Principles for Responsible Investment

ENGAGEMENT GUIDANCE ON CORPORATE TAX RESPONSIBILITY

WHY AND HOW TO ENGAGE WITH YOUR INVESTEE COMPANIES

UNEP FINANCE INITIATIVE | United Nations Global Compact

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

THE SIX PRINCIPLES

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.

CREDITS & ACKNOWLEDGEMENTS

Authors: Athanasia Karananou and Anastasia Guha, PRI
Editor: Mark Kolmar, PRI
Design: Alessandro Boaretto, PRI

The PRI is grateful to the investor taskforce on corporate tax responsibility for their contributions to the guidance:

- Harriet Parker, Investment Analyst, Alliance Trust Investments
- Steven Bryce, Investment Analyst, Arisaig Partners (Asia) Pte Ltd
- Francois Meloche, Extra Financial Risks Manager, Bâtirente
- Adam Kanzer, Managing Director, Domini Social Investments LLC
- Pauline Lejay, SRI Officer, ERAFP
- Meryam Omi, Head of Sustainability, Legal & General Investment Management
- Robert Wilson, Research Analyst, MFS Investment Management
- Michelle de Cordova, Director, Corporate Engagement & Public Policy, NEI Investments
- Rosa van den Beemt, ESG Analyst, NEI Investments
- Kate Elliot, Ethical Researcher, Rathbone Brothers Plc
- Matthias Müller, Senior SI Analyst, RobecoSAM
- Rosl Veltmeijer, Head of Research, Triodos Investment Management

We would like to warmly thank Sol Picciotto, Emeritus Professor, Lancaster University and Coordinator, BEPS Monitoring Group, and Katherine Ng, PRI, for their contribution to the guidance.

We would also like to thank Randy Evans (previously with NEI Investments), and the PRI team for contributing and reviewing earlier drafts, in particular: Fiona Reynolds, Valeria Piani, Justin Sloggett, Joy Frascinella, and Ben Pincombe.

Finally a special thank you to the following individuals and organisations for sharing their views with the PRI and the investor taskforce: Chas Roy-Chowdhury, Head of Taxation, ACCA; Kerry Stares, Private Sector Advocacy Adviser, ActionAid UK; Amir Ghandar, Senior Policy Advisor, International Federation of Accountants (IFAC); Barbara Davidson, Principal, Investor Liaison Programme, and Frederick Nieto, Investor Education Manager, International Accounting Standards Board (IASB); Sudip Hazra, Senior Analyst, Sustainability Research, Kepler Cheuvreux; Linda-Eling Lee, Executive Director, ESG Research, and Gaurav Trivedi, Senior Associate, ESG Research MSCI; Raffaele Russo, Head of BEPS Project, OECD Centre for Tax Policy and Administration; Michael Devereux, Director of the Oxford University Centre for Business Taxation, Professor of Business Taxation at Saïd Business School, and Professorial Fellow at Oriel College; and Alex Cobham, Director of Research, Tax Justice Network.

This document is produced by the PRI and does not necessarily represent the views of individual members of the investor taskforce.

ABOUT THE PROJECT

This guidance is primarily intended to assist investors to conduct ***company engagement***, thus promoting corporate tax responsibility: a more responsible corporate approach to tax practices, including better disclosure and transparency, good governance and appropriate management of tax-related risks. This will allow investors to support companies in achieving the right balance between controlling the tax bill and mitigating related risk.

The PRI's starting point for this project was the work of a small number of UK investors[1] who convened in 2014 to research the topic and talk to companies. The resulting discussion paper, made available through the PRI online collaborative platform, formed the basis for further work on the topic.

The PRI, reacting to requests from its signatory base, convened a **group of eleven global investors** to explore in more detail the issue of corporate tax planning: **Alliance Trust plc, Arisaig Partners (Asia) Pte Ltd, Bâtirente, Domini Social Investments LLC, ERAFP (French public service additional pension scheme), Legal & General Investment Management, MFS Investment Management, NEI Investments, Rathbone Brothers plc, RobecoSAM, and Triodos Investment Management**. Over the course of 2015, the taskforce held meetings with various stakeholders to inform their thinking and worked closely with the PRI to produce guidance on how to engage with investee companies on this topic.

1 The UK investor group included LGIM, Rathbone Greenbank Investments, Royal London Asset Management and the Church of England

FOREWORD 5

WHY ENGAGE ON CORPORATE TAX RESPONSIBILITY 7

AGGRESSIVE TAX PLANNING: AN OVERVIEW OF KEY STRATEGIES 13

HOW TO ENGAGE COMPANIES ON TAX-RELATED TOPICS: 15

STEP 1 - ENGAGEMENT CANDIDATES: IDENTIFYING RED FLAGS IN YOUR PORTFOLIO COMPANIES 15

STEP 2 - STRUCTURING YOUR ENGAGEMENT: QUESTIONS FOR MANAGEMENT AND THE BOARD 20

NEXT STEPS 24

APPENDIX 1: A REVIEW OF THE OECD BEPS PROJECT 25

APPENDIX 2: COMPANY DISCLOSURE - EXAMPLES OF GOOD PRACTICE 27

APPENDIX 3: ENGAGEMENT FINDINGS - DIALOGUE WITH EIGHT COMPANIES 30

APPENDIX 4: QUESTIONS FOR ASSET OWNERS ON TAX 33

APPENDIX 5: GLOSSARY AND RESOURCES

FOREWORD

In a global economic landscape dominated by worries about economic slowdowns and growing inequality, there is an increasing expectation from investors and beneficiaries that companies find a balance between controlling their tax bill and paying a "fair" share.

Aggressive tax planning by multinationals costs governments billions of dollars of revenue and creates market distortions, in both developed and developing countries. Relentless media coverage of controversial tax practices has directed public outrage at several companies. A PRI survey of pension holders found that in some countries more than 75% of beneficiaries thought it very/ fairly important that companies their pension is invested in do not exploit tax loopholes.

For these reasons tax issues have become a key area of focus for governments, international regulators and civil society. The UN's Sustainable Development Goals (SDGs) include countries improving their capacity for collecting tax and other revenue as one of the ways to finance the goals.

The PRI has been getting numerous enquiries from signatories asking what the investment community should be doing about encouraging corporate tax responsibility. Over 100 investors referred to corporate taxation in their most recent PRI reporting: investors are concerned about how close aggressive tax planning comes to crossing the grey line between avoidance and evasion, and about the increasing frequency with which companies are being challenged by regulators and other stakeholders.

As business has globalised, the tax landscape has become increasingly complex. However, managing tax issues appropriately is integral to a company's execution of its strategy, and investors are starting to focus on tax planning as a material risk.

Dialogue is vital. This PRI guidance is meant to facilitate engagement between investors and their portfolio companies by providing investors with a tool to identify and analyse tax-related risks, and ask thoughtful, challenging questions.

Fiona Reynolds, Managing Director, *PRI*

In the long term, well-run companies should pay an appropriate level of tax, adhere to the spirit as well as the letter of tax laws, and avoid the reputational, legal and financial risks posed by aggressive tax planning. **Responsible investors and well-run companies will acknowledge that *tax is not simply a cost to be minimised*, but a vital investment in the local infrastructure, employee-base and communities in which they operate**.

Fiona Reynolds

"Tax is an important consideration for universal owners, and yet, the lack of disclosure does not allow for appropriate assessment of risks for investors. We need to promote better governance and disclosure from companies."

Meryam Omi, Legal & General Investment Management

"Responsible tax planning has become an issue debated by various stakeholders around the world. This creates new expectations and opportunities for companies to improve their approach."

François Meloche, Bâtirente

"Some companies are already beginning to recognise that tax is both a financial and a corporate responsibility issue – and that values-based concerns about tax could impact long-term value."

Michelle de Cordova, NEI Investments

"This is not a zero sum game: Higher tax revenue can positively impact the ability of businesses to produce sustainable returns through increased investment in infrastructure and projects that grow the population of eligible consumers."

Robert Wilson, MFS Investment Management

"We consider tax-related issues to be an engagement priority, in order to urge companies to be more transparent and the financial industry to better tackle the issue."

Pauline Lejay, ERAFP

"A total lack of tax planning is bad for investors and evasion is illegal, but we know companies operate in grey areas. The key thing for investors is to understand where a company sits on this spectrum: how light or dark grey its tax practices are."

Kate Elliot, Rathbone Brothers PLC

WHY ENGAGE ON CORPORATE TAX RESPONSIBILITY

The business case for responsible investors to explore the long-term implications of tax-related risks is multifaceted. Investors could assess the financial materiality of tax risks and may choose to make tax a priority engagement topic In the event there is a lack of appropriate company disclosure. Investors could also examine tax responsibility issues that may become material in future, including the impact on society and human rights, and other issues that norms-based investors may feel they should be engaging on already.

> "Companies that are aligned with the needs of society will be less exposed to negative impacts from consumer pressure and increased costs associated with fines for poor practice. We also think that increased political will to regulate will favour more progressive, resilient companies."

Harriet Parker, Alliance Trust Investments

For large, "universal owners", tax becomes even more pertinent; **rather than just a cost to be minimised, it is a key systemic risk that could have a serious effect on the profitability and the sustainability of a company, as well as broader impacts on overall portfolio and macroeconomic returns**.

> "We believe that corporate decisions around taxation are financially material and therefore relevant for creating long-term value".

Matthias Müller, RobecoSAM

Aggressive corporate tax planning should be a concern to investors as it can:

- create earnings risk and lead to governance problems;
- damage reputation and brand value;
- cause macroeconomic and societal distortions.

The impact of tax-related risks can be severe and cover a large number of portfolio companies.

GOVERNANCE ISSUES AND EARNINGS RISK

Earnings that are reliant on tax planning rather than genuine economic activity are vulnerable to changes in tax regulation and enforcement. An overemphasis on minimising tax may encourage poor decision-making by company boards, such as non-strategic acquisitions that are more likely to be impacted by the closure of regulatory loopholes or the cancellation of sweetheart deals.

Even if specific tax regulations are not changed, more proactive enforcement by regulators suggests the earnings risk resulting from these strategies is increasing. As countries and their tax authorities become increasingly concerned with the exploitation of loopholes in international tax frameworks and are under fiscal pressure to fund additional government programmes, the incidence of tax disputes and litigation will increase.

Some boards appear unaware of the effect that incentives can have on tax planning: setting management targets or Chief Financial Officer remuneration based on earnings after tax could intentionally or unintentionally encourage them to focus on minimising the tax bill as opposed to growing earnings. Indicators for company-wide performance scorecards that are tax sensitive could impact the pay of all senior executives.

> "Where performance assessment is based on tax-sensitive indicators, our concern is that companies will be driven to employ riskier strategies in an effort to minimise tax."

Michelle de Cordova, NEI Investments

Aggressive tax planning strategies can impact the timing and even ability of firms to spin off or sell business units or assets, suggesting that aggressive strategies may be encouraging companies to avoid making necessary capital decisions.

Tax-related risks extend beyond short-term earnings risks, so companies and their boards should be prepared to deal with potential changes in their business environments. The board should be aware of risks due to possible changes in tax rules, including to any incentives the company may be taking advantage of, and be ready to challenge unduly complex strategies where it is clear that these have been employed solely to reduce the tax bill. When evaluating long-term risks, the board should seek to understand any potential impact on key stakeholders.

