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Educational Case

Starbucks: Social responsibility and tax avoidance

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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.

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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 presenting 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:

> 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)

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

[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.

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