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9-2016

Starbucks: Social Responsibility and Tax Avoidance

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Recommended Citation

Katherine Campbell and Duane Helleloid. "Starbucks: Social Responsibility and Tax Avoidance" (2016). *Management Faculty Publications*. 1.

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STARBUCKS: SOCIAL RESPONSIBILITY AND TAX AVOIDANCE

ABSTRACT

This instructional case is designed to explore how accounting choices, and specifically tax minimization practices, should consider a company's overall strategy and positioning within multiple stakeholder groups. Starbucks had been successful in growing its stores and presence in the United Kingdom (UK), and described the profitable growth to investors as something it wanted to build on in other international markets. However, in its 15 years of operations in the UK, the company had paid UK corporate income taxes only once. Using a combination of legal tax avoidance practices (e.g., transfer prices, royalty payments, interest expense), Starbucks UK had effectively shifted taxable income to other Starbucks subsidiaries where it would be taxed at lower rates.

In 2012, Starbucks in the UK faced a public relations furor over its failure to pay British corporate income taxes. While the tax avoidance practices Starbucks used were common among multinational companies, Starbucks had been very public in its commitment to being socially responsible and a good citizen of the communities in which it operated. This included, among other aspects, paying fair wages to employees and paying fair prices to coffee growers in developing countries. Thus, its critics found it easy to point out that not paying its fair share of taxes was inconsistent with the image Starbucks was portraying to consumers.

Case questions are designed to help you think about the strategic, legal, ethical, and public relations implications of tax minimization strategies, especially when companies portray themselves as responsible "citizens" of the communities in which they operate. The questions also probe whether other characteristics of firms, including their "home" country and the nature of the business, have implications for public perceptions about corporate tax minimization strategies.

Keywords:

Starbucks

Taxes

Tax avoidance

Transfer prices

Tax havens

Corporate social responsibility

United Kingdom

Great Britain

1. Introduction

After years of success and rapid growth, Starbucks found itself struggling as the global economy entered a financial crisis that would become “the great recession” (Barbaro & Martin, 2008). In January of 2008, Starbucks’ CEO, Howard Schultz, articulated a “Transformation Agenda” to address the challenges facing the company and ensure long-term future success (Schultz, 2008). Although this agenda was multifaceted and outlined many changes, Schultz was careful to note that the company’s commitment to social responsibility would not change. In the first of a series of “Transformation Agenda Communications,” Schultz stated:

But even as we execute this transformation, there are certain integral aspects of our company that will not change at all. These include our commitment to treating each other with respect and dignity, providing health care and Bean Stock for all of our eligible full- and part-time partners, and our commitment to our community efforts, our ethical sourcing practices and encouraging our coffee suppliers to participate in our CAFE practices program in our origin countries.
(Schultz, 2008)

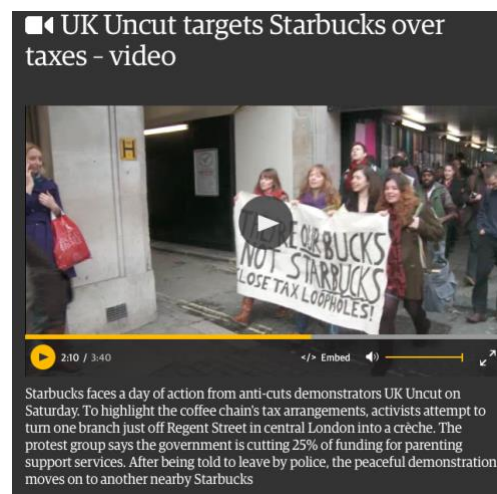
By the end of 2012, Starbucks was reporting increased earnings, revenue growing at more than 11%, and was raising its forward-looking profit forecasts (Baertlein, 2012). It also found itself facing a public relations challenge that threatened the company’s brand and reputation for corporate social responsibility (Houlder, 2012). On October 15, 2012 Reuters published a report titled, “Special Report: How Starbucks avoids UK taxes” (Bergin, 2012). This report described the location of Starbucks affiliates and the inter-company transactions that explained how Starbucks’ UK stores could generate operating profits but legally report no taxable income in the UK. This story received a lot of media attention, and Starbucks made some attempts to respond to the criticism it received for its tax avoidance efforts. These responses seemed to only fuel the criticism from the media, its customers, politicians, and UK businesses that paid UK corporate tax on profits. Amid UK budget cuts to social services, protesters sought to bring attention to the impact of corporate tax avoidance on tax revenues and social services in the UK. Starbucks became a target for protesters because its UK stores were quite visible and reported billions of pounds of sales, while the company had paid almost no UK income taxes since beginning operations in 1998. Exhibit 1 includes links to news videos including footage of the protests.¹

Public accusations of “immoral” tax avoidance and “ripping off” taxpayers (Syal & Wintour, 2012) were not consistent with Starbucks’ image and the community responsibility it had assumed:

¹ All data and information are from the time of the UK row over Starbucks’ tax avoidance - late 2012 (the company’s fiscal year ended in 2013). The epilogue provides updated information on subsequent events. Other companies are currently receiving scrutiny over their tax strategies, and firms face similar issues on a regular basis. The intent of keeping this case set in 2012 is to allow readers to experience events as an accountant or tax professional at Starbucks during that time period.

We've been building a company with a conscience for more than four decades, intent on the fair and humane treatment of our people as well as the communities where we do business, and the global environment we all share. We are proud of our heritage. Yet never before have we seen the marketplace and today's consumers have such a deep interest in and knowledge about what companies stand for and how they are living up to their promises. Not only is standing for something beyond making a profit the right thing to do, it is the way business must be conducted in the 21st century. Only by doing business through the lens of humanity can an organization establish a crucial reservoir of trust with its people and its customers. At Starbucks, it is a trust we must earn every day. (Starbucks, 2012c)

Exhibit 1: Video links



Jonathan Paige, [theguardian.com](http://www.theguardian.com), December 8, 2012, video available at <http://www.theguardian.com/business/video/2012/dec/08/uk-uncut-starbucks-taxes-video>; last accessed April 1, 2016.



Starbucks, Amazon, Google accused of UK tax avoidance
NBC Nightly News (reported by iTV's Libby Weiner), December 3, 2012, video available at <http://www.nbcnews.com/video/nightly-news/50056785#50056785>; last accessed April 1, 2016.

2. A tale of two Starbucks

Starbucks began UK operations in 1998 (Bergin, 2012), and as of September 29, 2013, 764 stores were open (549 company-owned and 215 licensed stores) (Starbucks, 2013a, pp. 4-6). In communications with analysts and investors between 2001 and 2011, Starbucks executives described its UK operations as profitable and held the unit's successful operation up as a model for other international markets (Bergin, 2012). Nevertheless, it consistently reported net losses to UK tax authorities, reporting a taxable profit only once in its first 14 years of operations in the UK (BBC News, 2013).

Starbucks characterized the performance of its UK operations in distinctly different ways to two different audiences: to investors, Starbucks described its UK operations as profitable, but to UK tax authorities the company reported losses (Bergin, 2012). Although this may seem disingenuous at best, there were no allegations of illegal actions. Financial accounting standards establish the parameters for reporting net income or loss reported to investors in a company's financial statements. Tax rules are distinct from financial accounting standards, making it quite common for taxable income to differ from net income reported in financial statements. Multinational corporations like Starbucks have operations in multiple taxing jurisdictions, further complicating the determination of the amount of income subject to taxation in any particular country.

