27 October 2014

Kepler Cheuvreux

Business ethics

ESG

Sustainability Research

Tax me if you can: game over

Turning grey areas into red flags for investors

Sustainability Research

Does tax minimisation boost long-term shareholder value?
Clear support for reducing the scope of tax avoidance globally continues to be expanded by austerity budgets, increased public awareness, and, above all, tighter regulatory environments. As a result, long-term shareholder value is at risk for companies engaging in aggressive tax minimisation.

Tax havens and tax hells
Tax planning techniques are already under threat in two main areas: the use of tax havens and the use of intergroup transactions that are not based on real commercial activity, including intercompany hybrid loans, transfer pricing used in IP royalties valuation and M&A. All jurisdictions, not just those offering secrecy and "harmful tax competition", face immense pressure to increase transparency and curtail the use of such mechanisms.

Invisible transactions becoming visible: impact on sectors
Banking has been the most affected sector, with non-cooperation with authorities on the identities of account holders no longer a viable business model for wealth management. While consumer-facing companies and the pharma sector have faced controversies and transfer pricing litigation, respectively, OECD proposals to make digital transactions more transparent mean that cyberspace may no longer be the largest tax haven.

Investors need country-by-country reporting more than ever
The EC is introducing country reporting legislation for the extractives and banking sectors and further sectors are likely to be added in the long term. In our view, country data has myriad uses in financial valuation and ESG analysis beyond tax.

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Kepler Cheuvreux

Business Ethics

ESG
Sustainability Research

Corruption indices: From disclosure to risk exposure

Sustainability Research

A new forward-looking indicator to assess risk exposure to corruption: We build on the Transparency International (TI) methodology to develop a new tool for investors that rates companies on their risk exposures to corruption. Using forward-looking indicators in the context of business exposure and news flow, our rating aims at mitigating increasingly material corruption risk and enabling engagement.

Sector risks emphasized under new regulation
Extractives have the most exposure due to payment transparency regulation in the US, also being finalised by the EC. Telecoms, construction and banks, proposed though not included in EC regulation, remain exposed longer term. Closer regulatory scrutiny has not disappeared and we rate companies in these sectors, also analysing the key industry specific issues presented. Companies in Aerospace & Defence and Cap goods remain in the regulatory limelight.

"The corruption research from Kepler Cheuvreux's team builds extremely effectively on Transparency International's research methodologies and primary analysis to demonstrate the risks that investors face from corruption and how investments can be better protected by good corporate governance and putting in place adequate anti-corruption procedures." ***Robert Barrington, Executive Director, Transparency International UK***

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Business Ethics

ESG
Environmental, Social and Governance

Soft law violation & liability
Towards Fiduciary Duty 2.0

Sustainability Research

Changing anatomy of liability: Civil society 2.0 & CSR regulation
The growing quantity and scope of normative standards and transparency mechanisms, which can form the basis for hard law, are proving an efficient avenue of reference for redress available to civil society and those with a grievance against a company. The proliferation of social media in corporate branding, online press and civil society campaigns presents new mechanisms of accountability and greater reputational risk.

Soft law and reputation risk targeting controversial companies
Corporates with controversial activities have increasingly found themselves in the crosshairs of "soft law" with over 175 cases so far filed via the OECD complaints process alone, comprising diverse environmental and social concerns but with human rights a central area. Reputational damage and resulting financial and operational impacts are often the greatest effect rather than monetary penalties.

Towards a new P/E ratio: price-to-ethics
Soft law documentation can provide useful indicators that integrate ESG factors into the business context. We uncover an OECD NCP supply chain report on Rana Plaza and extract from it engagement questions and indicators that can assist investors who are pushing for metrics that straddle both economic interest and sustainability concerns.

Investor collateral damage
Although CSR commitments may not be a legal obligation, the proliferation of soft law complaints and hard law litigations against corporates introduces new risks to investor assets. The credibility of corporate and investor claims relating to sustainability processes are particularly vulnerable, as they depend on trust rather than legally enforced audits. Furthermore, SRI investors are held as potential influencers of investee behaviour and may increasingly be drawn in to cases where corporates are targeted.

Limited Liability & Fiduciary Duty challenged
While investors' legal liability remains uncertain for controversial holdings, soft law precedents insist on responsibility for minority shareholdings, and more cases are likely to come up. The focus on fiduciary duty by long-term frameworks, such as the UK Stewardship Code and Kay review, implies the need for better investor due diligence and response processes to mitigate reputational risk, liability and facilitate the remediation of violations. This report aims to provide a detailed framework for these issues.

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Corruption indices: From disclosure to risk exposure Document link

Business ethics: Pharma corruption risk index Document link

Soft law liability & violation Document Link

See also Pharma & Biotech Sector Team Report:

The Great (Tax) Escape Document Link

Previous ESG Business Ethics reports include:

- *Aerospace & defence: working with the transparency international index*, January 2012
- *Conflict minerals*, November 2011

In their own words…

The OECD

"*You multinationals stand ready…It's over*." Director, OECD Center for Tax Policy & Administration, Pascal Saint-Amans, 2014 – on tax avoidance by MNEs

Civil society

"*Tax is the return due to society on its investments – the roads, educated workforces, courts and so on – from which companies benefit. If they avoid or evade tax, they are free-riding off benefits provided by others*." Tax Justice Network

"*Multinational corporations have a duty to account to each and every jurisdiction where they operate for what they do in that place*." Richard Murphy, creator of country reporting principles

