Principles for Responsible Investment

ADVANCING TAX TRANSPARENCY: OUTCOMES FROM THE PRI COLLABORATIVE ENGAGEMENT 2017-2019

FINANCE INITIATIVE UNEP
United Nations Global Compact
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

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

1 We will incorporate ESG issues into investment analysis and decision-making processes.

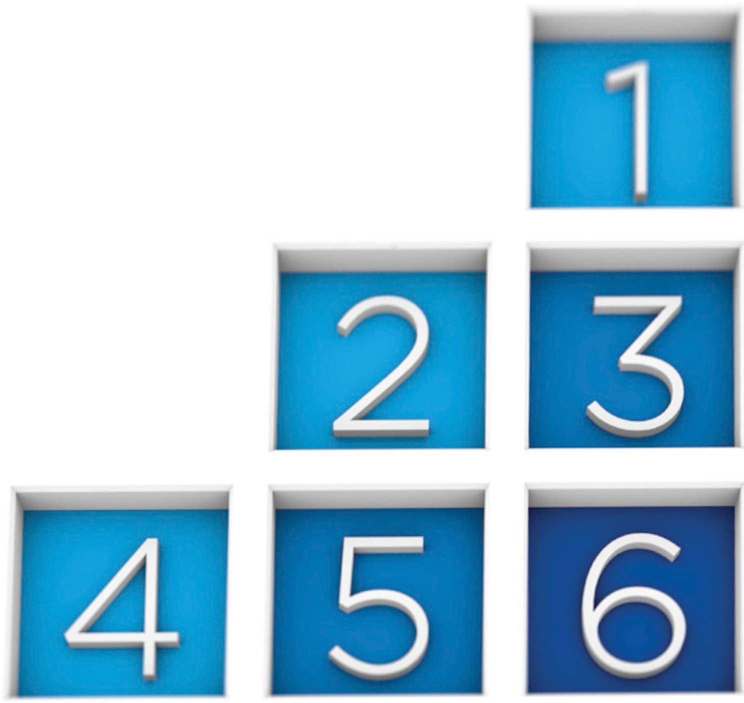
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

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

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

CONTENTS

ACKNOWLEDGEMENTS

We would like to thank the following advisory committee members for their contribution to the project:

- Lauren Compere, Managing Director, Boston Common Asset Management
- Carlota Garcia-Manas, previously Deputy Head of Engagement at Church Commissioners for England and Church of England Pensions Board
- Adam Kanzer, previously Managing Director and General Counsel, Domini Impact Investments
- Pauline Lecoursonnois, Sector Lead – Consumer Goods and Retail, Hermes Investment Management
- Harriet Parker, Partner, Investment Manager, Liontrust Investment Partners LLP
- Michelle De Cordova, previously Director, Corporate Engagement and Public Policy, NEI Investments
- Katarina Hammar, Head of Active Ownership, Nordea
- Pelle Pedersen, previously Head of Responsible Investment, PKA
- Kate Elliot, Deputy head of ethical, sustainable and impact research, Rathbone Brothers Plc
- Gail Counihan, previously Responsible Investment Analyst at Royal London Asset Management

We would also like to thank Rob Wilson (MFS Investment Management) for drafting the section on the US tax reform.

The investors that participated in this collaborative engagement include:

- Aequo Shareholder Engagement Services Inc.
- AMF
- ATP
- BMO Global Asset Management
- Boston Common Asset Management
- Caisse de dépôt et placement du Québec
- Candriam Investors Group
- Christian Super
- Church Commissioners for England
- DNCA Finance
- Domini Impact Investments
- Ecofi Investissements
- ERAFP - Établissement de Retraite Additionnelle de la Fonction Publique
- Etica SGR
- Hermes Investments Limited
- Ircantec
- Liontrust Investment Partners LLP
- LocalTapiola Asset Management Ltd
- LUCRF Super
- M&G Investments
- Martin Currie Investment Management
- Middletown Works Hourly and Salaried Union Retirees Health Care Fund
- Mirova
- NEI Investments
- Nordea
- OFI Asset Management
- Ostrum Asset Management
- PKA
- Rathbone Brothers Plc
- Robeco
- Royal London Asset Management
- Skandinaviska Enskilda Banken (SEB) AB
- Sycomore Asset Management
- Triodos Investment Management
- UAW Retiree Medical Benefits Trust
- Vision Super

ABOUT THE REPORT

This report summarises the outcomes of the PRI collaborative engagement on corporate tax transparency, which ran from 2017 to 2019. The engagement sought to: create awareness within companies of investor concerns around aggressive corporate tax practices and expectations of responsible tax practice; improve company disclosures across tax policy, governance and financial reporting; and identify best practice.

This document aims to support investors who want to take up this issue as an engagement priority. Specifically, the report:

- Evaluates the progress of target multinational companies in the healthcare and information technology sectors in the context of objectives of this initiative;
- Includes a summary of the engagement takeaways; and
- Sets out recommendations for investors on corporate tax responsibility going forward.

INTRODUCTION

Corporate taxation that is effective and fit for purpose can drive sustainable development, mitigate rising inequality and support inclusive growth and prosperity. In addition to financing much-needed public services, it can enable governments to fund social and environment programmes to address some of the pressing global challenges we face today. To meet these objectives, however, the global tax system must evolve and adapt, and businesses must embrace corporate tax responsibility.

In recent years, multinational companies have come under increasing scrutiny for their pursuit of tax avoidance[1], including through profit shifting, where they funnel profits to jurisdictions that charge lower tax rates instead of paying taxes where their earnings are generated. These tax practices can reduce tax revenues and cost governments globally between US$100bn and US$600bn annually.[2]

Tax avoidance also presents governance, reputational and earnings risks for companies. Although companies may argue that such practices drive profits, this position is less defensible when tax practices are subject to scrutiny by tax authorities and consequently result in unexpected reputational damage, litigation costs and penalties. An overemphasis on minimising tax may also encourage poor decision-making by company boards. Furthermore, corporate tax avoidance results in social and macro-economic distortions in the market by affecting competition and reducing capital available for socio-economic development, particularly in emerging countries.[3] IMF researchers estimate the impact of tax avoidance on developing countries to be around US$213bn a year.[4]

While global efforts led by the OECD are focused on curtailing tax avoidance, existing tax loopholes and outdated tax legislation have proved to be impediments. For instance, the slow phase out of preferential tax arrangements[5] for large businesses[6] and the ubiquitous corporate use of tax havens to minimise tax liabilities[7] have undermined the integrity of our tax systems. Additional tax challenges are presented by digitalisation – for example, while some corporate business models are no longer dependent on brick and mortar operations, taxation continues to be based on physical presence.[8]

In this context, there is an imperative for long-term institutional investors to understand aggressive tax practices within their investments, support a shift away from tax practices that are short-term and unsustainable, advocate the creation of a level playing field in tax policy matters and communicate expectations to companies in order to drive broader societal and economic objectives.

