting practices, and the personal characteristics of key employees who are involved in tax decisions. The likely reason for this focus is a lack of data on MNE tax strategies beyond the data that are offered in mandatory financial accounting reports, tax returns, etc. Accordingly, there are limited in-depth insights regarding the social and political dynamics of MNE tax and transfer pricing practices.

International Transfer Pricing

The domestic-oriented management accounting literature emphasizes the role of transfer pricing in efficient resource allocation and the performance measurements in decentralized organizational structures (e.g. Colbert and Spicer, 1995; Eccles, 1985; Horngren et al., 2014; Perera et al., 2003; Spicer, 1988; Van der Meer-Kooistra, 1994; Van Helden et al., 2001; Watson and Baumler, 1975).

In the context of MNEs and cross-border transfer pricing, most of the accounting and tax literature suggests that transfer pricing is used as a profit shifting mechanism (e.g. Bartelsman and Beetsma, 2003; Clausing, 2001; Clausing, 2003; Conover and Nichols, 2000; Emmanuel and Oyelere, 2002; Grubert and Mutti, 1991; Harris, 1993; Hines and Rice, 1994; Jacob, 1996; Klassen et al., 1993; Langli and Saudagaran, 2004; Oyelere and Emmanuel, 1998; Swenson,

2001) and generally portrays a confrontational and hostile relationship between MNEs and tax authorities. This stream of research draws on various types of archival data to develop quantitative analyses that demonstrate the aggressive tax avoidance schemes at MNEs that use transfer pricing (see Sansing (2014) for a literature review).

Although the current public debate focuses heavily on the tax and transfer pricing structures that are applied by well-known MNE brands, there is mixed evidence in the research literature regarding whether income shifting is a ‘large-MNE’ phenomenon. For example, Conover and Nichols (2000) found that large MNEs are more likely to shift income through transfer pricing, whereas Langli and Saudagaran (2004) did not find support for a size determinant. Moreover, the research findings in this domain suggest that transfer pricing and income shifting are not confined to specific geographical locations but occur in both developing and developed economies (e.g. Bartelsman and Beetsma, 2003; Clausing, 2001; Clausing, 2003; Collins and Shackelford, 1997; Emmanuel and Oyelere, 2002; Oyelere and Emmanuel, 1998; Sikka and Willmott, 2010; Swenson, 2001).

Other studies in the contingency-theory domain, however, have attempted to examine the design of and choices in transfer pricing systems, e.g., the choice of the transfer pricing method and transfer pricing objectives, through surveys or case studies of MNEs. These studies have found that aggressive tax management through transfer pricing is increasingly substituted for more conservative approaches (Borkowski, 2008; Cools et al., 2008; Cools and Slagmulder, 2009; Cravens, 1997; Plesner Rossing, 2013). For example, both Cools et al. and Plesner Rossing found that tax compliance objectives play an important role in the design of management control and cost accounting systems at MNEs. Similarly, Borkowski found that the release of FIN48 rules (now ASC740) caused MNEs to exchange risky transfer pricing positions with more defensive and proactive solutions to mitigate transfer pricing uncertainties, e.g., advance pricing agreements. This literature stream confirms recent professional surveys

that suggest that more conservative transfer pricing objectives and practices currently dominate the transfer pricing agenda at MNEs (e.g. Ernst & Young, 2013). A potential explanation is that tax directors are generally not compensated for engaging in overly aggressive tax positions (Armstrong et al., 2012) or that they are increasingly concerned with the consequences of a negative tax audit reported to top management. Additionally, tax authorities are becoming increasingly skilled in determining whether MNE transfer pricing practices adhere to legal requirements.

Despite a significant amount of empirical work, the corporate tax and transfer pricing literature does not provide an understanding of how MNEs and their transfer pricing practices are impacted by stakeholders, aside from tax authorities. Instead, the literature treats international transfer pricing as a tool for tax optimization (see Hanlon and Heitzman, 2010; Plesner Rossing and Rohde, 2014; Sansing, 2014, for reviews) or, more recently, as an issue of complying with technical tax regulatory standards, particularly the arm's length principle (Cools et al., 2008; Cools and Slagmulder, 2009; Jost et al., 2014; Plesner Rossing, 2013).

THEORETICAL GUIDANCE

Several important contributions have been made on the effects of non-compliance and fraudulent behaviors on corporate reputation (e.g. Fiordelisi et al., 2014; Gottschalk and Solli-Sather, 2011; Nardella et al., 2019). However, studies have generally been sparse on the nature and consequences of situations where companies behave according to higher expectations than the law prescribes (Gunningham et al., 2004 is an exception). Such above-compliance behavior is the core focus of the field of legitimacy theory (e.g. Deephouse and Carter, 2005; Deephouse and Suchman, 2008; Suchman, 1995). According to Suchman (1995, p. 574), "Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions".

The legitimacy concept views technical compliance with regulations as one, not the only, source of alignment with societal expectations.

Because it seeks to address the ‘social license’ beyond regulations, legitimacy theory has been extensively applied in the social and environmental reporting research to explain voluntary disclosures (e.g. Chauvey et al., 2015; Deegan, 2002). The cases in which civil society, such as NGOs, is empowered by critical media coverage to place pressure on corporations (e.g. Baumann-Pauly et al., 2016; Locke, 2003; Sell and Prakash, 2004) demonstrate that organizations may expectedly or unexpectedly encounter demands from various fields that force them to navigate among multiple and sometimes ambiguous norms and values, in addition to formal legal frameworks. The public and media debates on corporate taxes suggest that the organizational legitimacy that pertains to tax compliance may ultimately arise from a social construction that responds to expectations that may go beyond the law’s expectations. Therefore, managing tax legitimacy is different than the typical management that is found in tax expertise systems.