Economists on inequality

"*Everyone knows that corporations are not just cash machines for their shareholders, but that they also provide goods and services for their consumers, as well as jobs and incomes for their employees. Everyone that is except economists.*" Economist, Jean Charles Rochet, 2014

"*Without taxes, society has no common destiny, and collective action is impossible*." Economist Thomas Piketty, 2014

The business view

"*Apple carefully manages foreign, post-tax income to support its foreign operations through a corporate structure that protects and promotes the interests of its shareholders*." Apple CEO Tim Cook on minimising tax on the company's foreign cash pile, 2013

"*We are open to structures that create value for our shareholders and also create the most value for our assets.*" Basilea Pharmaceutica CEO Ronald Scott on being a potential tax inversion target, 2014

Executive summary

We think we will get to a point of "game over" in the longer term for companies routinely looking to increase shareholder value through the most aggressive forms of tax avoidance. While tax has always been a jugular issue for companies, the consequences are becoming increasingly complex as they are driven not only by regulatory and tightened enforcement risks, but have become a very public social issue for consumers and governments. Therefore, this raises governance issues not only related to financial risk, but reputational risk also with business impacts for longer time frames.

The drivers: austerity, increased public awareness and economic inequality debate

In times of austerity-driven budgets, corporates found guilty of paying less than is felt "fair" either by regulators *or* a public consumer base (whose standards are significantly stricter) are highly exposed to new lines of branding and financial risk. Our Autumn Conference in September 2013 included a number of experts in the area of taxation and fiscal policy. A consensus was found among our speakers that corporates' flexibility in using tax avoidance structures including (but not limited to) those using so-called but ill-defined "tax havens" will be limited in the years ahead.

New legislative proposals every quarter and enforcement of laws tightened

In legal terms, the risk comes both from a raft of innovative proposals from supranational bodies and nation states, but also from increased national enforcement of laws that have existed for some time. The OECD, which is instrumental in influencing tax policy and legislation to combat aggressive tax avoidance, is targeting the entire range of widely used corporate tax reduction mechanisms via the Base Erosion and Profit Shifting Program (BEPS), with ongoing global impacts expected in the long term.

Not just an issue for some faraway markets

Increased enforcement risk around pre-existing legislation means that in both emerging and developed markets, the recoveries of disputed tax payments are also a source of heightened potential risk for investors. Disputed payments can hinge on the retrospective application of tax law (draft US proposals on inversions, Vodafone and Shell's transfer pricing disputes in India and Germany's changes in "dividend stripping" tax status for the financial sector are all examples). Government enforcement power in terms of quantities of settlements (the largest transfer pricing settlement comes in at USD3.4bn), operational impacts (asset freezing and seizure) and timeframes of applicability (retrospectively) may well be larger than companies and investors expect. The political climate that has set the scene for increasingly aggressive legislation shows little sign of abating.

Banking and pharma issues are visible but sector effects to expand

Sector exposure has so far seen banks as the primary casualty in the drive to reduce tax avoidance and financial secrecy. Ongoing material financial impacts are clearly visible as a result of a business model in private banking divisions that are dependent on a lack of disclosure, a model which until recent years had remained relatively unthreatened. We highlight numerous USD1bn+ transfer pricing cases in the telecoms and pharma industry. The latter has also been thrust into the limelight due to US healthcare companies favouring

so called "tax inversions" in their M&A rationale by relocating domicile into lower tax jurisdictions.

Internet Media, Tech and Online Retail on watch

Technology has changed the business models of entire sectors in the last decade, and taxation has struggled to keep up with the agility and mobility of companies in the digital economy who are able to implement intangible value transfers globally to reduce tax payments in numerous countries. We highlight significant legislative consultations on internet media and digital transactions that attempt to create entirely new tax policies (i.e. via OECD BEPS and French national proposals) for any industry where value is created through the use of data and its transfer.

Limited tool for investors to identify companies at risk

However, the tools available to investors in identifying those companies most at risk also remain highly limited for now due to a lack of public transparency over tax payment data and policy. We are increasingly seeing innovative proposals from parliaments and stricter enforcement of the "spirit" of tax laws. One example is a recent UK proposal to require the Top 250 companies to declare their tax returns and organisational structures publically. Also, the *Fair Tax Mark* in the UK is a new non-profit lead initiative that lays down specific indicators and policy items to assist stakeholders in identifying tax risk.

Investors should push country reporting: benefits go beyond visibility on tax

We argue that country-by-country reporting is critical to investors (particularly sustainable investors) for a variety of reasons not limited to tax risk. These include the identification of operations and exposure in areas of high corruption, human rights, environmental and governance risk. ESG issues aside geographical detail around revenues, profits, employees, taxes and assets at a country level allow unlimited possibilities for valuation and benchmarking for mainstream financial analysts to be extended and made more accurate. The entire global investment community, not just Socially Responsible Investment, stands to benefit. While the EC has supported further transparency through country-by-country reporting of taxes paid, the regulatory proposals for such reporting will not produce data until at least 2016 for extractive sector companies through the Accounting and Transparency Directives, and potentially 2015 for the banking sector via CRD IV.

Consumer and brand value effects are a concern

Consumer boycotts are becoming a greater concern for corporates - we conclude that the phenomenon is not only here to stay, but very likely to increase against a backdrop of social media and internet press presence, but also given the political and regulatory momentum (sometimes opportunist) created through certain civil society campaigns which can call for boycotts.

Kepler Cheuvreux: sector analyst views of tax issues

Analysing our coverage, we highlight the common areas (usually outside the media spotlight) of tax risk for investors, which are more routinely covered by analysts, such as tax loss carry forwards and special tax regimes, but which nonetheless have an obvious impact on shareholder returns. The momentum is for more of the major tax breaks – e.g. patent box schemes reducing taxes on the basis of intellectual property activity – to be challenged and put under international regulatory (if not public) scrutiny.