> Tax avoidance undermines long-termism by limiting government spending on critical services such as infrastructure and on addressing externalities like climate change. These macro-economic impacts make corporate tax responsibility an important systemic issue for universal owners, even if some parts of their portfolio may perform better in the short term due to tax avoidance.

Institutional investors have the means to steer companies to focus on genuine economic activity as opposed to tax behaviour that can negatively impact their profitability and sustainability and reduce wider portfolio returns.

Tax is a material issue for investors, given underlying investment risks and risks to wider portfolio returns. Through strong and deliberate action, they can respond to concerns about tax fairness and inequality from end-beneficiaries and deter companies from avoiding taxes, even when these practices may be perceived to be within the law.

1 Tax avoidance is 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).

2 OECD, Combatting International Tax Avoidance, accessed 28 January 2020. Also see: How to make multinationals pay their share, and cut tax havens out of the picture.

3 See PRI (2015), Engagement Guidance on Corporate Tax Responsibility.

4 Tax dodging by big firms 'robs poor countries of billions of dollars a year'

5 OECD/G20 Base Erosion and Profit Shifting Project (2019), Harmful Tax Practices - 2018 Progress Report on Preferential Regimes. See criteria on page 15.

6 See, for example, European Authorities Launch Probe Into Secret Lux Leaks Tax Deal, Simon Bowers, 7 March 2019, ICIJ.

7 Academics estimate that nearly 40% of overseas profits made by US companies end up in tax havens. See Thomas R. Tørsløv, Ludwig S. Wier and Gabriel Zucman, 2018, The Missing Profits of Nations, NBER Working Paper Series.

8 OECD (2019), Tax and Digitalisation.

SPOTLIGHT ON CORPORATE TAX TRANSPARENCY

Given the compelling case for investor action, the PRI has worked with signatories since 2015 to provide guidance and support investors in achieving greater corporate tax responsibility.[9]

It has been evident in this work that the lack of corporate transparency on tax issues has impaired investment analysis and understanding of how companies are positioned on tax issues.[10] The opacity around tax structures that companies tend to employ has added another layer of complexity to this technically challenging topic. Investors are therefore demanding more accurate, timely and meaningful corporate reporting to enable better assessment of tax risks and opportunities and to identify leading practices in their portfolio.[11]

At the very minimum, investors expect more public disclosure to shed light on companies' stance on tax across all markets. They expect companies to employ governance mechanisms that enable implementation and appropriate oversight of a company's tax strategy. And they expect disclosure of underlying economic and financial data that support any wider assertions made by companies concerning those practices.

With that said, enhanced tax transparency is a means to an end and does not in itself guarantee responsible tax practice. However, in the absence of standardised reporting, robust disclosure will help investors gauge companies' positions on tax and facilitate assessment of their exposure to tax risks. For instance, meaningful disclosure could bring to light boardroom priorities and decision making around high-risk transactions. It could also help identify inconsistencies between companies' public positions and actions, providing a valuable backdrop for discussions with companies on the development of responsible corporate tax strategies and relevant implementation practices.

ENGAGEMENT AGENDA

Given the importance of tax transparency as outlined above, the PRI coordinated a collaborative investor engagement on the theme over 2017-19. The engagement built upon the work done by the PRI and a group of global investors in producing the Engagement Guidance on Corporate Tax Responsibility and the Investors' Recommendations on Corporate Income Tax Disclosure to facilitate investor-company dialogue on responsible tax and clarify investors' expectations.[12]

Through this engagement, 36 institutional investors (representing approximately US$2.9trn in assets under management) asked for improved disclosure from 41 portfolio companies with the aim of clarifying investors' expectations of corporate behaviour and identifying leading practices in the following areas:

- Publication of a global tax policy that outlines the company's approach to responsible tax;
- Reporting on tax governance and risk management processes; and
- Country-by-country reporting (CBCR).[13]

The engagement specifically focused on multinational companies in the healthcare and technology sectors due to those sectors' poor tax disclosures,[14] despite the heightened risks they face, particularly relating to:

- Alleged use of tax avoidance strategies reported in the media, for example in relation to the transfer of intellectual property (IP) rights across jurisdictions to reduce tax burdens;
- Regulatory fines and new regulations targeted to address tax avoidance and close tax loopholes (e.g. for the digital economy); and
- Their high tax gap[15] – that is, the difference between statutory tax rates and what is actually paid – relative to other sectors.[16]

9 PRI (2015), Engagement guidance on corporate tax responsibility

10 PRI (2018), Evaluating and engaging on corporate tax responsibility: an investor guide

11 PRI (2017), Briefing note: Investors' recommendations on corporate income tax disclosure

12 See the PRI explanatory notes to Investors' recommendations on corporate income tax disclosure.

13 Country-by-country reporting involves the company producing data on business operations and economic substance that contextualises the information on tax that a company reports. This information can take the form of a country-level breakdown of revenue, employee numbers, profits before tax, tangible assets and taxes paid, which is reconciled with financial statements. This is not the same as the publication of the OECD BEPS template that companies need to report privately to tax authorities. For more details, see p20, PRI (2018), Evaluating and Engaging on Corporate Tax Responsibility: An Investor Guide.

14 See PRI (2018), Evaluating and engaging on corporate tax responsibility: an investor guide.

15 Ankit Sayani, 2017, The tax gap: regulatory responses and implications for institutional investors, MSCI Issue Brief.

16 See p19, PRI (2018), Evaluating and engaging on corporate tax responsibility: an investor guide, for further explanation on considerations.

