KPMG Meijburg & Co Tax & Legal

Understanding the realities of global tax transparency

Are you ready?

Part one of a two-part series on the latest insights on tax transparency globally.

The first article of this two-part series, “Understanding the realities of global tax transparency - are you ready?” aims to immerse the reader in the world of tax transparency. We aim to share our vision on tax transparency and what we see in the market. The second article discusses KPMG’s suggested approach to the growing importance of tax transparency – also known as KPMG Tax Impact Reporting.

Increasingly companies are moving away from having an approach which is mostly focused on creating shareholder value when it comes to conducting their business. The increase of shareholder returns used to be the dominant decision-making factor, whereas the effect of a business on the environment and society was not always considered an equally important factor. Today and even more in the (near) future, for companies to succeed overtime, they need to balance the interests of their stakeholders. In order to meet the sustainability requirements stakeholders may have, companies may need to prioritize the Environmental, Social and Governance (ESG) aspects of running a business.

Various stakeholder groups (e.g., investors, governments, civil society, employees, NGOs and corporate rating agencies) consider tax as an important part of ESG. Having a sustainable approach to tax and being transparent about the company’s tax position are considered key for determining whether a company’s tax position is in line with ESG standards.

Although many companies acknowledge this, it is still not always clear what tax transparency is about. In this Q&A-article, we aim to give some background and more clarity on tax transparency in general and on the increasing attention towards this topic.

The questions in this article are gathered from our daily practice, e.g. from projects and conversations with clients, prospects and colleagues around this topic.

In one form or another, tax transparency has been part of discussions for many years. One of the earliest and most easily identified catalysts for bringing tax transparency to the main stage has been the development of Country-by-Country (CbC) reporting. In recent years tax transparency has become a point of public discussion more frequently and in more detail, which is illustrated with the following high-level (non-exhaustive) tax transparency-timeline showing some of the major developments (some of which are outlined in more detail further in this article):

Is tax transparency a new development or has it been around for some time already?

2003 – Introduction of the concept of CbC reporting
The idea of CbC reporting by multinational corporations was proposed for the first time in a report to the International Accounting Standards Board (IASB).

2003 – Extractive Industries Transparency Initiative (EITI)
A multi-stakeholder organization in the extractives industry-sector coming together to announce a voluntary reporting standard to push the use of tax transparency to make governments more accountable.

2008 – Financial crisis
Public expectations about corporate behavior and governance became a mainstream topic because of the 2008 financial crisis. Companies were not believed to pay their 'fair share' of tax. The release of Lux Leaks (2014), the Panama Papers (2016), the Paradise Papers (2017) and Pandora papers (2021) further strengthened this belief.

2010 – Enactment of US Dodd-Frank Act
This act requires extractive industries to publicly report all payments made to governments.

2013 – EU Accounting Directive
Companies active in the extractive sector in the EU were required to report payments to governments.

2013 – Capital Requirement Directive, IV
Financial institutions in the EU were required to publicly report certain CbC data.

2015 – The United Nations 17 Sustainable Development Goals (UN SDGs)
The UN adopted the 2030 Agenda for Sustainable Development, with 17 SDGs at its core.

2015 – Action 13: OECD Base Erosion and Profit Shifting (BEPS) action plan
Under this report from the OECD, large MNEs are required to submit (non-public) country by country reports to tax authorities, which are being exchanged between jurisdictions.

2016 – Launch of the Global Reporting Initiative (GRI) Sustainability Reporting Standards An independent, international organization that has provided the world's most widely used standards for sustainability reporting – the GRI Standards.

2016 – United Kingdom (UK) Finance Act
Large companies and groups in the UK are legally required to publish their UK companies' tax strategy. Similar developments have occurred in corporate governance recommendations for listed companies in other countries.

2018 – B team Tax Principles
A non-profit coalition of business leaders advocating sustainable business practices have developed and published a set of tax principles.

2019 – Introduction of the GRI 207: Tax Standard
The GRI develops a new standard on tax which includes a form of public CbC reporting.