Report structure

This report is structured around four major themes:

I) Regulation and tax reform

Part I is an introduction to the key tax reform changes that are beginning to be effected, with illustrative views of changes in major economies.

II) Social impacts

Part II is an overview of issues around equality and tax responsibility, which have come under closer public scrutiny since the financial crisis, and are of particular interest to SRI funds.

III) Sector impacts

In Part III we address the ways in which regulation and litigation have already affected key sectors such as banks, telecoms and pharma, and how fresh proposals may change the risk profiles of data-intensive industries (i.e. via the digital economy). New EC country reporting legislation targets banks, oil & gas, mining and forestry companies' disclosure on taxes paid.

IV) Tax transparency

In Part IV, desirable elements of disclosure are analysed and a tax screen model developed for SRI investors. We analyse key indicators of a company's approach to tax as well as the caveats for investors using them. Our analysts have commented on key tax issues by company and sector, and we include these findings in our analyst survey at the end of the report.

The impacts of tax minimisation are growing

Tax minimisation risk as a whole is rising, and this is having a variety of impacts. Some of these have existed for many years, such as litigation, the purest form of risk for analysts in the form of costs. More disputes are probable in the current political and regulatory environment, but multiple reputational and potentially operational side effects have now emerged. In the table below we cite some of the key impacts that contribute to our view that in the long term tax avoidance can lead to shareholder value destruction:

Table 1: The rise of tax minimisation impacts on business

Type	Impacts	Examples
Costs	Settlements in tax disputes i.e. transfer pricing	GSK USD3.4bn (US), AstraZeneca (USD1.1bn & GBP550m in UK), Vodafone (UK GBP1.25bn)
	Tax authority investigations from transfer pricing/ cross border M&A	Novo Nordisk (Denmark USD1bn disputed), Vodafone, SAB Miller, AT&T, Shell (India)
	Delays to M&A / asset freezes and seizure	Nokia factory in India in handset IP tax dispute
	Criminal penalties	Credit Suisse USD2.8bn settlement and guilty plea for criminal charges of aiding US tax avoidance
	Bail money deposits required in disputes	UBS loses appeal for EUR1.1bn bail request in French courts for allegedly assisting French client tax avoidance
	Financial pressure on tax minimisation dependant business	Entire European offshore wealth management business unlikely to recover prior margin levels
	Increased legal & compliance costs	All the above examples
	Potential exclusion from public contracts due to tax evasion convictions	Regulation exists i.e. for EU procurement, current levels of poor enforcement could increase in the long term
	EC investigations into unfair “fiscal state aid”	EC fiscal state aid investigations into Ireland and Netherlands may require repayments from companies with special tax agreements – so far Apple, Starbucks, Fiat potentially noted
	Suspension of key projects	First Quantum/ Glencore suspends Zambia copper projects after government withholds USD tax refunds (200m USD for Glencore)
Financial	Earnings volatility as a result of tax dispute/ controversies	AstraZeneca
	Low-quality earnings	Various
	Short-term price impacts of regulatory changes	Shire/ AstraZeneca 5%+ drops Sept 2014 on new tax inversion regulation from US
	Requirement for organisational restructuring (i.e. of location and alignment of subsidiaries) as stricter tax haven legislation is introduced	Various
	License to operate - boycotts & public protests	Vodafone/ Starbucks/ Amazon UK
Reputational	Negative associations from Impacts from televised senate/ parliamentary hearings on tax avoidance	Starbucks & Barclays (UK), Apple (US)
	Brand impact on entire bank from tax minimisation dependant business	Barclays tax avoidance units, European offshore wealth management sector

Source: Kepler Cheuvreux

I. Regulation and tax reform

Tax regulators try to enter the fast lane

Tax avoidance increasingly challenged by governments but...

G8 keen to confront tax avoidance

In 2013 G8 leaders committed to addressing tax avoidance, with corporates in particular being in their crosshairs. Though some of the declarations may be opportunistic political rhetoric - there is no doubt that country leaders, international legislative bodies such as the OECD and EC, mainstream media, large sections of the general public and of course civil society will keep the pressure up for concrete regulatory changes. In this context the long-term looks unfavourable for companies who prioritise aggressive tax avoidance in their financial strategy.

It is not always about the headline corporate tax rate

Global corporates have a choice over what rate they pay...

...but regulators are looking to limit that choice

Below we list some of the legislative approaches that are taking place amid this global tax reform phenomenon. These include increased ease of litigation, new proposals to limit avoidance mechanisms, and increased transparency both to regulators and to the public. We note that all this is despite an overall decline in corporate tax rates globally in the last eight years, generally at the expense of other key tax instruments such as indirect taxes, which have increased and top individual rates (for OCED countries). The impacts from the examples in the table below are developed through the report with reference to both companies and countries where relevant.

...we still have an unsatisfactory global legal framework

Due to gaps in legislation, companies can claim they are following the law. However, tax has started to impact the reputation of companies by becoming more than just a compliance issue. Media reports have been aggressive in attempting to hold companies to account and the senior managers of several companies have been called before the legislature to explain their positions in relation to profits made in the respective countries and the proportionality of tax contributions: e.g. Starbucks before the UK Parliamentary Committee and Apple CEO Tim Cook before televised US Senate hearings. To a lesser extent, boycotts have been threatened against consumer-facing companies, but have not had any significant visible financial impact as of yet.