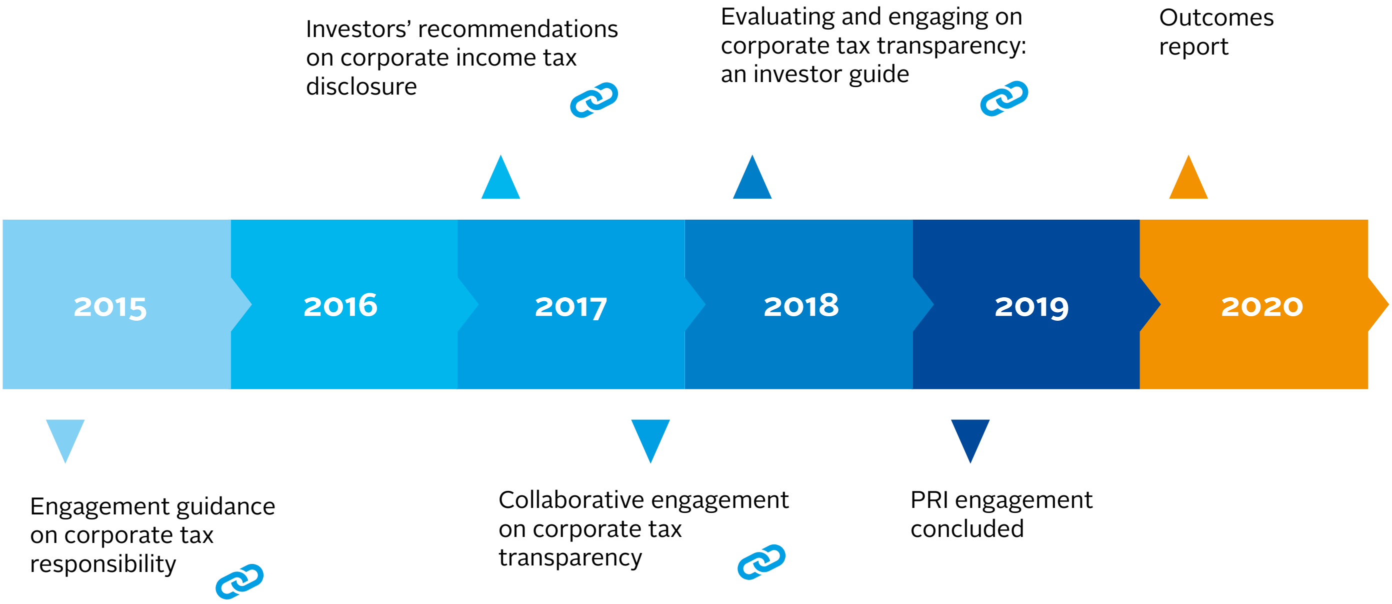
The engagement was informed by PRI-commissioned benchmark research which provided a view on the state of disclosure and identified gaps in the healthcare and technology sectors. The research findings from the assessment of 50 companies are discussed in detail in the PRI report.

A final evaluation was also undertaken at the end of the engagement to determine how companies have progressed. This outcomes report summarises the key findings of this research and highlights relevant engagement insights in the context of these trends (see Figure 1 below for a brief timeline of the PRI's tax publications).

In summary, the research found that:

- Companies most commonly report tax data that are required by regulations and accounting standards
- There are discrepancies between corporate disclosure and investors' expectations. For instance, there is:
  - A lack of evidence from companies of how their publicly disclosed tax policies are consistent with the overall strategic objectives of the organisation, and their broader sustainability commitments;
  - Few concrete examples of how companies determine if tax transactions are in line with their risk appetite; and
  - Insufficient explanation and granular data to validate corporate commitments to avoid aggressive tax planning.

Figure 1: A timeline of PRI's work on tax



TAX ENGAGEMENT AT A GLANCE

2017
2019

Over 35 institutional investors (circa US$3trn in AUM)

One of the largest collaborative initiatives on tax to date

OBJECTIVES

- Create awareness around aggressive corporate tax practices and expectations of responsible tax practice
- Improve company disclosures across tax policy, governance and financial reporting
- Identify best practice among companies

KEY ASKS

- Publication of a global tax policy that outlines the approach to responsible tax
- Reporting on tax governance and risk management processes
- Country-by-country reporting

FOCUS

High-risk sector-based engagement - technology and healthcare:

- Complex tax strategies at play, due to, for example, dependence on intellectual property
- Need for comprehensive disclosure, given the risks, but limited reporting

Target companies:

- 41 multinational companies with large market capitalisation
- 33 responsive companies

PRACTICES

Among the 33 responsive companies, recent disclosure indicated:

LEADING VS LAGGING

LEADING

- 23 global positions on tax were published
- 27 companies made a clear commitment to avoiding aggressive tax planning
- 25 companies indicated that the board (or sub-committee of the board) held responsibility for tax issues

LAGGING

- Only five companies explained their approach to tax havens
- No company in the target list produced a country-by-country report

ENGAGEMENT PROGRESS

CONTEXT

Among the 41 companies contacted in this initiative, 33 responded to investor requests for discussions on tax transparency. They either provided a written response or scheduled private meetings with investor relations teams, senior executives or senior personnel in company tax departments. Investors within the engagement found that conversations involving both investor relations and sustainability teams were extremely valuable in providing a deeper picture of organisational practices.

The investor group sought the following information in their dialogues with companies:

- High-level thinking and views on tax matters;
- Key risks, including changes in the regulatory landscape and companies' preparedness to address these changes;
- Identification of transactions and tax practices that are deemed too risky or unacceptable;
- Where responsibility for tax practices is held or delegated within the company, how information is shared and decisions made; and
- Views on enhanced transparency.

The selected companies demonstrated different levels of tax transparency. With companies with limited tax transparency, investors used the dialogue to communicate their expectations and explain how additional transparency would enable better investment decision-making. To overcome 'first mover' concerns among companies – about the risks involved in acting before their competitors – investors provided examples of good practice demonstrated by peer companies. Where companies were relatively familiar with data demands on this topic, the dialogues with investors were more technical, and explored the links between taxes paid and business operations in greater detail. Peer performance was still a matter of great interest, particularly where better disclosure was sought. Finally, where companies were leading in terms of their reporting practices, investors talked about their broader philosophy on tax and, given increasing stakeholder demand, the evolution of tax disclosures. They found that these companies considered deeply the impact of their tax disclosures and tailored their reporting accordingly.

SUMMARY

Overall, companies' receptiveness to the engagement on tax was mixed. Pharmaceutical companies were slightly more open to one-to-one conversations with investors on tax matters than their peers in the IT sector. IT companies were often reluctant to provide information beyond what was already publicly available, despite disclosure requests being centred on underlying policies and processes to manage tax risks. Engagement dialogues indicated that possible reasons for this may have been ongoing litigation, lack of prioritisation of the issue internally or caution concerning additional scrutiny.

Companies expressed greater willingness to engage when there had been a history of interactions with lead investors. Similar to collaborative engagements on other ESG topics, local investors championing engagement efforts were more successful in securing engagement meetings. For example, Danish companies were quick to respond to an investor based in the region but had not responded to requests for dialogue from a group of French investors. In this context, working collaboratively helped investors to better prepare, leverage experience and connections and signal joint commitment.

