Principles for Responsible Investment

# HOW TO CONSIDER TAX IN VOTING PRACTICES

**DECEMBER 2022**


UN environment programme finance initiative

United Nations Global Compact

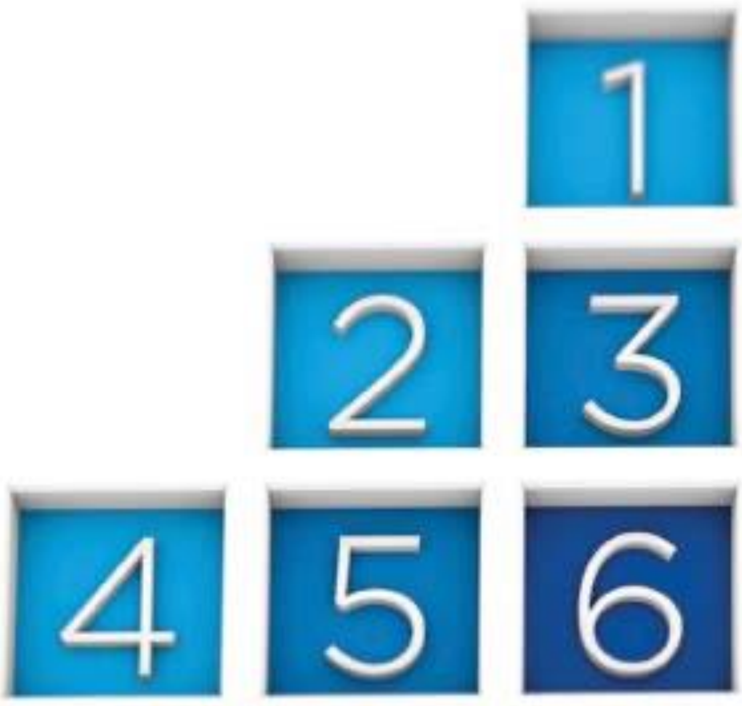
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

# THE SIX PRINCIPLES

## PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.




## PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

Shareholders have a powerful tool at their disposal to drive change on tax-related issues: voting at companies' general meetings. Voting is an essential channel for investors to communicate their expectations on tax in a clear and quantifiable manner.

This article aims to explore how investors can integrate tax issues within their voting policies and effect change.[1] We want to help shareholders to:

1. outline clear expectations on tax;
2. link tax expectations to relevant votes; and
3. ensure consistency between expectations, voting policies and wider responsible investment approach to tax.

We continue to work on tax and welcome input from signatories on how to effectively incorporate tax considerations into voting.

# WHY FOCUS ON CORPORATE TAX?

It is in investors' interest to ensure that corporate taxes contribute to stable, well-functioning socio-economic systems that are conducive to achieving investment returns and the Sustainable Development Goals (SDGs). Aggressive tax planning creates reputational, governance and earning-related risks. Heightened scrutiny from tax authorities and policy makers around corporate tax following the COVID-19 pandemic and global efforts to combat tax avoidance are only exacerbating those risks. Our latest paper on tax fairness explains why tax is a systematic issue and that it is in investors' interests to promote a robust tax system that fuels economic growth and stability rather than short-term returns.

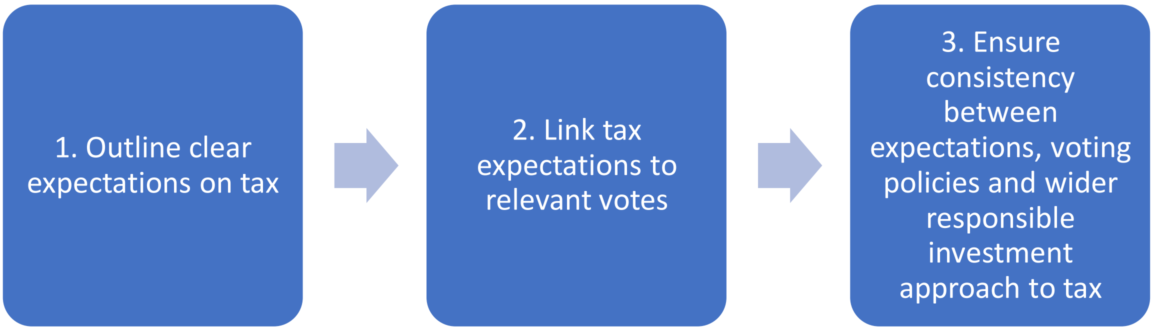
However, many companies are still reluctant to be more transparent and adjust their tax practices.[2] Investors have a responsibility to ensure their investees evolve with the landscape and expectations. We commissioned research in 2021 to assess the extent to which 120 institutional investors considered tax in their voting, RI, stewardship and engagement policies, as well as in their position papers on tax.[3] The research found little evidence that investors consider tax to inform their voting policies.