The agenda in tax reform is often two fold – though curbing avoidance is one simplification is another. And though the two can be symbiotic in reducing the possibility for misuse through fewer and increasingly harmonised standards, there is also an accompanying outcome of reducing the compliance burden on companies.

The language of tax is changing

Aggressive tax avoidance is being pushed closer to the category of "fraud" by legislators...

Politicians are using language as a tool to recast the image of tax evasion. At the EC level, one such example of this is the assigning of responsibility for "tax" and "fraud" to a single commissioner's remit, "Taxation, ***Fight against Fraud***", implying perhaps a view of taxation that is more centred on enforcement of regulation rather than being the sole privy of fiscal policymaking.

The US President, while perfectly aware that tax inversions are completely legal, labelled them with the stinging epithet "unpatriotic". Companies were quick to point to an unsatisfactory legal framework if a president resorts to the rhetoric of patriotism rather than legislation to change business behaviour. The UK Chancellor also used a similar line of rhetoric in citing the harm to the country through corporate tax avoidance.

...and labelled "unpatriotic" by political leaders

Reputation affects regulators' attitudes – not just a company's consumers

In terms of reputation we highlight that the risk is not solely consumer based. Once a global enterprise acquires a reputation for being tax aggressive there is evidence that regulators react to the reputational momentum of investigations. In the case of the media analysis of such tax investigations the fallout can extend to others within the sector on some occasions where avoidance practices are evidently shared. This is the case for Google and its peers, similarly we can see that from a televised senate hearing where Apple's CEO Tim Cook gave testimony justifying the companies tax position – there is perhaps some element of other regulators (including the EC) being emboldened to pursue Apple in Europe. One of the conclusions of the 2013 UK Salz Review into Barclays concluded the bank "may have underestimated the reputational effect of its dealings with the tax authorities, which have been another source of damage to the bank's reputation".

Reputational risk and opportunity around tax affects brand value

The mainstream brand valuation agency Interbrand, whose figures are widely used to quantify the impact of brand value on a variety of marketing and financial applications mentions tax in at least five of the companies in its most recent Best Global Brands report. Of the five significant mentions four relate to negative reputational impact. One however which fits with an urbanization megatrend notes opportunity in serving new tax collection channels: we note an increasing trend for tax to be a reputational factor where until recently it was considered a non-issue in branding terms.

Table 2: Tax issues can affect mainstream evaluations of Brand Value

	Brand Value Impact	Total Brand Value USDm	Extract from Best Global Brands report (2013)
Apple	Negative	98,316	Apples' reputation has taken a few hits this past year... a US Senate hearing examining the company's "highly questionable" tax minimization strategies.
Amazon	Negative	23,620	The issue of tax avoidance in the UK demonstrates that Amazon's expansion plans must be checked with responsibility and prudence, or it faces risks to its brand reputation
Goldman	Negative	8,536	Continuing to wrestle with negative public sentiment, the brand has been criticized for leveraging tax policy loopholes in The Volker Rule
Citi	Positive	7,973	The brand has its "Citi for Cities" initiative : A prime example is its "e-payment gateway" in Mumbai to improve the tax collection and receipt process
Starbucks	Negative	4,399	In the hot seat over corporate taxes in the UK, it remains to be seen whether this will have a long-term impact on the brand

Source: Interbrand Best Global Brands 2013

Table 3: Tax disclosure & avoidance: Key drivers of reform affecting global multinationals

Name	Type	Notes	Sector	Applicable Jurisdiction
OECD BEPS	Soft Law	OECD work to enable nation states to better implement a huge variety of measures to limit cross-border avoidance, understand new digital business models and raise standards of transparency and international harmonisation and tax cooperation	All	OECD countries focus with global impacts
EC state aid rules	Hard Law	EC investigations into nation states and potential bespoke agreements with companies on lower tax regimes that may amount to unfair unilateral advantages (fiscal state aid)	All	EU (currently Ireland, Luxembourg and Netherlands)
EC investigations into "patent box" schemes	Hard Law	EC investigations into national "patent box" schemes with low tax regimes for IP which may amount to unfair unilateral advantages (fiscal state aid)	All IP intensive sectors	EU
EC Accounting Directive	Hard Law	Country/ Project Reporting on Payments to Governments from 2016 (Review planned in 2018 may consider extension to other sectors)	Oil& Gas, Mining and Forestry	EU listed/large non listed
Dodd Frank 1504	Hard Law	Country/ Project Reporting on Payments to Governments (uncertain scope and timeframe)	Oil& Gas, Mining	US listed only
CRD IV	Hard Law	Country Reporting incl. Payments	Banks	EU
GAAR	Hard Law	A "General Anti-Avoidance Rule" can invalidate tax avoidance schemes which violate spirit of law even when technically legal	All	Multiple countries incl. US, Canada, Australia, New Zealand, South Africa, Norway, India and Hong Kong
EU Parent Subsidiary Directive	Hard Law	Amendment in 2014 closes loophole on hybrid loan arrangements where cross border intra group payments are used to benefit from double non taxation – to be implemented by 2015 year end.	All	EU
Stop Tax Inversion Act & US Budget 2015	Proposal	Proposals to limit use of inversions, e.g. by reducing tax deductibility raising percent threshold of foreign ownership	All	US
EU AML Directive	Proposal	Tightening money laundering regulations including transparency over beneficial owners via registers, reduces tax avoidance via visibility of ultimate beneficiary of entities	All	EU
Revised Adminstrative Cooperation Directive	Hard Law	28 EU Finance Ministers agreed to promote automatic information exchange as EU & International standard (OECD) – covering not just interest but also dividends, capital gains, account balances and other types of financial income from 1 January 2016, and for Luxembourg/ Austria from 2017	All/banks to facilitate	EU
G20 Tax Exchange Agreement	Proposal	2014 agreement by G20 countries to implement automatic exchange of tax information for 2017/18 (40+ countries already committed to implementation of OECD exchange standard)	All/banks to facilitate	G20/ OECD
CCCTB	Proposal	Consolidated Common Corporate Tax Base designed to allow for a single EU tax return which assigns national liabilities according to apportionment of activity/ geography, etc. Revised proposals to be presented by 2015	All	EU
Incorporation Transparency and Law Enforcement Assistance Act	Proposal	Transparency over beneficial owners via registers, reduces tax avoidance via visibility of ultimate beneficiary of entities / limitations on anonymous shell companies	All	US