3. Incentives and mechanisms for shifting and minimizing taxable income

Countries have different income tax policies, regulations, and rates. This creates incentives for companies to minimize taxes by shifting taxable income across jurisdictions. For decades, multinational companies have used well-known techniques to legally shift profits from high tax countries to lower tax countries. Transfer pricing, for example, is one of the most commonly used methods to shift profits.

A transfer price is the price charged in a business transaction between entities under common ownership. Multinational companies can reduce income taxes by locating a subsidiary in a country with favorable tax policies, and using this subsidiary as a supplier to other subsidiaries located in higher-tax countries. This tax advantage can be increased by charging the highest price possible for supplies, reducing the profit reported by the purchasing subsidiaries in high-tax countries, and increasing that of the supplier (the subsidiary in a low-tax country). Since the transacting companies are part of the same multinational company, transfer prices and the allocation of profits across subsidiaries have no effect on the total gross profit reported in the consolidated financial statements for the entire corporation. However, transfer prices and the allocation of profit across subsidiaries in multiple tax jurisdictions can substantially affect the total income tax paid by a multinational company, and thus its consolidated net income. It can also affect the amount of income tax that a multinational company pays in individual countries.

Transfer prices are established by companies under common control, and it can be difficult to determine an arms-length transaction price. Substantial judgment is often necessary to determine

where value is created in order to determine an appropriate transaction price. This creates opportunities for multinational companies to use transfer pricing opportunistically to minimize taxes. However, it also creates uncertainty and risk for multinational companies, since transfer prices are subject to scrutiny by income tax regulators. The amounts involved can be substantial. For example, in 2006 the US IRS reached a \$3.4 billion settlement with GlaxoSmithKline in a transfer-price dispute (McKinley, 2013).

In recent years, technology companies have become associated with the use of transfer pricing approaches to reduce income taxes. These companies rely on intellectual property, which is much easier to move than tangible property. A multinational company's intellectual property can be held by one subsidiary that then charges royalty or licensing fees to other subsidiaries. By selectively choosing the tax jurisdictions where intellectual property is held and establishing the licensing fees charged, multinational companies can effectively shift income across tax jurisdictions. Google has been particularly adept at using these techniques to minimize taxes. Over a three-year period beginning in 2007, Google saved \$3.1 billion and increased reported earnings by 26 percent (Drucker, 2010).

Tax rates vary by country, by the type of activity being taxed, and sometimes through special arrangements between companies and local tax authorities as part of an incentive package for the company to make investments in a certain location. For example, 2012 corporate tax rates in Switzerland were generally under 20% (varying significantly by canton), while corporate taxes were 24% in UK, 25% in Netherlands, and up to 40% in USA (KPMG, 2016). In certain countries corporate earnings were not taxed (e.g., Bahamas, Bermuda, Cayman Islands). However, the Swiss tax rate on commodity trading gains was 5%, and the rate on royalties for the use of intellectual property was as low as 2% (Bergin, 2012). Ireland also taxed royalties at 5%. Thus, a company that chose to have royalties paid to a subsidiary in a country with lower taxes on royalties, and traded commodities (e.g., coffee) through countries with lower taxes on trading gains, could reduce its overall tax bill compared to a company that did not structure transactions in this manner.

4. How Starbucks' shifted UK operating profits to other taxing jurisdictions

Transactions between affiliated companies under the common control of Starbucks helped to create the taxable losses reported to UK tax authorities. These can be categorized into the following three areas:

Royalty Payments: Starbucks' UK unit was charged a royalty fee for the right to use intellectual property including the Starbucks brand and various business operations. This fee, equal to 6 percent of sales, was deductible for UK taxable income. These royalties were channeled through various Starbucks owned companies in ways that reduced the effective tax rate to less than 5 percent (Wykes, 2013).

For every £1 million revenue, Starbucks UK would pay £60,000 in royalties to another Starbucks entity and deduct this amount in computing its UK taxable income. If Starbucks UK had not made these royalty payments, for every £1 million in revenue, its deductible expenses would

have been lower and its taxable income would have been £60,000 higher. At the UK corporate tax rate of 24%, Starbucks UK would have been subject to about £14,400 of taxes on every £1 million in revenue. The royalty payments effectively shifted taxable income from the UK to a jurisdiction with a much lower tax rate.

Transfer Pricing: The coffee sold at Starbucks stores in the UK was purchased from a Starbucks trading company based in Switzerland, and was roasted by a Starbucks company based in the Netherlands. Of course the actual coffee beans originated somewhere with a tropical climate, and may never have passed through Switzerland. Switzerland, however, was just the legal address for the trading company. Ultimately, the transaction prices between the three Starbucks entities determined a major component of the cost of the products sold by Starbucks' UK stores. By paying a higher price for coffee to another Starbucks entity, Starbucks UK increased costs and reduced taxable income reported in the UK, thus shifting profit to its Dutch and/or Swiss entities. Although corporate income tax rates were similar in the UK and the Netherlands (24 and 25 percent, respectively), in Switzerland, profits from international commodity trades were taxed at 5 percent (Bergin, 2012). Starbucks also had a special tax agreement with the Netherlands as part of its agreement to locate its roasting facilities there. Thus, Starbucks' corporate tax rate in the Netherlands was lower than the standard corporate rate (European Commission, 2015).

Example: Assume that Starbucks Switzerland paid suppliers £900,000 to have green (un-roasted) coffee delivered to Starbucks roasting facilities in the Netherlands, and charged the Dutch roasting entity £1.2 million for the beans and its sourcing services. The Dutch entity then roasted the beans, and sold them to Starbucks UK for £1.5 million to cover the cost of roasting and transport, as well as a royalty payment it made to another Starbucks entity for the "knowledge" it used to roast and package the beans. Assuming that the actual cost of the coffee delivered to the UK, including transportation, logistics management, and roasting, was £1 million, Starbucks UK paid an extra £500,000 for the roasted coffee. The inflated transfer price increased Starbucks UK's deductible costs, and thus reduced its taxable income by £500,000. At the UK corporate tax rate of 24%, if this transfer price had not been inflated, £500,000 would have flowed through to taxable income, and Starbucks UK would have owed £120,000 in taxes for every £1 million worth of roasted coffee beans.

Inter-company debt: Starbucks financed the growth of its UK operations with inter-company debt, and charged an interest rate (LIBOR² plus 4%) that was substantially higher than its corporate bond rate (LIBOR plus 1.3%) and the rate that other US multinational restaurant chains charged their subsidiaries (typically LIBOR plus 2%) (Bergin, 2012). The interest Starbucks UK paid to other Starbucks companies was deductible and reduced the amount of income subject to tax in the UK. Starbucks UK paid £2 million in interest payments to other Starbucks companies in its 2012 fiscal year (Bergin, 2012). Because of the high inter-company interest rate, Starbucks UK paid approximately £1 million more interest than it would have paid at its corporate bond rate. At a corporate tax rate of 24%, this incremental interest expense reduced UK taxes by £240,000. Starbucks UK's interest payments would represent interest

² LIBOR is an interest rate that banks charge each other, and is typically used as a benchmark for setting other interest rates.

revenue for another Starbucks entity and be subject to income tax, but once again that entity would be strategically located in a tax haven where the rate was substantially lower than the rate in the UK.