SOURCES OF SCRUTINY ON AGGRESSIVE TAX PLANNING STRATEGIES

Multinational enterprises (MNEs) have become much more vulnerable to unexpected tax assessments and increases in tax liability as strengthened enforcement has spread around the world. In particular, all but a handful of countries have introduced regulations on transfer pricing, the majority in the past five to ten years. Most have established specialist units to enforce these and other international tax rules, and many have received training from international organisations. In July 2014, the OECD (Organisation for Economic Co-operation and Development) reported to the G20 Development Working Group that such assistance was being provided to twenty low income countries since 2011, and gave examples of significant increases in tax collection from transfer price enforcement in Colombia, Kenya and Vietnam. Concerns about MNE tax avoidance have also led to stronger actions in developed countries (see box 1).

In 2015 the UK enacted a diverted profits tax (DPT)[2] aimed at specific tax avoidance structures (also known as the "Google Tax"), and Australia has proposed similar measures. In the United States, congressional committees have produced research on "international tax avoidance" techniques used by companies, or required tax directors of large corporations to testify regarding their tax strategies (hearings by the Senate's Permanent Subcommittee on Investigations chaired by Carl Levin). Scrutiny from US lawmakers has also arisen in response to the increase in inversions[3], or corporate re-domicile transactions, that have taken place over the last decade. This scrutiny led to new inversion rules in September 2014.

These concerns and political pressures led to a more concerted response from an international regulatory perspective through the OECD Base Erosion and Profit Shifting (BEPS) project[4]. This project attempted the first comprehensive reform of international tax rules for over 80 years, on the basis of a consensus among nearly 50 states.

The central aim of changes to international tax rules through the BEPS project is to ensure that companies are taxed according to "where their economic activities take place and value is created". Tax authorities will be given strengthened powers to assess corporate tax activity, most notably through two new and very powerful tools: country-by-country reports (CbCRs) and transfer pricing documentation. This will apply for the first tax year after 2016 for all MNEs with a turnover greater than 750m euros, but the limit will be reviewed in 2020.

BOX 1. EXAMPLES OF EARNINGS AND GOVERNANCE RISKS

In 2014, the European Commission decided to investigate tax arrangements between Apple and the Irish government dating back to 1991. In December 2014 its inquiries were extended to all member states, following the "Lux Leaks" revelations of secret tax rulings to over 340 large companies. In October 2015 the Commission decided that the tax rulings granted by Luxembourg to Fiat and by the Netherlands to Starbucks, which have been widely reported as sweetheart deals, constitute illegal state aid, meaning each company faces tens of millions of euros in additional tax bills.

In 2014 Google was faced with a tax bill from the French government estimated to reach €500m-€1bn. The demand was for underpayments resulting from Google's European tax structure, which saw the company funnelling most of its revenue through a Dutch-registered intermediary and then to a Bermuda-registered holding company, Google Ireland Ltd, before reporting it in low-tax Ireland (known as the Double Irish Dutch sandwich).

The US Treasury issued rules making mergers involving tax inversions[2] more difficult to achieve, resulting in a number of cross-border mergers unravelling, including US group Abbvie's proposed US$54bn of the UK pharmaceutical company Shire.

Pfizer has featured extensively in the media after entering into deals that did not pay off – all in order to cut the tax bill – such as the failed attempt to acquire AstraZeneca in order to shift its tax base to Britain. CEO Ian Read stated that if Pfizer were to move its domicile, he would prefer for the deal to close before the end of 2016, because tax reform might move back on to the agenda when a new US Congress is elected in 2017.

2 The DPT applies where tax arrangements between a UK company and a non-UK entity reduce UK tax liabilities, but these arrangements lack economic substance. It also applies where a foreign company trades in the UK but the activities are specifically designed to avoid creating a taxable presence in the UK.

3 An inversion is the re-incorporation of a company overseas in order to reduce the tax burden on income earned abroad

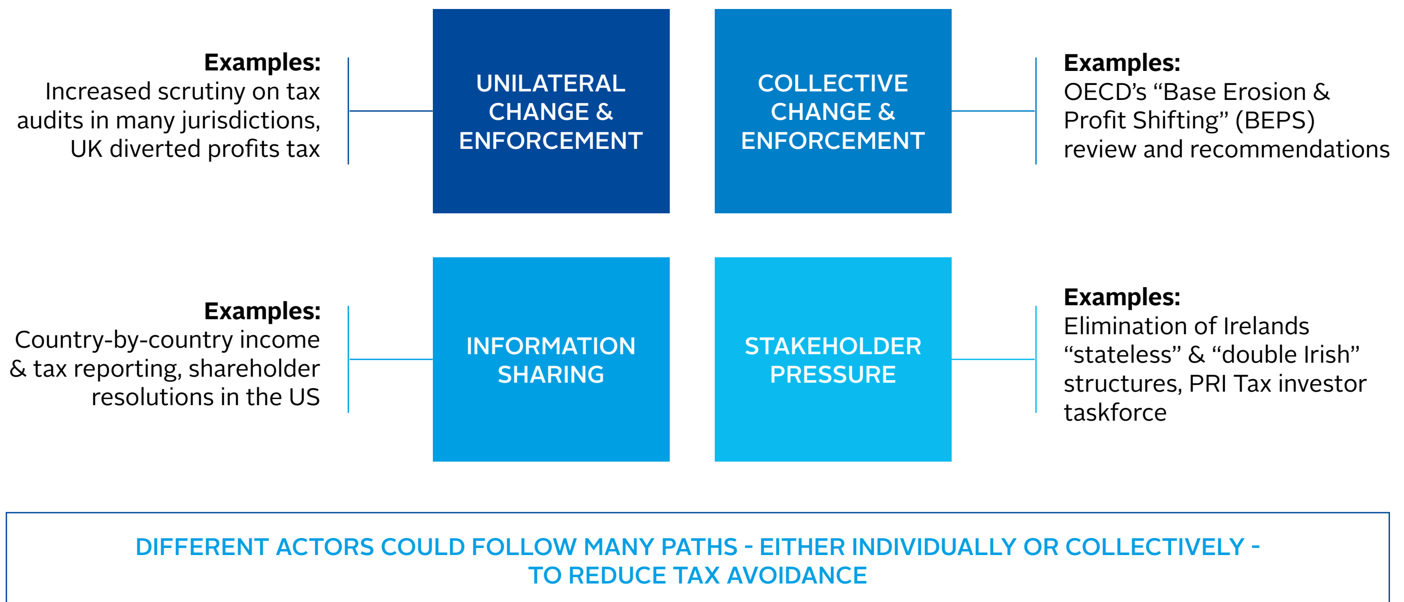
4 More information and a full review of the BEPS project can be found in Appendix 1

The need for transparency and better disclosure has been a focus area for global bodies such as The World Federation of Exchanges, which has included tax transparency as a "material ESG metric" for reporting by listed companies; the International Federation of Accountants (IFAC), which has called for jurisdictions to share information to promote accountability and long-term global sustainability; and the International Accounting Standards Board (IASB), the independent standard-setting body of the International Financial Reporting Standards (IFRS) Foundation, which has worked on changes to tax disclosure rules.

Investors have also started to be more vocal with their own concerns regarding aggressive tax planning (e.g. the Domini Social Investments and NEI Investments tax shareholder proposal submitted at Google in 2014. Brokers and research providers have also recently provided commentary and detailed reports (e.g. Kepler Cheuvreux, Sustainalytics report commissioned by Arisaig, VBDO).

In summary, earnings and governance related tax risks can arise from several angles, as outlined in the graphic below.

Graph 1. Change coming from many angles



DIFFERENT ACTORS COULD FOLLOW MANY PATHS - EITHER INDIVIDUALLY OR COLLECTIVELY - TO REDUCE TAX AVOIDANCE

REPUTATIONAL AND BRAND RISK

The media and NGOs have brought company practices to light through investigative projects and heightened public awareness of the topic, building public understanding of complex tax issues and in turn pushing governments (e.g. hearings by the U.S. Senate Permanent Subcommittee on Investigations and by the UK Public Accounts Committee) and other stakeholders, including investors, into addressing the issue.

While the historic focus of NGO groups, including the Tax Justice Network, Christian Aid, ActionAid, Citizens for Tax Justice, the FACT coalition and Oxfam, has been on the social justice and macroeconomic element of taxation, campaigners are increasingly framing arguments around financial and investment risks[5].

Although media article do not necessarily indicate any wrong or illegal practice, the impact on a company's reputation can be significant.

For sectors reliant on government licences to operate (e.g. mining), reputational damage may harm the relationship with the host and/or home country, hitting existing projects and affecting the ability to win future licences. A company may also be deemed as high risk by tax authorities, leading to more scrutiny for its structures and higher hurdles of justifying legitimate business activities.

5 ActionAid, an NGO tackling poverty, has published an investor guide intended to inform and generate awareness of the impact of tax avoidance from a financial risk perspective. The recent launch in the UK of a Fair Tax Mark accreditation scheme adds further NGO pressure on British companies to explain their tax practices.

For companies in consumer-facing sectors, negative media coverage can result in boycotts and consumer backlash. It can also undermine the efforts invested by the company into their corporate responsibility positioning and affect their brand value. Given this scrutiny, it is essential for corporate sustainability officers to understand their business's tax decisions and how those decisions impact the company's financial results and stakeholders, and for senior executives and boards to be able to explain to investors how their company's global tax strategies align with their sustainability commitments.

> "It is critical for companies to ensure that their sustainability officers are involved in tax strategy and relevant communications."
>
> Adam Kanzer, Domini Social Investments LLC

Although the OECD BEPS project proposes that CbCRs would be available only to tax authorities and should be kept confidential, many consider that their publication is inevitable. In fact, publication of similar country-by-country information is already required for companies in some sectors, such as the extractive industry. In Europe, it has already also been mandated for banks, and the Commission is considering whether the requirement might be extended to all sectors. Therefore, companies should be able to defend how they allocate profit to each country both to tax authorities and the general public to avoid reputational risk and investor backlash.

> "We have voted against the financial statements or discharge of duties of financial sector companies that have not reported on their tax practices country-by-country."
>
> Pauline Lejay, ERAFP

Table 1. Impact of tax issues on brand value. Source: Interbrand Best Global Brands 2013 via Kepler Cheuvreux

Tax issues can affect mainstream evaluations of Brand Value

	Brand Value Impact	Total Brand Value USDm	Extract from Best Global Brands report (2013)
Apple	Negative	98,316	Apples' reputation has taken a few hits this past year... a US Senate hearing examining the company's "highly questionable" tax minimization strategies.
Amazon	Negative	23,620	The issue of tax avoidance in the UK demonstrates that Amazon's expansion plans must be checked with responsibility and prudence, or it faces risks to its brand reputation
Goldman	Negative	8,536	Continuing to wrestle with negative public sentiment, the brand has been criticized for leveraging tax policy loopholes in The Volker Rule
Citi	Positive	7,973	The brand has its "Citi for Cities" initiative : A prime example is its "e-payment gateway" in Mumbai to improve the tax collection and receipt process
Starbucks	Negative	4,399	In the hot seat over corporate taxes in the UK, it remains to be seen whether this will have a long-term impact on the brand

MACROECONOMIC AND SOCIETAL RISK

At a macroeconomic level, aggressive tax strategies implemented by corporations may result in lower levels of public investments or less support for important social programs, impairing economic growth and undermining long-term investment returns.