Source: Kepler Cheuvreux

Avoidance versus evasion: the legal, the illegal and the grey areas

A central factor in tax controversy is the dispute over legality. Just like in any other crime, the plaintiff and defendant are likely to disagree over whether a violation has actually taken place. Aggressive tax avoidance, however, leaves prosecutors with clearer ammunition against companies in efforts to close the gap between legal avoidance and illegal evasion, in some cases retrospectively (see India M&A and transfer pricing disputes with Vodafone, etc.). In our view, a very broad level of tax reform is appearing, and, although uncertainty still exists as to extent of international agreement, almost all forms of tax regulation seem subject to increased scrutiny.

Illegal evasion and legal avoidance...with all this regulatory tightening the line gets thinner

The standards

Soft law

EC Code of Conduct (on harmful tax competition)

As a starting point, the simplest definition of unfair and potentially illegal tax competition is contained in the EC Code of Conduct recommendations: despite being "soft law", this is frequently cited when launching investigations into nation states' tax initiatives.

It's worth noting how the EC defines harmful tax competition...

...as we expect it to challenge EU member states

Companies practicing some forms of avoidance stand to lose out

Table 4: The EC tests of "harmful" tax competition

	EC Code of Conduct for Business Taxation
1	An effective level of taxation that is significantly lower than the general level of taxation in the country concerned
2	Tax benefits reserved for non-residents
3	Tax incentives for activities that are isolated from the domestic economy and therefore have no impact on the national tax base
4	Granting of tax advantages even in the absence of any real economic activity
5	The basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD
6	Lack of transparency

Source: European Commission

OECD BEPS

The wider work of the OECD BEPS (Base Erosion and Profit Shifting) programme will have an impact on companies' tax risk and tax payments through the longer-term ability to influence legislation globally both in terms of tax payment liability and tax disclosure (for example, as part of BEPS the OECD is considering the creation of a standardised country-by -country template to better assess transfer pricing).

BEPS covers a multitude of key tax avoidance mechanisms and also attempts to tackle the newly emerging area of "digital economy" business models where no permanent establishment may exist in countries where orders are transacted, and trans-nationality is the norm with almost no visibility on how cross-border business and personal data is used and aggregated to price final transactions.

Companies are also involved in BEPS consultations and business stakeholders as a whole are represented via BIAC (Business and Industry Advisory Committee to the OECD). Chambers of Commerce and industry sector lobbying bodies in the 34 OECD countries are members and coordinate representation from business.

Civil society tends to be less well represented and has criticised the BEPS outcomes for not going far enough and being limited to decision making with global impact by predominantly rich countries.

Table 5: OECD BEPS priorities

Priority	Explanation
The tax challenges of the digital economy	Addressing cross-border internet, digital value creation including treatment of location in virtual transactions, data flows and VAT
Hybrid mismatch arrangements	Neutralise arrangements exploiting differences in tax treatment of corporate entities, transfers and taxation instruments
Harmful tax practices	Improve transparency harmonisation, including work with non-OECD members
Tax treaty abuse	Prevent treaty shopping - i.e. use and negotiation for preferential offshore tax regimes
Transfer pricing & intangibles	Prevent artificial avoidance of "permanent establishment" i.e. through addressing exemptions/attribution/allocation of intangible value, etc.
Transfer pricing documentation and country-by-country reporting	A standardised country reporting template to assist transfer pricing regimes
The feasibility of developing a multilateral instrument on BEPS	Enable jurisdictions to develop a multilateral instrument to be used internationally

Source: OECD BEPS

OECD guidelines for MNEs

The OECD guidelines for MNEs contain a specific chapter (Chapter 11) on taxation applicable to corporates. They emphasise corporate citizenship, the spirit of the law, but also encourage boards to adopt strategies so that the "financial, regulatory *and reputational* (my italics) risks" related to taxation are identified and evaluated. They also mention transfer pricing, acknowledging the omnipresence of the phenomenon in global trade. In this area the "tax justice" movement is often critical of the OECDs adherence to the "arm's length" principle. The OECD guidelines acknowledge that it is "difficult both for multinational enterprises and for tax administrations and that its application is not an exact science." Some sections of civil society would like to push further and claim the concept itself is central in perpetuating tax avoidance.

It is noteworthy that cases may be brought against corporates who are seen as failing in their duties to adhere to the taxation element of the OECD guidelines; one such example is the case brought by the anti-poverty NGO War on Want against Alliance Boots in the UK, which it accuses of avoiding fair tax payments. This is a notable example of tax being as much an issue for developed nations such as the UK as emerging ones. **The argument that public services are deprived through tax avoidance applies as much in England, Scotland, Ireland and Wales as it does in Africa, Asia and South America.**

Glencore was the subject of a complaint brought by NGO Sherpa for tax avoidance in Zambia. The reputational impact continues and the government has itself recently withheld 200m USD of tax refunds for the company. With country-by-country reporting regulation under the EC Accounting and Transparency Directives, the impetus that leads to such

complaints (whether from civil society or tax authorities) may well increase with greater evidence of country contributions from the new directive.