5. Starbucks and social responsibility

Since 2001, Starbucks articulated a commitment to corporate social responsibility and issued a Global Responsibility Report (Starbucks, 2013b). Exhibit 2 includes excerpts from Starbucks' 2013 Annual Report (filed with the Securities Exchange Commission as Form-10K) that reflect the importance of social responsibility to the company's business and brand. In 2008, the company established a set of goals related to ethical sourcing, environmental impact, and community improvement (Starbucks, 2013b, p. 3). Starbucks' annual Global Responsibility Report includes a summary of its performance related to these goals. The Starbucks Global Responsibility Goal Performance Summary for fiscal 2013 is reproduced in Exhibit 3.

Exhibit 2

Selected excerpts from Starbucks 2013 Annual Report regarding social responsibility (emphasis added)

Item 1. Business

Global Responsibility

We are committed to being a deeply responsible company in the communities where we do business. Our focus is on ethically sourcing high-quality coffee, reducing our environmental impacts and contributing positively to communities around the world. Starbucks Global Responsibility strategy and commitments are integral to our overall business strategy. As a result, we believe we deliver benefits to our stakeholders, including employees, business partners, customers, suppliers, shareholders, community members and others. For an overview of Starbucks Global Responsibility strategy and commitments, please visit www.starbucks.com.

Item 1A. Risk Factors

You should carefully consider the risks described below. If any of the risks and uncertainties described in the cautionary factors described below actually occurs, our business, financial condition and results of operations, and the trading price of our common stock could be materially and adversely affected. Moreover, we operate in a very competitive and rapidly changing environment. New factors emerge from time to time and it is not possible to predict the impact of all these factors on our business, financial condition or results of operation...

Our success depends substantially on the value of our brands and failure to preserve their value, either through our actions or those of our business partners, could have a negative impact on our financial results. We believe we have built an excellent reputation globally for the quality of our products, for delivery of a consistently positive consumer experience and for our corporate social responsibility programs. Our brand is recognized throughout the world and we have received high ratings in global brand value studies. To be successful in the future, particularly outside of US, where the Starbucks brand and our other brands are less well-known, we believe we must preserve, grow and leverage the value of our brands across all sales channels...

Business incidents, whether isolated or recurring and whether originating from us or our business partners, that erode consumer trust, such as contaminated food, recalls or actual or perceived breaches of privacy, particularly if the incidents receive considerable publicity or result in litigation, can significantly

reduce brand value and have a negative impact on our financial results. **Consumer demand for our products and our brand equity could diminish significantly if we or our licensees or other business partners fail to preserve the quality of our products, are perceived to act in an unethical or socially irresponsible manner, fail to comply with laws and regulations or fail to deliver a consistently positive consumer experience in each of our markets.** Additionally, inconsistent uses of our brand and other of our intellectual property assets, as well as failure to protect our intellectual property, including from unauthorized uses of our brand or other of our intellectual property assets, can erode consumer trust and our brand value and have a negative impact on our financial results.

Source: Starbucks. (2013a). *Annual Report*. Retrieved from <http://investor.starbucks.com/phoenix.zhtml?c=99518&p=irol-reportsAnnual>; last accessed April 1, 2016.

Exhibit 3

Starbucks global responsibility goal performance summary for fiscal 2013

Starbucks Global Responsibility Goal Performance Summary									
Goal	Unit	2008	2009	2010	2011	2012	2013	Goal	Footnotes
Ensure 100% of our coffee is ethically sourced by 2015	%	77	81	84	86	93	95	100%	2008-2011 results include C.A.F.E. Practices only.
Invest in farmers and their communities by increasing farmer loans to \$20 million by 2015	\$M	12.5	14.5	14.6	14.7	15.9	11.9	\$20M	Commitment is defined as being made either by public declaration of intent or signed contract.
Improve farmers' access to carbon markets, helping them generate additional income while protecting the environment									
ON TRACK									
Mobilize our partners (employees) and customers to contribute 1 million hours of community service per year by 2015	Hours	245,974	186,011	191,224	442,353	613,214	630,912	1 M	2008 results for US and CA including Youth Action Grant service hours; 2009-2013 includes all global markets regardless of ownership.
Engage a total of 50,000 young people to innovate and take action in their communities by 2015	People	N/A	20,868	53,673	50,050	54,848	N/A	50,000	2010-2012 ACHIEVED; now tracking new youth leadership metrics.
Implement front-of-store recycling in our company-operated stores by 2015	%	N/A	N/A	5	18	24	39	100%	2010-2013 U.S. and Canada company-operated stores.
	Stores			382	1,390	1,843	3,086		
Serve 5 percent of beverages made in our stores in personal tumblers by 2015	%	1.1%	1.4%	1.5%	1.5%	1.5%	1.8%	5%	2008-2011 results restated using total beverages vs. total transactions.
	#	22,090,511	26,257,492	32,650,747	34,199,507	35,754,382	46,970,869		U.S., Canada, UK, France, Germany and Netherlands company-operated stores.
Reduce energy consumption by 25% in our company-operated stores by 2015	%	0	1.7%	3.3%	7.5%	6.5%	7.1%	25%	Percentage change to the 2008 baseline. Average energy use per square foot/store/month U.S. and Canada company-operated stores.
	KWH	6.80	6.69	6.58	6.29	6.36	6.32	5.10	Avg electricity use per square foot/store/month U.S. and Canada company-operated stores.
Purchase renewable energy equivalent to 100% of the electricity used in our global company-operated stores by 2015	%	20	25	58	50	51	55	100%	2008-2010 goal and results based on for 50% of U.S. and Canada company-operated stores.
	Million KWH	211.3	259.5	580	558	586	650		
Reduce water consumption by 25% in our company-operated stores by 2015	%	0	-8.3%	-21.7%	-17.6%	-17.5%	-21.1%	25%	Percentage change to the 2008 baseline. Average water use per square foot/store/month U.S. and Canada company-owned stores. 2009-2012 results low by -1-2% due to differences in rounding methodology.
	Gallons	24.35	22.36	19.09	20.11	20.08	19.22	18.27	
Build all new, company-owned stores to achieve LEED certification	%	N/A	N/A	N/A	75%	69%	65%	100%	Percentage of new company-owned stores built to achieve LEED® certification.

Source: Starbucks Global Responsibility Report, Goals and Progress 2013, p. 28

Additionally, Starbucks took strong positions regarding its responsibility to employees. Starbucks refers to employees as “partners” and provides benefits to all partners working 20 or more hours per week. These benefits include store discounts, weekly free coffee, 401(k) plans with matching contributions, discounted stock purchase options, tuition discounts at certain universities and a limited tuition reimbursement program, adoption assistance and health insurance for employees, their dependents, and domestic partners (Starbucks, 2012b).

Starbucks also took a strong position on the minimum wage. All Starbucks employees earned more than the federal minimum wage, and Howard Schultz, the CEO, has supported increasing

the minimum wage (Lobosco, 2014). Starbucks also has programs designed to create jobs (Starbucks, 2014a), and since 2007 has been a member of the Armed Forces Network, an organization that seeks to help employ and support veterans and military spouses (Starbucks, 2014b, Starbucks 2013c).

Starbucks' website provides a link to awards and recognition that it has received. Exhibit 4 reproduces this list from 2012. The list is prefaced with the statement that, "Since the beginning, Starbucks has been a different kind of company. One that is dedicated to inspiring and nurturing the human spirit." (Starbucks, 2012a). Most of these awards relate to Starbucks' social responsibility accomplishments, and the selection of awards included on the list reflects the value that the company places on recognition for ethical and responsible behavior.

