KPMG

Appendix

Inspiration paper sent to participants ahead of the roundtable event.

Wednesday the 9th of November 2022

Responsible tax – Roundtable

For leading companies on matters of tax transparency, the discussion has moved on from *whether* companies must disclose information and data on their approach to tax and their tax contribution, to questions on *how* and *what* exactly various stakeholders need.

As shown in our study and analysis of tax disclosures by top-listed companies across the Nordic region, approaches vary on how companies report on their tax affairs, both on the qualitative side and the quantitative side of the reporting.

While reporting standards such as GRI 207[1] and frameworks such as the Future Fit benchmark[2] set both qualitative and quantitative disclosure requirements, others, such as the WEF's stakeholder capitalism metrics[3] or the upcoming EU Directive on Public CbCR[4] focus on data, i.e. taxes paid, taxes collected. And then, the data to be reported, and how it should be collected, either varies from one standard to another, or isn't clearly specified.

There is a balance to be found to prevent that ESG reporting creates a "reporting mentality" instead of an "intention mentality".

While there might be agreement that there needs to be consistency in reporting, the bigger picture concerns what a company says it will do and what it actually does. In general, you often hear that there is a trust deficit between business and society; companies don't get the benefit of the doubt but rather are guilty until proven innocent — particularly when it comes to tax.

When society asks a company to produce a Country-by-Country Report (CbCR), is this really saying, "we don't trust you"? If that's the case, there is a bigger issue than tax numbers at play.

Therefore, ESG needs to be used to work towards building trust which involves explaining the purpose and role of the company in society. For any tax metric to be meaningful, companies need to explain their approach to tax and their strategy — matters such as the use of incentives and transfer pricing methodology and the role of tax in creating a sustainable business and a stable society in which people can prosper.

To restore trust, people want to see proof that tax policy actually results in tangible and verifiable outputs. That the purpose matches the action and the outcomes.

Standardized reporting versus mandated reporting

This situation leads to a dilemma facing reporting companies and their stakeholders. What information should be reported, what data, what contextual information will be sufficient proof that the intentions match the actions and outcomes – and is there a common ground that can be found? On the one hand, some companies consider existing standards for Country-by-Country Reporting (such as GRI 207) to be too challenging, while on the other hand, disclosures required by accounting standards are too high level to give much meaningful information on a company's tax profile.

While the upcoming, mandated reporting under the EU Directive will standardize the reporting for a number of companies, it is not a global standard (e.g. what will the Australian public CbCR[5] look like?), only applies to large MNEs, doesn't cover their global footprint (country-by-country), and doesn't set any requirements with regards to a tax policy and the qualitative part of the reporting.

A further concern, is that while there is indication that increased transparency helps improve trust, it seems that it is not because of what the numbers say, but rather the simple act of being transparent that improves trust with some stakeholders. The willingness of a company to be transparent is often taken as an indication that it has nothing to hide, and it generates goodwill with the public. But this goodwill sits on the assumption that *someone* will read the report, and point out any issues.

So is there a risk of certain companies doing the bare minimum, and of a form of greenwashing, by selecting specific data to present, having a public tax policy, but not evidencing how the tax policy is complied with, and the link between the commitments and principles made in the policy, with the actual tax decisions and tax numbers?

So, ahead of the roundtable, some questions to consider are:

- What information to report exactly, and how best to get there?
- What information and data are investors looking at and using for their decision-making process?
- What are other stakeholders looking at, and how?
- Does anyone actually read tax reports?
- Do those who read tax reports understand them?
- What data to report, and what contextual data to provide?
- How detailed should a tax policy be, and how to report on compliance with it?
- Do regulatory requirements like public CbCR, because of their limitations, their thresholds, and the political compromises, actually make it more difficult to compare companies' reporting?
- Do regulatory requirements for CbCR spell the end of GRI 207?
- Should Danish companies agree on a standard way of reporting that goes beyond the EU's public CbCR (while ensuring compliance with those requirements), and covers the qualitative aspect?
- What is the role of tax advisers, if any, in explaining and assessing company reporting, and educating the public?

Country-by-Country Reporting versus Total Tax Footprint

A key focus of tax transparency efforts has been on country-by-country reporting of corporate tax payments. This has been the focus of the OECD's CbCR, the focus of the debate on regulatory requirement for tax disclosures, and arguably a key feature of GRI 207. But corporate tax payments are just a share, sometimes a relatively small share, of the array of tax payments that businesses make – themselves just a part of the full picture of a company's total tax footprint, which includes the taxes they collect for the tax authorities.

Country-by-country reporting, even for responsible taxpayers who do not attempt to artificially reduce their tax burden, can lead to more questions than it answers, due to the complexities and technicalities of the tax system – concepts like deferred taxes are not widely understood even by many in the business community; incentives, breaks, and tax holidays require explanation; taxes paid during a financial year are often a mix of taxes due for the previous financial year, advance payments for the following year, adjustments for previous years…

In addition, the terms used in CbCR do not match the terms used in the statutory accounts of tax expense, including current and deferred tax expense in the P&L and current tax payable in the balance sheet. These mismatches create concern for the reporting companies and cannot easily be explained.

A significant indicator is the concept of Effective Tax Rate. At low levels of profitability or losses, this indicium produces odd effective tax rates. If one takes a recent CBCR report from a major public company group where the ETR was 30% for 2019 the breakdown on an entity basis is as follows:

Ranking of Group Entities by profit	Cumulative Percentage of Profit before Tax	Range of ETR on an entity basis	Average ETR for band (weighted)
Top 10	94%	1% to 85%	28%
Next 74	6%	-198% to 199%	82%
Total 84	100%	-198% to 199%	30%

These issues lead to some companies opting out of country-by-country reporting and reporting on their total tax footprint, sometimes split by regions, split by tax type or category, arguing it provides a more faithful picture of their tax contribution to society. But this approach can lead to stakeholders and readers questioning if embarrassing data is hidden in this aggregated picture.

So, ahead of the roundtable, some questions to consider are:

- Who are companies reporting for, and do different stakeholders have different expectations? What are those different expectations, and how do we manage them?
- What are the shortcomings of CbCR?
- What are the shortcomings of the total tax footprint approach?
- As we witness a shift towards green taxation, what about the reporting of, for instance carbon taxes, plastic taxes, and the like?
- How does tax reporting fit within the wider sustainability reporting strategy?
- What form of assurance provision do we need for tax reporting?

An incremental approach

There seems to be a paradox — if a company publishes a tax strategy, some stakeholders will still expect to see how much tax is being paid in each country as proof of how it works in practice. Data is sometimes demanded as a trust factor, but on its own it cannot build trust.

So how can a company start to build trust and engage before publishing the data to properly reflect and explain the strategy?

This question will be explored on the back of these two dilemmas.

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Endnotes:

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2. Future Fit Foundation, "Future Fit Business Benchmark – BE21:Tax", June 2021, https://benchmark.futurefitbusiness.org/be21.html#be21
3. World Economic Forum, "Measuring Stakeholder Capitalism", September 2020, https://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf
4. EUR-Lex.europa.eu, "Directives", January 2021, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX%3A32021L2101&from=EN
5. Commonwealth of Australia, "Budget October 2022-23", October 2022, https://budget.gov.au/2022-23-october/content/bp2/download/bp2_2022-23.pdf