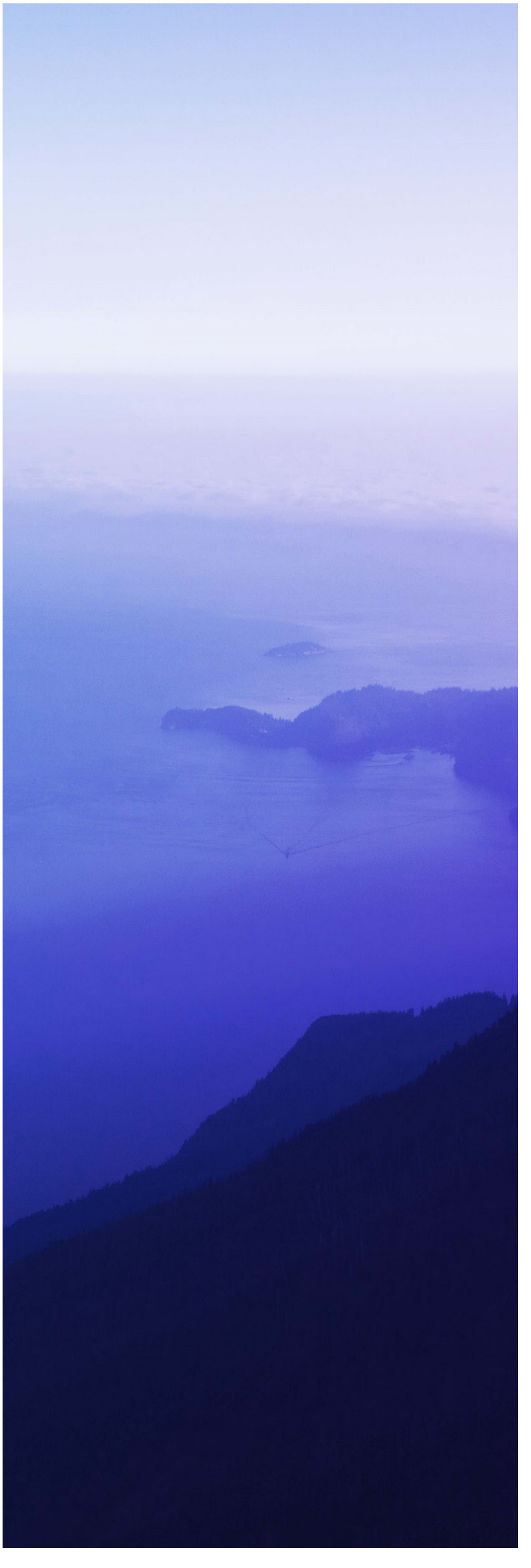
2020 – World Economic Forum (WEF) Stakeholder Capitalism Metrics
WEF's International Business Council releases a set of 'stakeholder capitalism' metrics, including reporting of taxes paid as a core metric and taxes collected and paid as a recommended metric for its ESG reporting.

2024 and onwards – EU public CbCR Directive
All companies with EU operations that exceed a revenue threshold similar to the OECD threshold of groups with a turnover exceeding €750m per annum, will have to publicly report specific CbC information. The first reporting year for companies in scope will be financial years starting on or after 22 June 2024.

How does tax transparency fit in with the ESG agenda?

Reporting on tax is not only about being transparent or about how much tax a company pays, but also actively demonstrating the way they behave with respect to tax, so that they support governments who are trying to achieve sustainable and inclusive growth. As such, tax touches all of the UN SDGs and all three elements of the ESG agenda:

- The E of Environmental – Environmental related taxes (e.g. carbon taxes), green incentives (e.g. renewable energy credits) & tax changing consumption behavior, acting as a "force for good" and helping to price externalities.



- The S of Social – is about human rights, work environment, and health taxes (e.g. sugar taxes), creating a better world. Social tax credits and social investment tax relief are becoming more widely available for companies pursuing social objectives. Also, an open, transparent dialogue between businesses, tax authorities, NGOs and consumers are key to building trust. The approach to tax and tax policies of businesses are increasingly evaluated as a measure for sustainability and change.
- The G of Governance – Tax is at the heart of governance and accountability within a business. Tax sustainability is increasingly becoming a high priority topic in board room discussions about governance. Stakeholders more and more require companies to demonstrate their commitment and contribution to society through tax transparency reporting. For instance, projects involving mergers and acquisitions (M&A) we now see due diligence reports that often include a (tax related) ESG-paragraph upon request from our clients.

Do you think the rise of the ESG agenda has accelerated the importance of tax transparency?

Yes, we see the way people and companies think and act is changing. ESG is increasingly finding its way into our daily lives. At a global level ESG has become a more important factor for doing business. For example, more countries are taking the fulfilment of the UN SDGs seriously and investors make ESG and tax transparency part of their investment strategy and sustainable finance initiatives. As a consequence, there is a mounting interest in taxation as a 'steering instrument' for making an impact through contribution to society and to the ESG agenda.

How do we become 'best in class' in the field of tax transparency, by publishing data or making qualitative disclosure?

Tax transparency can be seen as a journey. There is no 'one size fits all' and a general observation is that companies more and more move towards publication of quantitative data (on a country by country or regional basis), next to qualitative data (such as tax policy, tax strategy and governance). Publishing data is necessary, but our experience is that explaining the figures in the context of the group's approach to tax and how this is being implemented is critical to provide valuable information to stakeholders.