Tax payments should not be considered a zero sum game: higher tax revenue to governments can positively impact business' ability to produce sustainable returns through increased infrastructure investment and projects that grow the population of eligible consumers; it can also provide a pool of healthy, well-educated potential employees. Taxpayer-funded scientific research has produced critical innovations that benefit companies.

Aggressive tax planning can distort competition and result in companies with cross-border operations gaining an advantage over domestic rivals. This distortion can also discourage new business formation — a key driver of job creation, innovation and socioeconomic advancement — due to the lack of a level playing field for new entrants.

Tax responsibility is viewed by many in civil society as an issue of fairness, especially given that if corporate receipts fail, tax burdens will be placed on lower- and middle-income individuals, who are already burdened with increasing income inequality – highlighted as the most likely global risk in the World Economic Forum report for a number of years.

While the amount of tax revenue lost to aggressive tax planning is not clear, several organisations have highlighted huge estimates: a report from the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows, Poverty and Human Rights cited research estimating that developing countries lost US$5.86tln to illicit financial flows from 2001 to 2010, and that corporate tax abuses accounted for 80% of those outflows; the Independent Commission for the Reform of International Corporate Taxation (ICRICT) highlighted a report by the UN Conference on Trade and Development estimating corporate income tax losses for developing countries, due to profit-shifting by multinational corporations, at one-third of total corporate income taxes due — US$100 billion per year.

> "Proxy advisory firms, and many large investors, consider these issues company by company, without considering the larger systemic impact of company activities."
>
> Adam Kanzer, Domini Social Investments LLC

PREVALENCE AND IMPACTS

While media coverage highlights practices of the largest companies, the breadth of exposure across an investment portfolio is unknown. In spite of the increased scrutiny on tax practices, investors are largely unable to assess a MNE's tax risks due to a lack of transparency around the strategies a company might be using and the policy and governance practices that guide those strategies.

> "Lack of transparency on tax seems to be a good proxy for more aggressive practices. Therefore, to ask companies for more transparency about their tax practices is a reasonable first step for engagement."
>
> Matthias Müller, RobecoSAM

> "We use scenarios to assess the potential impact that increased tax costs would have on our target price for a stock, but the lack of transparency is a key hurdle."
>
> Harriet Parker, Alliance Trust Investments

The 2015 MSCI Tax Gap Analysis shows (despite lack of transparency making it difficult to identify cases) the potentially high exposure across an investment portfolio:

- 243 out of 1,093 companies in the MSCI World Index had a large tax gap[6];
- 20% of those companies' profit after taxes could result from tax strategies rather than core business activity;
- 26% of those companies use tax havens (compared to 16% in the wider index).

Table 2 on p 12 lays out a number of cases highlighting the severe operational, legal, and financial impacts on companies, showing that in the long term, aggressive tax planning can destroy shareholder value.

6 Defined by MSCI as the difference between the reported tax rate paid and the tax rate of where companies generate revenues, also see glossary

Table 2: The rise of tax minimisation impacts on business. Source: Kepler Cheuvreux.

Type	Impacts	Examples
Costs	Settlements in tax disputes i.e. transfer pricing	GSK US$3.4bn (US), AstraZeneca US$1.1bn and £550m (UK), Vodafone £1.25bn (UK)
	Tax authority investigations from transfer pricing/cross border M&A	Novo Nordisk US$1bn disputed (Denmark), Vodafone, SAB Miller, AT&T, Shell (India)
	Delays to M&A/asset freezes and seizure	Nokia factory in India in handset IP tax dispute
	Criminal penalties	Credit Suisse US$2.8bn settlement and guilty plea for criminal charges of aiding US tax avoidance
	Bail money deposits required in disputes	UBS loses appeal for €1.1bn bail request in French courts for allegedly assisting French client tax avoidance Idem HSBC
	Financial pressure on tax minimisation dependant business	Entire European offshore wealth management business unlikely to recover prior margin levels
	Increased legal and compliance costs	All the above examples
	Potential exclusion from public contracts due to tax evasion convictions	Regulation exists i.e. for EU procurement, current levels of poor enforcement could increase in the long term
	EC investigations into unfair “fiscal state aid”	EC fiscal state aid investigations into Ireland, Netherlands, Luxembourg and Belgium likely to require repayments from companies with special tax agreements – so far Starbucks €30m, Fiat €30m, Amazon, Apple noted
	Suspension of key projects	First Quantum/Glencore suspends Zambia copper projects after government withholds US$ tax refunds, US$200m for Glencore
Financial	Earnings volatility as a result of tax dispute/ controversies	AstraZeneca
	Low-quality earnings	Various
	Short-term price impacts of regulatory changes (especially use of “executive orders” in US to push through regulation)	Shire/AstraZeneca 5%+ drops Sep 2014 on new tax inversion regulation from US
	Requirement for organisational restructuring (i.e. of location and alignment of subsidiaries) as stricter tax haven legislation is introduced	Various
	License to operate – boycotts and public protests	Vodafone/Starbucks/Amazon UK
Reputational	Negative associations from impacts from televised senate/parliamentary hearings on tax avoidance	Starbucks and Barclays (UK), Apple (US)
	Brand impact on entire bank from tax minimisation dependant business	Barclays tax avoidance units, European offshore wealth management sector

AGGRESSIVE TAX PLANNING: AN OVERVIEW OF KEY STRATEGIES

Before engaging with companies on their tax practices, investors need to develop a good understanding of the main strategies that can be used by companies to reduce tax payments. These primarily involve shifting profits between subsidiaries in different jurisdictions to book profits in low-tax jurisdictions, rather than where the business activity takes place.

An MNE may consist of hundreds of affiliates. These entities may be used to hold assets (such as intellectual property rights), issue/manage debt and receive/transmit payments such as interest or royalties.

TRANSFERRING ASSETS (E.G. INTELLECTUAL PROPERTY)

A common strategy involves transferring assets (such as intellectual property (IP)) from a subsidiary in a high-tax jurisdiction to one in a low-tax jurisdiction.

Global tax rules require that these transfers be conducted using the arm's length principle, which states that any internal corporate transaction must be conducted as if two unrelated parties were making the deal. This approach has been useful as a guide to evaluate transfer prices between associated enterprises in an effort to prevent double taxation; however, the application of the principle has proven highly vulnerable to manipulation. Abuses often arise due to information asymmetries between the company, which has a better sense of the long-term value of the asset, and tax authorities, who are not privy to that information. This is particularly problematic for sales of intangibles, such as IP, for which there are few reference prices available in the market.

IP rights can generally be sold to subsidiaries in low-tax countries in four ways: asset sale, sale of services, licensing and cost sharing. When an asset is transferred, the selling subsidiary (for example, a US subsidiary) earns income that is taxed in that subsidiary's jurisdiction. The new owner (for example, an Irish subsidiary) then pays taxes over time on income from the asset. After the transfer, companies may allocate profits earned in numerous countries to the subsidiary in the low-tax jurisdiction where the asset now resides.

Conversations with tax advisors indicate that companies may abuse this system by not including expected future improvements to the IP (for example, an update to a particular piece of software) in their arm's length economic value calculations at the time of transfer. In some cases, legal ownership of the IP asset remains in the original country and benefits from that country's typically stronger legal system. The splitting of the legal and economic ownership of an IP asset creates a mismatch between the tax revenue needed to fund the strong legal system where the IP was developed and the tax revenue resulting from the income associated with the IP asset.

Changes in transfer pricing rules following the BEPS project will give tax authorities powers to characterise the terms of such licenses based on the actual functions performed, assets deployed and risks assumed by the parties, so that a function such as IP management would be assigned only a routine profit. Rules governing cost-sharing agreements will also be strengthened.

INTRA-COMPANY DEBT

A subsidiary of an MNE in a low corporation tax regime can lend money to a subsidiary in a high-tax regime. The debt repayments and interest expenses are then offset against corporation tax in the high-tax regime, thus reducing tax payments (and the interest rates can be well above those paid by the corporation on its external debt).

Media stories suggest that in certain cases intra-company debt balances at certain companies may be many multiples higher than its external debt balances. Similarly, interest rates paid on intra-company debt may be multiples higher than interest rates paid on external debt (for example, see Chevron tax ruling in Australia which could be subject to appeal). Lack of disclosure over intra-company debt enables abuses and keeps investors from being able to assess any earnings impact of potential regulatory changes.

The OECD has highlighted the use of hybrid schemes, which use differences in the cross-border tax treatment of financial instruments to achieve (a) two interest expense tax deductions in different jurisdictions for only one interest income tax payment and/or (b) an interest expense deduction with no corresponding interest income tax payment. The latter strategy uses an instrument that is considered a debt in one country and equity in another.

Tax authorities are seeking to restrict the opportunities for debt-related tax minimisation by closely scrutinising the profit attributed to financial management functions, and limiting interest deductions by applying a fixed cap.

MARKETING SERVICES AND TRADING COMPANY STRUCTURES

Companies can fragment functions (e.g. R&D, product design, logistics, transport, order fulfilment, or customer support) using marketing services or trading company structures, shifting profits from high-tax to low-tax jurisdictions.

In a **marketing services agreement**, an MNE designates sales staff in high-tax jurisdictions as "marketing" personnel. Although these marketing personnel maintain sales relationships, the company's remote employees in a low-tax jurisdiction actually finalise the sale, so that the majority of the profit is then booked in the low-tax jurisdiction rather than in the high-tax jurisdiction where the real sales activity took place.

In a principal or **trading company structure**, the potential abuse comes when a company designates a subsidiary in a low-tax jurisdiction to control functions such as ordering from third-party manufacturers and inventory management for the whole group, despite the actual products and inventory in many cases never flowing through the country where this subsidiary is based. The company will then state that subsidiaries in high-tax jurisdictions, which generally account for the bulk of sales, are simply responsible for distribution, in spite of the physical products being held or services to end customers being provided, in that jurisdiction.

If headquartered in the United States, companies may be able to avoid taxation of passive foreign income (e.g. the payment of dividends or royalty payments between foreign subsidiaries) by exploiting certain rules like the "check the box" rule, which enables a company to require the Internal Revenue Service (IRS) to disregard certain entities for tax purposes.

Following BEPS, tax authorities are likely to closely scrutinise the profit attributed to such functions relative to the nature of the activities performed and value created. Several governments are seeking to unilaterally reduce these activities through regulations like the previously mentioned UK diverted profits tax.

TAX HAVENS, SHELL COMPANIES AND TAX INCENTIVES

According to the OECD definition, a tax haven refers to a country which imposes low or no tax, and it can be used by corporations to avoid taxes which otherwise would be payable in a high-tax country. Most tax havens are characterised by opaque legislative, legal and administrative functions, few corporate governance requirements, and no effective exchange of information[7]. Corporations often have very few if any assets or employees in tax havens and may only operate cash boxes in that jurisdiction to legally manage their affairs.

While definitions and classifications of tax havens vary around the world, research by MSCI has shown that a significant percentage of MNE subsidiaries are unquestionably located in recognised tax havens.

