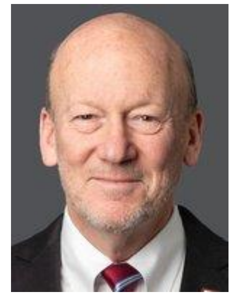
# Corporate Reporting Considerations As Tax Meets ESG

By **Michael Lebovitz and Jenny Austin**



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A high-ranking U.S. senator sends a letter to the CEO of a Fortune 500 company demanding information about the company's low effective tax rate.

During an earnings call, an analyst asks about a tax risk factor discussed in a U.S. Securities and Exchange Commission filing.

A newspaper lists a number of multinational companies that are not paying their fair share of income tax.

A global investment fund requires a company to disclose its global tax policy before making an investment.

A disgruntled employee becomes a whistleblower providing information about a company's tax planning strategies to a taxing agency.

These types of events are a few examples illustrating the intersection of tax and environmental, social and corporate governance and, in particular, the increasing external pressures for greater transparency into a company's global tax position.

Currently, except in certain countries and certain industries, public disclosure of corporate tax information is voluntary, although many companies already disclose some information with respect to their approach to global taxation. These approaches range from a global tax policy statement to a detailed report on the company's total tax contribution.

As the annual SEC filing season begins this month, it is a given that the press, analysts and other external stakeholders will again focus on corporate effective tax rates. The pressure for increased transparency will continue to build, and multinational companies need a plan for how to respond.

There are multiple approaches a company can take, but the common thread in these approaches is preparedness to enable the company to maintain control of its tax narrative. This article will discuss these trends in greater detail and provide a road map for how a company can respond to these challenges.

**The Emergence of Voluntary Tax ESG Reporting**

There has been an explosion of ESG reporting and disclosure in recent years.[1] While the main focus of this disclosure has been on environmental and sustainability matters, reporting with respect to a company's tax strategy and approach to taxation has become increasingly prevalent.

In 2014, the Dow Jones Sustainability Index began to include elements with respect to tax strategy, policy and reporting in its indexing criteria.[2] This inclusion was part of a larger focus on the effective tax rates of major multinationals and whether such companies were paying their fair share of taxation.

In 2017, the U.K. began to require large companies to publicly report their U.K. tax strategy.[3] This reporting includes information with respect to the company's approach to managing tax risk, its approach to tax planning and how it works with the U.K. taxing authority. While some companies responded to the U.K. rules by publishing a global tax policy statement, most companies complied by issuing a U.K.-specific tax policy statement.

As tax began to take a larger role in ESG reporting, various organizations developed standards for tax-related ESG disclosures with a view to making such disclosures consistent and more robust. Two important organizations in this regard are the Global Reporting Initiative, or GRI, and the World Economic Forum, or WEF.

The GRI is a leading independent body that has established a comprehensive set of standards by which companies report their ESG impact. Over 10,000 companies in over 100 countries have committed to GRI reporting.

In 2017, the GRI began to develop a specific set of standards relating to taxation. The final tax standard — GRI 207 — was released in 2019 and includes a comprehensive set of reporting information relating to a company's tax strategy, oversight of the tax function and relationship with taxing authorities. GRI 207 is effective for reports issued beginning Jan. 1, 2021.[4]

In 2020, over 100 companies participating in the WEF agreed on a common set of metrics for reporting on sustainable value creation. These metrics include and expand on the GRI 207 standards.

In particular, the metrics require the reporting of the total taxes borne by the company broken down by country, together with a report of additional taxes remitted by the company, such as employment taxes, sales tax and value-added tax, and taxes collected on behalf of another party. This reporting is often referred to as a company's total tax contribution.[5]

**Mandatory Public Tax Disclosure**

Under the laws of most countries, tax information is generally confidential and not subject to public disclosure. While companies report significant information with respect to taxation on their financial statements, this information does not generally identify the amount of tax paid to a particular country.

As debate increased regarding whether leading multinationals were paying their fair share of taxes, stakeholders began to focus on the use of tax haven entities and tax planning structures that enabled companies to shift large amounts of profits to low or no-tax jurisdictions.

In 2013, the Organization for Economic Cooperation and Development began its sweeping base erosion and profit shifting project. This landmark initiative has led to a global overhaul of international tax policy and provided new tools to taxing authorities around the world to challenge abusive tax structures and the use of tax havens.

One such tool was the development of the country-by-country tax report.[6] This reporting, now in use in the U.S. and around the world, is designed to enable a tax authority to compare the taxable profit realized in each country with the functions and assets deployed there.[7]

The country-by-country report facilitates this analysis by highlighting profits located in a tax haven. The country-by-country report is attached to the tax return of the company and is subject to automatic exchange of information between tax authorities around the world.