> "Joining forces with international investors by engaging collaboratively is even more valuable to us on a topic as complex and sensitive as tax practices. We believe the engagement has been successful in communicating responsible investors' expectations on the matter with a unified voice. Sharing best practices from leading companies in this area has been key to move the dialogues forward, as most companies are reluctant to be first movers on tax transparency,"
>
> Sara Carvalho De Oliveira, Sycomore Asset Management

Nevertheless, in some cases, investors had to escalate the engagement to elicit a response. A notification that they may be publicly named as non-responsive resulted in investors successfully scheduling calls with some non-responders. However, eight companies in the target list were considered by lead investors as 'unresponsive' (see box on the right) – as they were unable to organise meetings with the companies in question despite repeated requests. Although a couple of companies did provide written responses following the escalation, they were considered insufficient or lacking in substantive detail.

Over the engagement period, the group did see some improvements in disclosure among targeted companies. The dialogues also resulted in a greater level of understanding of the day-to-day management of tax affairs and cast light on technical concepts such as transfer pricing, double taxation and impacts from changes in national and international regulations. The key outcomes are described in detail in the next section.

UNRESPONSIVE COMPANIES

Of the companies contacted, eight companies were considered unresponsive by the lead investors in this engagement, failing to schedule meetings and providing little or no meaningful response to questions raised on their tax practices. These unresponsive companies were:

- Align Technology
- Alphabet
- Amazon.com
- Cisco Systems
- Danaher Corporation
- Facebook
- Sage Group
- Intuitive Surgical

DISCLOSURE AND ENGAGEMENT – KEY OUTCOMES

This section examines the three asks that investors made of companies as part of this engagement. These related to:

- Global tax policy: Companies were encouraged to formalise and publish a tax strategy that applies across the organisation and outlines the links between tax management and sustainability commitments.
- Tax governance and risk management: Companies were encouraged to disclose the role of the board in relation to tax matters, processes for defining and managing tax-related risks, and examples of unacceptable tax transactions/practices.
- Country-by-country reporting: Companies were encouraged to produce more meaningful data that substantiates their commitments to avoiding aggressive tax planning.

For each ask, this section provides a summary of:

- Changes in disclosure practices of responsive companies since the beginning of the engagement, based on follow-up research conducted in 2019;
- Engagement insights and progress vis-a-vis areas where tax reporting needs to develop; and
- Examples of meaningful disclosure.

The Appendix outlines examples of external factors that may have also influenced positive developments in tax transparency.

GLOBAL TAX POLICY

OBJECTIVES	STATUS	DETAILS
Encourage formalisation and publication of a tax strategy that applies across the organisation and outlines the link between tax management and sustainability commitments.	Some progress	▪ Among the 33 responsive companies, the number of global tax policies published increased significantly from seven in 2017 to 23 in 2019. US companies made the least progress, with nearly 50% yet to publish a global tax policy. ▪ Some of the published tax policies were generic and lacked granularity, highlighting opportunities for investors to drive more meaningful disclosures ▪ While the engagement discussions outside of the US revealed greater readiness to address tax in the context of societal expectations, corporate reporting in the US continues to be compliance focused.

RESEARCH FINDINGS

- Nearly all companies published their approach to taxation in the UK, complying with the requirements of the UK Finance Act 2016 (see Appendix 1 for more details). While these statements were often lacking in granularity and not particularly informative, the law appears to have prompted companies to evaluate their tax approach across their operations.
- A larger number of companies published their global tax policy during the engagement period. Specifically, 16 more companies published a global policy than in 2017, bringing the total number of publications to 23 among the responding companies. However, publication of a global tax policy by US companies is still not common practice – about 50% of US companies in this list were yet to publish a global tax policy.
- The quality of disclosure also varies. US-based companies tend to be mostly compliance-focused in the description of their approach, while their European counterparts make more direct links between their tax approach and their business, sustainability strategies and values.
- It is also encouraging that in 2019, over 75% of responsive companies had published a commitment against tax avoidance, with some referencing the principle of paying taxes where value is generated. This was a significant improvement from 2017, when just over one in five companies disclosed such a commitment.

EMERGING GOOD PRACTICE EXAMPLES

SPIRIT OF LAW

ASML, a Dutch technology company, specifically references compliance with the letter and the spirit of tax law in its tax strategy and transparency document.[17] It states that it is "committed to comply not only with the literal reading of the relevant laws, but also their intent".

COMMITMENT AGAINST TAX AVOIDANCE

Coloplast, a Danish healthcare company, states in its 2019 tax policy that it "does not allow commercial needs to override compliance with applicable laws, nor base commercial activities on tax avoidance schemes". Furthermore, the company notes that "all transactions and tax structures must therefore have a business purpose or commercial rationale as a prerequisite."

17 In complying with the spirit of the law, entities are encouraged to take into account not only the intention of legislators, but also the interests of internal and external stakeholders.

ENGAGEMENT INSIGHTS

Engagement conversations between investors and companies in Europe and Canada showed that companies were demonstrating a greater readiness to look at tax issues through a sustainability lens as opposed to viewing tax as a cost to minimise. Companies based in those countries emphasised commitments to avoid aggressive tax planning and explained how these commitments are aligned with their values and their sustainability strategies. For instance, one French healthcare company said that it was redirecting a significant exceptional tax refund towards initiatives aiming at eradicating poor vision in developing countries in line with its mission. A Canadian technology company explained how its approach to intellectual property was linked to paying its "fair" share of taxes. The dialogues also influenced positive developments in tax transparency in some companies. For example:

> A European technology company indicated to investors engaging with it that it was the first time that the publication of a tax policy had come up in a dialogue with shareholders. Following a conversation about potential concerns and existing good practice with the investor group, the company added a section dedicated to tax transparency in its annual report, which set out its tax principles, including a formal commitment to tax responsibility.

US-based companies, meanwhile, stressed that their tax disclosures were focused on compliance; discussions centred on maintaining a sustainable tax rate while adhering to tax laws and mitigating related risks in areas of operation. Few companies emphasised ethical motivations or linked their wider sustainability commitments to their policies on taxes. A sub-set of US companies were also resistant to publishing a global tax policy, despite disclosing one for their UK operations, raising potential questions around applicability of their tax commitments and principles across the organisation. In response, the companies stated that:

- Their UK tax strategy (which is published as a legal requirement) is reflective of their global position on tax;
- The publication of a global tax strategy was less of a priority and secondary to regulatory requirements; and
- The costs involved (for example from soliciting robust legal advice) exceeded the value added by publication.