The presence of MNEs' subsidiaries in tax haven jurisdictions through the use of shell companies (i.e. companies that do not have substantive assets, operations or employees, but serve as vehicles for transaction flows, or are set up for accounting purposes) may be a deliberate decision to take advantage of tax avoidance mechanisms.

Some jurisdictions with statutory tax rates that are in line with global averages will provide companies with individual incentives, to entice investment into the country. These incentives can include tax holidays, reduced tax rates and patent boxes. These arrangements can encourage companies to transfer substantial portions of their global income to that jurisdiction, regardless of the economic activity that is actually occurring there.

Many tax authorities and parliamentary oversight committees are concerned that incentives are over-generous, and offered for short-term political reasons, which has increased media and societal attention on the use of these strategies. International organisations such as the IMF and the OECD are urging more stringent evaluation of their costs and benefits. The European Commission is applying state aid rules more actively (see Box 1 and Table 2).

7 See also: "Harmful Tax Competition: An Emerging Global Issue", Chapter 2- Factors to identify tax havens and harmful preferential tax regimes.

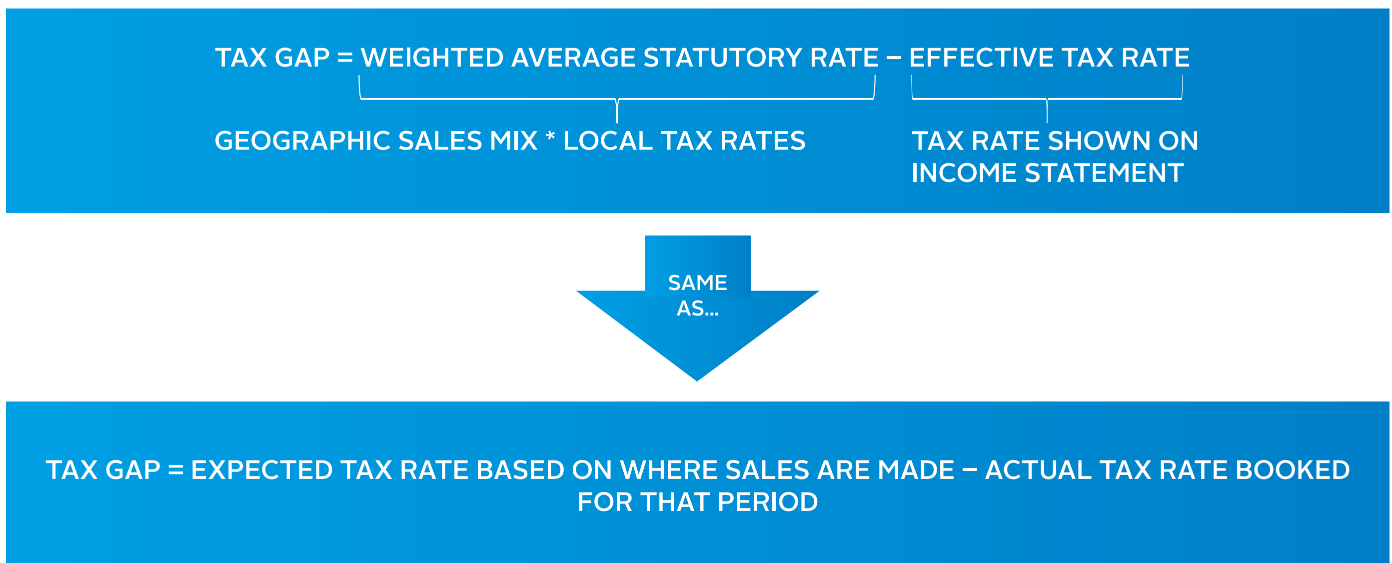
HOW TO ENGAGE COMPANIES ON TAX-RELATED TOPICS

STEP ONE - ENGAGEMENT CANDIDATES: IDENTIFYING RED FLAGS IN YOUR PORTFOLIO COMPANIES

LARGE TAX GAP

A good indicator of potential earnings risk is the difference between the effective tax rate on a company's income statement and the weighted average of statutory rates based on the firm's geographic sales mix[8]. Although the mismatch may be explained by factors unrelated to tax minimisation, such as tax credits, large and persistent tax gaps are generally the result of profit-shifting and aggressive tax planning.

Graph 2. Profit shifting: assessing the risk



FOREIGN EFFECTIVE TAX RATE

The foreign effective tax rate can be calculated using foreign profit data and current and deferred foreign tax data, which are both found in the tax footnote. Applicable primarily for companies based in a jurisdiction with a worldwide taxation system (e.g. the US), this rate can be then compared to the average statutory rate of the countries where the company does business, and a significant gap may call for further dialogue.

8 When calculating the weighted average statutory tax rate, an investor should use revenue mix, as the profit shifting discussed throughout this document may impact profit mix

Graph 3. Calculating the foreign ETR

Note 5 – Income Taxes

The provision for income taxes for 2015, 2014 and 2013, consisted of the following (in millions):

	2015	2014	2013
Federal:			
Current	$ 11,730	$ 8,624	$ 9,334
Deferred	3,408	3,183	1,878
	15,138	11,807	11,212
State:			
Current	1,265	855	1,084
Deferred	(220)	(178)	(311)
	1,045	677	773
Foreign:			
Current	4,744	2,147	1,559
Deferred	(1,806)	(658)	(426)
	2,938	1,489	1,133
Provision for income taxes	$ 19,121	$ 13,973	$ 13,118

FOREIGN EFFECTIVE TAX RATE
= FOREIGN CURRENT & DEFERRED TAXES / FOREIGN PRE TAX EARNINGS
= $2,938 / $47,600
= 6.2%

The foreign provision for income taxes is based on foreign pre-tax earnings of $47.6 billion, $33.6 billion and $30.5 billion in 2015, 2014 and 2013, respectively. The Company's consolidated financial statements provide for any related tax liability on undistributed earnings that the Company does not intend to be indefinitely reinvested outside the U.S. Substantially all of the Company's undistributed international earnings intended to be indefinitely reinvested in operations outside the U.S. were generated by subsidiaries organized in Ireland, which has a statutory tax rate of 12.5%. As of September 26, 2015, U.S. income taxes have not been provided on a cumulative total of $91.5 billion of such earnings. The amount of unrecognized deferred tax liability related to these temporary differences is estimated to be $30.0 billion.

MNEs can choose to deem some deferred foreign profit[9] as likely to be repatriated in an effort to cause their global tax rate to more closely resemble peers' or typical statutory rates, even though the company may not intend to actually repatriate the foreign cash. This decision will make the tax gap red flag outlined above appear acceptable, when the company may actually be highly aggressive in its tax planning.

BOX 2.
US COMPANIES REPATRIATING PROFITS

Over the last three years, Apple's global effective tax rate has averaged just over 26%, but a closer look reveals a very low foreign effective tax rate and a very high US effective tax rate. This high US effective rate is due to the company booking a large deferred tax liability for foreign earnings that could be repatriated in the future.

In April 2013 Apple broke several records in one month. It sold bonds worth US$17bn – the largest debt sale in history – and used the funds to increase dividends and orchestrate the biggest ever share buyback scheme, worth US$60bn, in the process regaining its position as the most valuable company in the world. But if it had US$145bn in cash and maintained a large deferred tax liability related to foreign profits that it expects to repatriate, why did it feel the need to raise debt?

The answer lies in the US cash repatriation rules. To bring that money back into the country would mean an estimated US$35bn tax bill, so borrowing was the cheaper option. This financial engineering was incentivised because although servicing the new bonds costs Apple about US$300m a year in interest payments, it got a tax break worth about US$100m a year for issuing the debt.

Apple executives told the Levin Senate subcommittee in 2013 that recording a deferred tax liability "provides no indication" that they intend to repatriate foreign profits, which suggests the decision to book its large deferred tax liability may simply be window dressing. The success of this mega bond issuance coupled with a global environment of continuing low interest rates, means such practices are likely to continue for US companies with large cash piles abroad.

9 Worldwide taxation systems employed by countries such as the US generally allow for a deferral of profits earned overseas as long as those profits are intended to be used to make future business investments.

LARGE OR GROWING UNRECOGNISED TAX BENEFITS (UTB) BALANCE

Also known as uncertain tax positions, UTBs[10] display the tax positions being taken by a company that management believes are less than 50% likely to be upheld by a tax authority. A large balance compared to peers (which can be calculated by dividing each company's UTBs by its enterprise value), or a growing balance, suggests a company that has recently adopted higher risk tax strategies r has faced a change of position from relevant revenue authorities.

NEW DISCLOSURES OR CHANGES IN LANGUAGE USED IN TAX FOOTNOTES

Although disclosure in tax footnotes is generally minimal, some companies provide information regarding recent changes to their tax strategies that may not have been reviewed by tax authorities and hence may increase earnings risk in future.

OPAQUE DISCLOSURE OF GEOGRAPHIC REVENUE MIX

Particularly when combined with any of the above red flags, poor disclosure of geographic revenues may hinder the ability of an analyst to assess the tax gap.

MEDIA STORIES OR GOVERNMENT INQUIRIES

Although these do not necessarily signify any wrongdoing, they are valuable in determining specific tax strategies used by a company – especially if there are repeated mentions – and are highly indicative of reputational risk. The company's response to any allegations may also be a good proxy for the board's risk tolerance related to tax practices.

LACK OF A TAX POLICY

Disclosure of how the company perceives and addresses tax-related risks, including information on overarching policies and governance of the issue, is critical. While many companies still do not provide any meaningful narrative or disclosure beyond numbers in their annual reporting, examples of good practices in this regard have emerged. Leading MNEs should be expected to follow this model.

BOX 3.
EXAMPLES OF COMPREHENSIVE TAX POLICIES

UNILEVER

Unilever*'s Global Tax principles "illustrate good corporate practice in the area of tax management and tax transparency, balancing the interests of our various stakeholders". The principles, for which internal training is provided, cover the following areas:*

- compliance
- transparency
- transfer pricing
- structure
- tax havens
- tax rulings
- relationships with governments
- relationships with tax authorities
- accountability and governance

The company explicitly states that "secrecy jurisdictions or so-called 'tax havens' are not used for tax avoidance", while under the last point, the company makes reference to its commitment to annual reporting to the Board on adherence to the tax principles.

GRUPO NUTRESA

Grupo Nutresa*'s tax policy reflects "Responsible Corporate Citizenship". The policy includes a set of seven principles and twenty rules that govern the formulation and implementation of the company's tax strategy. The guiding principles include:*

- ethics
- integrity and good faith
- legality
- responsible corporate citizenship
- world-class competitiveness
- social responsibility
- sustainable development

In addition, the policy attributes responsibility to the Board for ensuring compliance in all the companies that are part of the group.

10 While the UTB concept is part of US GAAP (generally acceptable Accounting Principles), not all jurisdictions are required to report UTB information.

A company having multiple subsidiaries in tax havens may also constitute a red flag, although there is no globally accepted definition or list of tax havens, inclusion in some lists has been heavily contested by some countries and full disclosure of subsidiaries is often lacking (many US companies have dramatically reduced the number of disclosed subsidiaries over the past few years). Investors, however, can make use of information provided by regional and national regulators, or organisations such as The Tax Justice Network (Financial Secrecy Index).

