

# Do Tax Havens Create Firm Value?

## Online Appendix

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October 6, 2016

# 1. The Event and the Political Background: Further Details

This appendix details the event and the political background.

## 1.1. What is the event?

ActionAid, a international NGO, released a report entitled “Addicted to Tax Havens” at the midnight of October 11, 2011 (our event date). This report listed the names and countries of all subsidiaries (over 30,000) held by the FTSE 100 firms (as of July 26, 2011). ActionAid used three sources to compile the data, namely publicly-available company reports, inquiry from individual companies (those that did not disclose their subsidiaries in their reports), and company information specialist Duedil.<sup>1</sup> Based on the list of tax havens (replicated in Table 1) compiled by the Government Accountability Office of the U.S. Congress (with the addition of U.S. State of Delaware and the Netherlands),<sup>2</sup> ActionAid identified 8,492 subsidiaries located in tax havens, around one fourth of the total number of subsidiaries.

**Table 1: List of Tax Havens in the ActionAid Report**

Andorra	Guernsey	Monaco
Anguilla	Hong Kong	Netherlands
Antigua and Barbuda	Ireland	Netherlands Antilles
Aruba	Isle of Man	Panama
Bahamas	Jersey	Saint Kitts and Nevis
Bahrain	Jordan	Saint Lucia
Barbados	Latvia	Samoa
Bermuda	Lebanon	Seychelles
British Virgin Islands	Liberia	Singapore
Cayman Islands	Liechtenstein	Switzerland
Cook Islands	Luxembourg	U.S. (Delaware)
Costa Rica	Macao	U.S. Virgin Islands
Cyprus	Maldives	Vanuatu
Gibraltar	Malta	
Grenada	Mauritius	

<sup>1</sup>The data set is downloadable at: <https://docs.google.com/spreadsheet/ccc?key=0AjR-5aT01TRYdGJqRmZVLW9FX2Vqam0ySE1CZ0wyUkE>.

<sup>2</sup>See p.12 of United States Government Accountability Office, “International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions,” December 2008.

Almost all major British media, including BBC, *The Independent*, *The Telegraph*, and *The Guardian*, covered this report on the same date.<sup>3</sup> In the morning of the same day, 6 MPs sponsored an early day motion (EDM) submitted for debate in the House of Commons. A total of 32 MPs signed the EDM. On the next day, October 12, 2011, 6 other MPs sponsored another EDM, signed by 36 MPs. Both EDMs urged the tax authority, HMRC, to act quickly to address the seemingly serious tax avoidance activities carried out by the largest U.K. firms. The argument is that such practices undermine the ability of the British government to raise taxes, while the U.K. austerity program was affecting the people and the government.<sup>4</sup>

### 1.2. *Why would the event move the market?*

We view the release of the ActionAid report as a significant event, not just because firms and managers care about their reputation and the media attention in relation to their tax planning activities (Graham et al. 2014; Ernst and Young 2014). To the extent that the success of a report depended on its impact on the society, ActionAid had the incentive to release the report at the “right” time. We provide the political background around the time the ActionAid released its report. Some of the key events are summarized in Table 2 below.

One may argue that if there had been a series of events leading to the investors to expect that the firms’ cost of using tax havens has been elevating, the report would not add much to such an expectation. If this logic follows, it would work against us by making it harder for us to find any significant effects in our event study.

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<sup>3</sup>See the news reports by BBC entitled “Tax havens: Is the tide turning?” at <http://www.bbc.co.uk/news/magazine-15239196>, by *The Independent* entitled “British firms attacked for routine use of tax havens” at <http://www.independent.co.uk/news/business/news/british-firms-attacked-for-routine-use-of-tax-havens-2368753.html>, by *The Telegraph* entitled “Banks heaviest users of low-tax territories” at <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8818974/Banks-heaviest-users-of-low-tax-territories.html>, and *The Guardian* entitled “Quarter of FTSE 100 subsidiaries located in tax havens” at <http://www.guardian.co.uk/business/2011/oct/11/ftse-100-subsiidiaries-tax-havens>.