Exhibit 4 Starbucks company recognition



Starbucks Company Recognition

Since the beginning, Starbucks has been a different kind of company. One that is dedicated to inspiring and nurturing the human spirit. Committed to serving the finest coffee, creating an exceptional customer experience, and being a great place to work. We are grateful to our partners (employees) for making us the company that we are. And we are honored to be acknowledged for their efforts.

Here are some of our recent awards and recognition.

- "No. 1 Best Coffee," Fast Food and Quick Refreshment categories
Zagat's Survey of National Chain Restaurants – 2009-2011
- "No. 1 Most Popular Quick Refreshment Chain"
Zagat's Survey of National Chain Restaurants – 2009-2011
- One of "The 100 Best Companies to Work For"
Fortune – 1998–2000, 2002–2012
- One of the "Most Admired Companies in America"
Fortune – 2003–2012
- One of the "World's 50 Most Innovative Companies"
Fast Company – 2012
- One of the "World's Most Ethical Companies"
Ethisphere – 2007-2012
- One of the "100 Best Corporate Citizens"
Corporate Responsibility/Business Ethics – 2000-2012
- "Sustainability Design Award"
Global Green USA – 2011
- "Most Ethical Company, European Coffee Industry"
Allegra Strategies – 2009-2011
- "Business Person of the Year," Howard Schultz, Starbucks chairman, president and chief executive officer
Fortune – 2011

Source: Starbucks website accessed January 7, 2015. This link is no longer available.
<http://globalassets.starbucks.com/assets/5e71c94483a44a5db41abf79581fbf22.pdf>

6. Starbucks' initial response to the UK protests

Reuters published its “Special Report: How Starbucks avoids UK taxes” on October 15, 2012 (Bergin, 2012). The company responded quickly to the media attention, posting a statement on its website entitled “Starbucks Commitment to the UK” on October 17th (Engskov, 2012a), reproduced in Exhibit 5. In this statement, Starbucks Coffee UK’s managing director, Kris Engskov, noted that while Starbucks had not paid UK corporate income tax, it had paid hundreds of millions of pounds in a variety of taxes in the UK, including National Insurance contributions for its employees. He also noted that the company was investing in UK operations, and contributing to the UK economy by opening hundreds of new stores, creating thousands of new jobs, and purchasing services and supplies from UK companies. By creating income opportunities of individuals and other UK businesses, Starbucks’ economic activities helped generate UK tax revenues (Engskov, 2012a).

Exhibit 5

October 17, 2012 Statement by Starbucks Coffee UK’s managing director

Starbucks Commitment to the UK

17 October 2012

Posted by Starbucks

Following a number of stories in the media over the last day about Starbucks and the amount of tax we pay each year, I believe it’s important that we share the facts with you on this important issue.

The most important thing to understand is that Starbucks does pay tax in the UK. Indeed over the last three years we have paid over £160 million in various taxes including National Insurance contribution for our 8,500 UK employees, and business rates.

The truth of the matter is, the one tax that has been debated in the media, corporation tax, is based on the profits we make in this country – and regrettably we are not yet as profitable as we’d like to be. Is our ambition to be much more profitable, and therefore pay more corporation tax? Absolutely right, and that is why we are making long-term investments in the UK, creating new jobs, opening new stores and delivering new and innovative products for our customers.

The UK represents a very important market for us and I want to be really clear about what contribution we make to the country. Yes, we pay our taxes, but we are here to invest and grow the business. We have raised capital to invest in 5,000 new jobs and open 300 new stores up and down the country. We are also creating 1,000 apprenticeship positions. We contribute to Britain by buying local products such as cakes, milk, sandwiches and using local suppliers to do things like store design and renovation. I am confident these kinds of investments will make us more profitable in the future, and as a result, the corporation tax we pay will increase.

I also wanted to clear up some misapprehensions about a few aspects of our business that have impacted our financial performance: how we source and roast our coffee beans, the royalty we pay to use the Starbucks brand in the UK and the competitive nature of selling coffee in the UK.

Let me start with the beans. To achieve economies of scale for the region we have a buying operation in Switzerland and a shared roasting plant in Amsterdam – it doesn’t make good business sense for wholesale bean buying or roasting to happen in each country. So for the UK we buy and roast our coffee in Europe, the same as other Starbucks businesses in the region.

In terms of the fees we pay to use the Starbucks brand, we pay a royalty levied against our revenues to use the brand in the UK. This is applied wherever we operate in the world at a consistent rate, as is the case for many other global brands.

Finally, the UK is one of the most competitive places to sell coffee in the world and this has had a real impact on the profits we make and therefore the corporation tax we generate. There are three reasons for this. The rent we pay on our stores here in the UK is among the highest in the world. We spend more on the quality of our coffee than our competitors – offering 100% Arabica and 100% Fairtrade espresso coffees. We also spend more on store design so the customer experience is as good as it could possibly be. We have heard that these investments in quality are important to our customers and they are certainly important to us – and well worth the investment. We

haven't always got it right in the past but all of these initiatives, and our focus on making sure we give British customers what they want and need, have put us on a track for growth.

I want to say that this is a really important issue to me and to Starbucks. The UK is one of the most dynamic espresso markets in the world, and we're proud to do business and pay taxes here. As we continue to grow, we will employ more and more partners and contribute to the communities where we do business in new and meaningful ways.

Thank you for listening and I look forward to reading your comments and suggestions.

Kris Engskov
Managing director
Starbucks Coffee UK

Source: <http://www.starbucks.co.uk/blog/starbucks-commitment-to-the-uk/1240>, last accessed April 1, 2016.

Mr. Engskov acknowledged that Starbucks Coffee UK did buy coffee that was sourced by a Swiss affiliate and roasted by a Dutch affiliate, but argued that this made good business sense due to economies of scale. He justified the royalty fee paid for use of the Starbucks brand by arguing that this fee was applied globally at a consistent rate and that the practice was similar to that of other companies with global brands. Mr. Engskov did not comment on the tax implications of its transfer pricing or the tax benefits of the particular arrangements of the transactions across affiliates based in countries with different tax policies (Engskov, 2012a).

As media attention grew, and Starbucks' UK tax avoidance was criticized by its customers, politicians, UK competitors and other UK businesses that paid the UK corporate tax on income, Starbucks once again responded with a public statement. On December 6, 2012 Mr. Engskov posted an "open letter" on the company's website and made a speech at the London Chamber of Commerce & Industry announcing its decision to change its approach to corporate tax (Engskov, 2012b). While reiterating that Starbucks had always paid taxes in accordance with the law, Mr. Engskov announced that the company would "voluntarily" choose not to claim UK tax deductions for inter-company royalty payments, interest charges or mark-ups on coffee included in transfer prices. Starbucks estimated that in 2013 and 2014 it would pay approximately £10 million in each year for UK corporate tax on income (Engskov, 2012b). Mr. Engskov's open letter is reproduced in Exhibit 6, and a link to his speech announcing the change in tax policy is provided in Exhibit 7. On its UK website, Starbucks posted a page with Tax FAQs that includes a link to the London Chamber of Commerce and Industry speech (Starbucks, 2014c).

Exhibit 6

December 6, 2012 open letter from Starbucks Coffee UK's managing director

An Open Letter from Kris Engskov

06 December 2012

Posted by Kris Engskov - managing director Starbucks Coffee Company UK

Today, we're taking action to pay corporation tax in the United Kingdom— above what is currently required by tax law. Since Starbucks was founded in 1971, we've learned it is vital to listen closely to our customers – and that acting responsibly makes good business sense.

Over the more than 14 years we've been in business here in the UK, the most important asset we have built is trust. Trust with our partners (employees), our customers and the wider society in which we operate.