[1] Voting policies refer to voting guidelines or principles
[2] PRI (2020), Advancing tax transparency: outcomes from the PRI collaborative engagement 2017-2019
[3] Annual stewardship reports or webpages were not reviewed as part of this analysis

# THREE KEY STEPS FOR INVESTORS

Our research found that there are three steps investors can take to better integrate tax in their voting policies. The next sections provide examples of current practice and recommendations for investors to consider.

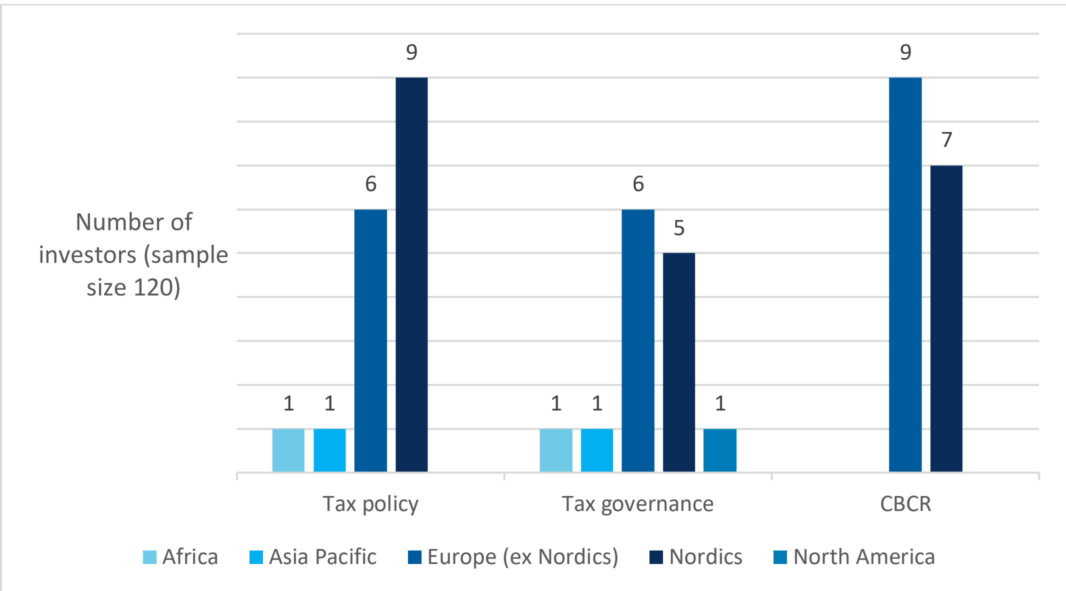
**Figure 1: Three steps for investors to integrate tax in voting policies**




## 1. OUTLINE CLEAR EXPECTATIONS ON TAX

Our commissioned research points to a missed opportunity to hold companies to account: 14% of investors assessed had disclosed at least one expectation and only 5% had disclosed expectations in all three areas of responsible tax management: tax policy; tax governance; and country-by-country reporting (CBCR).

**Figure 2: Few investors outline their expectations on tax**



**Recommendation: Investors should articulate clear expectations regarding investees' tax policies, relevant governance mechanisms, and tax disclosures including public CBCR.**[4]

Investors clearly articulating their views and expectations on tax disclosure is valuable for portfolio companies. It enables portfolio companies to understand investors' stance and clarifies the type of resolution an investor is likely to support. For asset owners that outsource some or all of their voting to third parties, expectations should be communicated to investment managers and form part of the process when it comes to selecting, appointing and monitoring external investment managers.

Expectations on disclosures are particularly important as the lack of transparency is the primary barrier to assessing whether investee companies have implemented a responsible or aggressive tax strategy. Disclosures enable investors to make sound judgements about investee corporate tax practices and engage with portfolio companies in a more informed and constructive way.