Legitimacy theory attempts to explain how and why corporations respond to outside criticism and the dynamics that are involved in the legitimacy processes that underlie the social license. The following three themes appear to be important to the analysis of the legitimacy processes concerning corporate taxes: the nature of the norms, the forms of responses/changes by corporations that seek legitimacy, and the consequences of legitimacy processes.

First, the actors that are involved (both the actors that question corporate behavior and the corporations that seek legitimacy) must acknowledge the importance of demands and claims for norms and values (Gunningham et al., 2004). However, the exact nature of the norms and values is often difficult to specify because social pressures may not favor a certain solution but merely articulate disapproval of corporate behavior. The limited clarity and visibility of norms force corporations to navigate with uncertainty (Gunningham et al., 2004) and to experiment

with their legitimacy boundaries (Gendron et al., 2015). In addition, the sources of norms and values may range from technical specifications to more subjective opinions. Especially in the context of professionals, such as tax specialists, and their engagement with legitimacy processes, a distinction between professional legitimacy and normative legitimacy can be made (Deephouse and Suchman, 2008). Professional legitimacy relates to a certain specialized body of knowledge. In contrast, normative legitimacy refers to the norms that relate to the broader norms and values that may or may not accord with technical specialist knowledge. The potential gap between professional/technical prescribed norms and the norms that emerge from outside professional groups (normative legitimacy) has been referred to as the ‘reasonableness gap’. Porter (1993) suggested that society may have ‘unreasonable’ expectations and that professional groups may address this gap by informing the public. Nevertheless, ‘educating the public’ may not always work, and the importance of seeking normative legitimacy may force professional groups to use other responses to close this potential gap.

Second, in areas of legitimacy crisis, civil society is often mobilized — particularly in the form of NGO actions. Moreover, as Gunningham et al. (2004) indicate, the government, politicians, and the media may empower civil society. In fact, this intertwinement between different actors and different pressures or dynamics — whether labeled regulatory, economic and social (Gunningham et al., 2004) or pragmatic, moral and cognitive (Suchman, 1995) — intensifies and augments the issues that require corporate responses. Suchman (1995) identifies many responses that corporations can use strategically to gain, maintain or repair legitimacy. For example, a corporation may seek to conform to expectations in the environment by establishing its business in certain environments or targeting consumers where it is likely to be perceived as legitimate. More proactive responses could be attempts to influence the environment to a state where legitimacy is obtained (or repaired), which could range from aiming to merely inform the environment to manipulating the environment. Furthermore, if legitimacy must be

repaired, corporations may simply adapt to expectations, i.e., restructure their operations, or they may choose to ignore, deny, or attempt to justify or explain their actions.

Third, the consequences of legitimacy processes may be symbolic or material and correspond to what institutional theory refers to as decoupling or substantial influence (Schembera and Scherer, 2017). It is easy to see that responses to social pressure may either be rhetorical and seek to explain corporate activities to outsiders or serve as window-dressing and the manipulation of public perceptions and attempt to paint a certain picture of corporate behavior. These dynamics may involve image restoration (e.g. Benoit, 1997). Thus, the search for a ‘fit’ may not link society’s values to the identity or ‘inner values’ of the organization but rather provide a link between outside values and the ‘front stage’ of an organization (Gendron et al., 2015). Accordingly, efforts to gain legitimacy from stakeholders can focus on ‘revealing’ inner workings and beliefs. However, whether the ‘front stage’ of an organization permeates the inner workings and beliefs of organizational actors is not necessarily as important as its social license, which is ultimately the perception of outside stakeholders. In addition, the responses to the demands for certain norms may also produce material effects because they may in fact alter corporate activities or produce unintended consequences.

Some research studies confirm the existence of corporate over-compliance due to legitimacy-seeking processes. For example, in the US pulp and paper mill industry, an analysis shows that many companies surpass environmental regulatory requirements and incur significant additional costs for their inputs and business processes to comply with the Clean Water Act beyond its formal content (McClelland and Horowitz, 1999). Other studies examine company responses to pressure due to, e.g., perceived unacceptable labor conditions (Connor and Atkinson, 1996) or disclosed corruption (Schembera and Scherer, 2017). However, the interplay between the tax-related measures of tax compliance and community pressure for MNE tax contributions (i.e., payments) has not been subject to empirical analysis. Therefore,

there is a lack of insight regarding how and under what circumstances an MNE will face the external pressures that are not embedded in formal tax law. These pressures include the ways in which an MNE can subsequently attempt to (re)establish its ‘social license’ when various NGO and government groups organize pressure to change its corporate practices beyond legal tax standards.

RESEARCH METHOD

This research is based on a study of Starbucks Coffee, with its UK subsidiary serving as the main unit of analysis. The advantage of the longitudinal study approach applied is that it allows for an in-depth analysis of individual events over time and, therefore, the study of specific processes (Gephart, 2004). We use Yin (2009) and Miles and Huberman (1998) to guide the design and analysis of the collected data.

This study draws on a variety of publicly available data that were obtained from different key sources, including Starbucks, the UK Parliament’s website, a UK grassroots movement called ‘UK UNCUT’, various business media, and social media, e.g., Twitter, Facebook, and YouTube. Specifically, this includes Starbucks’ financial statements, tax and CSR policies, and official reports on taxes and transfer pricing. Data from the UK Parliament included transcriptions from the formal hearings of the Public Accounts Committee and Starbucks’ Global Chief Financial Officer, as well as other documents that related to the taxation of MNEs in general and Starbucks specifically. Moreover, UK UNCUT’s website provided an overview of the protest activities against Starbucks, including videos and photos that were obtained. In addition, UK UNCUT provided explicit instructions to individuals who seek to organize action against a company or public institution. Furthermore, many articles were obtained from business news, which provided background material and a basis for direct quotes from the key players who were involved in the process. Finally, Starbucks was asked to comment on our

analysis and conclusions but did not reply. Table 1 summarizes the data that were used for the analysis.