Making declarations about supporting transparency should be accompanied with disclosure of meaningful tax data and explanatory wording. We have noticed in practice that not living up to your own proclamations or the (tax) transparency standards a company's stakeholder may require, can cause public scrutiny by stakeholders and/or otherwise lead to bad press.

Further, publication of tax contribution data and qualitative data actually enables dialogue between the company and the interested stakeholders, and that dialogue is what builds trust.

Is it true that the accurate collection of data is something businesses are struggling with?

Indeed, we see that this collection of data is something that companies are trying to navigate. In many cases the collection is still done manually, using excel spreadsheets sent to tax personnel in different subsidiaries, which increases the margin for errors in the process.

Does publishing in line with a recognized tax transparency standard help build trust with stakeholders?

Tax transparency may take different forms, but usually they offer guidance on what information should be published in order to become more tax transparent. Many of the standards have been developed jointly with multiple stakeholders, so, publishing in line with a recognized tax transparency standard may indeed help in building trust with stakeholders.

That being said, if a company claims to report in accordance with a sustainability standard or makes certain claims with respect to its approach to tax, which are not true in practice, we have seen examples of scrutiny and criticism from stakeholders. So, whenever you claim to follow a standard, follow it.

Many sustainability standards, however, encompass much more than tax reporting, and often, the decision whether to follow this standard is taken outside the tax team. If this is the case, the tax team should still strive to report the tax elements and, if they cannot achieve it this year, then an explanation should be given as to why to publication has not been made.

There seems to be a lot of different kinds of (tax transparency) reporting initiatives, can you provide some clarity on what the landscape looks like?

While some mandatory governmental initiatives have been introduced in the last 20 years, or are soon to be introduced, recently a number of voluntary initiatives are emerging as the leading forces of change in sustainability reporting. Initially, the focus of tax transparency reporting standards and frameworks focused on the financial and extractives sectors. However, the adoption of wider voluntary reporting standards such as the Global Reporting Initiative (GRI) is growing across many sectors. In some jurisdictions the legislative and regulatory environment is also changing, meaning local (governmental) initiatives now also requiring more tax transparency from companies (see for instance the recent elections won in Australia by the Labor Party who have proposed tax transparency initiatives such as CbCR).

The most visible initiatives on the 'tax transparency reporting-podium' at this moment are set out below.

EU Public Country-by-Country Reporting (CbCR)

On 11 November 2021, the European Parliament formally adopted the public EU CbCR directive (the Directive). EU members can apply for earlier application – but in any case, as of financial years starting on or after 22 June 2024, companies that meet the below requirements will be required to publish CbC data (similar to OECD CbC data, but aggregation differs).

Aanwezigheid in EU van niet-EU hoofdkantoor te voldoen aan 2 van 3 voorwaarden

EURm	Middelgroot[a]	Groot
Balanstotaal	<20	<20
Omzet	<40	<40
Werknemers	*<250*	*>250*

Noot: (a) Exclusief klein of micro.

It affects multinational groups or standalone undertakings with:

- A consolidated net turnover of at least EUR 750 million (in the last two consecutive financial years); and
- An entity or branch in the EU (either headquarters (HQ) and/or subsidiary/branch) whereby for non-EU HQ, their EU presence must include medium-sized or large subsidiaries.

GRI Standard 207: Tax

The GRI reporting framework is the most prominent and widely used voluntary standard and for periods beginning on 1 January 2021, those who report under GRI will find that GRI 207 is now a mandatory standard.

GRI 207 is designed to help an organization both understand and communicate its approach to tax, tax governance, control and risk management, stakeholder engagement and management of concerns related to tax, and to report amongst others its income, tax and business activities on a CbC level. We discuss GRI further here.

In practice we see companies that report in accordance with GRI standards, but which do not report on GRI 207 in full or in part. This can – based on GRI standards – in principle only be the case if tax is not considered a material topic or by making reference to the reasons for omitting as included in GRI 1 - Foundation (or GRI 101 before 2021), which are: not applicable, legal prohibitions, information not available/incomplete or confidentiality constraints. GRI 1 describes a topic as material when it reflects the organizations significant economic, environmental and social impacts or where it would substantively influence the assessments and decisions of stakeholders. A

group's approach to tax can directly influence how much tax it pays, (or, taking another perspective, how much revenue is received from it by governments) so we would expect tax to have a large social impact and therefore to be material to any group reporting in accordance with GRI. Although we would not recommend omitting tax information that is required under GRI 207 as this is contrary to the aim of increasing disclosures, if such approach is taken (based on GRI standards this can only be in exceptional cases), a company should include detailed disclosures on why such omission has been made.

