ESG VIEWPOINT

Responsible Taxation: A Necessity to Achieve the UN SDGs

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At a glance

- Responsible tax conduct is instrumental to driving the achievement of the UN Sustainable Development Goals – but the OECD estimates that aggressive tax avoidance results in US$100 – 240 billion in lost government revenue annually.
- Greater corporate tax transparency is critical for investors to accurately evaluate and assess a company's business strategies and risk management.
- There is increasing global regulatory and legislative momentum to introduce tax transparency rules for multinational corporations.
- Discover our expectations of issuers in relation to responsible tax practices, as well as our related engagement and voting.

Engagement and voting efforts as well as expectations outlined in this Viewpoint reflect the assets of a group of legal entities whose parent company is Columbia Threadneedle Investments UK International Limited and that formerly traded as BMO Global Asset Management EMEA. These entities are now part of Columbia Threadneedle Investments which is the asset management business of Ameriprise Financial, Inc.

Overview

Corporate tax transparency is not only seen as an indication of a company's contribution to the countries and societies it operates in, but also as a reflection of its values.

As a result, headlines of aggressive tax avoidance have had profound impacts on public trust and led to consumer boycotts and fines. Notably, these scandals have occurred in Big Tech, given the number of intangible assets and thus the ease of transfer pricing to lower tax jurisdictions. However, corporate tax scrutiny goes beyond this sector. Greater corporate tax transparency is critical for investors to accurately evaluate and assess a company's business strategies, and risk management, given the financial materiality of the potential fines and risks. This Viewpoint sets out our active ownership expectations on corporate tax transparency for issuers.

Remember the Panama Papers? In 2016, 11.5 million files from a Panamanian law firm's database were leaked, revealing more an international network of tax havens involving high-profile people, government officials and businesses.

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Why is corporate tax transparency an issue? | Rio Tinto case study | Challenges | Regulation | Best practice | Engagement and voting | Conclusion

Why is it an issue?

Responsible tax conduct is instrumental to driving the achievement of the UN Sustainable Development Goals; tax revenues are required to build critical infrastructure, address inequality, and ensure a just transition (ensuring the transition towards a green economy happens in a fair and inclusive way).[1]

Aggressive tax practices directly hinder this; the OECD estimates that aggressive tax avoidance results in US$100 – 240 billion in lost government revenue annually. While at a company level, tax avoidance exposes companies to risks, including reputational damage, loss of their social license to operate, and financial risk from potential legal expenses and fines if companies are subject to investigations by tax authorities. Tax havens are also an obstacle to social and economic development. Through the offshore system, corporations and individuals are escaping more than just tax obligations, but also regulation, transparency, and criminal responsibility for unlawful activities such as money laundering.

US$100 – 240 billion

is lost government revenue annually due to tax avoidance.

Case study:

Rio Tinto to pay almost $1 billion in tax avoidance settlement

> Australia's biggest iron ore miner, Rio Tinto, has agreed to pay a total penalty of $991 million for its tax avoidance activities during the period 2010 to 2021. This represents one of the largest tax settlements in the country's history. The company, alongside other global miners such as BHP, had been scrutinised for years by the Australian Tax Office for allegations of using its Singapore-based marketing businesses to take advantage of the low tax rate and shift its profits gained from the purchase of its commodities from their Australian mining operations and selling them onwards to customers at higher prices.

1 The Just Transition Mechanism: making sure no one is left behind | European Commission (europa.eu)
2 Base erosion and profit shifting – OECD BEPS
3 Rio Tinto agrees to pay nearly $1 billion in tax avoidance settlement with Australian Tax Office - ABC News

From 2023, 15% minimum corporate tax rate for multinationals with consolidated revenues of at least €750 million in at least two out of the last four years.

Challenges with the topic of taxation

Investors no doubt face a dichotomy when it comes to responsible tax practices. Lower corporate taxation may boost short-term profitability and financial returns for investors; however, this is at the expense of wider societal benefits, including social, economic, and environmental development.