Sustainability reporting standards

UNGC (United Nations Global Compact)

Corporate tax avoidance is not directly addressed by the UNGC. However, Principle 10 defines corruption as the misuse of power for gain in the broadest sense. The principle states "corruption in all forms" and the wider but indirect implications of tax avoidance could include denying funding for infrastructure improvements, thus compromising principles such as environmental responsibility. In a broader sense, the economic development of a country can clearly be compromised through systematic tax avoidance by a number of industries. However, once again the connections are not always straightforward. Tax avoidance can contribute to a greater occurrence of child labour and the propensity of overall human rights violations where economic drivers are present.

GRI (Global Reporting Initiative)

The Global Reporting Initiative G4 framework contains guidelines on tax reporting, as shown below, including country-level disclosure. However, no companies, not even those rated A+, can be said to fully report each item.

Table 6: Global Reporting Initiative (GRI G4): EC4 reporting criteria guidelines

a	Report the total monetary value of financial assistance received by the organisation from governments during the reporting period, including, as a minimum:	Tax relief and tax credits
		Subsidies
		Investment grants, research and development grants, and other relevant types of grants
		Awards
		Royalty holidays
		Financial assistance from Export Credit Agencies (ECAs)
		Financial incentives
		Other financial benefits received or receivable from any government for any operation
b	Report the information above by country.	
c	Report whether, and the extent to which, the government is present in the shareholding structure.	

Source: GRI G4

Finally EC1: direct economic value generated and distributed focuses on payments to governments;

"All organization taxes (such as corporate, income, property) and related penalties paid at the international, national, and local levels. This figure does not include deferred taxes because they may not be paid. For organizations operating in more than one country, report taxes paid by country".

The GRI also looks at the role of community investments. In some countries valuable work may be done through voluntary and philanthropic investments in local infrastructure and community projects. However, although a community investment presence may result in more license to operate and local goodwill, we would separate such voluntary activity from official tax payments to governments themselves, as voluntary community-level inputs do

not contribute systematically to national infrastructures and economic development at the same sustained level as a well-functioning tax base.

Regulatory developments: a country view

In opposing global tax minimisation practices the major difficulty with tax laws is that they are decided at national level: any country unilaterally implementing a tax law will need to weigh the overall potential benefits with reduced attractiveness of investment in that country. This form of tax competition means that without major blocs of countries acting in tandem, loopholes are far more difficult to close.

Tax is not a charity…

Although we are still a long way from internationally coordinated and systematic control of global corporate tax avoidance, OECD and EU implementation and very public signals of reform from a number of countries lead by key EU economies and the US suggest that a long-term change looks to be in place. The current pressure on cross-border loop holes and low-tax jurisdictions is being applied simultaneously and this suggests that the options for tax avoidance are likely to be reduced over the long term.

…but companies need and use infrastructure

US tax reforms

Inversions

Tax inversions have been at the centre of press attention and **the political and public backlash against inversion** has been strong in the last year. Many large US companies have for years taken advantage of a loophole in US tax law which allows a US acquirer to reduce its global effective tax rate by re-domiciling the combined entity in a lower-tax country. This phenomenon has been accelerated by the US laws requiring repatriation of foreign corporate cash to be taxed at the high domestic rate (the US has the highest corporate tax rate of any OECD country).

US foreign-held cash and tax inversions can sometimes go hand in hand

The three main legislative approaches aimed at limiting the attractiveness of inversions are a proposal entitled “Stop Corporate Inversions Act 2014”, the proposed US Budget for 2015 and widespread calls for a reduction in the US corporate tax rate - for which there is a general tax reform bill proposing a federal corporate tax rate reduction from 35% to 25%.

The Stop Inversions Act 2014 includes a clause that may retroactively disallow such activity from 8 May 2014, although the consensus from several surveys including one conducted by the KeplerCheuvreux pharma team indicates that retrospective implementation may not go through (due to lack of unified political appetite). The US Budget proposals would potentially apply from 1 January 2015.

Key potential regulatory outcomes include the raising of foreign percentage ownership limits from 20% to 50% for both the Inversions Act and the US Budget in order to claim the lower offshore domiciled rates. Although calls are likely to continue in the longer term for a “tax holiday”, which allows limited periods for the relocation of foreign cash at lower rates than the current 35%, this outcome seems unlikely in the short term under legislative proposals. Tim Cook, the CEO of Apple (which sits on a foreign cash pile of USD137.7bn), suggested in a Senate hearing on his company’s tax minimisation policies that a single-digit figure is appropriate.

In September 2014, a New York senator proposed a three-year window to 2017 for limitations on inversions but with a potential 20-year retrospective time frame (i.e. from 17 April 1994) for interest rate deductions to be reduced from 50% to 25%. The legislative proposal, while likely to meet significant resistance, addresses two other common concerns: intercompany transactions and interest rate reduction carry forwards, which would be restricted.

Later in the same month the US Treasury Secretary applied new rules for those inversions where foreign ownership is between 20-40%. Though the impact of the full rules remain unclear they do not apply retrospectively (before 22 September) and the primary limits are around access to foreign cash, particularly where hopscotch loans (to a foreign parent rather than US) are applied or a foreign subsidiary is spun off post inversion.