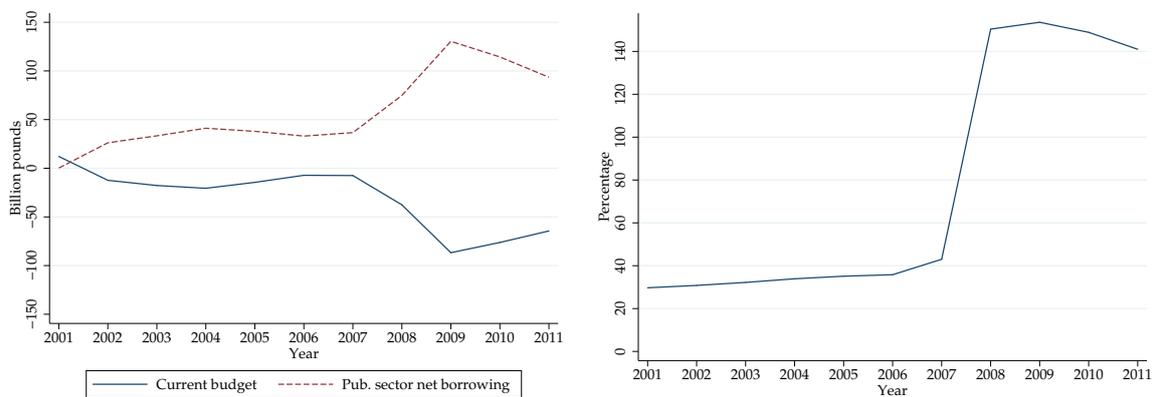
<sup>4</sup>Details of the motions can be found at <http://www.parliament.uk/edm/2010-12/2242> and <http://www.parliament.uk/edm/2010-12/2232>

**Table 2: Major Events Surrounding the Event Date**

Date	Event
2001 to 2011	Increasing government budget deficit in the U.K.
2010	Austerity programs in the U.K.
2010	Various anti-austerity protests in the U.K., Greece, and Spain
June 2010	Scandal of the British Permanent Secretary for Tax at HMRC
March 23, 2011	U.K. Treasury's report on "Tackling Tax Avoidance"
September 17, 2011	Occupy Wall Street in the U.S.
October 11, 2011 (Event date)	ActionAid report; Scandal of Goldman Sachs
October 11 and 12, 2011	12 Members of Parliament sponsored two early day motions, each signed by more than 30 MPs, urging HMRC to tackle tax avoidance by big corporations with reference to the ActionAid report
October 15, 2011	Occupy London
October 26, 2011	OECD's report on "The Era of Bank Secrecy is Over"

*Budget deficit in the U.K.* Figure 1 shows that the U.K. budget deficit had been increasing: it had been in the red since 2001, with increasing net public borrowing year after year; the net debt as a percentage of the U.K GDP (including financial interventions) reached 151% in 2008, and leveled off at 156.4% in 2009, 150.9% in 2010, and 144.9% in 2011.<sup>5</sup> In an attempt to address this issue, in 2010, the Conservative and Liberal Democrat coalition government initiated an extensive austerity program involving a series of substantial reductions in public spending.

**Figure 1: U.K. Fiscal Budget**



(a) Current budget and public sector net borrowing, including financial intervention (b) National debt as a percentage of GDP, including financial intervention

<sup>5</sup>Data come from *The Guardian* Data at <http://www.guardian.co.uk/data>.

*Public hatred toward tax-avoiding firms* The public hatred towards large corporations that avoid tax, either legally or illegally, peaked during that period, which triggered large scale protests in the U.K. and elsewhere. In 2010, various anti-austerity protests occurred in Greece and Spain. In the U.K., tuition hike and education expenses cut were common subjects in the news around the time. On November 10, 2010, a series of student protests against many austerity plans of the British government was launched. These protests in Europe were antecedents for the “Occupy Wall Street” protest in the U.S., which started on September 17, 2011, about a month prior to the the release of the ActionAid report.