The fact remains that Starbucks has found making a profit in the UK to be difficult. This is a hugely competitive market and we have not performed to our expectations over the many years we've been in business here.

It has always been our plan to become sustainably profitable in the UK. We annually inject nearly £300 million into the UK economy and are exploring additional initiatives to expand our growth and speed our way to profitability in future.

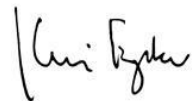
And while Starbucks has complied with all UK tax laws, today we are announcing changes that will result in the company paying higher corporation tax in the UK. Specifically, Starbucks will not claim tax deductions for royalties and standard intercompany charges. Furthermore, Starbucks will commit to paying a significant amount of tax during 2013 and 2014 regardless of whether the company is profitable during these years.

Starbucks will continue to open our books to HM Treasury and HM Revenue and Customs on an ongoing basis to ensure our financial performance and tax structure is transparent and appropriate.

The commitments Starbucks is making today are intended to begin a process of enhancing trust with customers and the communities that we have been honoured to serve for the past 14 years. And we will do even more. Our contribution will increase as we train over 1,000 apprentices over the next two years and pursue a series of initiatives that will increase employment and investment.

We know we are not perfect. But we have listened over the past few months and are committed to the UK for the long term. We hope that over time, through our actions and our contribution, you will give us an opportunity to build on your trust and custom.

Yours sincerely,



Kris Engskov, managing director, Starbucks Coffee Company UK

Source: <http://www.starbucks.co.uk/blog/an-open-letter-from-kris-engskov/1249>; last accessed April 1, 2016.

Exhibit 7

Link to video of Mr. Engskov's December 6, 2012 announcement of Starbucks's change in tax policy.



Starbucks commitment to the UK

The image shows a video player interface. The main video frame shows Kris Engskov, Managing Director of Starbucks Coffee UK, speaking at a podium. The podium has a sign that reads 'Kris Engskov, Managing Director, Starbucks Coffee UK'. Behind him is a large screen with the text 'The Voice of London Business'. A play button is overlaid on the video. Below the video frame is a progress bar showing '00:00 / 09:27' and a volume icon. Below the progress bar is the text 'Starbucks Speech at London Chamber of Commerce & Industry'. To the right of the video frame is a small thumbnail image of Kris Engskov with the text 'Our Commitment to the UK Starbucks Speech at London Chamber of Commerce & Industry'. Below the video player are four icons: 'email', 'share', 'get code', and 'transcript'.

Tax FAQs

Q: Why has Starbucks decided to review its tax approach in the UK?

A: There has been much debate about reforming the current tax system in this country, specifically around corporation tax. Starbucks has paid the level of taxes required by the law. However, we have listened to our customers and it has become clear that you expect more from us than just to follow the letter of the law.

The most important asset that we have built in our time in the UK is trust – trust with our employees, customers and the wider society in which we operate. We fundamentally believe that acting responsibly and listening to our customers makes good business sense.

This is why we have decided to make clear to you that we are changing our approach to corporation tax.

Q: Why does Starbucks not pay tax in the UK?

A: Starbucks pays a range of taxes in the UK, but it is true that we have not paid a meaningful amount of corporation tax. Corporation tax is based on the profits a company makes. We have found making a profit in the UK difficult and therefore have not been in a position to pay much corporation tax.

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

Source: <http://www.starbucks.co.uk/our-commitment>; last accessed April 1, 2016.

Starbucks' decision to pay more UK tax than required by law did little to defuse protests about its tax avoidance practices and failure to pay UK corporate tax on income (Houlder, Jopson, Lucas & Picard, 2012). UK Uncut, the group responsible for organizing many of the tax avoidance protests at Starbucks stores in the UK, posted a press release on December 8, 2012 that commented:

Responding to Starbucks' announcement that it will not claim tax deductions in the UK on a range of its tax arrangements and Starbucks statement regarding worker safety, Hannah Pearce, a UK Uncut supporter said:

"Offering to pay some tax if and when it suits you doesn't stop you being a tax dodger. This is just a PR stunt straight out of the marketing budget in a desperate attempt by Starbucks to deflect public pressure – hollow promises on press releases don't fund women's refuges or child benefits" ...

Kara Moses, at the UK Uncut protest in Birmingham, said "So many people have come to this protest because there is genuine public outrage that multinational companies are being allowed to avoid tax while benefits and essential services are cut. Starbucks' admission that they have not been paying enough tax is a clear admission of guilt, and shows that direct action by the public works. We will keep the pressure up to end tax avoidance and these cuts that are devastating women's lives around the country." (UK Uncut, 2012)

Even UK tax officials and politicians responded negatively to Starbucks' announcement. BBC News quoted Stephen Williams, a Treasury spokesman for the Liberal Democrats, as stating:

"People have been joking that some of these multinationals seem to think that paying tax is voluntary. Well Starbucks have just confirmed the joke really.

Tax is something that is a legal obligation that you should pay according to the tax rules of a particular country. It's not a charitable donation in order to gain sort of brand value. But that seems to be what Starbucks are doing." (BBC News, 2012)

7. Starbucks mission, taxes, and social responsibility

Starbucks' Mission Statement included phrases including "To inspire and nurture the human spirit," "we take our responsibility to be good neighbors seriously," and "The world is looking to Starbucks to set the new standard." (See Exhibit 8 for Starbucks complete mission statement, circa 2011.) Starbucks' practices to shift income from the UK to low tax countries were completely legal, and common for multinational companies. As a company that portrayed itself as being a responsible citizen in the countries in which it operated, the criticisms that it paid no UK corporate income taxes had clearly hit a chord with consumers and the media in the UK. It was clear that Starbucks' initial explanations, and then its subsequent decision to voluntarily pay income taxes, had not quieted critics. As the company considered what further action should be

taken, it needed to consider not only the public relations implications, but also whether the negative publicity would influence “socially responsible consumers” to shift their business to competitors.

Exhibit 8

Starbucks mission statement

To inspire and nurture the human spirit— one person, one cup, and one neighborhood at a time. Here are the principles of how we live that every day:

Our Coffee It has always been, and will always be, about quality. We’re passionate about ethically sourcing the finest coffee beans, roasting them with great care, and improving the lives of people who grow them. We care deeply about all of this; our work is never done.

Our Partners We’re called partners, because it’s not just a job, it’s our passion. Together, we embrace diversity to create a place where each of us can be ourselves. We always treat each other with respect and dignity. And we hold each other to that standard.

Customers When we are fully engaged, we connect with, laugh with, and uplift the lives of our customers— even if just for a few moments. Sure, it starts with the promise of a perfectly made beverage, but our work goes far beyond that. It’s really about human connection.

Our Stores When our customers feel this sense of belonging, our stores become a haven, a break from the worries outside, a place where you can meet with friends. It’s about enjoyment at the speed of life—sometimes slow and savored, sometimes faster. Always full of humanity.

Our Neighborhood Every store is part of a community, and we take our responsibility to be good neighbors seriously. We want to be invited in wherever we do business. We can be a force for positive action— bringing together our partners, customers, and the community to contribute every day. Now we see that our responsibility—and our potential for good—is even larger. The world is looking to Starbucks to set the new standard, yet again. We will lead.

Our Shareholders We know that as we deliver in each of these areas, we enjoy the kind of success that **rewards** our shareholders. We are fully accountable to get each of these elements right so that Starbucks—and everyone it touches—can endure and thrive.

