THE PRINCIPLES FOR RESPONSIBLE INVESTMENT PODCAST TRANSCRIPT

WHY TAX SHOULD BE ON THE AGENDA FOR RESPONSIBLE INVESTORS

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Sebastien Akbik

Hello and welcome to the PRI podcast. My name is Sebastian Akbik. I'm a corporate governance analyst at the PRI. Today we're going to discuss one of the least understood ESG issues, and I would even say a major blind spot in ESG, the issue of tax, but change is on the horizon. A major milestone was reached in 2022 with three shareholder proposals asking Amazon, Cisco, and Microsoft to disclose basic information on their tax contributions in each country where they operate. Amazon tried to prevent the resolution from going to a vote, but that challenge was rejected by the Securities and Exchange Commission. And investors with 3.6 trillion of assets under management wrote to the chair of the Securities and Exchange Commission expressing support for the shareholder proposal to go to a vote. All three resolutions received more than 20% votes in favour, which is significant for first time resolutions. 2023 also looks promising. Our two guests today have co-filled similar shareholder proposals on tax transparency at the US companies of Chevron, ExxonMobil, and Cono Phillips. Our two guests are Kiran Aziz, Head of Responsible Investments from KLP and Daniel Mulé, Policy Lead, Extractive Industries Tax and Transparency from Oxfam America. Welcome to you both.

Daniel Mulé

Hello and great to be here.

Kiran Aziz

Hi there.

Sebastien Akbik

So, Kiran, why do you respond to companies or investors who believe that paying less taxes is in the interest of shareholders?

Kiran Aziz

First of all, thank you very much for having me. Sebastian and I would say that we invest pension money, which means that we have a long-term perspective on, on our investments. And if you look at global tax avoidance, which is a major problem, and we see that multinational companies could pay a role in aggressive tax avoidance. So, in that regard, I think it's fair to say that having a tax behaviour, which is responsible, is quite a key component of corporate responsibility. That's one thing. And the other thing is that our main purpose is to analyse opportunities and risks to your investments. One other element is that corporate taxes, they play a quite important role in the public finance of develop countries. And paying taxes is one of the ways where businesses can contribute to societies on, and, you know, they use the legal and financial infrastructure, which they rely on. So, this is a way to finance that as, as well.

Sebastien Akbik

And Daniel, if I can turn to you now, why did Oxfam decide to focus on tax transparency in the extractive sector?

Daniel Mulé

Oxfam is a long-term shareholder in each of these three companies that we've highlighted but we're also an international development organization that is dedicated to addressing the root causes of inequality. And at Oxfam, we've appreciated that PRI has stressed the links between tax avoidance and inequality. Recent estimates place tax avoidance at about 312 billion globally. That that estimate may actually be an undercount. It may be perhaps two to three times larger than that. Similarly, there is an oil, gas and mining sector statistic that puts tax avoidance at $44 billion in losses to governments. And again, that's a conservative estimate. Much of that comes from the global south in emerging markets. These are countries that heavily rely on these sectors. And so ultimately, profit shifting in mining oil and gas has a disproportionate impact on inequality. And that's for at least three reasons.

Daniel Mulé

The first is that these resource rich developing countries rely so heavily on those sectors for tax revenues. The second is that extractive projects in oil, gas, and also in mining, are often subject to sector specific or even project specific fiscal regimes. And so, tax avoidance has multiple impacts on the fiscal benefits or losses that come to governments. And then lastly, and really importantly, the economic activities in these sectors is based on exhaustible resources. Once you take the oil reserves out of the ground, the profits dry up. There's nothing left to tax. And so importantly, countries really only have one shot to ensure that they are securing the adequate fiscal benefits that outweigh the significant harms that also come from these sectors. And those are adverse impacts to communities, residents, and the planet. And so for us, it made a lot of sense to focus particularly on oil and gas in our efforts on tax transparency. So, there you have huge impact in the sector and also huge risks in the sector. And for us, that was sufficient for a particular focus on pushing at three companies that we've engaged with for some time.