TAX GOVERNANCE AND RISK MANAGEMENT

OBJECTIVES	STATUS	DETAILS
Encourage disclosure on the role of the board in relation to tax matters, the company's process for defining and managing tax-related risks and examples of unacceptable tax transactions/practices.	Some progress 	▪ Most companies referred to governance and risk management processes in their tax policies. ▪ Even where disclosure was lagging, engagement assured investors that companies had a level of board accountability and oversight of tax transactions. ▪ Companies were open about key tax risks with investors. In-depth discussions also covered the role of tax incentives and the rationale for operations in tax havens or the lack thereof.

RESEARCH FINDINGS

- Board or board-committee responsibility for tax issues appeared to be common practice (reported by 75% of responding companies in 2019). Companies leading in this area disclosed information on the types of topics that were discussed and the frequency of discussions with the audit committee or the risk committee. Some companies went further, disclosing decision-making processes around high-risk tax transactions, including in the context of expansion of business operations. This compares favourably to disclosures in 2017, when fewer than a third of responding companies indicated board-level responsibility for tax issues.
- In contrast, few companies (below 20%) communicated about transactions and practices that they deem unacceptable, representing only a small improvement since 2017. The companies that did report explained their operations in tax havens and attitude to tax reliefs.
- An area of risk that could be better explained related to intellectual property and potential transfer-pricing risks. While commitments around these were clearly set out in tax policies, more contextual disclosure covering where intellectual property is held and the link to company tax structures would be valuable for investors.
- More positively, we now see examples of companies that provide channels to report concerns about violations of the law and company standards on tax issues – indicating that companies are beginning to embed expectations around appropriate tax practices across the business.

EMERGING GOOD PRACTICE EXAMPLES

ROLE OF THE AUDIT COMMITTEE

Novo Nordisk, a Danish pharmaceutical company, specifically discloses in its 2018 annual report that its audit committee discussed ongoing tax cases.

TAX PLANNING

The global tax strategy of US biotechnology company Gilead makes specific reference to tax considerations as part of business expansion. It states: "Changes in our business operations, including new business transactions, require us to evaluate tax consequences and determine alternatives to mitigate potential tax risks. For example, members of our tax team participate in cross-functional team efforts in assessing and implementing our expansion into global markets and in business development initiatives."

RISK MAPPING

EssilorLuxottica, a French company with operations in the healthcare sector, says in its 2018 registration document that it has established risk mapping on tax avoidance at the group level.

COMPLIANCE/ WHISTLEBLOWING

Danaher Corporation[18], a US-based technology company, outlines sanctions in its global tax strategy for non-adherence with the company's global tax standard of conduct. It also highlights channels for reporting actual or potential violation of tax law or standards of conduct.

18 Although this is an example of good disclosure, the company was unresponsive during the collaborative engagement.

ENGAGEMENT INSIGHTS

Tax governance and risk management issues proved to be the low-hanging fruit in this engagement. Even where companies were reserved about tax matters overall, discussions around governance and risk management tended to be open and insightful. Companies that hadn't published information about the role of their board sub-committees discussed this in their meetings with investors, highlighting, for example, where responsibilities lay and reporting procedures to the board.

The discussions revealed that board deliberations on tax varied across companies. In some cases, material risks on tax were escalated and reviewed by the entire board where appropriate. In other cases, audit committees had ongoing visibility over tax matters and received regular briefings on key developments, for example on the assumptions and assessments relating to the US tax reform (see Appendix).

One US technology firm indicated that its audit and finance committee received regular updates on metrics related to tax audits and was briefed on the currency of audits, history of interactions with tax authorities and accuracy of tax risk assessments. As an example, the company explained the decision-making process and the communication channels used when a change in tax residency status in one of its countries of operation prompted restructuring. The changes had resulted in extensive discussions with the audit and finance committee in considering its options and a conscious decision was made to avoid the use of a well-known tax loophole. Both tax- and non-tax-related issues were considered in the decision-making process.

The dialogues also provided some examples of how the tax strategy is embedded in the organisation. For example, a European healthcare company indicated that its head of tax had performance metrics on trust, reputation and implementation of ethical standards and these were cascaded down to the broader tax team. In addition, staff from the tax team were on steering committees across the company to engage with the business on decision making for major projects.

> "We've seen progress in public tax principles, with several companies adding elaboration on tax control frameworks and the purpose of the tax function. Yet it remains very difficult to fully grasp the implementation of these tax statements. More granularity on tax principles and their relationship with the value chain of companies would enhance understanding for investors and the public as a whole."
>
> Michiel Van Esch, Robeco

Where public reporting of the information discussed would be helpful, investors pushed for the information to be made public, and some companies responded. For instance:

> A US-based technology company was asked to clarify the role of the audit committee in tax-related decisions during a discussion with the investor group on tax governance. The company then updated its audit committee charter, outlining the committee's responsibility to undertake an annual review of the company's policies and processes for tax planning and compliance.

In discussions about key risks, the US tax reform came up regularly, as did the OECD Base Erosion and Profit Shifting (BEPS)[19] programme and potential increased exposure to transfer pricing and double taxation risks. Some of the other top tax risks identified through company dialogue are listed in the diagram below:

Investors also sought to discuss companies' operations in low or no-tax jurisdictions. Where this was an engagement topic, it was positive that some companies were able to justify their presence in these jurisdictions by reference to valid commercial transactions or the revenues earned in those regions. They were also comfortable outlining changes to tax positions.

Figure 2: Top tax risks identified by engaged companies

In the context of changing fiscal environments, some investors engaged with companies on risks relating to tax incentives, given the material impact tax advantages can have on the effective tax rates paid by companies. As a result of this dialogue, these investors made significant strides in their understanding of companies' positions, existing reliefs and impacts on business.

They also pushed for granular data on the key characteristics of financially material tax incentives. An example of public disclosure following dialogue is detailed below:

> An investor engaging with a technology company in Europe advocated for public reporting on the expiry dates of the tax reliefs given its significant dependence. Following the engagement, the company disclosed the details in its latest annual report.

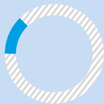
For instance, a European technology company said that operations in tax havens acquired through mergers or acquisitions had been dissolved, while another explained how operations in tax havens came to be acquired and committed to close them down in two to three years.

One example of better disclosure in this area, the result of private dialogue, is highlighted below:

> The investor group in an engagement with a European healthcare company provided feedback on current reporting on tax and areas for improvement. One area for further clarification was around its use of tax havens. The company was open to this feedback and strengthened its tax policy in 2019, specifically outlining its approach to operations in tax havens.