Source: This version of Starbucks’ mission statement comes from an author’s file, circa 2011. This version can also be found in Harvard Business School Case 9-314-068, Starbucks Coffee Company: Transformation and Renewal. The company has since adopted a different mission statement.

8. Questions

1. How were Starbucks’ consolidated financial statements affected by Starbucks’ efforts to minimize UK corporate tax?
2. What tax strategies did Starbucks use to minimize the taxes it paid in the UK?
3. Is the allegation that Starbucks did not pay its “fair share” of UK taxes accurate?
4. Is it inconsistent for a company to claim to be socially responsible, and take credit for paying fair wages to employees and fair prices to suppliers in developing countries, and then not pay their “fair share” of taxes to local governments?
5. Even if it is legal for a company to avoid paying taxes in a country (or state, county, or city), is it ethical to shift taxable income away from the jurisdiction generating the profits to another jurisdiction with a lower income tax rate?
6. What organizational goals were affected by Starbucks’ efforts to minimize taxes? How should this affect the company’s future tax planning?

7. Prior to the negative publicity, which stakeholders were the primary beneficiaries of Starbucks tax avoidance in the UK? Which stakeholders were potentially harmed by Starbucks' tax avoidance?
8. If tax avoidance is a common practice among multinational companies, why was Starbucks targeted for its tax avoidance activities?
9. The media reports and protests focused on the amount of income taxes that Starbucks paid in the UK. Are Starbucks' other contributions to UK tax revenue relevant to this discussion? Why was the attention focused solely on Starbucks' corporate income taxes?
10. What motivations might underlie Starbucks' decision to voluntarily pay corporate income taxes in the UK?

9. Teaching notes

9.1 Educational objectives

This case is intended for use in an upper level financial accounting course, and has been tested in a senior-level capstone financial accounting course. The case describes how Starbucks' reported its UK financial results for tax purposes differently than it described the performance of its UK operations to investors. This case could also be used in taxation or ethics classes, but we do not have data on efficacy in those courses, and instructors would likely choose to structure the discussion or written assignments in those courses differently than is outlined in this teaching note. Key objectives of the case are to help students:

- identify the potential inconsistencies between utilizing tax avoidance strategies while simultaneously portraying an image of corporate social responsibility
- explain how some stakeholders might be negatively impacted by a company's aggressive tax avoidance strategy
- appreciate some of the ethical issues that should be considered prior to shifting taxable income from high tax locales to lower tax locales
- explain how a company's organizational goals (e.g., growth, profits, reputation) could be negatively impacted by a decision to aggressively pursue legal tax avoidance practices

The ten discussion questions listed in Section 8 are designed to get students to think about specific issues that will facilitate meeting the four educational objectives through knowledge building. The core issue in the case is whether it is disingenuous for a firm that deliberately projects an image of social responsibility to practice tax avoidance. Simply stated, is paying one's fair share of taxes an important aspect of social responsibility, in the same way as fair wages for workers, charitable contributions, sustainability, and environmental responsibility? This issue illustrates the potential relation between tax strategies and other corporate priorities and strategies, and thus the importance of communication between accountants/tax advisors and those responsible for overall strategies, corporate brands, and public relations.

9.2 Conceptual background

This case is meant to generate discussion around two primary topics: corporate social responsibility and stakeholder management in the context of tax planning. It clearly could also

be used to explore some international business and public relations issues. These last two issues are identified in the case, and briefly brought up in the discussion questions, but are not explored in any detail.

The issue of corporate social responsibility now appears in most principles of management textbooks, business and government textbooks, and strategic management textbooks. Thus, most accounting students are exposed to the topic on several occasions as part of their core courses in their business curriculum. One definition of corporate social responsibility is as follows:

Corporate social responsibility occurs when an organization seeks to meet or exceed legal and normatively mandated standards, by considering the greater good of the widest possible community within which it exists, both in local and global terms, with regard to the environmental, social, economic, legal, ethical, and philanthropic impact of the organization's way of conducting business and the activities it under takes. (Clegg, Kornberger, & Pitsis 2011, page 405)

The question of whether corporate social responsibility “pays off” for a company has generated many empirical and philosophical articles, with a fairly comprehensive review by Vogel (2005). He concludes that “the business case for virtue is strongest for firms that have made CSR a part of their strategy for attracting and retaining customers, employees, investors, and for highly visible global companies that have been targeted by activists.” It would appear that Starbucks fits this definition.

Stakeholders are those individuals or groups whose interests can be affected by an organization's decisions, and/or can affect an organization. While the lists of which individuals and groups constitute stakeholders of a corporation varies across books and definitions, most definitions refer to both internal and external stakeholders (e.g., Kinicki & Williams 2013, page 69). A corporation's obligation to communities is often mentioned, as is the importance of interacting with government regulators.

Myron Scholes and Mark Wolfson (1992) developed a widely known view of tax planning that takes into consideration all taxes (i.e., explicit and implicit), effects on all parties, and all costs (i.e., financial reporting, agency, etc.). Another important concept in tax planning is that companies cannot minimize taxes without affecting other organizational goals (Scholes, Wolfson, Erickson, Hanlon, Maydew & Shevlin, 2014). These concepts can be discussed in the context of Starbucks' UK operations and its efforts to minimize income taxes.

9.3 Evidence regarding case efficacy

The public backlash Starbucks (and several other US companies, including Apple and Google) faced in the UK over their tax avoidance practices was discussed in an undergraduate Advanced Accounting class, and students' engagement in these discussions provided encouragement for writing this case. As there were only lower level course offerings for accounting students in Summer 2015, the case was beta-tested in a Strategic Management class that had a large number of accounting students.

Approximately a week before the case was distributed in Summer 2015, students were asked to respond to two questions regarding their views on topics that would be discussed in this case.³ After the cases were discussed, students answered the exact same questions again. Each student provided a unique identifier so that the pre and post responses could be matched. Each student also indicated his or her major. Students were asked to respond whether they strongly agreed, agreed, were neutral, disagreed, strongly disagreed, or had no opinion regarding the following statements:

1. It is the duty of public companies such as Starbucks, Amazon, Ford, United Airlines, etc., to do everything legally allowable to minimize the overall taxes paid to the cities, states, and countries in which they operate.
2. A company should engage in smart tax strategies to shift profits from high tax locations to low tax locations (or tax havens) as long as no tax laws are broken.

The results were scored with a “1” for strongly agreed and a “5” for strongly disagreed, with 2-3-4 corresponding to the intermediate responses. Exhibit 9 summarizes the results of the pre and post case questionnaires, including analysis of the difference in mean values for the pre and post case questionnaires.

Exhibit 9
Evidence of changes in students’ views

Results of Student Pre-case and Post-case Student Questionnaires						
	Observations (All Students)	Observations (Accounting Students)	Average Pre Response (All Students)	Average Post Response (All Students)	Average Pre Response (Accounting Students)	Average Post Response (Accounting Students)
Q1 – Tax Minimization	57	23	2.32	2.91	2.13	2.87
			t-statistic = 3.97 P < .0001		t-statistic = 3.51 P < .001	
Q2 –Shifting Profits to Tax Havens	57	23	1.88	2.43	1.65	2.70
			t-statistic = 4.39 P < .0001		t-statistic = 4.9 P < .0001	

For the questions on tax minimization and shifting profits, the pre-case responses indicated that students generally agreed that reducing taxes is an important action that corporations should take. The post case responses were on the “agree” side of neutral (less than 3.0), but students had moderated their views on tax reduction. The change in response was greatest for the accounting students compared to other majors (e.g., marketing, management, finance, economics).