### Examples of current practice:

There are some good examples of organisations setting out their views on tax transparency.

Nordea Asset Management outlines expectations on transparency as well as responsible practices: "*We recognise the importance of companies being accountable for and transparent about their tax practices. We expect our portfolio companies to have a tax policy that outlines the company's approach to taxation and how it aligns with the overall business strategy. We also expect companies to have a robust tax governance and management framework in place, to pay taxes where economic value is created and to provide country-by-country reporting*."

Scottish Widows believes *"investee companies should pay fair levels of tax and comply with all tax laws and regulations in countries of operation. […] We are supportive of country-by-country reporting in order to provide transparency regarding a company's business model and tax planning strategy and encourage adoption of the GRI's Tax Standard".*

Some organisations have formulated expectations on other tax avoidance-related issues, such as asking companies to explain why they have operations in low-tax or secrecy jurisdictions.

DNB states, "[…] *if requested, multinational enterprises should be prepared to publicly explain the business case for locating subsidiaries in the following: a) 'Closed' jurisdictions and / or significantly low-tax environments ('tax havens'). b) Countries where no local employees carry out business functions to any substantive degree or where the number of such employees is very low compared to the economic value generation attributed to that part of the business / country. If the board decides to deviate from the guidelines above, they should be prepared to provide a public explanation detailing their reasons for the deviation*."

[4] Country-by-country reporting (CBCR) is the disclosure of tax information for each jurisdiction where a company has operations. This includes employee count, revenue, profit, corporate income tax, etc. It allows investors to assess whether a company's use of low-tax jurisdictions is legitimate and helps establish a link between taxes paid and commercial substance of operations

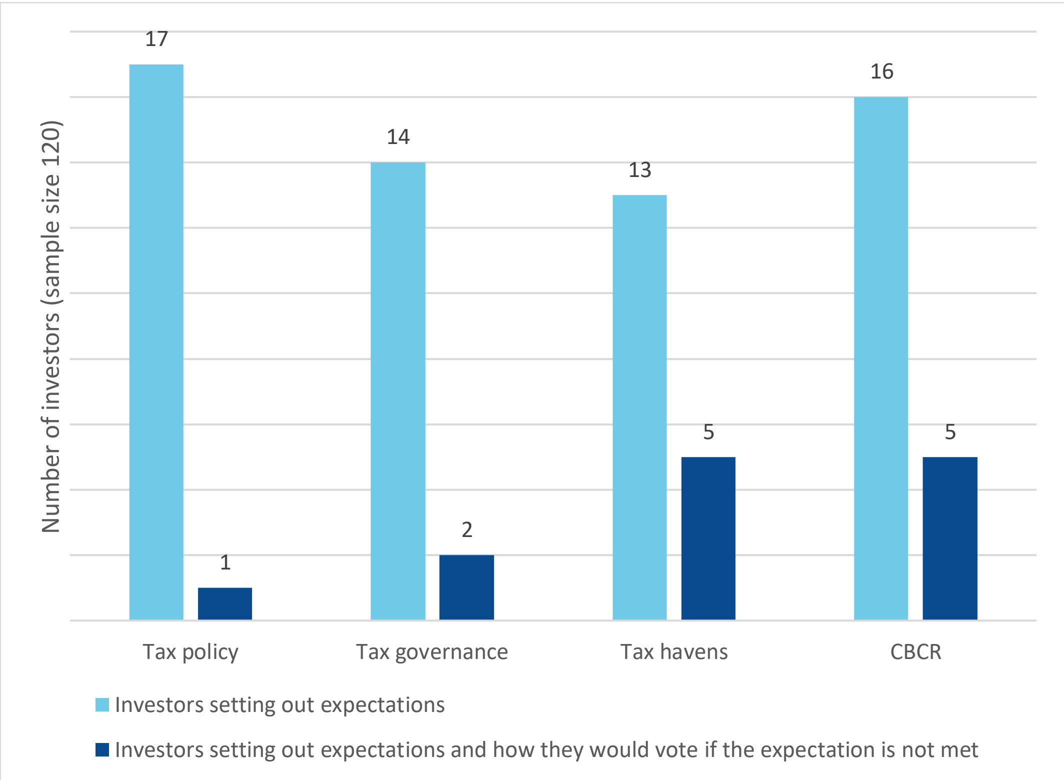
[KLP](#) outlines what commitments it expects to see in a tax policy: "*KLP expects companies to have a policy on the responsible payment of tax. This policy must state that business decisions shall have real substance and that the company shall not engage in any practices, through transactions and legal structures, which contribute to tax evasion. Taxes should be paid where the actual economic value is generated.*"

## 2. LINK TAX EXPECTATIONS TO RELEVANT VOTES

Our research reveals that investors tend to formulate tax-related expectations without defining how they would use their vote to assert their positions. Only 15% of the investors assessed set out how they would use their votes if portfolio companies did not meet expectations (see Figure 3 below).