Digitalisation has exacerbated tax challenges as multinational companies' cross border business models make it easier to shift tax planning strategies to take advantage of low or no-tax locations where there is little or no economic activity. From 2017 to 2019, we joined the PRI collaborative engagement on corporate tax transparency[4]. The engagement was challenging, particularly on the topic of country-by-country reporting. However, it shed light on the inconsistencies between investor expectations and corporate disclosure. Investors wanted companies to publish a global tax policy on their approach to responsible tax, report on their tax governance and risk management processes as well as country by country reporting. However, the engagement found that companies rarely went beyond reporting information required by regulators and accounting standards.

[4] https://www.unpri.org/governance-issues/advancing-tax-transparency-outcomes-from-the-pri-collaborative-engagement/5541.article

[5] OECD releases Pillar Two model rules for domestic implementation of 15% global minimum tax - OECD

Regulation is growing and imminent

Unsurprisingly, there is increasing global regulatory and legislative momentum to introduce tax transparency rules for multinational corporations. In 2021, the OECD published 'model rules' to address the tax challenges arising from a digitalised economy. It states that multinationals with consolidated revenues of at least €750 million in at least two out of the last four years are subject to a minimum corporate tax rate of 15%.[5] There is also an EU directive for multinational companies with total consolidated revenues of at least €750 million over the last two consecutive years to publicly disclose their profits and tax on a country-by-country basis. EU member states must transpose this directive into national law by 2023, with enforcement coming into play a year later. Beyond the EU, a bill will now be considered in the US, which would mandate public disclosure of country-by-country financial reporting by large corporations.

Our expectations for responsible tax practices are in line with the GRI 207: Tax Standard[6]

The Global Reporting Initiative is a globally recognised sustainability standard; the requirements and recommendations in the GRI 207 Tax Standard provide investors with valuable examples and contextual information. Disclosures in line with the standard enable consistent analysis and comparison across companies. These expectations include:

1 Publication of a global tax policy that outlines the company's approach to responsible tax practices (policies should be consistent with the overall strategic objectives of the organisation and their broader sustainability commitments).

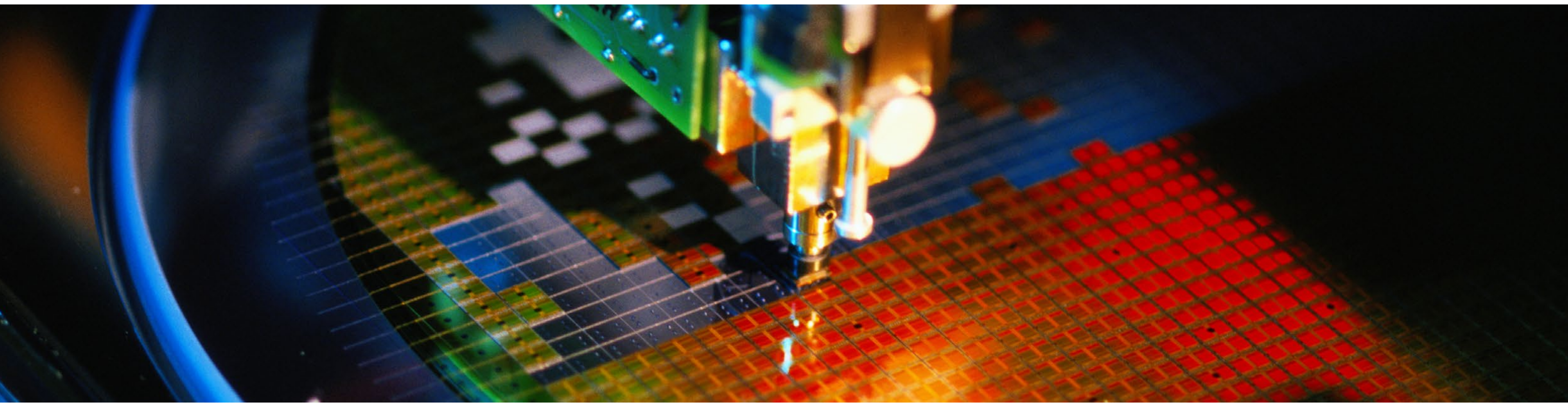
2 **Companies should report tax governance and risk management processes.**
a. The role of the board in relation to tax matters and the frequency of discussion with the audit or the risk committee.
b. Processes for defining and managing tax-related risks, and examples of unacceptable tax transactions/practices.
c. Availability of grievance mechanisms to report concerns on the company's conduct and integrity in relations to tax.