Four days after the ActionAid report was released, the “Occupy London” protest started on October 15, 2011. It was a high-profile protest and demonstration against economic inequality. On the same day, *The Economist* published an article entitled “Tax Havens - Trouble Island: Public Anger and Shareholder Unease Threaten Tax Havens’ Tranquility,” which described the heavy use of tax havens among large corporations.<sup>6</sup> Occupy London peaked in October and November 2011. Behind many of the related protests centered around London was an organization called U.K. Uncut, which organized protests aiming at exposing the irony of the austerity programs while large corporations were avoiding tax. Their Facebook account and website detailed their actions and contained the associated photo/video galleries and many other statements they made on the government and the large corporations.<sup>7</sup>

*Tax scandals of HMRC* The HMRC was suspected to have an unusual incentive to take noticeable actions at the time. HMRC has been plagued with external public hatred toward corporate tax avoidance and internal scandals. The ActionAid report was released amid various tax scandals about Dave Hartnett. In 2010, Dave Hartnett, the then Permanent Secretary for Tax at HMRC, was named by the Bureau of Investigative

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<sup>6</sup>See <http://www.economist.com/node/21532264>.

<sup>7</sup>For example, on October 13, 2011, the U.K. Uncut launched a Big Rip Off Day Action. Exactly 3 years before that day, on October 13, 2008, the British government was forced to step in and take control of Royal Bank of Scotland (one of the FTSE 100 firms). U.K. Uncut claimed, “While the government forces painful ‘austerity’ cuts on us, the banksters’ greed continues. RBS bankers paid themselves 950 million in bonuses this year!” (See <http://www.ukuncut.org.uk/actions/697>.)

Journalism, a research group at City University London, as the most “wined and dined” civil servant in Britain.<sup>8</sup> He was reported to have been treated to corporate hospitality 107 times over a period of three years. Companies that entertained him included Goldman Sachs, JP Morgan, Ernst & Young, KPMG, PriceWaterhouse Coopers, and Deloitte. Around the time the ActionAid report was released, he was alleged to have been involved in two major events related to tax avoidance: the so-called “sweetheart” deals between HMRC and Vodafone, one of the FTSE 100 firms, and another deal with Goldman Sachs.<sup>9</sup>

According to a news article by *The Telegraph*, “Goldman Sachs, among other companies, used off-shore companies to pay directors and bonuses in dividends rather than income. In 2005, HMRC showed the schemes were illegal but Goldman refused to settle. By 2010, according to a public judgment, the unpaid bill was £40m in interest. Recent reports claim Goldman has now settled with HMRC but did not pay the interest bill. HMRC said in a statement it “does not do ‘sweetheart’ deals.”<sup>10</sup>

*U.K. government’s plan to tackle tax avoidance* In March 2011, the U.K. Treasury published a report entitled “Tackling Tax Avoidance.”<sup>11</sup> The report states that the U.K. government is committed to tackling the issue. It also outlines in detail the roles played by HMRC.<sup>12</sup> Continual efforts had been made by the U.K. Treasury and

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<sup>8</sup>See the “Top Ten: Civil Servants” announced by the Bureau of Investigative Journalism at <http://www.thebureauinvestigates.com/2010/06/16/top-ten-civil-servants/>.

<sup>9</sup>See, for example, the news article by *The Telegraph* entitled “The taxman’s corporate controversies” on October 12, 2011 at <http://www.telegraph.co.uk/finance/newsbysector/industry/8822500/The-taxmans-corporate-controversies.html>.

<sup>10</sup>See the news article entitled “Goldman Sachs ‘escaped paying £20m National Insurance bill in HMRC deal” on October 11, 2011 at <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8821083/Goldman-Sachs-escaped-paying-20m-National-Insurance-bill-in-HMRC-deal.html>.

<sup>11</sup>See [http://www.hm-treasury.gov.uk/2011budget\\_taxavoidance.htm](http://www.hm-treasury.gov.uk/2011budget_taxavoidance.htm).

<sup>12</sup>At the international level, various organizations are also involved in tackling tax avoidance. For example, since the 1990s, the Organisation for Economic Co-operation and Development (OECD) has been trying to urge tax havens to sign information exchange treaties, with an aim to eradicate bank secrecy that facilitate the tax avoidance activities of individuals and corporations. A turning point came in April 2009. As [Johannesen and Zucman \(2014\)](#) describe, “The OECD specified that each tax haven should conclude at least 12 treaties to be in compliance and drew up a list of 42 non-compliant havens. The G20 threatened to impose economic sanctions on non-compliant havens. In just five days, all havens committed to signing 12 treaties and the G20 declared the era of bank secrecy over (G20, 2009).” On October 26, 2011, the same month the ActionAid report was released, the OECD released a report entitled “The Era of Bank Secrecy is Over: The G20/OECD Process is Delivering Results.”