The B Team

The B Team Responsible Tax Principles include a Call to Action for Businesses where the initiators invite companies to join them in endorsing The B Team Responsible Tax Principles and strengthening their approach to tax management, relationships and approach to public reporting.

One of the main calls for action with regard to reporting is that companies should explain their overall effective tax rate and provide information on the taxes paid at a country level, linked to information on their economic activity, all reported on an annual basis.

The Dow Jones Sustainability Indices (DJSI)

The DJSI is an index that includes companies that are recognized as the top performers in the field of sustainability, which since 2014 also takes a company's approach to tax into account.

The parameters for DJSI include reporting requirements on (i) Tax Strategy and Governance, (ii) Tax Policy, (iii) Tax Reporting, including reports on key business, financial and tax information for each tax jurisdiction where the entities included in an organization's audited consolidated financial statements are resident for tax purposes (regional reporting on taxes paid is not compliant), and (iv) Effective Tax Rate, including the reported tax rate (income statement) and cash tax rate (cash flow statement) for the last two financial years.

A company's DJSI scoring for tax purposes will -in principle- be reduced by 1/3 in case the company does not report in line with GRI 207. This in turn will have an impact on the company's overall DJSI score.

World Economic Forum – International Business Council

In September 2020 the WEF and its International Business Council (IBC) released the Stakeholder Capitalism Metrics (SCM), a set of ESG metrics and disclosures that measure the long-term enterprise value creation for stakeholders of a company, including from a tax perspective.

In 2021, WEF reported that a growing coalition of over 60 business leaders across various industries announced their commitment to the SCM.

The core and expanded set of SCMs can be used by companies to align their mainstream reporting on performance against ESG indicators and track their contributions towards the UN SDGs on a consistent basis. WEF core metrics include reporting on the total global taxes borne by the company, including corporate income taxes, property taxes, non-creditable VAT and other sales taxes, employer-paid payroll taxes, and other taxes that constitute costs to the company, by category of taxes.

Dutch VNO-NCW Tax Governance Code

As an example of one of the many national initiatives, the Dutch business organization VNO-NCW has published its Tax Governance Code on 18 May 2022.

VNO-NCW is an employer organization which speaks on behalf of companies of all sizes and across all sectors in the Dutch market.

Most striking element of the tax governance code would be the commitment by companies that have signed the code to report annual information on their corporate income tax accrued and paid on a cash basis, at a country level. The total tax borne and collected by the companies, including corporate income taxes, property taxes, (non-creditable) VAT and other sales taxes, employer / employee related taxes, and other taxes can be reported globally or per country.

What is the difference in stature between these various reporting initiatives and how does this relate to the level of detail that should be reported according to these initiatives?

There is no clearly defined difference in stature between the reporting initiatives. Although some are applied / followed more frequently than others, we also see companies applying multiple standards at the same time. Which reporting initiative is preferred may also depend on the sector or area a company is active in, or on the corporate governance set-up or general principles of a company.

Further, companies reporting fully in accordance with GRI 207 may -in general- obtain a higher score on other initiatives – such as the tax rating for DJSI. Reason being that the level of detail that is requested by GRI 207 is higher than that of DJSI.

The ‘big player’ GRI is driven by wider sustainability sign up – the developments on wider public reporting are expected to further gain importance as GRI 207 is becoming “mandatory” for those reporting under GRI as of financial years on or after January 1, 2021.

What action could be taken by companies with regard to tax transparency reporting?

Tax transparency will be different for every company and will depend on industry, prior activity, preference regarding the level of transparency, tone at the top and level of current transparency with regard to taxes.

If a company is not yet reporting in line with any tax transparency initiative, it can assess what reporting initiative(s) would be most suitable for the company and which initiative would be best for meeting possible requests/demands from the stakeholders. A dialogue with stakeholders specifically on tax transparency seems recommendable. For a company already disclosing in line with a standard, it could first assess whether all requirements are indeed met, and reporting is in line with the initiative(s). Second, the company could assess whether it wants to go into more detail with its disclosures and whether the current disclosures meet stakeholder's expectations.

Adequate impact reporting on taxes can be considered key in building trust and some companies have sought for assurance from third parties in their tax transparency initiatives. Assurance can be provided in different forms, e.g. in relation to compliance with sustainability standards, the company's own tax policy, strategy and governance, or on the tax contribution data.

KPMG firms can help you wherever you are on this journey.

In the next article of this two-part series your questions with regard to our several solutions and supporting technology options will be answered by us in more detail – so stay tuned!

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