Kiran Aziz

I think it's really important what Dan said, that emphasizing that tax burden is, is a key driver inequality. And a lot of the institutional investors had committed to work for UN sustainable goals. And, and, and taxes in that sense would be a quite vital aspect.

Sebastien Akbik

That's a great point. The links between tax and climate change and inequality and the SDGs are so strong. Kiran, if I can turn to you on the risks that you see for companies engaging in tax avoidance.

Kiran Aziz

As investors person, we always look for material risks. So like I said in my introduction, that if there are legal structures or corporate structure which rely on healthy tax incentives, these tax incentives could change due to a different focus from the governments or from, it could be any amendments in the regulations, then you are opposed to a financial risk. That's one thing. And the other aspect of that is that there is also reputational risk, not the past controversies, such as Panama papers have showed how the multinational companies play a quite significant role in order to avoid tax avoidance. And we as investors, we rely on public available information in order to assess whether there is risk exposed to the companies. And if there is not sufficient reporting in place, it'll also be difficult for us to see any material risk.

Sebastien Akbik

And yes, at the PRI we've been telling investors that companies should derive their competitive advantage from better products and services or higher productivity and not artificial tax structures that are vulnerable to changes in regulation or even simply changes in enforcement of existing regulations.

Daniel Mulé

I think that's right. I think what we often see is companies relying on overly generous tax incentives or extreme aggressive tax planning in a way that is an attempt to increase short-term profits, but ultimately undermines the long-term profitability and health of the company. And so, one thing that we often suggest is that if there's a fiscal approach or fiscal deal that looks too good to be true for a company, it likely is because later down the line there will be risks that materialize related to that. As Kiran noted. And in the extractive sectors, I think this is in particular an important issue to keep in mind because social license in the extractive sector has a broader impact and can actually stop projects from proceeding when a company is not respecting its social license to operate. Certainly, controversies around the beneficiation from projects at the national level or at the local level can lead to community conflict to fiscal renegotiation, to license revocation, and all of those things stop the project, stop its profitability entirely. So, the prudent thing for a company to do and for investors to care that a company is doing is to make sure that the company is engaging in a responsible way with respect to tax, and investors can better appreciate whether or not that's the case. If a company is disclosing tax transparency reports like the ones that we've called for aligned with GRI at these three companies,

Sebastien Akbik

Why target these three companies specifically?

Daniel Mulé

That's a great question, Seb and at Oxfam we push for tax transparency across sectors. But again, we think there's particular merit in tax transparency in oil, gas and mining because of the high risks of profit shifting and disproportionate impact. And interestingly enough, the sector itself already recognizes this. So already we have a number of companies in the mining, oil and gas sectors that have voluntarily disclosed tax transparency reports. Many of those are aligned with the GRI standard already. This includes a range of different companies, including many peers of Exxon, Chevron, and ConocoPhillips. So, we have large miners like Anglo-American and Rio Tinto, but also major international oil companies including BP, shell total Repsol, Equinor and all of these companies have recognized that there's value in these sorts of disclosures. Now, with respect to the three companies that we've highlighted in these resolutions, Exxon, Chevron and Conoco, Oxfam has been a shareholder in these three companies for more than a decade, pushing them to embrace broader transparency in a number of different respects, including on contract disclosure payments to governments disclosure and on tax.