When prioritising which companies to engage with and preparing to engage them, investors should also take into account sector-specific, region-specific and company-specific factors:

Sector-specific risks	Certain sectors have developed a reputation for aggressive tax planning, as they are more exposed to scrutiny (e.g. consumer goods), or are well placed to employ different strategies (e.g. IP rights at pharmaceuticals). Aspects of recent or upcoming legislation may be more pertinent to some sectors (e.g. focus on technology though BEPS, obstacles to M&A activity by Pharmaceuticals).
Regional tax systems	Depending on a company's domicile, location of headquarters and business operations, tax-related risks may change significantly, especially in the absence of a global tax system. Political agendas, national government's approach, media and consumer pressure may play a significant role.
Company profile and operations	The company's structure, history and nature of activities should be taken into account. For example, presence in a tax haven as a result of past M&A activity may be acceptable.

"We select companies in three stages:

- Stage one is using company reports and other data to find out the weighted effective tax rate and how much this deviates from the actual rates.
- Stage two is broadly looking at what sort of tax policies these companies have.
- Stage three is looking at publicly reported cases of inappropriate tax practices within our portfolio companies."

Steven Bryce, Arisaig Partners (Asia) Pte Ltd

"How do we use information on tax? Unfortunately, we can't be very precise today because we just don't have enough disclosure from companies, but we have used our tax research in several ways[11]:

- We have made direct financial modelling adjustments. Over the next 2-3 years, we think an effective tax rate in the high teens is probably sustainable for companies with substantial foreign operations. As a result, many analysts have made a modelling adjustment to bring the tax rate up from as low as a single digit percentage to anywhere from 15-25%.
- In other situations where we are less convinced that tax will be a material risk over the next few years, analysts have simply modelled higher tax rates into their downside scenario analyses.
- A few portfolio sales have also occurred for companies where we felt like the risk was high and not well understood by the market.
- In certain instances, our two-plus years of in-depth research on tax planning strategies has provided us with insights regarding the opportunities that some companies may have to lower their tax rate. The assessment of these opportunities has been a primary driver of multiple "buy" recommendations issued by analysts."

Robert Wilson, MFS Investment Management

11 A related case study on how to integrate tax into fundamental analysis and company valuations will be included in the upcoming PRI publication on integration.

STEP TWO - STRUCTURING YOUR ENGAGEMENT: QUESTIONS FOR MANAGEMENT AND THE BOARD

The list of questions proposed in this section can be used to research the company's tax profile based on current financial or sustainability reporting.

When researching tax profiles, analysts should be looking at how the company geographically segments its revenues, or whether it already provides information on tax in its annual report or as part of sustainability disclosure.

Some of the questions could be used for enhancing knowledge of the company's practices, which could be integrated into investors' existing financial models or decision-making frameworks. Some could inform engagement requests for companies to improve oversight, governance and transparency.

The questions posed by an investor will ultimately depend on the tax profile of the company, the investor's own priorities, any existing relationship with the company and the stage of the dialogue. Even when questions are not answered by companies at first instance, raising them will communicate to company management that they need to be more thoughtful about their tax strategies and how they communicate them to their investors.

The list below covers six broad themes that could be used to structure the engagement dialogue. While there is no one size fits all model, the themes are presented in a suggested order for engagement i.e. starting from policy, governance and risk management, and moving on to more technical questions.

> "Not enough mainstream investors are asking these questions, so companies feel they don't need to be more transparent."

Meryam Omi, Legal & General Investment Management

> "Investors need to keep asking questions on tax:
>
> - In the first year we sent out 122 letters and only got 12 replies, none of which included the data we were looking for.
> - In 2013, we sent out 128 letters and got 48 replies but with only little substance.
> - In 2014 we asked 132 companies and got 39 responses, but they were much more substantive."

Rosl Veltmeijer, Triodos Investment Management

1. TAX POLICY

Check: if the company has a comprehensive tax policy publicly available.

A. Key question: Have you considered publishing a tax policy/principles to indicate your approach towards taxation?

B. Who has ultimate responsibility for setting your tax policy?

C. Do you subscribe to any corporate responsibility standards, and if so do they include any standard about responsible tax management[12]?

D. Do you engage with policy makers on tax issues, directly or through active involvement in a business or industry group?

[If yes:]

  i. What tax issues are you currently lobbying on?

  ii. What groups are you using?

E. How does the board ensure that your tax strategy aligns with your sustainability commitments?

2. TAX GOVERNANCE

Check: whether the company provides disclosure on clear board level oversight of tax strategy.

A. Key question: Is tax formally a part of the risk oversight mandate of the board? How often and for what reason is tax discussed at board/committee level?

B. How do you manage tax planning policies, from board down to line-manager level?

C. What is the role of your external audit firm in your tax planning strategy?

D. Is your executive team and line/divisional managers judged by financial performance before or after tax?

i. [If yes] Have you considered whether this might have an impact on their approach to tax planning?

E. Do your external tax advisers also conduct your financial audit?

[If yes]

  i. How do you manage conflicts of interest?

F. How large is your in-house tax department?

G. How much have you spent on tax advice from external advisers in the past three years?

3. MANAGING TAX-RELATED RISK

Check: whether the company discloses any information on tax-related risks and how they are managed, including any discussion on pending investigations of tax positions[13].

A. Key question: How do you define and manage tax-related risks? What are your top three tax-related risks?

B. How does your internal audit team monitor tax-related risks?

C. Has the board discussed the potential risk of tax strategies negatively impacting relations with key stakeholders, such as consumers, local or national governments?

D. Has your board discussed the possible ramification of your tax strategies on the firm's brand or reputation?

E. How would you characterise your relationship with the tax regulator in your home country?

F. What is an example of a tax planning strategy that was rejected by the executive team or the board as too risky?

4. THE EFFECTIVE TAX RATE

Check: the company's global effective tax rate and if the origin of any significant difference versus its weighted average statutory tax rate is explained in detail.[14]

A. Key Question: What drives the gap between your effective tax rate and your weighted average statutory rate based on your geographic sales mix?

B. Are there specific tax law changes currently being considered or to be adopted in the short term (e.g. following BEPS, by national governments), that if enacted would cause your rate to increase significantly?

C. [For companies based in a jurisdiction with a worldwide taxation system (e.g. the US)] What drives the percentage gap between your foreign effective tax rate and your non-domestic weighted average statutory tax rate?

D. [If the company's Unrecognized Tax Benefit balance is large or has grown] What is driving the increase in your Unrecognized Tax Benefit? What does this growth suggest about the amount of risk that your organization is taking on as it relates to questionable tax positions?

---

12 The OECD Guidelines for MNEs is a good example of an international corporate responsibility instrument covering taxation, contributing to and drawing upon a significant body of work, most notably the OECD Model Tax Convention and the UN Model Double Taxation Convention between Developed and Developing Countries.

13 Disclosure on this item might be limited because of companies' caution to not share commercially sensitive information or influence the outcome of the pending case.

14 Chief Financial Officers, corporate tax directors, and corporate sustainability officers should have information on the effective tax rate (ETR) for the corporate group, all domestic operations and all foreign operations, as information that enables the computation of these data points is available in current filings

5. TAX PLANNING STRATEGIES

The questions below refer to the use of aggressive tax planning strategies.

Overarching key questions:

A. To what extent does your profit after tax rely on your presence in tax havens or incentives and structures that enable very low taxation (e.g. <15%) of profits?

B. Have you reconsidered your tax planning strategies, or do you intend to reconsider them, in light of changes following the BEPS project?

5.1. CORPORATE STRUCTURE

A. Key question: How many separate legal entities (under common control[15]) make up your corporate group, and do you disclose all of them?

B. Have you conducted a review of these and of the group structure recently, to check the functions they perform, and if the structure could be simplified?

C. Have any of your agreements or structures been notified to the authorities under a disclosure scheme, or have you considered whether any might need to be notified?

D. How many of these entities are formed or resident in a jurisdiction that could be described as a tax haven (and based on what definition e.g. the OECD list, Tax Justice Network)?

E. What is the role of these tax haven entities?

5.2. INTELLECTUAL PROPERTY RIGHTS

A. Key question: What is the internal ownership structure that governs your firm's intellectual property assets?

B. Have you reconsidered these structures, or do you intend to reconsider them, in light of the changes to transfer pricing rules following the BEPS project?

C. If you have transferred IP, or on an ongoing basis transfer IP, out of the region in which it is developed, what is the business purpose and how do you determine the value of the IP that is transferred?

[If yes]

i. Where is the IP transferred to?

ii. What functions are performed by the entity which owns these assets?

iii. How many people does it employ, and what profits are attributed to it?

D. If you use cost-sharing agreements to move IP out of the region in which it is actually developed, when were your most critical cost sharing agreements initially created, and have you reviewed them, especially in light of the BEPS project proposals?

E. [If applicable] Given that much of your Research & Development/design work and hence new intellectual property generation appears to occur in XX country where your principal R&D/design facilities are located, why doesn't your XX country subsidiary receive a higher share of your profits based on the value it is creating?

5.3 FINANCIAL STRUCTURES – INTRA-COMPANY DEBT

A. Key question: Do you have subsidiaries in low tax jurisdictions that make intra-company loans?

[If yes]

i. Where are they located, and why?

B. How does your aggregate intra-company debt balance or interest expense compare to your external debt balances or interest costs paid to third parties?

[If the company has a large intra-company debt balance]

i. What is the purpose of the large intra-company debt balance?

ii. What would be the impact of the likely introduction of stricter interest deduction limitations following the BEPS project?

C. What is the average interest rate on your intra-company debt and how does this rate compare to your external debt?

D. Is any of your intra-company debt paying an interest rate above your most recent externally-financed debt rate?

E. Do you use hybrid debt structures to lower your effective tax rate?

[If yes]

i. Have you considered the implications for these structures of the proposals on hybrid mismatches in the BEPS project?

5.4 TRADING COMPANY OR MARKETING SERVICE STRUCTURES

A. Key question: Have there been material changes to your corporate tax structure in the past four years (e.g. separation of high value-adding from routine functions)?

B. Do you use a principal or trading company structure (e.g. where one subsidiary controls third party manufacturing, marketing, and distribution decisions) to manage your operations?

C. [If company uses a trading company or marketing services structure] What are the primary subsidiaries in this structure, where are they located and what are their business functions?

15 Paragraphs B1 to B3 of IFRS 3(www.IFRS.org) 'Business Combinations" indirectly provide the concept of common control. Namely it refers to two or more companies under the control of one person/entity

D. [If company uses a trading company or marketing services structure] Do you receive tax incentives or have any Advanced Pricing Agreements (APAs) with the countries impacted by this structure?

E. Have you reconsidered these structures, or do you intend to reconsider them, in light of the changes to tax rules and their enforcement (e.g. BEPS project, EU state aid investigations)?

5.5 TAX INCENTIVES

A. Key question: Are there any jurisdictions that have provided you with tax holidays or incentives?

[If yes]

B. What is the value of these incentives (in monetary terms, or in terms of the impact that they have on your overall effective tax rate)?

C. What countries have provided these incentives, what is their end date, and what investment or other requirements have been placed on your business as a result of agreeing to these incentives?

D. If for some reason these incentives are not renewed upon expiration, or you cease to be eligible for them, what strategy would you pursue to avoid an increase in your effective tax rate?