Open ended questions regarding the case elicited the following comments from accounting students:

- I never realized before how sneaky tax accounting can be. We should be taught this.
Our tax class did not prepare us to shift expenses like Starbucks does.
- Starbucks needs to hire public relations people who are as good as its tax planners.
- It is comical to see how ridiculous some activists can be, picking on Starbucks.
- This shows how hard it can be to try and be a ‘good’ company.

³ The questionnaire also asked for their views on completely unrelated airline industry topics appropriate for two different cases that were also being beta-tested that semester.

- This highlights a philosophical divide between a shareholder and stakeholder view of business.
- I never thought that a tax strategy needed to do more than follow the laws and minimize taxes. But I guess it is better to pay some taxes to avoid being called out in the media.
- The protestors don't really care about the taxes, they just want some big company to protest against. They should be protesting [in parliament], not a coffee shop.

Some students' responses went the other way (they became more adamant that companies should engage in tax minimization), and in discussions, it became clear that these students thought Starbucks was doing the right thing, and they thought it was wrong for Starbucks to be taking the heat for just following the laws.

Accounting students were generally sympathetic to Starbucks, and to the work of the accountants and tax planners. They felt these individuals were simply doing their job, as it was understood to be. But the students also recognized that the result of this "effective" tax planning had caused a great deal of bad press for Starbucks, distracted management from more important tasks, and was not consistent with the image of corporate social responsibility that Starbucks was trying to convey to its stakeholders.

Desiring more data from accounting students on case efficacy, the exact same case was distributed to 39 students in a senior-level capstone financial accounting course in Fall 2015. Several of the discussion questions were slightly modified or dropped, based on the different audience (a capstone financial accounting course in fall compared to a strategic management class in the summer), and to improve the clarity of the questions. The case was distributed a week in advance of the scheduled class discussion, and students were asked to prepare and submit written answers to the discussion questions prior to the class discussion. Exhibit 10 highlights observations from their written answers.

Exhibit 10
Students written responses to discussion questions

Discussion Question	Comments on Students' Written Answers (with percentage of students receiving a "C" or better on this question in parentheses)
1. How were Starbucks' consolidated financial statements affected by Starbucks' efforts to minimize UK corporate tax?	Students had little difficulty with this question, as this is stated in the case and is consistent with students' knowledge from prior accounting classes. (100)
2. What tax strategies did Starbucks use to minimize the taxes it paid in the UK?	Students had little difficulty repeating the information from the case. (100)
3. Is the allegation that Starbucks did not pay its "fair share" of UK taxes accurate?	The class was about split about 50/50 on this, and both sides were able to provide a justification for their position. (100)
4. Is it inconsistent for a company to claim to be socially responsible, and take credit for paying fair wages to employees and fair prices to suppliers in developing countries, and then not pay their "fair share" of taxes to local governments?	The majority of the class believed that there was an inconsistency, and effectively justified their answer. A minority argued that "fair share" and "legal" were equivalent concepts and were not convinced that there was any inconsistency. A couple of students missed the point of this question. (95)
5. Even if it is legal for a company to avoid paying taxes in a country (or state, county, or city), is it ethical to shift taxable income away from the	The quality of students' answers to this question varied considerably, and the difference may have been influenced by whether they had (or were simultaneously) taking an accounting ethics class. Some students clearly articulated an ethical

jurisdiction generating the profits to another jurisdiction with a lower income tax rate?	framework for decision-making (e.g., utilitarian), while others offered no basis, and others simply equated legal with ethical. (85)
6. What organizational goals were affected by Starbucks' efforts to minimize taxes? How should this affect the company's future tax planning?	Students had little difficulty with this question, and regardless of their previous views on fairness, equity, and inconsistencies, were clear that tax planning would change going forward. (100)
7. Prior to the negative publicity, which stakeholders were the primary beneficiaries of Starbucks tax avoidance in the UK? Which stakeholders were potentially harmed by Starbucks' tax avoidance?	Most students struggled with this, perhaps because their exposure to stakeholder analysis had occurred a couple years prior. Few went past direct stakeholders (e.g., shareholders, UK government), and most provided perfunctory responses. (With minimal prodding, a much more extensive list of stakeholders was discussed in class.). (60)
8. If tax avoidance is a common practice among multinational companies, why was Starbucks targeted?	While not explicitly discussed in the case, most students had little difficulty identifying the reasons why Starbucks had been targeted. (95)
9. The media reports and protests focused on the amount of income taxes that Starbucks paid in the UK. Are Starbucks' other contributions to UK tax revenue relevant to this discussion? Why was the attention focused solely on Starbucks' corporate income taxes?	There were a wide range of answers to this question, ranging from talk of media conspiracy to views that it seems pretty obvious that profits were being hidden or shifted. (80)
10. What motivations might underlie Starbucks' decision to voluntarily pay corporate income taxes in the UK?	Students had little difficulty with this question. (100)

Class discussion of the case generally followed that outlined in Section 9.4 (Implementation Guidance), which follows this section. The class began with a fairly lengthy discussion of Starbucks mission, and its emphasis on corporate social responsibility. All students were familiar with the company, and some expressed how the values of the company mattered to them. Others indicated that a simple desire for coffee and a good place to study motivated them to frequently visit Starbucks, and they had no interest in the company's social mission. The class moved through the basic accounting issues quickly, and spent little time on the issues related to public relations. The discussion of what constitutes a "fair share" of taxes and whether avoiding taxes is ethical generated considerable debate, most quite healthy. It was important to make sure the different sides and rationales were openly discussed, not with a goal of changing opinions, but with a goal of understanding the bases for different opinions. The purpose of the case discussion, as it addressed topics related to questions 3 through 9, was not to identify correct or incorrect answers, but to deepen and broaden understanding of the issues and perspectives. At the conclusion of the class, a survey was distributed asking students to reflect on what they had learned, as presented in Exhibit 11.

Exhibit 11
Students views regarding the case's impact on their understanding of issues

Post Case Discussion Student Survey Results				
Strongly Agree = 1	Agree = 2.	Neutral = 3	Disagree=4	Strongly Disagree=5
	Mean (n=39)	Median (n=39)	Probability that the mean is 3 or greater.	
1. This case helped me understand the mechanisms used by some companies to minimize their taxable income in certain countries, and shift taxable income to lower tax countries.	1.46	1	<.00001	
2. This case helped me understand how some stakeholders might be negatively impacted by a company's aggressive tax avoidance strategy.	2.05	2	<.00001	

3. This case helped me understand the potential inconsistencies between utilizing tax avoidance strategies while simultaneously portraying an image of corporate social responsibility.	1.82	2	<.00001
4. This case helped me understand why protestors might choose to make an example out of a company such as Starbucks, rather than another company.	2.07	2	<.00001
5. This case helped me understand some of the ethical issues that should be considered prior to shifting taxable income from high tax locales to lower tax locales.	1.74	2	<.00001
6. This case helped me understand how a company's organizational goals (e.g., growth, profits, reputation) could be negatively impacted by a decision to aggressively pursue legal tax avoidance practices.	1.59	2	<.00001

The responses in the Post Case Discussion Student Survey Results clearly show that the Education Objectives outlined in Section 9.1 were met, and that students also gained some knowledge related to the mechanisms of tax avoidance as well as an understanding of why some companies may be more likely to be “called out” for their tax practices than others.