PLEASE INSERT TABLE 1 HERE

CASE ANALYSIS

Case Company: History and UK Development

Starbucks Corporation is a roaster, marketer and retailer of specialty coffee that is based in Seattle, Washington, USA. The company was established in the US in March 1971 and opened its first coffee shop in Seattle at Pike Place Market. It has since grown to become one of the largest coffee chains in the world, and Starbucks operates more than 23,000 locations worldwide that employ approximately 238,000 people.

Starbucks' location ownership structure is a mix between company-operated and licensed locations. At the time of the legitimacy crisis, at the end of 2012, Starbucks Corporation's total net revenue amounted to \$13.3 billion, mainly from company-operated locations. In 2012, Starbucks' main market in terms of revenue was in the Americas (US, Canada, and Latin America), where 75 percent of its total net revenue was generated. Other significant areas of revenue include China and Asia Pacific (5 percent); Europe, the Middle East and Africa (9 percent); and 'Channel Development' areas (10 percent).

Starbucks entered the European market in 1998 and opened its first European location in London. At this time, according to Starbucks' chairman Howard Schultz, the goal was to open 500 locations in Europe to expand the Starbucks' brand on a more global level (BBC, 1998). The UK entry of Starbucks was based on an acquisition of an existing UK-based coffee chain with 64 coffee shops, Seattle Coffee Company. Howard Behar, President of Starbucks Coffee International, explained the rationale behind the acquisition.

We don't believe we are an American company but an international brand ...
We hope to benefit from the pub culture in the UK to make Starbucks a natural
meeting place for people.
(BBC, 1998)

By 2012, Starbucks' UK market consisted of 593 company-operated locations and 168 locations that were operated through a licensee arrangement. Based on data obtained from Starbucks' Annual Reports 1999-2016³, Table 2 illustrates the Starbucks' UK location development from 1999 to 2016⁴.

PLEASE INSERT TABLE 2 HERE

UK Tax Avoidance and the Thomson-Reuters' Report

Although the debate on MNE tax avoidance has been sporadically present since the beginning of the 21st century, it was not until 2009 that a more intense public discussion emerged in the UK regarding alleged tax avoidance by MNEs. On February 2, 2009, one of the UK's largest media publications, *The Guardian*, published an examination of MNE financials between 2004 and 2007 that disclosed many tax-related accounts to indicate the degree of corporate tax avoidance at specific MNEs. Notably, Starbucks was not present on the list, which contained well-known British MNEs, including British Airways, Rolls-Royce Group, and Vodafone. Subsequently, a more intense public debate emerged, and *The Guardian* played a leading role among the media outlets that covered the topic. In February 2009, *The Guardian* launched another series of articles under the theme of 'The Tax Gap Series' to expose the scope of alleged tax avoidance and the structural approaches for profit shifting that are commonly used by MNEs.

The Guardian will examine the extent of tax avoidance by big business, day by day over two weeks. We are naming more than 20 major British companies,

³ <https://investor.starbucks.com/financial-data/annual-reports/default.aspx>

⁴ For 2007 and 2008, the number of UK licensed stores was not specified in the Annual Reports.

and analysing their secretive tax strategies to ask: are they paying their fair share?
(The Guardian, 2009a)

Subsequent to this ‘naming and shaming’ of MNEs, several news stories focused on alleged MNE tax avoidance and the potential tools for reducing corporate taxes at both the local and group levels. One of *The Guardian*’s follow-up stories stated that

Some [multinationals] have paid zero or minimal tax over the last four years, and many attempt to draw a veil of secrecy over their tax affairs...Almost a third of the UK's 700 largest firms paid no corporation tax in 2006... (The Guardian, 2009b)

Although it was not initially among the prominent MNEs that were publicly scrutinized, Starbucks later became the primary subject of another controversial article on MNE tax avoidance. On October 15, 2012, Thomson-Reuters’ UK branch published a Special Report (the Report) entitled ‘How Starbucks avoids UK taxes’ (Thomson-Reuters, 2012). The Report indicated that Starbucks’ UK operation had not generated taxable profits since 2009. Furthermore, it emphasized Starbucks’ use of transfer pricing as the reason for why its UK profitability was reduced, which resulted in no taxes paid. The Report problematized three intercompany payments: (1) Starbucks UK’s payments to Starbucks Group companies in the Netherlands in return for the use of the Starbucks brand and business process know-how, (2) Starbucks UK’s payment of interest to the US on an intercompany loan (i.e., transfer pricing on capital), and (3) Starbucks UK’s payments to Switzerland and the Netherlands that involved the sourcing and roasting of the coffee beans that were used in its UK operation. Although the Report did not suggest that Starbucks had broken any laws, several examples were provided regarding why Starbucks’ transfer pricing practices could be considered more aggressive than other well-known MNEs. For example, regarding its intercompany loan arrangement, the Report noted that

Starbucks' UK accounts show a third way it cuts its tax: inter-company loans. These are a common tactic for shifting profits to low-tax jurisdictions, according to a guidance manual used by the UK tax authorities, who try to limit

the technique...Starbucks hardly cuts its UK subsidiary a good deal. Its group bonds carry a coupon of Libor plus 1.3 percent. Libor, the London Inter-Bank Offered Rate, is an international interest rate benchmark frequently used in commercial lending. Starbucks charges its UK unit interest at Libor plus 4 percentage points. For comparison, KFC charges its subsidiaries around Libor plus 2 percentage points and the UK units of McDonald's pay affiliates interest at or below the Libor rate. (Thomson-Reuters, 2012)

Hearings at the Public Accounts Committee

The Report led to extensive and highly negative news coverage, as well as strong public reactions from many of Starbucks' stakeholders, including Members of Parliament, customers, and UK-based institutions that were concerned with MNE tax avoidance, particularly UK UNCUT, who immediately announced that Starbucks was a potential target of future activism after the Report (The Guardian, 2012b).