6. COUNTRY BY COUNTRY REPORTING (CBCR)

A. Key question: How are you preparing for Country by Country Reporting (CbCR)?

B. What effect do you think submission of CbCRs will have on your tax exposure in countries where you do business?

C. Has your Board considered whether your CbCR should be publicly disclosed?

D. Would you make your CbCR available to your investors?

E. Do you believe that your firm could adequately defend the allocation of profits to the various countries where you have activities, including sales, if your CbCR were to become public?

NEXT STEPS

Investors should be asking companies for better disclosure on their tax practices, to further understand if and how companies and their boards identify and respond to tax-related risks, and government and other stakeholders' expectations.

At a minimum, this requires companies to disclose meaningful information on tax policies employed and policy/governance frameworks. Additional confidence can then be derived from transparency around tax payments, provided such disclosure is adequate to allow investors to properly assess how the company's tax strategy is being realised in practice. The level of disclosure should be appropriate to the structure of each company's own business and should help the audience avoid misinterpretations.

"It is important for investors engaging with companies on tax matters to build a common understanding of what responsible tax planning means and what are good corporate practices."

François Meloche, Bâtirente

"Transparency and disclosure are not necessarily the same thing: you can get more disclosure but it won't necessarily be useful or meaningful."

Kate Elliot, Rathbone Brothers PLC

Investors should also consider engaging with policy makers and standard setters. Government policies and international regulations are at the heart of this debate and can implement change across the globe.

The PRI will be collecting feedback from the investment community and other stakeholders on this engagement guidance. Further dialogue between investors and companies will be facilitated as means of furthering this work, and defining investor expectations.

The PRI will also be collecting signatory feedback on, and exploring options for, public policy engagement. Academic research on the risks posed by aggressive tax planning to shareholder value is a new field with room for further work, and this will be explored by the PRI's Academic Network.

As part of the PRI's work on integrating ESG analysis into financial analysis of companies (integrated analysis), tax issues will be included in a range of case studies showcasing examples of risk to valuations.

APPENDIX 1: A REVIEW OF THE OECD BEPS PROJECT

By Professor Sol Picciotto,
Coordinator of the BEPS Monitoring Group

The project on Base Erosion and Profit Shifting (BEPS) was initiated by the Organisation for Economic Cooperation and Development (OECD), and backed by the G20 world leaders in the St Petersburg Declaration of September 2013. Its final outputs were released on 5 October 2015, approved by the OECD Council and the G20 Finance Ministers, and will be welcomed by the G20 leaders in November. The general aim of the BEPS reforms is to ensure that MNEs are taxed "where their economic activities take place, and value is created".

However, these are still proposals, which need to be implemented through national law and administrative action, as well as tax treaty changes. The project will continue for another five years, both to coordinate and supervise implementation, and pursue uncompleted work on some topics.

Implementation will take three main forms:

- changes to national law, in some cases regionally coordinated (e.g. in the EU);
- revisions of the OECD Transfer Pricing Guidelines (TPG): these are expected to be applied immediately through administrative action by OECD members, as well as by G20 states, although some may enact domestic regulations to apply their own versions;
- changes to tax treaties and their commentaries: a multilateral convention aiming to ensure rapid revisions to existing treaties is to be negotiated during 2016, open to all states; however, states will take their own decisions whether to ratify the convention, and it remains to be seen whether it will have a core package of provisions that must be accepted as a package, or be an optional list.

Hence, although its first stage is completed, the BEPS project entails a period of major changes in tax rules at every level, creating considerable uncertainty and risk.

The approach chosen - to provide tax authorities with stronger tools, mainly to disallow deductions and to adjust transfer prices - will exacerbate the problem of uncertainty, since the proposals generally entail increased complexity, as well as depending on general principles involving subjectivity and discretion in their application.

This will place considerable responsibility on both the tax officials charged with applying them, and companies and their tax advisers who must decide how to comply. Yet the general public do not regard it as acceptable for companies to defend complex corporate structures which seem aimed at reducing tax liability by saying that they comply with the letter of the law. Responsible corporate behaviour now clearly requires a good faith effort to comply with its spirit.

WHAT IS ACTUALLY CHANGING AFTER THE OECD BEPS PROJECT?

The main areas in which new rules or significant revisions will be introduced are:

- **COUNTRY-BY-COUNTRY REPORTING (CBCR) AND TRANSFER PRICING DOCUMENTATION**
  Detailed templates have been agreed for MNEs to file in each country a Master File and a Local File, to make it easier for tax authorities to audit transfer pricing. Also from 2017 every MNE with a turnover higher than US$1bn will be required to file a CbCR with the tax authority where its parent is resident, to be sent automatically to every other country where it lists a taxable entity; there is also a secondary mechanism for direct local filing if the country of the parent does not obtain or share the report. The CbCR is to be confidential to tax authorities, and must be used only for risk assessment. It must include a listing of every entity in the group, their country of formation and residence, and principal activity as well as a breakdown for each country of revenue, profit before income tax, income tax paid and accrued, number of employees, stated capital, retained earnings and tangible assets.

- **TRANSFER PRICING**
  Several chapters of the TPGs have been extensively revised. The main effect is to give tax authorities greater powers to adjust prices of transactions between related parties, so that they reflect the actual functions performed, assets deployed, and risks assumed by the various parties. The intention is to disallow attribution of significant profit to entities within a corporate group claiming to perform activities, such as management of intellectual property or financial management, unless they can be shown to have the genuine capacity to do so, while those transmitting capital (cash boxes) would get only a routine return. However, there is scope for considerable discretion, and hence disagreement, in evaluating functions, and especially deciding where risk is borne.

- **HYBRID ENTITIES AND HYBRID INSTRUMENTS**
  Deduction will be denied for payments to the extent that (i.e. in proportion that) they are not included in the income of the recipient, if this is because there is a different treatment in the countries involved in classification of the entity (e.g. it is considered to be a company in one country but a partnership in the other), or of the instrument (e.g. treated as debt in one but equity in the other). If the country of the payer does not deny the deduction, the country of the payee may deny a duplicate deduction or tax the payment; and taxation in the country of the payee has been adopted as the rule in the EU, under an amendment to the parent-subsidiary directive. The regulations proposed are highly complex, especially to deal with abstruse arrangements, e.g. imported mismatches, so may not be considered a

high priority in smaller countries. They may also lead to attempts by tax planners to devise even more complex structures to avoid them.

- **DENIAL OF INTEREST DEDUCTIONS**
  Countries are recommended to establish a fixed cap for deduction of interest, within a range of 10%-30% of either EBIT or EBITDA, with the possibility for the company to choose a group ratio if it is higher. This safety valve may make it easier for countries that already have a fixed cap to reduce it (a number of countries currently have a 30% cap, the US 50% plus specific deductions). Many countries are likely to change their rules along the lines recommended – especially those that currently apply thin capitalisation rules, which have been found to be ineffective – but since the report allows considerable flexibility, the rules are likely to vary significantly.

- **TAX INCENTIVES OR PREFERENCES**
  These will be scrutinised under a peer-review system through the Forum on Harmful Tax Practices, with a strengthened requirement to show substantial economic activity in the country, and a nexus between expenditure on that activity and the income benefiting from the preference. An initial review found 16 innovation box regimes as wholly or partially non-compliant, and these should be revised (including the UK's patent box). At the same time, the clarification of criteria is likely to encourage other countries to introduce regimes, and several have already announced their intention to introduce innovation boxes (e.g. Ireland, Italy and Switzerland). A procedure has also been agreed for automatic exchange of information on tax rulings between tax authorities, aiming to prevent sweetheart deals.

- **TAXABLE PRESENCE**
  Revisions are proposed to the tax treaty definition of a permanent establishment (PE), which defines taxable presence. These will make it more difficult for a firm to avoid attributing profit from sales in a country if it has an affiliate or agent there that concludes the contracts, or performs sales-related functions, unless they are merely "preparatory or auxiliary". Amazon has already announced a reorganisation of its European structures in response to the likelihood of such measures.

- **MANDATORY DISCLOSURE SCHEMES**
  Countries are encouraged to introduce requirements for disclosure of aggressive or abusive transactions, arrangements or structures, either by their promoters or users or both, with recommendations for rules targeting international schemes. Arrangements for exchange of information and cooperation between tax authorities regarding such schemes will be strengthened and extended.

APPENDIX 2: COMPANY DISCLOSURE - EXAMPLES OF GOOD PRACTICE

TAX POLICY AND PRINCIPLES

Company name: Unilever NV / PLC
Sector: Consumer Non-cyclicals
Country: UK / The Netherlands
Source: Unilever website

As part of the 'Sustainable Living' section of their website, Unilever has a page on Tax that includes a set of Global Tax principles and a summary of taxes paid by type and region.

> Extract from the annual report:
> "The tax Unilever pays is an important part of its wider economic impact and plays a key role in the development of countries where we operate. We are supportive of international tax reform and believe public trust in tax systems for companies is essential. We have published a set of global tax principles covering issues including transfer pricing, use of tax havens and relationships with tax authorities that represent good corporate practice. They also balance the interests of our various stakeholders."

Company name: Grupo Nutresa SA
Sector: Consumer Non-cyclicals
Country: Colombia
Source: Grupo Nutresa website

Grupo Nutresa has published a comprehensive tax policy which is "an expression of responsible Corporate Citizenship", based on a "duty to contribute to funding the State and the strict compliance of the law". The tax policy includes a set of seven principles and twenty rules that govern the formulation and implementation of the company's tax strategy.

> The Grupo Nutresa guiding principles include: ethics; integrity and good faith; legality; responsible corporate citizenship; world-class competitiveness; social responsibility; sustainable development

In addition, the policy attributes responsibility to the Board of Directors for ensuring compliance in all the companies that are part of the group.

> Grupo Nutresa, Compliance with the tax policy:
>
> - (...) The Grupo Nutresa S. A. Board of Directors will be responsible for ensuring compliance with this Policy in all the companies that are part of Grupo Empresarial Nutresa, participating actively and permanently in the progress of this matter; to do so, the President of Servicios Nutresa S. A. S. will report to the Finance, Audit and Risk Committee on the progress in implementing and executing this Policy (...)

Company name: Koninklijke DSM N.V.
Sector: Pharmaceuticals
Country: The Netherlands
Source: Tax position paper

DSM has produced a comprehensive position paper on its approach to tax, which includes its policy, governance, data on the economic value generated and distributed, and an analysis of its global effective tax rate.

> "DSM believes that a responsible tax approach is an integral aspect of sustainable business. DSM views the fulfillment of its tax obligations as part of the process of creating long-term value for all stakeholders... DSM supports the idea of a global solution for fair tax policies and systems. Thus, DSM closely monitors and provides input on the OECD initiative on Base Erosion & Profit Shifting."

DSM also detail how compliance with both direct and indirect tax matters is monitored through a 'Tax Control Framework' in order to achieve an effective, efficient and transparent tax function.

> "The Tax Control Framework is a tax risk management and control system, which ensures that the DSM tax team is aware of the worldwide tax risks for DSM, risks for which the tax function is responsible based on the DSM Corporate Requirements. The tax team possesses sufficient insights to adequately manage these risks. The key stakeholders in the Tax Control Framework are well-established and include: Supervisory Board, Managing Board, tax team, business, external auditors, as well as the tax authorities in countries where DSM is operating."