HMRC as shown in the General Anti-Abuse Rule, which “could deter and counter tax avoidance, whilst providing certainty, retaining a tax regime that is attractive to businesses, and minimizing costs for businesses and HMRC.”<sup>13</sup>

Since 2009, the HMRC had been issuing an annual report entitled “Measuring Tax Gaps.” The report calculated, among other figures, the gap between the collected tax and the amount HMRC expects to collect from large corporations. The 2011 report was released on September 21, 2011. In particular, the percentage tax gap (defined as the tax gap as a proportion of the theoretical liability) for corporation tax increased from 10.3% in 2008-2009 to 11.7% in 2009-2010 (HMRC, 2011, p.6).

Lesley Strathie, the then head of HMRC, was very ill in 2011. She eventually stepped down as the chief executive from HMRC on November 9, 2011 and passed away on January 14, 2012. It is reasonable to say that the ActionAid report was released at a time when people expected a new chief executive of HMRC would soon replace Lesley Strathie, and the new head might take more proactive actions to tackle tax avoidance.

*Potential boycotts by consumers* Consumers are also likely to take actions by boycotting these firms. For example, an ethical consumer movement group in the U.K. called Ethical Consumer maintains a “boycott list,” consisting of firms that are considered operating in an unethical manner, including tax avoidance. BP, an oil company in our sample, is also among the firms in their boycott list.<sup>14</sup> Besides, according to a BBC report in 2012, U.K. Uncut protested against Starbucks for tax avoidance and boycotted the company. The company only reported taxable profit once in 15 years in the U.K. In response to public criticisms, Starbucks agreed to pay “a significant amount of tax during 2013 and 2014 regardless of whether the company is profitable during these years.”<sup>15</sup> Apart from consumer groups and organizations, individual consumers

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(See the report at <http://www.oecd.org/tax/exchange-of-tax-information/48996146.pdf>.) Meanwhile in the U.S., the Foreign Account Tax Compliance Act was enacted in 2010, specifically tackling non-compliance by U.S. taxpayers using foreign accounts.

<sup>13</sup>See [http://www.hm-treasury.gov.uk/tax\\_avoidance\\_gaar.htm](http://www.hm-treasury.gov.uk/tax_avoidance_gaar.htm).

<sup>14</sup>See <http://www.ethicalconsumer.org/boycotts/boycottlist.aspx>.

<sup>15</sup>See the report entitled “UK Uncut protests over Starbucks ‘tax avoidance’” on December 8, 2012 at <http://www.bbc.co.uk/news/uk-20650945>.

may also boycott these tax-avoiding firms.<sup>16</sup> Therefore, when the ActionAid report revealed the tax avoidance activities of the FTSE firms, consumers may boycott these firms, resulting in a loss of reputation.

Against the above background, we argue that the release of the ActionAid report would trigger the investors to expect a variety of possible reactions of the government and the public toward these firms. In contrast, a specific bill or an act may not have done so for three reasons. First, any bill or act can be lobbied, especially its details (Zingales, 2004).<sup>17</sup> Second, its effectiveness depends on the enforcement. Third, the lengthy drafting and passing of any bill makes the exact day 0 of the “event” debatable.

### 1.3. *Why would corporate governance matter in the U.K. context?*

Desai and Dharmapala (2009) find that in the U.S., corporate governance affects the relation between firm value and its tax avoidance activities. At least one real business practice used among the U.K. firms shows that corporate governance matters in the U.K. too.