At the request of the Public Accounts Committee (PAC), public hearings were scheduled to explain the lack of UK corporate tax payments from Starbucks, as well as from Google and Amazon, who were also part of the media coverage. Furthermore, the PAC requested that HMRC⁵ Director Lin Homer provided oral evidence concerning the alleged MNE tax avoidance. Lin Homer appeared in front of the PAC on November 5, 2012, in a heated atmosphere where severe criticism was raised by the committee regarding why HMRC was not collecting more taxes based on significant MNE revenues.

Margaret Hodge (Committee Chair): In 2004-05, corporation tax was 18% of tax revenue; today, it is only 13%. Doesn't that demonstrate your failure to get to grips with tax avoidance in the corporate sector?' [...] It [the corporate sector] has grown, yet you are taking more from — dare I say it? — hard-working individuals paying their PAYE⁶ than you are from corporations as a proportion of your total tax take. [...] You are saying you are doing that deliberately because the government wants to make this an easy place to be (for MNEs).

Lin Homer: I think the government's position on multinationals is that we do want them to see the UK as competitive. We do expect everybody to pay their fair share. Corporation tax has been coming down but not to those levels. There

⁵ Her Majesty's Revenue and Customs (UK tax authorities)

⁶ Pay-As-You-Earn tax — a withholding tax on income payments to employees.

are other elements that are properly allowed to be taken into account to reduce the tax yield that will include losses, but it will also include some investments in certain assets or research.

The Committee Chair then sought to clarify the attitude of HMRC towards the issue of tax morality, particularly in the context of MNEs compared with the ‘small business’ UK taxpayer.

Margaret Hodge: Undoubtedly, you have looked at what has been rumbling around the media for weeks. I do not think a day goes by when they do not ring me up about yet another tax avoidance scam that they have uncovered. Do you agree that tax avoidance, particularly by global corporations — if we can look at them a bit — although it may be legal, is wrong?

Lin Homer: Probably most countries are trying to collect their share of the tax that is due to them, and I think it would be fair to say that the Chancellor thinks it is important that he and his colleagues in the OECD environment do what they can together to ensure that big companies are not, in a sense, gaming the system [...]

Margaret Hodge: You are giving a mixed message, Lin. You have to understand that there is a mood of anger and huge frustration out there. Ordinary people and small businesses in all our constituencies feel hassled by you. They feel that if they do not pay their tax, somebody comes very quickly — indeed, you may get an agency to come and get the money from them — whereas big corporations might be invited in to HMRC for a cup of coffee, or your officials might go have a cup of coffee in the UK head office of the global corporations, but no similar stringent, fair and equal effort is put into ensuring that they pay their fair rate of tax. ?

One week later, on November 12, 2012, top executives from Starbucks, Google and Amazon appeared in front of the Committee for a formal hearing⁷ regarding their tax practices. Notably, on the day of the hearing, Starbucks’ representative at the committee hearing, Global Chief Financial Officer Troy Alstead, added a written statement on the Starbucks website that outlined tax-related information regarding Starbucks’ global tax rate and its contribution to indirect taxes.

...It’s also important to emphasize that Starbucks’ overall (group-level) corporate tax rate for 2012 is approximately 33%, nearly double the median effective tax rate of 18.5% for other multinational US companies [...]

At the PAC hearing later that day, Starbucks was represented by Troy Alstead, while Amazon was represented by Andrew Cecil, Director of Public Policy. Google was represented by Matt

⁷ The full transcript of the committee hearing can be found at:
<http://www.parliamentlive.tv/Event/Index/ab52a9cd-9d51-49a3-ba3d-e127a3af018c>

Brittin, Vice President for Sales and Operations, Northern and Central Europe. The Minutes of Evidence demonstrate the suspicious attitude among the committee's members towards the MNEs regarding their tax arrangements and results. The committee chair, Margaret Hodge, confronted the MNE representatives with the following opening remarks:

The purpose of our session is to get some understanding of the way in which you manage your financial arrangements and to try to understand why you don't pay the corporation tax that it appears, on the facts, is due.
(UK Public Accounts Committee, 2012)

The hearing continued with the questioning of each MNE representative, starting with Troy Alstead from Starbucks. Initial questions concerned the fact that Starbucks had reported success in the UK market during previous investor calls. However, none of these financial years had materialized in tax payments to the HMRC. This lack of tax payments troubled the Committee, as shown in the dialogue between CFO Troy Alstead and Committee Chair, Margaret Hodge.

Margaret Hodge: The other thing that is odd to me is that if you have made losses in the UK over 15 years, which is what you are filing, why on earth are you doing business here?

Troy Alstead: We know that we must be in the UK to be a successful global company.

Margaret Hodge: But you are losing money here.

Troy Alstead: It is a critical market.

Margaret Hodge: Why don't you go over to the US and focus on the US, where you say you are making money — if it's true?

Troy Alstead: Yes, I assure you that it's true.

The hearing then focused on Starbucks' transfer pricing model, including some clarification of the specifics that were included in the Thomson Reuters' Report. Committee members sought more insights into the intercompany payments that were made from Starbucks UK to its group companies because these payments could have caused the lack of positive income on the UK tax return if the payments were not at arm's length. For this reason, the focus was kept primarily on Starbucks' group company in the Netherlands and Switzerland. The US-based

parent company of the Starbucks group was also included in the hearing to provide an overall understanding of Starbucks' transfer pricing model on a more global level.

According to Troy Alstead, Starbucks has its Europe/Middle East regional headquarters and roasting plant in the Netherlands, where it employs approximately 220 people and operates a coffee roasting facility and distribution center. Approximately 6,800 tons of coffee are physically distributed from the Netherlands to multiple Starbucks locations, including the UK. The coffee beans that are used in the Dutch operation are legally owned by a Swiss-based Starbucks company. This Swiss company performs the global coffee buying for the Starbucks group and then resells the beans directly to the Starbucks locations across Europe at a cost plus 20 percent mark-up. Therefore, the legal transaction of finished roasted coffee beans to Starbucks UK comes from the Swiss Starbucks group company, and the Dutch company acts as a service provider for the Swiss entity. Committee member Stephen Barclay led this part of the hearing.