Company name: Indra Sistemas SA
Sector: Technology
Country: Spain
Source: Annual Report 2014, page 54

Indra states in their Annual Report that the company's activities in countries regarded as tax havens is not fiscally motivated but is aimed solely at developing the company's international business, always with the approval of the Audit and Compliance Committee and the Board of Directors.

Indra proceeds to disclose a significant presence or carried out projects in countries that are included on the latest list of tax havens published by the Tax Justice Network. As a whole, Indra's 2014 revenues in places considered to be tax havens represented 3.3% of the company's total revenues.

The "Contribution to the environment" chapter describes Indra's tax contribution to the public sector in the communities in which it operates. Indra tries to continuously identify content of interest for its stakeholders and gradually improve the content of its Report. For instance,

the Scorecard chapter of this Report includes, for the first time, a summary table of Indra's tax contribution by country, in response to demand from various stakeholders and in anticipation of possible legal requirements

Company name: Koninklijke Philips NV
Sector: Technology
Country: The Netherlands
Source: Philips website

Philips have published on their website information on their approach to tax, how it is managed internally, and also a set of six principles:

Philips' Tax Principles:

- Philips acts in accordance with applicable tax laws and regulations
- Philips seeks an open and constructive dialogue with the tax authorities
- Philips reports income in the countries where the value is created in accordance with internationally accepted standards, applying the arm's length principle
- Philips does not use legal entities in secrecy* countries and does not use legal entities in countries without commercial and/or economic activities, solely for tax avoidance
- Philips recognizes the importance which tax plays in the area of advancing local and global economic development
- Disclosures are made in accordance with applicable regulations and reporting requirements such as IFRS

Company name: Stora Enso Oyj
Sector: Basic Materials
Country: Finland
Source: Stora Enso website (tax footprint reported in document called "the Progress Book").

A page explaining Stora Enso's approach to tax planning. An extract has been included below:

"Stora Enso's approach is to conduct non-aggressive tax planning. This may involve taking advantage of tax incentives granted by governments on reasonable grounds where Stora Enso's business operations are in alignment with the goals of the incentive scheme."

Company name: SSE PLC
Sector: Utilities
Country: UK
Source: SSE website

SSE were the first FTSE 100 company to be awarded the Fair Tax Mark. An extract from their group tax policy has been included below:

"SSE strives to minimise its total tax liability within the framework of legislative reliefs but does not take an aggressive stance in its interpretation of tax legislation. It's policy is to operate within both the letter and spirit of the law at all times, therefore SSE does not use artificial tax avoidance schemes or tax havens to reduce the Group's tax liabilities."

Company name: RWE npower holdings PLC
Sector: Utilities
Country: UK
Source: Tax policy

Highlights include:

- We manage our tax affairs responsibly and transparently
- We don't bend or exploit the rules, and we don't use contrived or artificial structures to reduce our tax liabilities.
- We take advantage of the reliefs and incentives that exist but show respect for the intention, as well as the letter, of the law at all times.
- We are committed to conducting our affairs in a way that maintains our Low Risk tax classification, first awarded to us by HMRC in 2008.

COUNTRY BY COUNTRY REPORTING

Company name: Barclays PLC
Sector: Financials
Country: UK
Source: Country snapshot report 2014

Barclays provide a table of information on their operations in countries in which they have significant business activities, as well as a brief explanation of the business they undertake in each country and how the numbers are generated. These include: turnover; profit / (loss) before tax; corporation tax; social security; VAT; bank levy; other taxes; public subsidies received; average number of employees.

Barclays go on to outline their approach to tax, which includes a set of Tax Principles and a description of activities in offshore financial centres.

> "Arrangements that artificially transfer profits into a low jurisdiction would not be compliant with the Tax Principles... Our Tax Principles make it very clear that all tax planning must support genuine commercial activity... The total amount of profit not taxed in the UK, in respect of all our entities incorporated in low tax jurisdictions where we do not have a substantial business, was less than £2m in 2014 (less than 0.09% of the Group's profit before tax). We continue to have an objective of reducing the number of entities that we operate in low tax jurisdictions, but recognise that many such companies were established for a genuine commercial purpose that is consistent with our Tax Principles."

Company name: Statoil ASA
Sector: Energy - Oil & Gas
Country: Norway
Source: 2014 Payments to Governments report

Statoil provide detailed reporting for all countries, with separate tables and contextual information for each individual country. Payments are disclosed at the project and country level, split into the following types: taxes; royalties; fees; bonuses; host governments entitlements (value); host governments entitlements (Million barrels of oil equivalent / mmboe).

Company name: Tullow Oil PLC
Sector: Energy - Oil & Gas
Country: UK
Source: Transparency Report

Tullow disclosure tax on a cash basis, disclosing payments where they have arisen
and disclosing category level payments on: production entitlements; income taxes; royalties; dividends; bonus payments; licence; infrastructure improvement payments.

APPENDIX 3: ENGAGEMENT FINDINGS - DIALOGUE WITH EIGHT COMPANIES

The following summaries are general findings from one-to-one discussions with the Heads of Tax in eight multinational organisations (five in consumer brands and three in mining). The engagement meetings were conducted by a small group of UK investors aiming to understand the factors which have shaped the companies' policy, practices and disclosures on tax. The conversations took place privately in order to encourage open discussion, and the names of the companies are therefore not disclosed. A standard questionnaire was used as a framework to guide each meeting, dividing the issues into three main categories: policy, practice and disclosure.

1. TAX POLICY

OVERVIEW

Tax is an integral part of corporate strategy and is discussed regularly at board level, although the formality and frequency varies from one company to another. In general, the CFO takes overall responsibility for tax and the policy is signed off at the board level, usually by the Audit Committee.

Public disclosure of company tax policy remains uncommon, although it is gaining traction. The scarcity of disclosure does not necessarily reflect the absence of a tax policy; rather, it demonstrates uncertainty on the part of companies as to the need for formal disclosure. Some companies thought that investors ought to be sufficiently reassured about the fitness and authenticity of the company's approach to tax as a result of external auditors having signed off the company's disclosure and practice, although it is noted that audit opinions do not extend to tax practices.

Broadly, greater public scrutiny has raised the profile of tax in internal discussions, including at the board and non-executive director level. It has also highlighted the need for companies to communicate more effectively with external stakeholders in order to build or restore trust which may have been eroded by NGO or media coverage. These moves, however, have not fundamentally changed the governance of, or policy stance on, tax for most companies.

All companies communicate very strongly that their tax policy is fully compliant with relevant legislation. Beyond that, there is a marked difference between companies; some take the view that governments, and the associated fiscal authorities, are the only stakeholder in the tax debate, whilst others aim to have regard to the views of a wider pool of stakeholders.

Despite the variation in stances, companies agree that the spotlight on tax is likely to remain.

LEADING PRACTICES

In the sample group of Mining and Consumer Goods companies, those that exhibit leading practice on policy setting attribute their approach to two important principles: the licence to operate; and a foundation of consumer trust. These companies tend to take a conscious stance on tax matters; such as their exposure to tax havens, being recognised as 'low risk' by Her Majesty's Revenue and Customs (HMRC), and the general positioning of tax policy at the group level. Leading firms also take a forward-looking approach to their tax policy, identifying activities that may become unacceptable over the medium term. Their tax policy and general position are disclosed in their annual reports or on their websites.

This strong approach to tax policy is matched with regular (often twice yearly) review meetings with the board and risk committee. In addition, tax teams often have a close relationship with sustainability/corporate responsibility teams, which helps to increase meaningful communication on their businesses' overall economic contribution in different countries.

These companies articulate how they engage inclusively with a broad range of stakeholders on the tax debate, i.e. consumers and civil society, in addition to legislators and government officials (although this has tended to focus on giving an account of the engagement, rather than explaining how it has affected specific tax practices or stances).

2. TAX PRACTICE

OVERVIEW

Most companies articulated a strong group-level stance on tax, which was often conservative, and sought to avoid taking an aggressive position. The majority already benefit from quarterly or real-time engagement offered by HMRC, but the relationship is more complicated for those with tax authorities in other jurisdictions.

Tax generally seems to occupy a significant portion of the various committee discussions (audit, risk, tax, board). Their focus is largely on substantive operations, rather than on those areas that different interest groups consider to be 'risky' such as use of tax havens.

Interesting variations between tax governance frameworks emerged: such as a centralised versus a decentralised system. Some companies indicated recent moves towards centralisation of the governance and oversight of their tax function. They considered that this would strengthen corporate oversight and allow the impacts of tax decisions to be assessed more effectively as part of regular business decisions. Central teams are, however, strongly supported by local and regional offices with their fingers on the pulse of local dynamics.

Attitudes towards open dialogue with local governments and legislators, particularly in developing markets, were distinctly varied from one company to another. The level of dialogue ranged from very open, regardless of disputes, to minimum interactions and a focus on statutory compliance.

Disagreements over interpretation of law with different tax authorities are normal and frequent, although levels of appetite for litigation risks differ greatly.

Nearly every company had some presence in jurisdictions that could be classified as having particularly favourable tax conditions. Most of these entities were justified on the grounds of having substantial business activities in the jurisdictions in question, having been gained as a result of acquisitions, or reasons other than tax to situate a particular operation in a specific jurisdiction – a favourable legal framework, for example. Some voiced concerns over the potential legislative changes on the use of shell companies, where the governance framework over tax controls is often opaque.

In general, companies articulated that transfer pricing (connected party transactions) was conducted in line with the OECD's 'arm's length' principles, reducing the scope for mispricing. The scrutiny by external stakeholders, however, continues to be focused on the impact of transfer pricing and the amount of tax actually paid by companies in each jurisdiction.

LEADING PRACTICES

Leading companies regard tax as a central function with local tax teams reporting directly into the group. This allows them to respond to local challenges whilst maintaining direct visibility over their tax practices. They indicate the value of knowledge-sharing amongst their regional and country tax staff, where best practices could be learned from each other.

Progressive approaches to tax seem to focus on open dialogue with regulators, where the ultimate goal is to help develop their local tax authorities' understanding of the business. Building capacity in tax management over time, through effective communication and education, was also seen as important. This is particularly pertinent in countries with weaker governance regimes.

Where tax requirements are unclear, these companies seek independent professional advice on arrangements that 'should' be upheld if challenged, rather than seeking to pay the minimum possible. Some also engage with the IMF or World Bank to get external opinions on reasonable agreements.

They recognise that austerity and economic slowdown causes some countries to change their fiscal regime, and therefore constant monitoring is required. Risks are routinely flagged and monitored, not just financially, but also from a reputational point of view. Establishing a forward-looking approach to tax helps ensure companies respond deftly to changes in local tax regulations. They also talk of internal flags for 'deals' which may not be sustainable and therefore need to be closely monitored.

Risks in relation to uncertain tax positions are reviewed by region and category level to assess where similar issues may rise. Similarity between the cash tax paid and the accounting tax charge levied may indicate that it is less likely that artificial tax arrangements are being pursued, although there are a number of other explanations for such differences.

Most companies actively engage with HMRC: a few indicated that size, geographic reach and jurisdictional complexity were not necessarily a barrier to achieving low risk status. Some companies also indicated that they were reviewing operations in jurisdictions commonly cited as 'tax havens' and that changes may be made.