19 See Appendix for further discussion

COUNTRY-BY-COUNTRY REPORTING

OBJECTIVES	STATUS	DETAILS
Encourage the disclosure of more meaningful data that substantiates companies' commitments to avoiding aggressive tax planning (as a starting point, this information could include detailed reporting on revenue, employee numbers, tangible assets, profits before tax and corporate income taxes paid at the country level). Clarify expectations and discuss the practical challenges of gathering the data requested.[20]	Limited progress 	▪ Country-by-country reporting was not provided by any of the companies in the engagement. ▪ This was one of the most challenging areas for investor dialogue, with most companies stating that voluntary public disclosure was out of the question. ▪ A minority among the engaged companies agreed with the concept of granular reporting but did not make any commitments. A handful of companies published data broken down by region, top countries by revenue and subsidiaries.

RESEARCH FINDINGS

Granular data at the country level is not readily accessible from company disclosures, but a few companies have begun to report at a regional level or across top operations by revenue. Narratives around these disclosures, including explanation of key changes in trends, could be significantly improved.

EMERGING GOOD PRACTICE EXAMPLES

SYSTEMATIC REPORTING ON TAX

CSL, an Australian healthcare provider, published a tax transparency report in 2018 covering an international breakdown of taxes paid, revenue, profit, and number of employees for material operations. The report also highlights the company's approach to tax and how it is linked to business activities and governance arrangements.

REGIONAL REPORTING

Sanofi, a French pharmaceutical company, has published its geographical footprint, identifying manufacturing and R&D sites, and the regional breakdown of its workforce, net sales, income tax and other taxes paid during the year, in its 2019 Tax Policy Factsheet.

ENGAGEMENT INSIGHTS

The primary objective for investors in raising country-by-country reporting was to make company representatives aware of the usefulness of this information to investors. They clarified that investors are not looking for publication of tax returns or the OECD template provided to tax authorities. They encouraged publication of data on taxes along with contextual information and narrative to allow investors to make a considered assessment of how the company is positioned on tax. Investors also made companies aware of the draft Global Reporting Initiative (GRI) standard on taxes and payments to governments, which includes a comprehensive framework for country-by-country reporting.

Company responses to requests for public country-level data were lukewarm at best. The engagement conversations brought to light key barriers to granular reporting (see diagram below), even by those companies seeking to lead on tax transparency. They also underscored the role for policy makers in creating a level playing field for tax reporting.

Most companies that were engaged with felt strongly that country-level reporting could compromise their competitive advantage through disclosure of profit margins; this was a particular concern when most revenue could be attributed to a single activity. There were also concerns about possible misinterpretation of data due to a lack of technical expertise among broader stakeholders who could draw inaccurate conclusions based on headline figures.

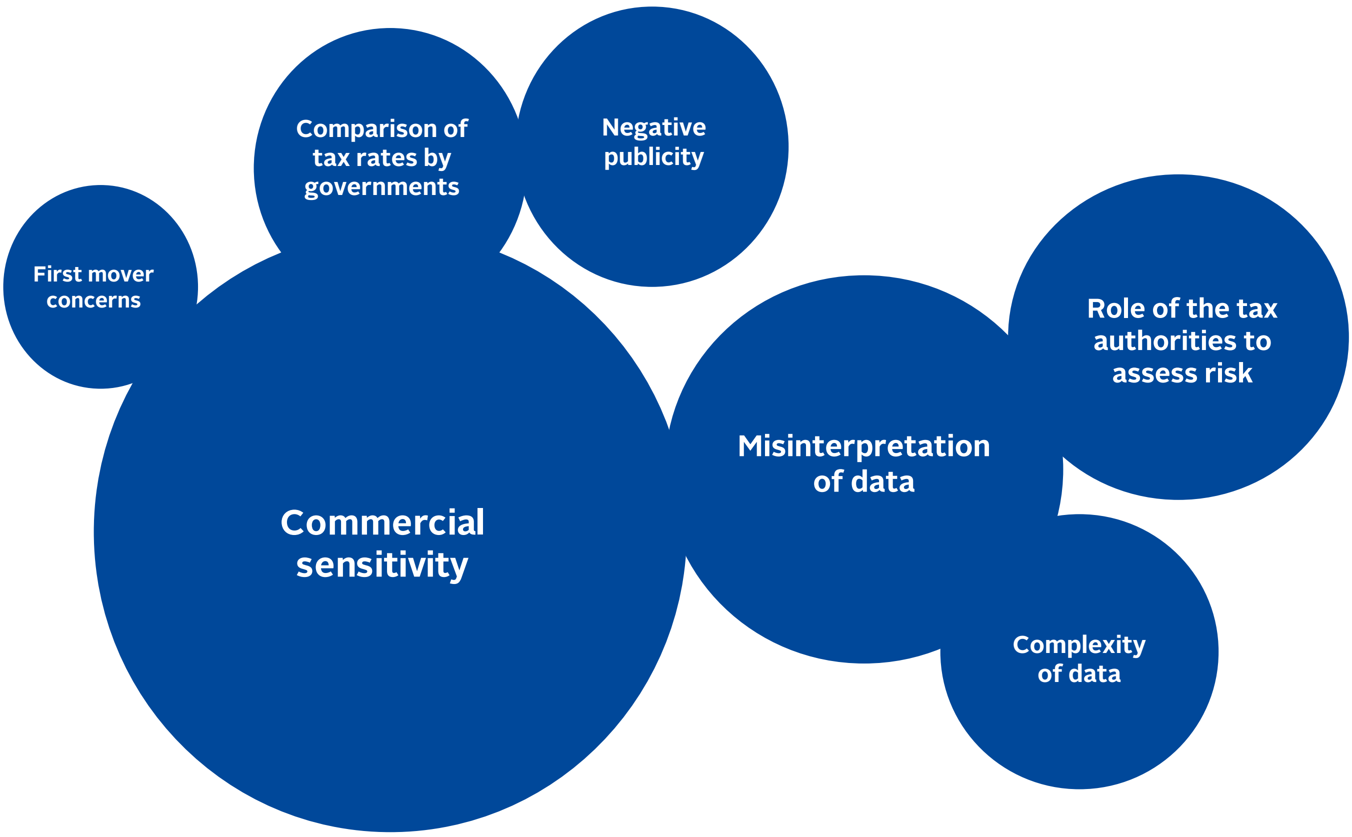
20 Some investors also engaged to improve the quality of financial reporting currently available in tax reconciliations and reporting relating to tax provisions and disputes.