HMRC had investigated a dubious business strategy called offshore employment benefit trusts (EBTs). In the past, companies were allowed to use EBTs to pay top corporate executives their bonuses. EBTs, together with haven subsidiaries, can help tunnel funds to the managers and save them from paying taxes. However, this obscure practice also involves layers of transactions. In the end, it is hard for outsiders and shareholders to evaluate whether a firm is paying a reasonable amount of money to the managers via EBTs. The many clever ways of avoiding taxes using EBTs made HMRC rule EBTs as illegal in 2005.<sup>18</sup> There is, of course, no guarantee that apart from

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<sup>16</sup>For example, in a news report by BBC, a consumer in the U.K. responded to the tax-avoiding activities of Google, Starbucks, and Amazon by uninstalling the Google browser, not buying coffee from Starbucks, and not using Amazon to do online shopping. See the report entitled “Google, Amazon, Starbucks: The rise of ‘tax shaming’” on May 21, 2013 at <http://www.bbc.co.uk/news/magazine-20560359>.

<sup>17</sup>Firms may also actively lobby and sneak in small details in a bill that would be hard to be observed, a concern raised in Zingales (2012, p.189), “any but the simplest proposal would be massaged so heavily in Congress that the outcome would be ineffectiveness or worse than the status quo. In writing legislation, the devil is invariably in the details. The details here are just too subtle to become a public political issue. Lobbyists gain a tremendous advantage by understanding and maneuvering the details in legislation to the advantage of their clients.”

<sup>18</sup>HMRC indeed had taken other actions as well to combat tax avoidance. The following two reports

EBTs, there are no other business practices managers can use with the help of offshore tax havens to divert resources.

Using tax havens and obscure layered transactions allows firms to compensate and therefore motivate the management without a substantial tax burden. However, if these practices are not subject to enough checks and balances (e.g., by good corporate governance measures), the resulting managerial diversion can reduce the firm value contributed by the use of tax havens.

#### 1.4. Changes in news coverage around the event

Apart from the news coverage of the ActionAid report on the event date, the report seemed to have aroused the attention of the media (and the public) about the tax avoidance activities of the U.K. firms. We conduct a search in Factiva for news articles related to tax avoidance *and* ActionAid before and after the event date. This search is conducted separately for U.K.-specific and U.S.-specific news articles, the latter being a control group. Table 3 shows a summary of the results. We find that, for the U.K., within two quarters before the event, there were 14 such news articles; the number of news articles increases to 48 within two quarters after the event. In contrast, the corresponding numbers for the U.S. are 4 and 3, respectively.

**Table 3: Tax Avoidance-related News Articles in Factiva Before and After the Event**

	Pre-event		Post-event	
	Apr. 11, 2011 - Jul. 10, 2011	Jul. 11, 2011 - Oct. 10, 2011	Oct. 11, 2011 - Jan. 10, 2012	Jan. 11, 2012 - Apr. 10, 2012
Number of U.K.-specific news articles	11	3	34	14
Number of U.S.-specific news articles	3	1	3	0

Besides, we search news articles in Factiva for tax avoidance-related news for each sampled firm.<sup>19</sup> We then define two dummy variables to indicate whether there are increases in the number of negative news articles within one quarter and two

show the actions they have taken: <http://cdn.hm-treasury.gov.uk/2011budget.taxavoidance.pdf> and <http://www.hmrc.gov.uk/large-businesses/prog-approach.htm>.

<sup>19</sup>The exact search terms are “((evasion or evade or avoid\* or haven\* or dodg\* or penal\* or punish\* or fraud\* or transparen\* or misaccount\* or “treasure island” or loophole\*) same (tax AND firmname)) AND ActionAid.”

quarters before and after the event. In Table 4, we show the correlations between the use of subsidiaries and the changes in negative news coverage. We find that changes in negative news coverage are positively and significantly associated with the firms' numbers of subsidiaries in total, in tax havens, and non-tax havens; the changes in negative news coverage are also positively associated with the firms' shares of tax haven subsidiaries, although the correlations are not significant.

**Table 4: Correlations between the Use of Subsidiaries and Changes in Negative News Coverage**

	(1)	(2)	(3)	(4)
	No. of subsidiaries	No. of subsidiaries in tax havens	No. of subsidiaries in non-tax havens	% of subsidiaries in tax havens
$\Delta$ Negative news coverage (1 quarter)	0.692 (0.000)	0.780 (0.000)	0.644 (0.000)	0.153 (0.188)
$\Delta$ Negative news coverage (2 quarters)	0.588 (0.000)	0.643 (0.000)	0.555 (0.000)	0.126 (0.280)

Note:  $p$ -values of the correlation coefficients are in parentheses.

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