3 **Country-by-country reporting.**
a. Disclosure of data that validates companies' commitments to avoiding aggressive tax planning and inform assessment about the level of taxes paid in a jurisdiction. (For example, detailed reporting on legal entities, revenue, employee numbers, tangible assets, profits before tax and corporate income taxes paid at the country level).
b. Clarify expectations and discuss the practical challenges of gathering the data requested.

4 Companies should regularly engage with stakeholders including governments to support the development of effective tax systems and legislations.

5 Companies should promote responsible tax practices in line with the B Team Responsible Tax Principles, GRI Reporting Standards, Fair Tax Global Multinational Business Standard through involvement in industry associations and other external bodies.

6 gri-207-tax-2019.pdf (globalreporting.org)



Best practice

Since 2013, Vodafone has published an annual tax report disclosing its commitment to the B Team's Responsible Tax Principles and its alignment with the GRI-207 Tax Standard.

It has a risk management policy aligned with the OECD recommendations, detailing its approach to tax risk mitigation and transfer pricing. The company has board-level oversight of its tax governance, with critical issues reviewed at least twice a year. It also discloses a summary of its contributions on a country-by-country basis. This level of granular information, such as the number of employees, revenues, and profits, is a good indicator of how representative each country is as part of a company's broader operations and whether the operation is purely for tax optimisation purposes.

Engagement

Our current engagement on responsible tax focusses on the technology sector. We have outlined our expectations as per the previous page to 6 issuers and we will continue to engage and report on the progress made against these expectations. We have also joined the PRI Tax Reference Group to build our knowledge on tax issues, and contribute to industry discussions.

The level of granular information a company provides per country of operations is a good indicator of whether or not the operations are purely for tax optimisation purposes.

Case study:

A 2022 proxy voting case study

> This year, Amazon had a shareholder proposal on corporate tax transparency, despite its efforts with the US Securities and Exchange Commission to dismiss the shareholder resolution. The proponent requested the company to publish a report in line with the GRI-207 tax standard. According to the Institute on Taxation and Economic Policy, Amazon's effective tax rate in the US for 2021 was 6.1% on US pretax income of $35.1 billion.[7] This means it managed to avoid paying an additional $5.2 billion[8] in federal income tax, which would have occurred under the statutory 21% tax rate without any (entirely legal) tax breaks. Amazon also made the news[9] in 2018 when it went on the hunt for its secondary US headquarters; localities lined up with offers of various tax breaks to entice the company, despite this often being a bad long-term deal for local communities. Currently, the company does not disclose revenues, profits, or tax payments in non-US markets, making it difficult for investors to assess its responsible tax practices. Therefore, in line with our engagement expectations, we supported this shareholder proposal.

[7] Amazon Has Record-Breaking Profits in 2020, Avoids $2.3 Billion in Federal Income Taxes – ITEP

[8] Amazon Avoids More Than $5 Billion in Corporate Income Taxes, Reports 6 Percent Tax Rate on $35 Billion of US Income – ITEP

[9] Olympics-like Bidding for Amazon's HQ2 Is a PR Stunt Meant to Extract Tax Subsidies – ITEP

Conclusion

- The societal benefits of increased corporate tax transparency clearly outweigh the reporting burden. Under the OECD guidelines BEPS Action 13, country-by-country reporting is required. Multinational corporations are already reporting this information to tax authorities; the only difference is that it is not publicly available. As responsible investors, we continue to encourage issuers to increase transparency on their corporate tax practices to enable an informed assessment of their tax strategies, which is critical for investment decision-making.

Get to know the authors

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Lorraine joined the Responsible Investment team in 2021 and is focusing on the TMT sector. Before joining, she worked at an investor network raising awareness on sustainability in food systems. When not working, she likes to spend her time practicing yoga and making lopsided bowls in pottery studios.

Cassie Traeger, Vice President, Responsible Investment

Cassie joins our team as a US governance and voting specialist. Her role will be focused on corporate governance engagement, analysis, and voting in the US. Prior to joining our RI team, Cassies worked at both Glass Lewis and ISS, where she supported institutional investors' proxy voting with a focus on the development and implementation of bespoke ESG voting guidelines. Cassie holds an MBA from Boston University and Bas in German and Japanese from the University of Maryland.

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