Stephen Barclay: And how many people work in the Swiss operation?

Troy Alstead: I believe that our global coffee buying operation perhaps has 30 people.

Stephen Barclay: Thirty people. And what mark-up do you apply to the coffee you buy in the Swiss operation before it is transferred?

Troy Alstead: The margin that Starbucks makes on coffee that is sold to the UK and everywhere else is approximately 20% – that is the gross margin on that product sale, which is a very consistent wholesale margin on any product anywhere.

[...]

Stephen Barclay: And how do you come to the figure of 20% from that?

Troy Alstead: That is benchmarked, based on transfer-pricing regulations in tax authorities all around the world.

In addition to the transfer of physical goods, Troy Alstead revealed during the hearing that Starbucks UK paid a royalty fee to the Dutch Starbucks company to account for various intangible assets that were used in the UK operations. Committee Chair Margaret Hodge was critical of this intercompany transaction, and she challenged the substance and value of the individual intangibles that were used by the UK coffee shops. However, Troy Alstead testified

that a large pool of independent companies had historically agreed to pay a similar fee⁸ for the use of these intangibles.

Margaret Hodge: Mr. Alstead, we are sceptical of your story. I think the allegation is that the way in which you set charges against the UK business means that you manipulate the profits out of the UK into tax havens. Let me take you through the charges that have been put in public. The first is that you charge for intellectual property. I gather it was originally 6%, and I understand that somehow there has been a negotiation with HMRC and it is now 4.7%. I have to tell you that I am a coffee addict, so I drink far more coffee than is good for my health. I cannot tell the difference between a Starbucks coffee and one from Nero, Costa or anywhere else, so perhaps you can enlighten me. [...] how on earth do you then get that 6% or 4.7% is the fair and proper charge?

Troy Alstead: Two or perhaps three ways. One is understanding what global brands charge for those goods and services to licensees around the world. In the UK, that ranges from close to 5% up to a maximum of 8% or so. [...] The royalty rate, as we have seen around the world, ranges from that 5% or so.

Margaret Hodge: This is really interesting, so you go for what is in the market – what you think you can get away with — and charge it.

[...]

Troy Alstead: We have 20 licensees around the world who are independent companies. These licensees are big, sophisticated companies who willingly pay us the 6% royalty, because they clearly recognize the value of the goods and services, the store design, the trademark protection and the value of the global brand that comes into that band.

Margaret Hodge: I think it is about tax avoidance.

A final transfer pricing issue that Starbucks mentioned at the hearing was an intercompany loan from the US parent company to the funding of various UK operations. According to Troy Alstead, the loan was provided on arm's length terms to Starbucks UK, which needed a cash infusion because of perpetual losses.

Stephen Barclay: In the accounts for the Starbucks Coffee Company UK Ltd., you transferred £50 m into equity in a business that has been losing money year in, year out. Can you explain why you moved £50 m from cash into equity, please?

Troy Alstead: Yes, that was because the business has been losing money. As a result of our challenges with profitability in the UK, the UK business has not been able to make its payments – it has not been able to meet those cash needs alone — so it has needed the infusing of cash. ...Tax authorities on both sides of that transaction — on both sides of the ocean — require that that be an arm's length transaction, so the interest rate was set at arm's length rates during that period of time.

⁸ In theory, the royalty rate that is agreed upon by an MNE with an independent company resembles a market price that can be used for transfer pricing purposes, provided that the structural conditions of the intercompany transaction and the market transaction are sufficiently comparable.

Margaret Hodge: Higher — higher than anybody else.

Troy Alstead: Right now, that rate would be about 4.9% —

Margaret Hodge: Yes, that is higher than anybody else that we have come across — to your own wholly owned subsidiaries. It is a bit odd. These are wholly owned subsidiaries and you charge a higher interest rate. The only explanation can be to get money out of the UK to avoid tax.

Troy Alstead: No, because that loan is to the US business. Actually, the US has a substantially higher corporate tax rate. There is absolutely nothing about the loan that could actually produce tax savings for us, because it is a much higher tax regime in the US than it is in the UK.

For the remainder of the hearing, the PAC continued to emphasize the ethical dimension of MNEs' tax practices, including whether their level of UK corporate tax contribution corresponded fairly to the benefits that were made available for businesses by UK society. This critique was explicitly argued by the Committee Chair in a dialogue with the Google representative, which seems applicable to the way in which the PAC viewed the norms concerning the corporate tax payments of MNEs in general, including Starbucks.

Margaret Hodge: So you are minimising your tax even though it is unfair to British taxpayers.

Matt Brittin: It is not unfair to British taxpayers. We pay all the tax you require us to pay in the UK.

Margaret Hodge: We are not accusing you of being illegal; we are accusing you of being immoral.

The Public Riot

Even at the time of publication of the Thomson Reuters' Report, strong public reactions had emerged and were subjected to intense media coverage. The PAC hearing further enhanced this coverage and evoked significant reactions from many Starbucks stakeholders. These reactions included heated debates on social media platforms, such as Twitter and Facebook, and even specific designated groups that encouraged a boycott were formed.⁹

On the day before the PAC hearing on November 11, 2012, UK UNCUT announced that they would react to the alleged tax avoidance by Starbucks and called for a protest. The call was followed by a press release on the same day as the hearing, which suggested that one cause of

⁹ See, for example: <https://www.facebook.com/BoycottStarbucksTaxDodgers/>

the government cuts of public services that were available to vulnerable women could be linked to the perceived tax avoidance by Starbucks. UK UNCUT is a grassroots movement that seeks to emphasize alternatives to austerity by using “acts of creative civil disobedience to show our opposition to the Government’s cuts to our public services.”¹⁰

UK UNCUT’s link to the Starbucks hearing was explained by UK UNCUT activist Sarah Greene in *The Guardian* (The Guardian, 2012a). According to Greene, UK UNCUT attempted to link government cuts, particularly the cuts that affect women, and tax avoidance by MNEs. Specifically, the view of Greene was that funding for refuges and rape crisis centers faced cuts unless companies paid their fair share of taxes. According to Greene, the government could easily bring in billions of pounds that could fund vital services by clamping down on tax avoidance but was instead

...making cuts that are forcing women to choose between motherhood and work, and trapping them in abusive relationships.