Several thought that such granular reporting would only be feasible if all their peers were to report on a mandatory basis. Some companies that didn't object to the concept per se did not want to be first movers in their reporting and draw unwelcome scrutiny. One company stated that its view was that public reporting is less of a priority as tax authorities now have additional tools at their disposal to review company practices via the Automatic Exchange of Information (see Appendix). They believed that the extensive reporting to tax administrators that this requires, and the subsequent scrutiny it brings, should offer greater confidence to investors that companies' aggressive approaches to tax will be kept in check.

In contrast to those opposing public country-level reporting, two companies indicated that they were following the debate and are looking to report in a format that is meaningful for investors but which did not harm commercial interests. Some companies also supported the idea of reporting at a regional level to address concerns around competitive disadvantage.

The below diagram illustrates the key concerns raised by companies in this engagement and the frequency with which they were raised (with the size of the bubbles indicating how many companies raised each issue):

Figure 3: The main concerns of companies regarding publication of country-by-country reports



RECOMMENDATIONS AND CONCLUSIONS

Tax avoidance is a systemic issue for investors. It can not only have adverse impacts on the profitability and sustainability of investee companies, but it can also affect overall portfolio returns and macroeconomic conditions. It can exacerbate economic inequality and undermine sustainable development. It is, therefore, critical that investors play their part in addressing tax avoidance.

The PRI's collaborative engagement on tax transparency focused on addressing a lack of information to investors regarding corporate tax policy, governance and financial reporting in high-risk sectors. Through private dialogue with companies, investors clarified their expectations for improved disclosure and responsible practice.

One of the key learnings from this initiative has been that, although they can have some influence, one-off engagement conversations alone are unlikely to prompt changes in business practices on tax at the level required. As regulatory landscapes change at the national and international level, so will companies' tax strategies. And leadership in tax transparency does not necessarily guarantee a responsible approach towards tax.

To achieve impact, investors should systematically consider tax practices within investment decisions and pursue ongoing engagement with various actors including corporates themselves, policy makers and other stakeholders.

Some steps they can take are highlighted below:

WORKING WITH COMPANIES

1. **Ongoing monitoring and engagement:** Investors should proactively assess and monitor companies' disclosed data over time and hold them to account for questionable behaviour, such as pursuing acquisitions motivated primarily by tax considerations.

2. **Local collaborations:** Investors may also want to consider collaborations with local stakeholders to deepen relationships with companies in different jurisdictions.[21] Academic research indicates that investor engagement with companies headquartered in the same area tends to be more successful given cultural and linguistic connections.[22] This is backed up by our engagement insights.

3. **Consistent disclosure requests:** Companies often struggle to balance additional disclosure requests with current reporting practices, particularly given the diversity of reporting frameworks and varied expectations around transparency from different stakeholders. Investors have a key role to play in supporting frameworks for disclosure that harmonise expectations from multiple stakeholders. One example is the new GRI standard on tax released in December 2019.[23]

GRI GLOBAL STANDARD FOR TAX

The GRI Tax Standard is the first global standard for comprehensive tax disclosure at the country-by-country level. It supports public reporting of a company's business activities and payments within tax jurisdictions, as well as its approach to tax strategy and governance.

21 For instance, the French Social Investment Forum is coordinating an engagement with investors who are members of its Dialogue & Engagement commission, which together represent €4.5trn of assets under management. The first phase took place in 2019 through a letter sent to CAC40 companies outlining responsible investors' expectations on the topic.

22 Elroy Dimson, Oğuzhan Karakaş and Xi Li, Local leads, backed by global scale: the drivers of successful engagement, PRI RI Quarterly (October 2017).

23 GRI Standards (2019), GRI 207: Tax 2019.

4 **Escalation:** Where corporate behaviour does not improve, investors should escalate as appropriate – for instance through voting or filing resolutions. This will communicate the level of priority accorded to the topic to both companies and other investors. Some examples of voting approaches that have driven greater impact on tax responsibility are detailed below:

VOTING INFORMED BY THE COLLABORATIVE ENGAGEMENT RESULTS

The Church Commissioners, part of the Church Investors Group, has a voting guideline guided by the "Tax Transparency" indicator provided by FTSE ESG Ratings. In line with these guidelines, it targeted companies in 2019 considered the worst performers by FTSE. PRI data on the progress within the collaborative engagement acted as a reality check. A good track record of responsiveness towards PRI investors countered a poor assessment by FTSE; poor responsiveness triggered consideration of a negative vote. As a result, the Church Commissioners voted in 2019 against the re-appointment of the chair of the board at seven companies due to insufficient disclosure around tax-related issues and a lack of an appropriate response to investor engagement on the topic.

PROXY VOTING GUIDELINES ON TAX

NEI Investments' proxy voting guidelines include specific tax guidelines to address:

a) Tax base erosion; and
b) Management proposals to reincorporate in another jurisdiction that appear to be motivated primarily by aggressive tax planning.

The guidelines state that in general:

- NEI will vote for a proposal to block or prohibit a company from re-incorporating in a tax haven;
- It will vote for a proposal to establish and disclose a responsible tax policy; and
- It will vote against a proposal to reincorporate in another jurisdiction that appears to be motivated primarily by aggressive tax planning.

VOTING PRINCIPLES ON COUNTRY-BY-COUNTRY REPORTING

ERAFP evaluates issuers on their transparency and fiscal responsibility. In its 2019 guidelines, ERAFP commits to vote against financial statements when companies fail to disclose country-level information with key financial and operational data. Its voting policy is communicated to companies by asset managers managing their equity portfolio and voting on ERAFP's behalf.

WORKING WITH POLICY MAKERS, STANDARD SETTERS AND REGULATORS

In addition to effective stewardship, investors can engage with policy makers and other stakeholders to contribute to tax responsibility consistent with companies' wider sustainability commitments.

Policy intervention is critical to achieving a level playing field on tax reporting for companies. Investors should use their influence to raise corporate tax transparency as an agenda item with policy makers, standard setters and regulators. It is only with meaningful and timely disclosure that companies can demonstrate their positioning around tax practices and help investors understand their alignment with broader corporate strategy; regulation has a key role to play in that respect.