Daniel Mulé

But unfortunately, Exxon, Chevron and Conoco remain laggards in all of these areas, and they've refused to publish a tax transparency report in particular. And this is despite these three companies being no stranger to tax controversies. So Chevron faced a 654 million tax bill following a successful lawsuit followed by the Australian Tax Authority. Exxon has seen its projects stopped in Papua New Guinea ultimately delaying subsequent note negotiations around a new project and leading to government negotiations that secured a substantially higher government take for the country. And then Conoco Phillips has also had significant costs associated with settlements of tax bills in countries around the world, including in Vietnam and continues to see concerns around tax liabilities play out around the world. And so all of these examples suggest that there is real reason for investors to care about the tax practices and tax transparency of these three companies, and yet it seems to just fall on deaf ears. And so, at this point, Oxfam decided in this cycle that it made sense now for us to push this ask via a shareholder resolution at each of these three companies. And we've been very pleased to see strong support from the investor community already.

Kiran Aziz

I would just like to add that it's really, we really appreciate the work Oxfam is doing in this, in this space and some, some of the tools we have available is, the first one is to address our expectations to dialogue with the companies. And the other thing is GM are quite important arena for us to, to show our expectations. And our expectations are mainly to the board. So, I think and you know, you select board members at the GM and, and telling that this is also one of the core issues for us where we want the board and management to pay their attention to is, is a quite strong signal.

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Sebastien Akbik

So, we, you both mentioned the lack of transparency and these resolutions are about asking for more transparency on tax contributions made by these companies on a country-by-country basis. And you mentioned the GI207. Can you tell us more about the GI207 and what is a tax transparency report? Exactly.

Kiran Aziz

Reporting is, is quite crucial for us to analyse the company and if you look at a lot of the investors, they say they would like the companies to report according to country by country reporting, and it's mainly an annual reporting, which is a core element of transparency, corporate tax disclosure, and it breaks down key elements of the financial statements by jurisdiction. It provides the local tax authorities visibility to revenue, income taxes paid you know, how much capital employment retained earnings and not at least tangible asset and activities. So, it's information, which is mainly given to the tax authorities, but we want the companies as a good practice to publish that as well.

Sebastien Akbik

And I, just wanted to emphasize that it's, the information is of huge importance to investors, but it's also information that is relatively basic for companies to collect and publish.

Kiran Aziz

And not just investors, I would also say civil society actors such as Oxfam, because then you will be able to tell, you know, whether it, it's a concern of wider and not just limited to the financial risk as well.

Daniel Mulé

Yeah, and maybe just complimenting a bit what Kiran suggested, importantly, the GRI 207 standard on tax also includes complimentary information in addition to the country-by-country reporting that Kiran mentioned of company financial information. It also includes disclosure around the company's approach to tax it's tax governance control and risk management approaches, and the disclosure of company stakeholder engagement and management of concerns related to tax. So, there is a lot of qualitative data that compliments the quantitative data that is essential to assessing whether or not taxes are being paid in line with economic activity. And beyond that many companies also choose to provide narrative explanations of their financial data in order to assist in proper interpretation of that data. And again, on a country-by-country basis. So, if you look at the tax transparency reports coming out from Shell, for instance you'll see that there are narrative descriptions for each country of operation which helps to further clarify what concerns might exist and address anything pre-emptively too.

Daniel Mulé

So, from the company perspective, this can be an additional opportunity to really tell the story of why the taxes and financial information are allocated as they are and pre-empt other concerns that might come up when readers take a look at those disclosures too. So, I know many companies that are not yet disclosing before they disclose, they initially think, well, if we put this information out there, we're just going to be subject to greater criticism and greater scrutiny. And in fact, what we've seen already and is well demonstrated in the extractive sector is that in fact, putting out this information doesn't cause the sky to fall. It instead arms investors with more information to be able to ask the right questions and also gives the company its own opportunity to tell its story of why taxes might look different in certain jurisdictions as well. And we think that frankly, more transparency, more disclosure of information to investors, to civil society and more broadly to the public, including to tax authorities that might not be participating in that automatic exchange of information is ultimately a win-win for companies that are willing to take this important step. And that's why we see so many doing it and we see so many investors calling for this data in particular.

Sebastien Akbik

I think these are great points, and if I can emphasize the importance of the qualitative information, because investors want both the quantitative information, which is this country-by-country information, but also the context to me, it's like publishing a climate report, an emissions report with only the numbers. It's not helpful for investors. Investors want to understand the emissions profile, why the emissions are going up, why the emissions are going down, why the emissions are that way in this country, et cetera, cetera. And it should be the same for tax. And we've seen a lot of changes and progress on the international stage in terms of reforming the international tax system. So can I ask you both, what do you make of the 2021 agreement on a global minimum tax, which is also referred to as the OECD Pillar two agreement?

Daniel Mulé

I think the agreement is a step forward in ensuring that companies are paying their fair share of taxes and the jurisdictions where they operate. Oxfam has been critical of the agreement at times and, and parts of it, but it is nonetheless a step forward. But it also is now going beyond the original agreement in that it's moving forward into implementation now with EU member states agreeing to a 15% minimum corporate tax rate that would apply on a country-by-country basis just last December. And the reality is that for investors, there is a risk that this could cause an increase, an unexpected increase in tax liability without any advanced notice. And so, when we look at companies like Chevron, Conoco, and Exxon that are continuing to resist providing disaggregated financial information it frankly becomes less and less defensible.

Daniel Mulé

Investors need this information in light of the uptick in global regulatory efforts to tamp down on tax avoidance, and particularly with initiatives like this OECD tax framework now being implemented without adequate tax transparency, investors risk being caught by surprise by the impact that these major tax reforms could have on the companies they're investing in. And so it's beneficial for the companies and for investors to provide this disclosure in advance and to be able to plan for it for investors to be able to manage risks. Kiran, I'm curious if this has also been a strong argument from the investor side too, that in fact, investors need to be able to understand potential regulatory changes.

Kiran Aziz

Yeah, and that’s for sure Daniel, that regulation plays a quite big role here and, for this potential engagement. I think it's, you know, the purpose is that the companies, they pay a fair share of tax wherever, wherever they operate, and generate profits. And we also need to remember that a lot of tax regulation is not necessary fit for a more digitalized and globalized world economy. Especially if you look at the companies within tech and pharmaceuticals.

Sebastien Akbik

What do you say to fellow investors or other stakeholders or people who might think that tax is just too complex that you need to be a tax accountant to look at the issue?

Kiran Aziz

I would say, of course it's technical, it's complex as Sebastian, but you know, this is also, a reason for why more investors need to engage with companies on this particular issues. And for us, the most important role we have is to raise the right questions and then the companies need, needs to good sufficient answer, which you know, which gives a sense to the wider stakeholder community. So, don't let your complexity be in the way, but rather start engaging. And, you know, PRI has done a quite good job. There are always other investors to collaborate with in order to get some get some understanding. So I will just urge other investors to engage on this topic because this is vital for the years to come.

Daniel Mulé

I agree with Kiran. I don't think you need to be an expert to necessarily dig into some of the details, but this is an area where increasing attention is being paid and there's a premium being placed on collaborating to better understand these tax disclosures and the impacts that tax might have for various companies. You don't have to be an expert to review tax transparency disclosures, just as you don't have to be a climate scientist to engage on climate. And yet it is important for companies to understand that citizens civil society and particularly investors are looking at their tax practice and that there they want more disclosure from these companies as well.

Sebastien Akbik

Some great insights there. Thank you so much to both of you for joining and for sharing your experience on this issue.

Kiran Aziz

Thank you. It was a pleasure and thanks for a good conversation.

Daniel Mulé

Yes, thanks so much and look forward to continuing to collaborate with you both and investors engaging on tax transparency.

Sebastien Akbik

And for investors who want to engage on tax transparency. While you don't need to start from scratch, head to the tax fairness section of PIR's website unpi.org for extensive guidance on questions that you can ask companies and investment managers and basic analysis that you can conduct on your portfolio companies. So, thank you for listening. And remember, if you've enjoyed this podcast, please do like and subscribe.

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