Fellow UK UNCUT campaigner Anna Walker indicated in *The Guardian* article that the group wanted to “galvanise the anger” that women were feeling.

We've chosen to really highlight the impact of the cuts on women this time. So there is going to be a real focus on transforming Starbucks into those services that are being cut by the government...[such as] refuges and creches.

The protest call, entitled “CALL OUT! 8 Dec. Refuge from the cuts — target Starbucks!” called for protestors to join one of UK UNCUT’s events at Starbucks coffee shops. The callout provided guidance on how to identify one of many Starbucks shops where protests were planned, as well as a five-step guide for organizing a local protest. To further motivate action, the callout announced the following:

Is your local rape crisis center being closed? Then why not turn your local Starbucks into a refuge? Bring your kids, because 50% of people living in refuges are children. Housing benefit cut? Bring your sleeping bags. Are you working less hours because subsidised childcare is a thing of the past? You could set up a Starbucks crèche.

¹⁰ <http://www.ukuncut.org.uk/about/>

As a closing remark, the call out exhorted the following:

Bring your own coffee... see you on the high streets!

On December 6, 2012, two days before the UK UNCUT protests were scheduled, Starbucks published a letter on their website entitled “An Open Letter from Kris Engskov¹¹”. The letter opens with the following remarks:

Today, we’re taking action to pay corporation tax in the United Kingdom — above what is currently required by tax law.

Regarding Starbucks’ lack of tax payments in the UK, the letter states that

...even though we [Starbucks] have always paid our taxes to the letter of the law, we know that to retain public trust we need to do more.

The letter states that for income years 2013 and 2014, Starbucks would make certain changes to its transfer pricing, which resulted in the company paying higher corporation tax in the UK. Specifically, Starbucks UK would not claim deductions on its tax return for intercompany royalties. Furthermore, the company decided to forgo tax deductions for payments that were related to intercompany charges for interest and mark-up on the coffee that was bought from Starbucks group companies¹². It was suggested that by forgoing these — in a technical sense — legal deductions¹³, the increase in taxable income on the UK tax return would result in an estimated £10 m per year.

UK UNCUT did not seem to notice the Starbucks initiative. Two days later, on Saturday, December 8, 2012, UK UNCUT organized a public protest in and around more than 50 Starbucks locations throughout the UK, including London, Liverpool, Cardiff, Bristol and Shrewsbury (Skynews, 2012). The UK UNCUT Facebook page included many photos of the

¹¹ Managing Director, Starbucks Coffee Company UK.

¹² According to the PAC hearing of Starbucks’ CFO Troy Alstead, the royalty rate was 6 percent, the mark-up on coffee was 20 percent, and the intercompany loan rate amounted to 4.9 percent.

¹³ We do not opine whether these specific rates are set at arm’s length; we merely state that taking deductions for such types of transactions is legitimate based on the UK tax code.

nature of the action. One of the key messages was written on a protest sign that was carried by a child who had joined the protest: Too little, too latte.¹⁴

One of the comments on the posted picture captured what appeared to be the general perception among protestors:

Any attempts to offer goodwill gestures above and beyond the law will still be met with protests, so there's no point offering them.

Postscript

In the wake of the December 2012 action, the explicit critique of Starbucks diminished but was maintained by the media, politicians, and UK UNCUT, although in a less controversial and more general sense. The PAC continued their critique of MNEs' tax behavior. The PAC's critique also became more explicit towards the external financial service firms that assist MNEs. A PAC Report entitled 'Tax Avoidance: tackling marketed avoidance schemes' was published in January 2013 based on additional hearings with HMRC Director Lin Homer as well as financial advisory institutions that allegedly promoted tax avoidance schemes. Furthermore, the PAC Report's summary referred to the perceived success of putting Starbucks in the public spotlight.

It is clear from Starbucks' reaction to our hearing on their tax practices that public opinion can influence the activities of many organisations.

This report also continued to be critical towards the UK tax authorities by stating that

We (PAC Committee) are surprised that HMRC does not do more to ensure that the banks are not facilitating avoidance through the provisions of loans.

Notably, in 2013, Starbucks paid a significant amount of taxes — some of which can be considered voluntary payments — for the first time since entering the UK market. Data that

¹⁴

https://www.facebook.com/ukuncut/photos/ms.c.eJwdx8kNACAMA7CNEM1R0v0XQ~_CfpRBtGWWcWfpvVFLDvLu8GWN08wLmfAmf.bps.a.448091448572122.95816.141516115896325/448515038529763/?type=3&theater

were obtained from Starbucks UK's annual accounts shows that the retraction of transfer pricing payments from Starbucks UK to its various group companies for the use of the brand name, the mark-up on coffee beans, etc. significantly impacted the income years 2013/14, 2014/15 and 2015/16 and reported tax expenses of £12 m, £8.4 m and £6.7 m, respectively. Notably, in 2016, one of the key performance indicators (KPIs) identified by Starbucks UK was the "UK corporation tax expense". However, no explicit reactions from consumers, politicians, UK UNCUT, etc. were identified on social media platforms or in more formal media coverage. In fact, negative social media comments continued in these years despite Starbucks' tax-related KPI focus. YouGov BrandIndex, an organization that examines the values of well-known brands, found that despite their efforts — including additional tax payments with no legal basis — Starbucks was not able to recover its UK brand status fully prior to the Thomson Reuters' Report and the public hearing. Conversely, Google and Amazon recovered fairly quickly. In 2015, YouGov BrandIndex found that Starbucks had a value of -3.2¹⁵ compared to +4.6 prior to the Report and the following public protest. Data from YouGov reveal that people who dislike the Starbucks brand currently report 'tax dodging' as the number one reason.¹⁶ In April 2015, Starbucks announced that they would relocate their headquarters for Europe, the Middle East and Africa from Amsterdam to London.