They feel that generally investors prefer stability in the tax payments rather than aggressive stances which may not be sustainable.

3. TAX DISCLOSURE

OVERVIEW

There was a divergence in attitudes towards increasing tax disclosure in response to external scrutiny. While some were reluctant to disclose any more detail than the statutory requirement, and felt it was not their role to educate stakeholders on matters of tax, others felt that disclosing more and opening up the conversation was the more responsible approach.

Those who were more reticent to increase public disclosure pointed to the availability of existing public disclosures and questioned the usefulness of introducing further requirements. Some mentioned their participation in industry-wide initiatives such as the CBI tax group. They felt that if standards and guidance documents already exist, investors should work to promote and follow these rather than duplicating efforts or, worse, promoting conflicting approaches. Some thought that there is already a proliferation of standards by different bodies (EU, OECD, etc.), making it difficult to advocate one form over another.

Many of the sample companies questioned the function and usefulness of country-by-country reporting. They felt that raw data would be largely meaningless and, as such, disclosure would need to be accompanied by extensive explanation and background in order to make sense to readers. The impact of deferred tax on headline numbers was one such concern regarding open disclosure. Reluctance also stemmed from a concern that raw data would be misinterpreted by the media (whether intentionally or simply due to a lack of understanding) resulting in unwanted attention-grabbing headlines.

Commercial sensitivity to disclosing tax payments at a country-by-country level was a concern especially for companies where such disclosures could be used to derive research and development and marketing spend, thereby giving away competitive edge. As such, creating a level playing field for all companies would be key to making this disclosure impartial. Even if disclosure requirements were standardised for all listed companies, it was noted private companies or local players would not have to comply.

The cost of increased disclosure was generally felt to be high, although it seems much more of an effort for some than for others. Those who already disclose tax in each country noted that the initial spend is the highest, reflecting the effort required to generate the first numbers and establish the right structures, but that spend decreases in the following years as disclosure only requires updating in line with the standardised formats. The cost of external audit, however, remains significant.

Many pointed to the narrow focus on corporate tax payments, which is only a part of the overall economic contribution a company makes in a country. The general view from interviewees was that economic contributions made through employment, income or other tax contributions, and local sourcing needed to be taken into account. In terms of the most appropriate metric to report on publicly, the feedback from companies was that this largely depends upon the reason why additional disclosure is being called for. For example, total economic contribution can be useful in assessing a company's overall socio-economic impact in a given country or region, but may be less useful in determining how aggressively a company has arranged its tax affairs.

Generally, companies highlighted the need to be clear about the reasons why we are asking for greater granularity and what end-purpose this will serve. The challenge is to identify the most crucial information and to disclose this in an efficient, clear and meaningful way. The current push for more tax disclosure addresses two different issues: EITI (Extractive Industries Transparency Initiative) for corruption at government levels and NGOs on 'fair share' of payments. Without clarifying the ultimate goal of disclosure, some original intentions may not be addressed. Importantly, providing more raw data will not necessarily build stakeholder trust due to the low level of public understanding of complex tax legislation.

Following the work of the OECD on Base Erosion and Profit Shifting (BEPS), companies are likely to have to share country-by-country data with tax authorities, which will not have to be disclosed publicly. Most companies were comfortable with this development and appreciated that this initiative would improve the risk assessment capacity for fiscal authorities.

LEADING PRACTICES

Companies publicly disclose granular details of their tax payments. Their experience, and the reception of their stakeholders, seems to be positive both internally and externally, although some companies appear to be still in the process of figuring out the best format and communication tools.

Tax departments collaborate with their companies' sustainability/corporate responsibility teams so as to ensure they articulate more effectively to stakeholders their overall economic contribution. Reports prepared in this way reflect a strong link between tax management and sustainability/corporate responsibility commitments in operating countries.

They are keenly aware that some investors are starting to ask about their tax stance in detail, contrasting starkly with companies that cite lack of investor interest in this topic. Those taking the lead in disclosure also emphasise their desire to stay ahead of impending regulations.

The greatest threats (even for those companies most confident in their ability to furnish increased disclosure) come from the lack of comparability with peers and the lack of a level playing field (e.g. local competitors, particularly those in emerging markets, who may not be subject to the same requirements for increased disclosure). As investors, we need, therefore, to advance this conversation, while further clarifying the overall purpose and benefits of increased disclosure in the market.

APPENDIX 4: QUESTIONS FOR ASSET OWNERS ON TAX

QUESTIONS FOR PENSION SCHEMES ON TAX

Written by Meryam Omi,
Legal & General Investment Management

FOR MY OWN SCHEME

Is this an investment risk to my portfolio?

- What is the current versus future risk?
- What is the downside potential for my investments?
- Who is responsible for looking after it?

Is this a reputational risk for my scheme?

- What schemes/structures are we utilising?
- Are we transparent enough to our members and other stakeholders?
- What conflicts exist that might compromise our position?
- What is our official stance and policy recommendation?

FOR MY INVESTMENT CONSULTANT/ADVISORS

How do you see tax as an investment risk?

- Has tax been identified by the constant/research teams as an area of risk?

How do you determine which managers are managing this risk most effectively?

- Have all of my managers have been assessed in regards to their investment due diligence on tax risks?

FOR MY INVESTMENT MANAGERS

How do you engage with companies on tax risks

- Which companies in my portfolio have the highest risk in regards to tax-related issues?
- How is tax disclosure and risk incorporated into your investment due diligence process and financial modelling/valuation?
- Have you engaged with companies on the issue of tax practice and disclosure? If so, at what level of the organisation have you engaged (e.g. tax director, senior management, the board)?
- Have you looked at and used the PRI guidance on tax engagement?

What are you doing to drive better transparency?

- Do you believe you have sufficient clarity regarding the potential tax risks of the companies you own?
- What research do you conduct when there is insufficient clarity?
- Do you believe policymakers/regulatory bodies need to promote better tax disclosure by companies? If so, how are you encouraging these bodies to seek improved tax disclosure?

How do you manage your own conflict on this topic?

- How is your engagement with investee companies on tax aligned with your organisation's own tax planning strategies?

How do you collaborate with other investors and industry bodies on tax?

- Do you feel this is an issue that can be solved as an individual investment manager or a collective body of investors?
- Are you part of any industry body or network to improve tax disclosure?

APPENDIX 5: GLOSSARY AND RESOURCES

A list of resources on tax-related issues can be found here. The glossary below contains terms used within this document. Further useful tax terms and definitions can be found in the online resources above.

TERM	DEFINITION
Aggressive Tax Planning	Taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. See also: Tax Planning
Arm's Length Principle (ALP)	The condition or the fact that the parties to a transaction are independent and on an equal footing. Often used in the context of transfer pricing to ensure a fair division of taxable profits and to prevent profits being systematically deviated to lowest tax countries.
Base Erosion and Profit Shifting (BEPS)	Tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.
Country by Country Reporting (CbCR)	Part of the OECD's BEPS project, country-by-country reporting requirements will require MNEs to provide aggregate information annually, in each jurisdiction where they do business, relating to the global allocation of income and taxes paid, together with other indicators of the location of economic activity within the MNE group. This also includes information about which entities do business in a particular jurisdiction and the business activities each entity engages in.
Deferred Taxation	The postponement of tax payments from the current year to future periods. This arises from temporary differences between the carrying amount of an asset (or liability) within the balance sheet and its tax base. Taxable temporary differences are those on which tax will be charged in the future when the asset (or liability) is recovered (or settled).
Double Taxation	The levying of tax by two or more jurisdictions on the same declared income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes). This double liability is often mitigated by tax treaties between countries.
Effective Tax Rate (ETR)	The rate at which a taxpayer would be taxed if his tax liability were taxed at a constant rate rather than progressively. ETR = actual tax liability / total taxable income.
Exchange of Information (EOI)	Most tax treaties contain a provision under which the tax authorities of one country may request the tax authorities of the other country to supply information on a taxpayer. Information may only be used for tax purposes in the receiving country and it must be kept confidential
Intellectual Property (IP)	Literary, dramatic, musical, artistic and scientific works are intellectual property which is protected by copyright, patent, registered design, trade mark, etc. A common tax optimisation strategy is to transfer ownership of IP rights to an affiliate which manages intragroup licensing (often through a conduit in a country with extensive tax treaties) to ensure royalty payments are not subject to withholding taxes.
Multi-National Enterprises (MNE)	Company or group of companies with business establishments in two or more countries.

Permanent Establishment (PE)	Term used in double taxation agreement to refer to a situation where a non-resident entrepreneur is taxable in a country; that is, an enterprise in one country will not be liable to the income tax of the other country unless it has a "permanent establishment" through which it conducts business in that other country.
Tax Avoidance	The arrangement of a taxpayer's affairs in a way that is intended to reduce his or her tax liability through legal methods (although often in contradiction with the intent of the law it purports to follow).
Tax Base	The assessed value of a set of assets, investments or income streams that is subject to taxation.
Tax Burden	For public finance purposes the tax burden, or tax ratio, in a country is computed by taking the total tax payments for a particular fiscal year as a fraction or percentage of the Gross National Product (GNP) or national income for that year.
Tax Evasion	Illegal arrangements where the liability to tax is hidden or ignored. This implies that the taxpayer pays less tax than he or she is legally obligated to pay by hiding income or information from the tax authorities.
Tax Gap	The difference between a company's Effective Tax Rate (ETR) and the Weighted Average Statutory Rate (geographic sales mix * local tax rates). Although there may be non-tax related reasons for this gap, large and persistent tax gaps are often the result of profit shifting and tax optimisation.
Tax Haven	A country which imposes a low or no tax, and is used by corporations to avoid tax which otherwise would be payable in a high-tax country.
Tax Holiday	A government incentive program that offers a tax reduction or elimination to businesses. Tax holidays are often used to reduce sales taxes by local governments, but they are also commonly used by governments in developing countries to help stimulate foreign investment.
Tax Planning	Also known as Tax Optimisation, it encompasses any arrangements with the attempt to minimise tax liability. See also: Aggressive Tax Planning
Tax Treaty	An agreement between two (or more) countries to resolve issues involving double taxation. A tax treaty may be titled a Convention, Treaty or Agreement.
Transfer Pricing	The setting of the price for goods, services or intangible property sold between controlled (or related) legal entities within an enterprise. Abusive transfer pricing occurs when income and expenses are improperly allocated for the purpose of reducing taxable income.
Unrecognised Tax Benefit (UTB)	Also known as "Uncertain Tax Positions", it is a liability for income-tax-related positions that may be challenged on audit and ultimately disallowed in whole or in part.
Value Added Tax (VAT)	Specific type of turnover tax levied at each stage in the production and distribution process. Although VAT ultimately bears on individual consumption of goods or services, liability for VAT is on the supplier of goods or services. VAT normally utilises a system of tax credits to place the ultimate and real burden of the tax on the final consumer and to relieve the intermediaries of any final tax cost.

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 issues and to support signatories in integrating these issues into investment and ownership decisions.

The six Principles were developed by investors and are supported by the UN. They are voluntary and aspirational, offering a menu of possible actions for incorporating ESG issues into investment practices. In implementing the Principles, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

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 Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org