Among the investors that identified how they would vote, almost all said they would support a shareholder resolution but did not mention other votes. Only two investors stated how they would use the other votes available to them (e.g., reappointing directors or auditors). Even though tax is a board-level responsibility, only two of the investors that had disclosed expectations on board oversight had set out how they would use their votes if this expectation was not met e.g., vote against any or all director(s).

**Figure 3: Expectations on tax are not informing how investors use their votes**



**Recommendation: To better effect changes in investee practices, investors should ensure the expectations and positions that they have defined on tax are reflected in the way they vote.**

Investors should introduce tax considerations into voting policies and shareholder resolutions (see examples below). If these options are not available, investors should consider other stewardship mechanisms to advance responsible tax practices (see Step 3).

## INTRODUCING TAX CONSIDERATIONS INTO VOTING POLICIES

Below is a list of situations where investors can consider how to use their votes.

- **(Re)appointing board / audit committee members**. Investors can specify in their voting policies that they would vote against reappointing any / all member(s) of the audit or risk committees given that tax usually falls within their remit. If circumstances do not allow the investor to vote against the members of these committees, investors could vote against any other board member. Investors can also vote against the chair of the ESG or sustainability committee to raise awareness that tax also falls within the scope of their responsibilities.
- **Assessing mergers, acquisitions or reincorporations.** Reincorporation into low-tax, secrecy or controversial jurisdictions should be given more consideration and any region that is on the EU list of non-cooperative jurisdictions is a serious red flag. However, the EU list contains only a limited number of jurisdictions, so investors should look at various sources to build their own list of controversial areas. Investors should carefully consider management's motivations behind reincorporating in a controversial area and assess whether tax is a primary driver or consequence of the change in structure. Investors should engage further if not enough information is disclosed. Other factors (e.g., the company has a history of aggressive tax practices, or is not transparent) may inform investors' votes.
- **Reappointing an auditor / considering excessive tax advisory fees.** Investors could set out in their policies that they would vote against reappointing an auditor where tax advisory fees make a significant portion of non-audit fees, as this may indicate that the company is dedicating significant resources to its tax planning (and excessive non-audit fees may undermine the auditor's independence). Investors may want to question companies that do not provide sufficient information on other services provided by auditors.

Investors can use these votes when the company is not addressing significant tax-related risks or does not provide evidence of adequate oversight of the company's tax strategy. Investors can identify criteria that would trigger a vote e.g., the investee company is fined; has ongoing tax disputes or significant unrecognised tax benefits for which insufficient information is shared with investors; the investee company's tax practices are called out by policy makers; or the investee company has a low effective tax rate for which no explanation is provided, potentially suggesting risky practices.

**Examples of current practice:**
AllianceBernstein and Domini Investments specify that "careful scrutiny" and "special consideration" will be given to reincorporations in "tax havens" respectively.

As part of its principles on tax management, NEST has a clear expectation on excessive tax services. "*We do not support boards where tax services form a significant proportion of non-audit fees.*" This statement is backed up by a voting guideline on excessive non-audit fees specifically aimed at the audit committee chair: "*Where a company's external auditor also provides services in relation to tax and the value of such services is of a significant proportion of the audit fee (25 per cent), we will vote against the audit committee chair.*"

Mirova considers tax practices in voting on executive compensation. It "*does not support resolutions relating to shareholder and executive compensation if the company's tax practices reflect excessive optimization*".

## FILING AND SUPPORTING SHAREHOLDER RESOLUTIONS

Investors could signal in their policies clear criteria that would trigger support for a shareholder resolution e.g., resolutions requesting disclosures in line with the GRI Tax Standard 207 or asking the board to adopt a tax policy. Voting in favour of a tax-related resolution is a less forceful vote than, for example, voting against a board member. As such, investors need to be more ambitious in the criteria they use to support shareholder resolutions e.g., they may not vote against all investee companies that do not disclose CBCR, but they may want to support all shareholder resolutions calling for CBCR.