This move will mean we pay more tax in the UK.¹⁷ (Official Starbucks website)¹⁸

¹⁵ YouGov's BrandIndex is a daily measure of brand perception among the public, and it tracks many brands across multiple sectors simultaneously. BrandIndex tracks the perception of the following values independently: Buzz (whether people have heard anything positive or negative about the brand in the media or through word of mouth); Attention (the percentage of the general public that has heard anything, positive or negative about the brand in the media through word of mouth); Quality; Value; Customer Satisfaction; Reputation; General Impression; Recommendation; Brand Awareness; Word of Mouth Exposure; Current Customer; Former Customer; Purchase Intent; Purchase Consideration; and Ad Awareness.

¹⁶ <https://yougov.co.uk/opi/browse/Starbucks>. Accessed January 11, 2017.

¹⁷ International transfer pricing rules require that the allocation of profits within an MNE group is based on the functions performed, assets used, and risk assumed by individual group companies; see, for example, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD, 2010). Therefore, Starbucks' restructuring implies that a relatively larger part of group pre-tax profits is allocated to the UK company post-restructuring.

¹⁸ <https://news.starbucks.com/views/starbucks-moves-european-head-office-to-london>, Accessed January 12, 2017.

CONTRIBUTION

The majority of research on MNE tax management has identified the determinants and demographics for aggressive tax management. Likewise, in the transfer pricing domain, most literature has addressed technical accounting issues, the implementation of tax regulatory requirements and its implications for management accounting at MNEs (e.g., Cools and Slagmulder, 2009). However, the recent increase in public scrutiny of MNE tax practices from many stakeholders beyond the tax authorities have justified calls for tax research that integrates social and institutional perspectives (Avi-Yonah, 2008; Gracia and Oats, 2014; Knuutinen, 2014; Mulligan and Oats, 2016). We respond to this call by showing how MNE tax practices may entail legitimacy processes beyond the interrelations between tax expertise systems and the law to develop social trust. Furthermore, Mulligan and Oats (2016) have argued for the importance of examining the relations between MNE tax professionals and the outside environment. We concur with this argument, and this paper shows how and why tax professionals cannot be seen as independent from the external context that comprises social and economic interests. One difference between this study and the study by Mulligan and Oats (2016) is that they mainly explored how tax professionals shape the policy and societal context in which professionals operate, whereas we addressed the ‘norm-shaping’ dynamics in the opposite direction.

Although the current literature portrays corporate tax and international transfer pricing as a technical discipline of tax minimization or compliance between MNEs and tax authorities (e.g. Chen et al., 2014; Cools et al., 2008; Cools and Slagmulder, 2009; Klassen et al., 2016; Plesner Rossing, 2013), we illustrate the forces that can be evoked when the media, politicians, NGOs, and consumers exert simultaneous pressure with tax shaming to convey fairness-driven arguments on MNE tax behavior. Thus, we argue that MNE executives and board members

cannot treat international transfer pricing as merely a technical regulation-driven discipline to be addressed by accounting and tax experts alone. Instead, they must take on the responsibility of understanding the motives and power of an expanding group of stakeholders concerning corporate taxation, including the potential for such stakeholders to simultaneously apply ethical commercial pressure on the MNE and its tax practices.

The Starbucks case shows how shared agendas among civil society, consumers, politicians, and the media can intensify this pressure. Accordingly, we suggest that academics in the domain of tax governance and MNE tax behavior include a wider range of potential explanatory variables. Specifically, the existing literature appears to depart from an ‘a priori’ assumption that tax avoidance is a standard driver of MNE tax behavior, although this paper suggests that completely opposite motives may drive tax decision-making to include more fundamental commercial objectives.

In addition, the analysis shows that MNEs are facing a significant challenge with how to respond to societal expectations regarding tax behavior. After having acknowledged that technical arguments were insufficient, Starbucks management seemed to believe that a voluntary tax payment of approximately £20 m would end the confrontational atmosphere that emerged initially. However, the payment did not produce the expected effect and left Starbucks in a state of uncertainty concerning what additional initiatives beyond formal legal compliance would create a stable situation. This illustrates that the route towards obtaining legitimacy among stakeholders appears to be more challenging and unpredictable compared to what it takes to understand and gain legitimacy from tax authorities, who explicitly communicate perceived technical violations in regulatory applications. Some researchers have emphasized that it is important to show how organizational decision-makers experiment with legitimacy boundaries (Gendron et al., 2015). One contribution of this study is that we show how such experimentation may occur within the field of corporate taxation and international transfer

pricing, including the challenges that emerge when top management's response strategies depart from a pure legalistic perception of 'right and wrong' without consideration of societal expectations.

We conclude that in addition to the legality of intercompany transactions with tax implications (professional legitimacy), there is a second layer of public acceptance that MNEs must obtain; this *de facto* layer can be very powerful because it has the potential to interfere with the core commercial part of MNEs' activities. Starbucks responded to a misalignment with expectations in the second layer to repair legitimacy (normative legitimacy). Although all of Starbucks' responses have attempted to alter public perceptions, it is noteworthy that only the first response was symbolic in the sense that Starbucks intended to 'educate the public' with no intention of changing its behavior (before and during the PAC hearing). The second stage of the Starbucks response went beyond mere rhetoric and had consequences in substance as Starbucks made changes in their transfer pricing and structural conditions. This situation further demonstrated that Starbucks was experiencing what Schembera and Scherer (2017) depict as a strong 'legitimacy shock', in which organizations are likely to go beyond symbolic responses and are more likely to react 'radically and instantly'. This study reveals similar dynamics and confirms the dramatic nature of the substantive changes that were associated with such responses (Schembera and Scherer, 2017). Accordingly, the influence on organizational practices appears to be not only substantive but also irreversible because changes in tax practices cannot be reversed and were later followed up by a major restructuring to move the European headquarters to London.