Students in both classes clearly indicated that the case had deepened their understanding of tax avoidance and its potential implications, with the data in Exhibit 9 indicating that the case had changed views on the issues. The case raised issues for students regarding the role of accountants and tax advisors, and how the advice these professionals provide, and the choices they make, need to be consistent with the overall strategy of the company and its public image. The case was effective in helping accounting students think about these issues, and their roles as professionals.

9.4 Implementation guidance

The case (through section 8 of this document) should be distributed to students with sufficient time for them to read and analyze the situation (perhaps a week in advance). Students should also be encouraged to view the videos via the links in the case.⁴ The concepts and facts presented are fairly straightforward, and do not require any complex computations or detailed instructions.

Opening with discussion of Starbucks' mission, and its emphasis on corporate social responsibility can be a good way to get students thinking about why Starbucks is able to charge what it does for a cup of coffee. While some consumers are probably simply getting coffee and not thinking about much else, other consumers may be loyal to Starbucks because they want to be a part of, and affiliated with, the company's overall mission and socially responsible reputation. Expanding this discussion to explore the roles of Starbucks' various stakeholders, and how they influence, and are influenced by, Starbucks naturally follows.

It makes sense to tease out the details of Starbucks' tax minimization practices, just to make sure all students understand the transactions, and why these are all technically allowable under the tax

⁴ Over time, these links and the videos may no longer be available. They are not essential to understanding the issues in the case, but do contribute to students' ability to “see” and “hear”, in addition to reading about, the issues.

code. While the transactions have no effect on operating profit, they clearly impact taxes and net income.⁵ A numerical example that faculty may find useful to share with students is available upon request.

The next topic for discussion is the media reports, protests, and Starbucks' responses to the issue. While Starbucks' Kris Engskov attempted to address the situation and put his company in a good light, it appears his efforts proved unsuccessful in deflecting criticism. As described in Section 9.6 (Epilogue), Starbucks' UK sales suffered, suggesting there was a real business cost to Starbucks' tax avoidance transactions – a cost that might have been greater than the tax savings.

The final aspects of the discussion will certainly vary depending on instructors' preferences, and the place in the course when this case is taught. A generic closing is to emphasize how everyone in a company needs to understand the strategy of a company, the company's relations with stakeholders, and potential implications of decisions they make. It would appear that Starbucks' employees and its tax advisors involved with tax planning and tax strategies did not consider how stakeholders could view tax avoidance as inconsistent with Starbucks' mission and espoused socially responsible values.

Faculty are encouraged to modify the discussion questions as they see fit, given their context and the preparation of students in ethics and stakeholder analysis. It may also be appropriate for faculty to add questions related to issues related to other corporations' tax avoidance strategies that are in the news at the time the case is taught.

9.5 Solutions

Suggested answers to the discussions questions, a hypothetical numerical example comparing taxes payable for a firm not using tax avoidance strategies to one using the case tax avoidance strategies, and a grading rubric, are available upon request from Duane Helleloid (duane.helleloid@und.edu).

9.6 Epilogue

Subsequent to its announced plan to voluntarily pay more UK corporate taxes than required by law, Starbucks did indeed pay taxes. After paying no UK corporate tax for many years, Starbucks promptly began fulfilling its pledge and paid approximately £5 million in June 2013 (Petroff, 2013). In December 2014, Starbucks made the final £5 million payment of the £20 million of the taxes it voluntarily pledged to pay (Neville, 2014). A statement near the time of this final tax payment suggesting that it would be years before the company would generate a profit and pay “normal” taxes in the UK, however, sparked renewed furor (Neville and Prynne, 2014). In 2015, Starbucks UK reported a pre-tax profit of £34million, and paid taxes of just over £8 million (Davies, 2015).

⁵ Interestingly enough, and this is not in the case since it makes the discussion potentially more confusing, Starbucks has an effective tax rate of about 32% during this time period. This indicates that the company was paying income taxes at a substantial rate somewhere, even though it had not been paying corporate taxes in the UK.

In its fiscal year 2013 (the period immediately following the UK tax avoidance reports), Starbucks reported its first ever decline in UK sales (Bond, 2014). Since 2013 the company has made changes to its mission statement, and on its website updated its statements about corporate social responsibility. However, the basic message that the company is concerned about multiple stakeholders and takes an active stand to improve the world in which it operates has not changed.

In April of 2014, Starbucks announced that it would move its regional headquarters for Europe, the Middle East, and Africa (EMEA) to London from Amsterdam. As a consequence, the company expected to pay more UK taxes. Although this move was made in the wake of substantial criticism and protests related to UK tax avoidance, and announcement of the planned move triggered questions about the tax implications, Starbucks cited business reasons for the move (Jolly, 2014).

The European Commission⁶ initiated investigations against several companies in 2014 regarding the shifting of expenses from high-tax to low-tax locations. Amazon was questioned over its practice of having most goods sold in Europe officially billed as coming from its Luxembourg company, even though the goods may have never been in Luxembourg. The Commission also questioned the reasonableness of the royalty payments paid between countries (Fairless, 2015). In October 2015, the Commission ruled that both Starbucks and Fiat had benefitted from inappropriate tax deals with the Netherlands and Luxembourg, respectively. Starbucks was found to be paying unusually high prices to its Swiss subsidiary for green coffee, as well as paying royalties for knowledge of coffee-roasting techniques to a different company it controlled. These transactions significantly reduced the profit of Starbucks in the Netherlands. In the same ruling, Fiat's Finance and Trade subsidiary in Luxembourg was found to be using unreasonable accounting assumptions regarding its capital base and remunerations. Fiat, it wrote, was using an "artificial and extremely complex methodology that is not appropriate for the calculation of taxable profits reflecting market conditions." In each case, the European Commission concluded that the companies were responsible for underpaid taxes of 20-30 million euros. The ruling indicated that both firms used "artificial and complex methods to establish taxable profits" and that these methods did "not reflect economic reality" (European Commission, 2015).

There are several inter-governmental initiatives that have a goal of constraining countries (or tax jurisdictions) and companies from engaging in "sweetheart deals" or overly generous tax deals. The European Union has become more aggressive in suggesting that member countries can not strike deals with individual companies that cause these firms to shift profits where they will then be taxed at unusually low rates (European Commission, 2015; European Commission, 2016). While most European rulings requiring the payment of back taxes by companies engaged in aggressive tax minimization tax practices are under appeal, these rulings may be causing some companies to reconsider future tax minimization. Another initiative is the OECD's BEPS Project (Base Erosion and Profit Shifting), which will require country-by-country reporting of

⁶ The European Commission is, in general terms, the executive branch of the European Union. It represents the interests of the European Union as a whole, rather than individual constituencies or countries.

sales, profits, assets, and employees (OECD, 2015). The full details and implementation of BEPS are still underdevelopment, with intergovernmental sharing of company data not likely to take place until 2018.

Payment of income taxes is increasingly being viewed as a dimension of corporate social responsibility and continues to draw attention from regulators, legislators, and the media. While this case describes Starbucks' tax avoidance tactics, corporate tax inversions are another example of a legal tax-motivated transaction that is currently receiving scrutiny (McKinnon & Paletta, 2014; Rubin, 2015; Pfizer, 2016). This continued public scrutiny of corporations' tax minimization tactics highlights the notion that paying taxes is part of citizenship.

Acknowledgements

The authors would like to acknowledge the helpful comments received at the 2015 Western Casewriters Association Conference, the feedback from many students at the University of North Dakota who used earlier versions, suggestions of two fine reviewers, as well as advice from the associate editor and editor of *The Journal of Accounting Education*.

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