Investors can file resolutions to communicate their expectations on tax and can disclose in which circumstances they would do so. Effective shareholder resolutions should highlight the systematic impacts of corporate tax avoidance on investor returns as well as the tax-related concerns for the company in question (ongoing disputes, evidence of aggressive tax planning, controversial transaction, lack of transparency, etc.).

**Examples of current practice:**
The Oblate International Pastoral Investment Trust, together with PIRC, filed a resolution at Amazon, asking the company to produce a tax transparency report in line with the GRI Tax Standard 207. Amazon was selected by the filers in part because it was one of eight unresponsive companies in our 2017-2019 stewardship initiative on tax. The proposal received support from one in five independent votes.

ERAFP states that it will support "*any shareholder or issuer-led initiatives that promote financial transparency and the payment by companies of taxes due in the countries where they operate and produce or market their products and services*".

### COMMUNICATING VOTING RATIONALES PUBLICLY

For a vote to be an effective communication tool, investors should communicate with companies, as well as publicly, the rationale behind the vote. There are many reasons why investors would vote a certain way e.g., a vote against reappointing an audit or risk committee chair is not necessarily related to tax. Therefore, disclosing voting rationales prior to and after voting ensures companies get the right message.

Pre-declaring voting intentions publicly can also promote transparency and foster enhanced dialogue between investors and issuers. Investors can use PRI's Resolution Database to pre-declare and see other signatories' voting intentions.

## 3. ENSURE CONSISTENCY BETWEEN EXPECTATIONS, VOTING POLICIES AND WIDER RESPONSIBLE INVESTMENT APPROACH TO TAX

Around half of the investors reviewed made at least one reference to responsible tax in their RI or voting policy. Among those that referenced tax, 40% identified tax as a priority issue for company or policy engagement, and around 43% indicated that they integrated tax considerations into their investment process. However, among these investors, only a small number had disclosed expectations for portfolio companies on tax disclosure, or tax more broadly.

The research exposed a notable disconnect in the way investors consider tax issues in their investment, engagement and voting processes. For instance, investors that communicated how they prioritised tax transparency in their investment processes did not have corresponding disclosure expectations. Similarly, several investors that had prioritised tax engagement did not outline the criteria for engagement or the tax-related principles that would determine how they would use their vote.

**Recommendation: Investors should systematically address tax issues throughout their responsible investment approach. Voting policies should be reinforced by a coherent stewardship strategy.**

### INTEGRATING TAX INTO PORTFOLIO CONSTRUCTION

Investors can integrate tax considerations within their portfolio construction, for example, by excluding some companies based on pre-defined tax-related criteria. They may also consider disclosing some of those criteria and ensuring it is consistent with the expectations for existing portfolio companies.

Investors should look at various indicators or metrics (using our previous engagement guides) to assess a company's record on tax and inform their decisions. Tax is complex and one red flag may not always warrant exclusion, but it may justify engagement.

**Examples of current practice:**

While Varma references the EU list of non-cooperative jurisdictions, it also monitors investees' presence in "low tax rate countries": *"Varma closely monitors, e.g., the EU list of non-cooperative jurisdictions (i.e. the EU's blacklist), and Varma does not invest in countries that are on the list or in investees situated in low tax rate countries for tax reasons."* This wording suggests that Varma recognises there are legitimate reasons for exposure to low tax rate countries, provided that tax avoidance is not the main driver.

## COMBINING STEWARDSHIP TOOLS TO INFLUENCE COMPANY BEHAVIOUR

Voting and engagement should complement and reinforce each other. This connectivity is particularly important when engaging with companies that are slow to respond to investor demands, as is often the case when engaging on tax issues.[5] Voting policies that embed expectations on tax can be a starting point and provide a clarified framework for corporates and investors to engage on. Companies that are at different stages in terms of tax responsibility and transparency may require a different combination of engaging and voting.

Voting may be used a first step, or investors can engage first, and then use their votes if the outcomes are not satisfactory. Investors can specify in their policies that they will vote against management where the company does not respond to engagement and / or meet the investor's expectations.