As part of this paper, we argue that MNEs cannot determine their ability to obtain commercial legitimacy based on an aggregated (group-wide) effective tax rate measure. Starbucks seemed to believe that emphasizing their group-wide effective tax rate of approximately '...double the median effective tax rate of 18.5% for other multinational US companies' would mediate the

UK criticism. This strategy did not work, and we argue that MNEs must evaluate their effective corporate tax rates and tax contributions on a *country-by-country* basis in the process of achieving commercial legitimacy from host economies.

One question that emerges from the analysis relates to why Starbucks was harmed so explicitly, whereas Amazon and Google suffered little direct attention and less immediate brand effects in the post-hearing public protest (Gribnau and Jallai, 2016). One potential explanation could be that MNEs with a physical retail presence, such as Starbucks, are easier targets for tax avoidance campaigns because opponents have greater opportunities to mobilize consumers and the media with visible pressure. Conversely, businesses that operate through a virtual online-based business model appear to be much more difficult to target in physical and visible demonstrations. This question adds to the complexity of the legitimacy processes that are faced by MNE top management in that external critics, e.g., grassroots movements and politicians, are likely to need to justify their actions to their constituencies and may therefore use MNEs as a platform for self-promotion. This may explain why the voluntary response from Starbucks had a limited effect on the public perception as opposed to what was expected by management because, from the perspective of key tax stakeholders, it concerned perhaps the protest *process* more and derived attention than the actual end result (e.g., actual additional tax payments).

Furthermore, Starbucks' voluntary tax payments are not without legal consequence. The voluntary payment to the U.K. tax authorities presents a problem for acquiring the U.S. foreign tax credit under Internal Revenue Code section 901. According to Treasury Regulation § 1.901-2(a)(2)(i): 'A *foreign levy is a tax if it requires a compulsory*¹⁹ *payment pursuant to the authority of a foreign country to levy taxes.*' This is further explained in Reg. § 1.901-2(e)(5)(i): '*An amount paid is not a compulsory payment, and thus is not an amount of tax paid, to the extent that the amount paid exceeds the amount of liability under foreign law for tax.*' As no

¹⁹ Our emphasis.

tax claim was current against Starbucks under formal UK law, it seems clear that the excess payment made through transfer pricing cannot be considered ‘compulsory’ under US law. We argue that for the MNE top management, it is critical to include the likely rejection of tax credits²⁰ elsewhere in addition to the local ‘tax’ cost incurred when evaluating the expected benefit from voluntary tax payments in an attempt to stabilize the social contract.

Finally, this paper implies that the institutional space of MNE taxation seem to be more complicated than previously assumed and goes beyond the standard perception of a bi-directional confrontation between MNEs and tax authorities, with the latter backed by a powerful tax policy maker community. The PAC hearing of the UK tax authorities suggests that the alliance between tax policy makers and tax authorities assumed in previous literature may not be strong after all. In fact, the hearing suggests that tax policy makers consider their alliance with the tax authorities as rather fragile, partially due to the alleged favoritism to MNEs compared to domestic taxpayers. It may be that the relationship between MNEs and certain local tax authorities has a much more collaborative nature compared with the standard confrontational relationship that is assumed in the current literature. We argue that tax alliances seem to be more complex than previously assumed by scholars and constitutes one of several interesting avenues for future research in the area of tax governance and tax risk management in MNE.

In this paper, we have attempted to make a first step towards the development of knowledge in the field of tax governance and the way tax strategies are shaped over time through an MNE’s interaction with its key tax stakeholders. As our study is a single case study, the generalizability of findings is limited. We hope that other researchers in the areas of MNE tax governance, CSR and business ethics of corporate taxation can use the conclusions and

²⁰ Such a limitation on tax credits is a general standard in international tax rules in countries offering tax credits on foreign income tax. Hence, the argument applies to MNE top management, in general, and not only US-based multinationals.

propositions put forward in this paper in future work based on larger data samples. A next step could be to survey MNE boards to understand how tax governance models are applied and the way boards and C-suite managers interact in the process of designing effective internal tax controls and ensuring accountability and transparency in an MNE's global tax contributions.

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Table 1. Data inputs used in case analysis

Content	Source of origin	Type
<u>Starbucks</u>		
Organizational chart	Company website	Text document
Annual reports 1999-2016	Company website	Text document
Ethics and Compliance: Standards of Business Conduct	Company website	Text document
Open Letter from Starbucks UK's Managing Director	Company website	Text document
<u>UK Parliament and sub-committees</u>		
House of Commons: Public Accounts Committee	UK Parliament website	
The work of the Public Accounts Committee 2010-2015	UK Parliament website	Text document
Public hearing of MNEs: Minutes of evidence	UK Parliament website	Online video and transcripts
UK tax authorities (HMRC): Annual Report and Accounts 2011-12	UK Parliament website	Text document
Tax avoidance: Tackling marketed avoidance schemes	UK Parliament website	Text document
<u>UK UNCUT</u>		
Comments on Starbucks' tax practices	https://twitter.com/UKuncut	Online text
Planning of actions at Starbucks locations	http://www.ukuncut.org.uk/	Online text
Guidance on action planning	http://www.ukuncut.org.uk/organising-an-action/	Online text
<u>Other</u>		
Business media articles and video clips	Thomson-Reuters, The Guardian, BBC, SKYNEWS, New York Times, Dailymail.	Text documents and online videos
London protest at Starbucks cafes	Youtube.com	Online video
London protest at Starbucks cafes	The Guardian	Online video

Table 2. Starbucks UK's store development 1999-2016