While there are known weaknesses in how the country-by-country report captures data, the report is intended to be a risk assessment tool for a tax authority.

Like the rest of the tax return, the country-by-country report is considered tax return information and is, therefore, confidential and not subject to disclosure. However, many stakeholders believe, and are aggressively advocating, that public disclosure of the country-by-country report will expose aggressive tax planning and unwarranted use of tax haven entities.

The GRI reporting standards discussed above include public country-by-country reporting as part of GRI 207. However, as noted, GRI reporting is voluntary.

In November 2021, the European Union adopted a directive to require public disclosure of select data from the country-by-country report by large multinationals.[8] EU member states have 18 months to implement the directive in their local laws, with the new rules being effective in June 2024.

Similarly, legislation has been introduced in the U.S. Congress to require public country-by-country reporting as part of a company's SEC reporting. It seems clear that multinationals should expect that some form of public country-by-country reporting will be required in the near future. When such reporting becomes public, multinationals will need to be ready with the narrative that puts the report in perspective.

**Developing an Approach to Tax ESG Reporting**

Multiple external forces are driving increased tax transparency, and it is expected that at some point most major companies will be forced to issue some form of a related statement on their approach to taxation. This may arise from pressure from the press or investment analysts or as a result of a major competitor issuing its own tax policy statement and market pressures forcing a company to follow suit.

Eventually, when public country-by-country reporting becomes mandatory, companies will need to be prepared to respond to external inquiries that will likely arise.

As noted at the outset, there are multiple approaches to tax ESG reporting, but the common element in every approach is preparedness. A company may decide that it will not proactively issue a tax policy statement, but it will be prepared to respond to specific inquiries when they arise.

This approach can be effective if the company is prepared to respond quickly and effectively. Preparation must include collecting the relevant information, developing the narrative and identifying who within the organization will respond. The outcome of this approach is generally an internal tax ESG policy and a communications protocol.

On the other hand, a company may decide to issue some form of tax policy declaration. Here, a company must decide what form the declaration will take.

One approach is a values-driven statement that describes the company's approach to tax planning, how it works with tax authorities, and the relationship between where taxes are paid and where the company conducts operations.

Another approach expands the narrative with information regarding the company's total tax contribution. As noted above, a company's total tax contribution includes the corporate income tax paid by the company together with other taxes paid, including employment taxes, VAT and other taxes.

While the focus of much of the external pressure on large multinationals has been on low effective corporate income tax rates, many believe that total tax contribution is a better reflection of the role tax plays in a company's overall social contribution. This has led some companies to issue an expanded tax policy declaration which describes the total taxes paid around the world.

Determining which approach to take is a process that often starts with a review of the company's core values and applying those core values to taxation.

Grounding the tax ESG process in the company's core values will produce a result that reflects the company's contribution to the societies where it conducts business and converts the process and eventual work product from a defensive posture to a positive contributory posture that has the necessary buy-in from all the relevant internal stakeholders.

**Initiating a Tax ESG Process**

The decision on when and how to report requires input from various internal stakeholders, including tax, finance, legal, government affairs, marketing and communications departments, as well as the company's ESG leadership. It is essential that the process have an executive imprimatur.

Often this project is initiated by the board's audit committee. The audit committee then directs a group of the above-mentioned stakeholders — a tax ESG working group — to develop a plan for tax ESG reporting.

This plan often includes updating the audit-committee charter to ensure that it reflects the committee's oversight of tax ESG matters as part of its overall oversight of the tax function. The audit committee or tax ESG working group often engages an external advisor to help guide the process.

**Concluding Observations**

Companies must be prepared to respond to the increasing pressure for tax transparency. At a minimum, this preparation enables the company to control its tax narrative. More broadly, a company that is prepared is able to approach these pressures from a position of strength, with the confidence that its internal and external stakeholders recognize the company's positive financial contribution to society.

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[1] See, generally, Market Trends 2020/21: Disclosure Related to Climate Change | Perspectives & Events | Mayer Brown.

[2] See the-sustainability-yearbook-2019-five-years-of-pushing-for-change-assessing-corporate-tax-strategies.pdf (spglobal.com).

[3] Publish your large business tax strategy - GOV.UK (www.gov.uk).

[4] See gri-207-tax-2019.pdf (globalreporting.org).

[5] See WEF_IBC_ESG_Metrics_Discussion_Paper.pdf (weforum.org).

[6] See, generally, Action 13 - OECD BEPS.

[7] See Country-by-Country Reporting Guidance | Internal Revenue Service (irs.gov).

[8] See Public country-by-country reporting | European Commission (europa.eu).