The PRI engagement group members have lent their voice to policy engagements on tax including, for example, in expressing support for greater corporate tax transparency in the US via an engagement letter to the Financial Accounting Standards Board (FASB):

An investor letter coordinated by the FACT Coalition, in responding to the FASB Revised Exposure Draft for the Proposed Accounting Standards Update to Income Taxes (File Reference No. 2019-500), called for disaggregated corporate income tax disclosures in financial statements. The signatories to the letter emphasised the need for corporate reporting at the country level to enable better evaluation of tax risks and opportunities.

Another example are the letters, coordinated by the PRI, sent to members of the European Parliament's ECON Committee, supporting disclosure requirements in line with investors' expectations, including country-by-country reporting.[24]

24 For the letter urging disclosure, written by Fiona Reynolds, Managing Director of PRI, see here.

OTHER COLLABORATIVE INITIATIVES

There are several ongoing initiatives that advocate greater corporate tax responsibility and aim to raise industry standards on tax reporting. These initiatives can supplement investors' stewardship activities and establish a direct channel for working together with companies. For instance:

A group of business leaders, in collaboration with civil society and other institutions, developed the Bteam responsible tax principles to establish "an approach to taxation that companies can endorse to demonstrate responsibility and play their part in creating a stable, secure and sustainable society".

Another example is the Oxfam Tax Dialogue, which brings investors and companies together for workshops and roundtables on tax issues.

As these initiatives develop, it is expected that conversations will become more nuanced and enable peer-to-peer learning with companies in a number of sectors.

CONCLUSIONS

Tax responsibility is a key priority for the PRI. We will continue to work with our signatory base to pursue an ambitious agenda with the goal of ensuring a global tax system that is effective and fit for purpose.

In doing so, some of the areas that the PRI could further explore include:

- Promoting inclusive growth and prosperity through the lens of tax responsibility, in conjunction with various stakeholders;
- Developing guidance for signatories on policy engagement on tax; and
- Supporting investors in promoting good tax practice within their investments and their own operations.

APPENDIX: MOMENTUM FOR CHANGE

Tightening regulation and emerging international co-operation have had a role to play in some advances in tax transparency during the period of the engagement (2017-19).

The OECD's work on Base Erosion and Profit Shifting (BEPS) is, without doubt, the most significant international tax initiative. It sets out 15 actions for governments to take to tackle tax avoidance,[25] and provides an array of tools and instruments to help governments protect their tax base. Two key developments are particularly relevant for this engagement:

AUTOMATIC EXCHANGE OF INFORMATION

Action 13 of the BEPS project focuses on transparency and the exchange of data between tax authorities in participating jurisdictions to counter tax avoidance, evasion and money laundering. Where participating countries[26] implement these transparency measures in national legislation, multinational companies that meet size and revenue thresholds are required to file a country-by-country report (BEPS CbC) with their tax authorities. Companies have started to provide BEPS CbC reports, which include elements of their financial reporting for fiscal years beginning 1 January and 1 July 2016.[27] While there is no obligation for multinationals to make this data publicly available, the new regulations on reporting to governments are creating momentum for discussions around tax transparency.

DIGITALISATION

The digitalisation of businesses calls into question the fundamentals of our current tax system. The OECD indicates that this is a priority area for future work under BEPS and has agreed with the G20 to develop by 2020 a consensus solution to tax challenges arising from the digitalisation of the tax economy. A proposal on how companies should be taxed and the rules around profit allocation has gone through consultation[28] and the idea of a minimum global corporate tax rate is being debated.[29] This development creates opportunities for increased scrutiny by tax authorities and could have major tax implications for technology companies.

UK FINANCE ACT

Multinational companies that are required to carry out BEPS CbC fall under the remit of the UK Finance Act, which requires mandatory publication of their tax strategy in relation to UK taxation setting out:

- The company's approach to risk management and governance arrangements;
- The company's attitude towards tax planning (so far as it affects UK taxation);
- The level of risk in relation to UK taxation that the company is prepared to accept; and
- The company's approach towards its dealings with Her Majesty's Revenue and Customs.

This regulation has resulted in companies making progress in terms of tax transparency as reflected in the increase in the publication of tax policies or strategies by companies with UK operations.

US TAX REFORM

Rob Wilson, Research analyst, MFS Investment Management

In December 2017, US President Donald Trump signed the Tax Cuts and Jobs Act, which provided a number of benefits to multinational corporations. The new law substantially lowered the headline tax rate for US-based income and essentially eliminated the US's former worldwide taxation system, which had led many US companies to retain substantial amounts of foreign profits – and the cash associated with those profits – overseas. The new law also enabled foreign-derived intangible income to be booked at a lower tax rate, which essentially created a "patent box" arrangement within the US taxation system.[30]

Although the tax reform was generally beneficial for US and non-US companies, a variety of infrequently discussed changes will negatively impact certain multinational corporations. For example, the Base Erosion Anti-Abuse Tax places a 10% minimum tax on earnings stripping, and the Global Intangible Low-Taxed Income (GILTI) imposes roughly 12% tax on foreign earnings that exceed a 10% tangible asset return. The GILTI rate grows to around 15% in 2025. Looking forward, the deductibility of interest expense will decrease as the measure of evaluation moves from 30% of EBITDA to 30% EBIT. This change will impact both external and internal intracompany debt, which could impact companies that use debt as part of their tax minimisation strategy.

25 OECD/G20 BEPS Project, BEPS Actions.
26 59 countries as of May 2019
27 OECD/G20 Inclusive Framework on BEPS, Progress Report July 2018-May 2019.
28 OECD, OECD invites public input on the Secretariat Proposal for a "Unified Approach" under Pillar One, published 9 October 2019.
29 OECD proposes global minimum corporate tax rate, 8 November 2019, Financial Times.
30 For example, see HMRC Guidance (2007), Corporation Tax: the Patent Box.

This recent US tax reform was a major change to the system of taxation for companies operating in the US; however, corporate tax continues to be an important point of debate within the US political arena, which could lead to further changes in the coming years. In addition, many US companies may need to comply with new laws being considered and implemented in other jurisdictions, such as digital revenue taxes. As a result, corporate taxation policy will remain a financially material topic for multinational companies and their investors.

CREDITS

AUTHOR:

Vaishnavi Ravishankar, PRI

CONTRIBUTORS:

Athanasia Karananou, Betina Vaz Boni and Shelagh Whitley, PRI

EDITOR:

Mark Nicholls

DESIGN:

Alessandro Boaretto, PRI

The Principles for Responsible Investment (PRI)

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

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

More information: www.unpri.org

PRI Principles for Responsible Investment

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

United Nations Environment Programme Finance Initiative (UNEP FI)

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

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

United Nations Global Compact

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

More information: www.unglobalcompact.org

United Nations Global Compact