**Example of current practice:**

Etica Sgr links engagement with voting: *"Etica Sgr aims to discuss, inter alia, the following issues (and to vote in favour of any shareholder motions in that respect): the publication of a tax policy; the inclusion of tax in the mandate of the Board of Directors; assessment of the tax risk; the publication of information on transactions and taxes paid at the level of the individual countries in which the company operates."*

**Further resources**

- **Engagement guidance on corporate tax responsibility:** Includes identifying red flags in portfolio companies and detailed engagement questions.
- **Investors' recommendations on corporate income tax disclosure**

## ENGAGING WITH POLICY MAKERS AND KEY STAKEHOLDERS

A regulatory or policy shift can have wide-reaching consequences on tax transparency and practices. When a standard body or jurisdiction mandates some level of tax transparency, for example, this contributes to a level playing field for companies, and leads to companies publishing comparable information for investors. Nevertheless, it should be clear to investors that policy engagement and investee stewardship are complementary, not mutually exclusive.

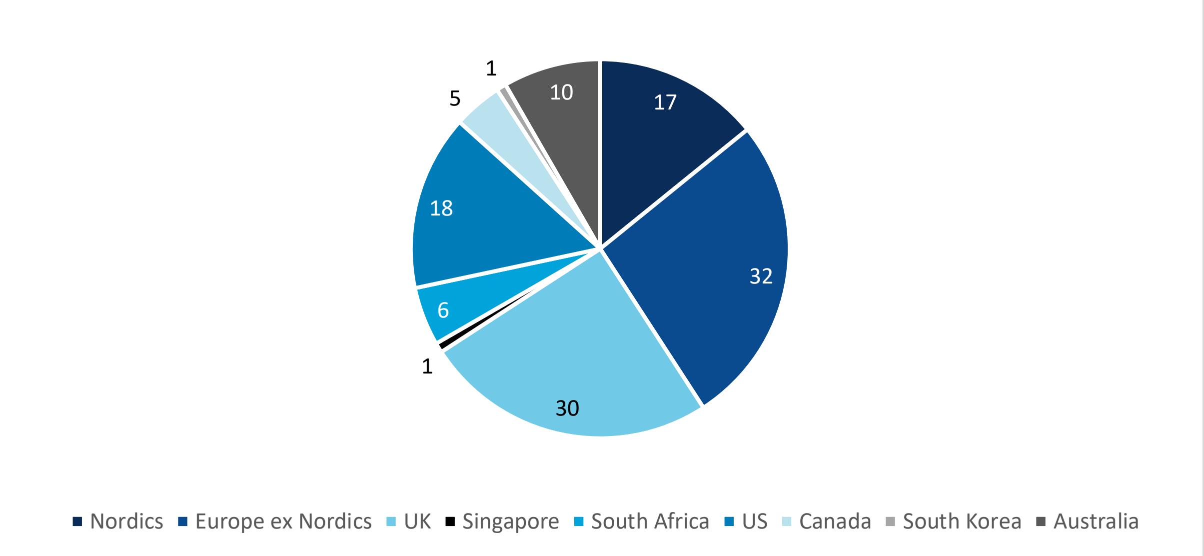
[5] PRI (2020), Advancing tax transparency: outcomes from the PRI collaborative engagement 2017-2019

Investors should support efforts to increase tax transparency by responding to consultations or communicating their positions to policy makers and / or standard setters. Investors can also engage with their proxy advisers.

# METHODOLOGY

We reviewed tax-related policies and positions of 120 institutional investors from Europe, the UK, the US and other key markets (see Figure 4 below).

**Figure 4: Geographical breakdown of investors assessed**




The research examined the following three areas:

1. **Do investors have high-level expectations and / or refer to tax as a material issue in their RI or voting policies?**

2. **Do investors include specific company expectations in their voting policies? Examples include:**

- disclosure on tax policy, governance, risk management, country-by-country reporting of tax and basic financial information;
- tax optimisation;
- tax havens and secrecy jurisdictions;
- tax advice and auditors; and
- alignment of taxes paid with economic value generated.

3. **Whether, and how, investors integrate corporate tax responsibility when it comes to their:**

- investment process;
- company and / or policy engagement; and
- voting policies.

# CREDITS

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## The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

**The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.**

## United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UN environment programme | finance initiative

## United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact