EXPLANATORY NOTES
INVESTORS' RECOMMENDATIONS ON CORPORATE INCOME TAX DISCLOSURE

The PRI in collaboration with 10 global investors developed the *Investors' recommendations on corporate income tax disclosure*[1] (see Appendix 1) in 2017 to identify a list of corporate income tax indicators that would facilitate investment analysis and drive corporate tax transparency. This document is a supplement to the [PRI Engagement Guidance on Corporate Tax Responsibility.](https://www.unpri.org)

The recommendations outline what comprehensive tax policies, robust governance and risk management frameworks and detailed financial reporting would include.

The recommended disclosures are intended to provide guidance to companies that are seeking to enhance their disclosure of tax-related information to meet investors' and other stakeholders' increasing demands.

While some of the information in this document is currently published by companies leading on tax disclosures, some recommendations are aspirational and capture investors' future expectations around tax disclosures that will facilitate sound investment decisions.

As the recommendations are not prescriptive, an evaluation of the relative importance of each of the indicators has not been undertaken. Nonetheless, they allow investors to consider the maturity of their portfolio companies' disclosure practices and to initiate conversations with companies around how they can more meaningfully articulate their position on tax issues.

Policy: A comprehensive tax policy should outline the principles that form the basis of an organisation's tax practices, embedding discussions on both the financial and broader societal impacts of the company's tax decisions.

Governance and risk management: Companies should provide information on the governance and risk management framework that ensures effective implementation of the tax policy.

Financial/quantitative reporting: Companies should report transparently on key tax data points.

Companies adhering to the recommendations will provide investors with:

- an overview of the company's policy/approach to tax, including how the firm balances the letter of the law with the intent of the law and societal expectations on tax;
- reassurance that appropriate governance and risk management measures are in place;
- data and examples to ascertain future financial, legal, regulatory and reputational risks; and
- data and examples to determine if the firm's tax practices reflect its tax policy/framework.

[1] While companies may contribute through other forms of taxes (such as taxes withheld on behalf of employees and consumers, and industry specific taxes), the recommendations focus on corporate income tax.

TAX POLICY/STRATEGY

The recommendations encourage companies to:

- **Publish a tax policy** (signed by a board member) that clarifies the organisational approach to tax, noting key principles and commitments. Information in the tax policy that is contextual and organisation-specific, rather than generic, can provide much-needed context for investors and other stakeholders.
- **Articulate how the corporation's tax strategies impact the bottom line and ensure that the broader societal and economic needs of the societies in which they operate are met.** Investors and other stakeholders expect companies to consider how corporate income tax paid can impact profitability and sustainability issues in an integrated manner.
- **Define and communicate tax risk appetite** (i.e. the level of risk that companies are willing to accept in pursuit of strategic objectives) in relation to their interaction with tax authorities, dealing with ambiguity in legal interpretation or broader social expectations. This narrative should be supported by examples of tax practices that the board deems acceptable and those that they do not.
- **Explain the links between where value is created through operations and sales, where customers are based, and where taxes are paid.** This will explain why any potential discrepancies between these factors may emerge. Companies can further demonstrate that they pay taxes in line with commercial activity via detailed financial reporting (such as country-by-country reports).
- **Discuss tax advocacy and lobbying activities.** This could cover spend, description of key activities and inconsistencies between companies' tax policies and the positions of their trade associations to which they belong. Companies tend to influence public policy through consultation responses and, where this is the case, positions on key tax reforms/developments may be noted.
- **Commit to ongoing tax transparency** to emphasise their intention to proactively communicate to stakeholders their principles and tax practices, backed by meaningful data. They may also reference third-party guidelines and other principles that they subscribe to.

GOVERNANCE AND RISK MANAGEMENT

Strong governance frameworks will facilitate effective implementation of tax policies and assure investors that policies are adhered to. The recommendations encourage companies to:

- **Clearly set out responsibilities and mechanisms to implement their tax policies.** This includes clear communication that the board is aware and ultimately accountable for the tax strategy, and supported by senior management and the relevant board sub-committee. Relevant mechanisms could include developing an appropriate monitoring and control framework as well as whistleblowing channels for staff to flag where tax decisions are not in line with the policy.
- **Provide appropriate training**, not only to staff who implement the tax strategy, but to other staff in the organisation such as those in the finance department, the executive committee and board to build awareness around how tax decisions are aligned with the tax strategy of the company and other relevant or affected business functions.
- **Review reputational risks** at the board level, while actively considering stakeholder perceptions and the intent of the tax laws when they were legislated.

PERFORMANCE

Quantitative data should support the policy commitments and assertions made by a company. Where there are deviations, a narrative should be provided to explain them.

The recommendations encourage companies to report on:

- **An explanation of what drives the difference between what the company is paying and what it is required to pay**, i.e. the difference between the weighted average statutory rate based on the sales mix and the effective tax rate (also referred to as the tax gap). Companies can then provide a narrative on the tax gap without having to refer to the differences in the tax rates paid across the jurisdictions in which they operate.
- **Factors contributing to growing unrecognised tax benefit (UTB) balances** (tax positions being taken by a company that management believes are less than 50% likely to be upheld by a tax authority). UTBs may provide a real-time assessment of a company's changing tax strategy. For instance, a persistently large and growing UTB may signal a high tax risk tolerance, the effects of which are not visible on the current income statement.
- **Intracompany debt balances** (including where the debt is held and the average interest rate paid by subsidiaries). Disclosure of substantial intracompany debt transactions will facilitate early investor-company dialogue on the nature of these debts and the company's level of reliance on them.
- **Financially material tax incentives (explaining investment requirements, expiry date and likelihood of renewal)**. Tax incentives can have a material impact on the effective tax rate by reducing the amount of tax that is required to be paid. Therefore, granular data on when the most material tax incentives expire is critical. Investors will also want to understand what corporate investment requirements have been set in exchange for these tax advantages.
- **Public country-by-country reporting** and a list of subsidiaries and their business nature. Country-by-country reports can provide an indication of whether taxes paid are reflective of the commercial reality in which a company operates. Investors can use these reports to understand corporate transactions that are likely to be queried by other stakeholders. In line with the OECD BEPS template or other frameworks, country-level data on revenue, profits before tax, employee numbers, corporate income tax paid and other taxes and tangible assets can help investors understand if taxes paid match business substance.
- **A list of current disputes** with tax authorities where they are material will allow investors to discern the risk of corporate exposure to litigation. This information can be used to cross-check companies' assertions of risk appetite and policy implementation.