Pay what you owe before you go?

In September 2014 two senators from the democrats announced a new bill which would require settlement of US taxes before relocation could go ahead, effectively introducing an exit tax. Due to republican opposition the bill seemed unlikely to go ahead at time of writing but is a clear indication of the increased preparedness to propose legislative innovations.

US FATCA (*Foreign Account Tax Compliance Act)*

A major impact on cross-border tax information sharing has been instigated by the US authorities, who implemented a law called FATCA:

The Foreign Account Tax Compliance Act passed in 2010 requires financial institutions to confirm US citizenship of potential accountholders and collect and pass on a 30% withholding tax where status is not verified. This has meant considerable compliance expense for European banks and an increased reluctance to take on a US client base. Critics have argued that the costs of compliance with the law would be double the amount raised and be borne disproportionately by non-US financial institutions.

Table 7: US Foreign Account Tax Compliance Act

	FACTA
Jurisdiction	FATCA targets tax non-compliance globally by US taxpayers with foreign accounts
Reporting	By US taxpayers about certain foreign financial accounts and offshore assets
	By foreign financial institutions about financial accounts held by US taxpayers or foreign entities in which US taxpayers hold a substantial ownership interest
Withholding tax	30% applied by financial institutions for payments to foreign entities that do not document FATCA status

Source: IRS

Stop Tax Haven Abuse Act

This bill's proposed intention is clear from its title. If successfully passed, the act looks to raise around USD220bn over ten years by limiting a number of tax avoidance schemes, including one of the most widely used: intellectual property income transfer to offshore subsidiaries. Employment, revenues and tax payments by country would also need to be disclosed.

It would allow the US regulator to prohibit US banks from transacting with foreign banks in tax havens. It also specifically cites an intention to rectify some of the tax revenue imbalances in favour of small business and individual tax payers:

Table 8: Stop Tax Haven Abuse Act - key proposals include:

US Stop Tax Haven Abuse Act	
1	Country-by-country reporting for employment, revenues and tax payments
2	Reduce deductions on expenses related to offshore operations and reduce deferrals on offshore income generated
3	Tighten CFC rules by prohibiting offshore entities from using the "check the box" rules to defer passive income
4	Prevent use of short-term loans from offshore subsidiaries to repatriate income.

Source: US Senate

Incorporation Transparency and Law Enforcement Assistance Act

This bill, proposed in 2013, would require the disclosure of beneficial ownership for any incorporations in the US; tax evasion is mentioned as one of the reasons for the bill. The impact for companies would be potentially greater traceability of company organisation structures and ownership. Clear impacts would also be felt around money laundering and tracing proceeds of corruption.

US cash abroad

Domestically, US companies have come under fire for very large amounts of cash posted abroad, which either remain unrepatriated or are reinvested for growth, occasionally through eye-catching acquisitions. As an example, we take Google and its SEC 10-K statement on foreign cash:

"As of December 31, 2013, USD33.6bn of the USD58.7bn of cash, cash equivalents, and marketable securities was held by our foreign subsidiaries. If these funds are needed for our operations in the US, we would be required to accrue and pay US taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the US and our current plans do not demonstrate a need to repatriate them to fund our US operations."

There has been speculation that one reason for its USD1bn project for a new European HQ in London has been the incentive to spend the foreign cash pile.

The US non-profit groups Citizens for Tax Justice and PIRG studied 362 of the Fortune 500 companies, estimating a total of USD90bn of federal taxes had been avoided.

Table 9: US company cash piles abroad versus tax haven subsidiaries (FY 2013)

Company	Tax haven subsidiaries	Amount held offshore (USDm)	Tax rate paid on offshore cash	Estimated US tax bill on offshore cash (USDm)
Apple	3	111 300	2%	36 444
General Electric	18	110 000		
Microsoft	5	76 400	3%	24 400
Pfizer	128	69 000		
Merck	131	57 100		
International Business Machines	15	52 300		
Johnson & Johnson	60	50 900		
Cisco Systems	56	48 000		
Exxon Mobil	38	47 000		
Citigroup	21	43 800	8%	11 700
Procter & Gamble	32	42 000		
Google	2	38 900		
Hewlett-Packard	27	38 200		
PepsiCo	137	34 100		
Chevron	13	31 300		
Coca-Cola	13	30 600		
J.P. Morgan Chase & Co.	83	28 500	13%	6 400
Oracle	6	26 200	4%	8 000
Amgen	8	25 500	0%	9 100
United Technologies	27	25 000		
Abbott Laboratories	79	24 000		
Bristol-Myers Squibb	10	24 000		
Eli Lilly	26	23 740	0%	8 309
Goldman Sachs Group	15	22 540	17%	4 060
Qualcomm	11	21 600	0%	7 600

Source: US PIRG

Tax anomalies encourage debt financed dividends even with cash piles

The above phenomenon of foreign cash has also seen US companies such as Apple, Microsoft, Cisco, Chevron and Merck financing their dividends through debt rather than cash usage, which would mean higher levels of repatriation taxes. The tax-driven phenomenon, known as synthetic cash repatriation, has also been a factor in the increased level of debt (which grew over three times as fast in 2010-13 as cash, according to an S&P survey).

Table 10: S&P-rated universe (1,100 companies)

	2010	2013
Cash holdings	0,204	1,23
Gross debts	748	4

Source: S&P

European tax reforms

Though a proposal for a Common Consolidated Corporate Tax Base (CCCTB) has been on the cards for some time it has not materialised at EU level to present a binding framework for corporate taxation. A theoretical "one stop shop" tax return for the EU was proposed – with a single corporate tax return for the EU based on apportionment whilst continuing to allow each state to set its own corporate tax rate.

In the shorter term the greatest impact may come from EC fiscal state aid investigations – such as those into Ireland, Netherlands and Luxembourg possibly setting the precedent for companies (Apple, Fiat and Starbucks are currently named) to return payments to states where bespoke tax deals are held to be illegal. The scope of such arrangements is not clear but numerous large global listed companies may have such arrangements (particularly with Luxembourg).

France

France maintains its own list of tax havens, with the countries recently listed as below. The reason for the UK territory Jersey's potential inclusion for some months from 2013 had been the alleged non-respect of a tax information-sharing agreement. Jersey authorities had protested the inclusion on the basis that an individual is challenging Jersey's legal right to comply with the French government request for data using due process. The two French banks, SG Hambros and BNP Paribas, which maintain operations in Jersey would have been potentially impacted if Jersey had been included in 2014. The result for French transactions linked to Jersey or other tax havens on the list is that a 75% withholding tax could be applied, where full information is not provided to justify otherwise

France's list of tax havens briefly included Jersey

Banks are most affected by country tax haven "blacklists" via increased client regulatory burdens

Table 11: France's list of tax havens

1	Jersey (removed 2014)
2	British Virgin Islands
3	Bermuda (removed 2014)
4	Botswana
5	Brunei
6	Guatemala
7	Marshall Islands
8	Montserrat
9	Nauru
10	Niue

Source: French Ministry of Finance

We note also the case of UBS in France where a bail request by Paris courts for 1.1 bn EUR was demanded and upheld in September 2014 after an appeal by the bank. The charges were money laundering related as a result of assisting French clients to avoid French taxes.

UK

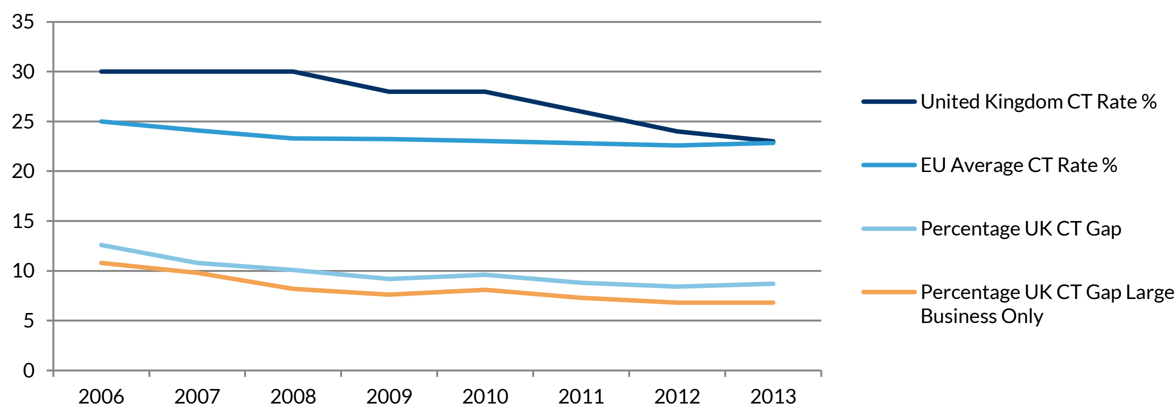
The UK tax gap alone rose by GBP1bn in 2012, up from GBP34bn the previous year. The UK HMRC attributed this to the increase in VAT to 20%, meaning overall amounts owing increased.

The gap between taxes owed and collected rose by GBP1bn in the UK in 2012

In the graph below we can see that UK corporate tax rates have been drastically lowered from 30% in 2006 to the 2014 rate of 21% (roughly converging with EU average of 21.34%). At the same time figures available for the tax gap – i.e. difference between expected and actual UK corporate tax receipts shows that large business is attributable for approx. 80% of this gap (SMEs the remainder). This large business corporate tax gap % has steadied with the lowering of the corporate tax rates if HMRC figures are correct.

Drastically lowering corporate tax rates can mean large business pays more of what is expected

Chart 1: UK Corporate Tax Rates (%) reduced progressively but CT tax gap still mainly attributable to large business



Source: Kepler Cheuvreux, HMRC, KPMG

The UK Prime Minister has been vocal in his criticism of the illicit use of tax havens; however, almost one-fifth of global tax havens are part of the UK via overseas territories and crown dependencies, according to NGO Tax Justice Network. Although the UK Prime Minister has recently spoken out in favour of certain lower-tax zones, such as the Isle of Man, adding it would be unfair to continue calling it a tax haven because of its increased international cooperation, critics regularly cite UK territories, such as the British Virgin Islands, Bermuda, Jersey and Guernsey, as being central to a variety of corporate tax avoidance mechanisms.

Strong criticism of tax havens has come from the Prime Minister of the UK...

...which is claimed to have one-fifth of the world's tax havens in its overseas territories and crown dependencies

Table 12: The UK's own tax havens

UK tax havens		
1	Cayman Islands	British Overseas Territory
2	Turks and Caicos Islands	British Overseas Territory
3	Bermuda	British Overseas Territory
4	British Virgin Islands	British Overseas Territory
5	Anguilla	British Overseas Territory
6	Montserrat	British Overseas Territory
7	Gibraltar	British Overseas Territory
8	Isle of Man	British Crown Dependency
9	Guernsey	British Crown Dependency
10	Jersey	British Crown Dependency

Source: HMRC

Although a number of US companies such as Starbucks, Amazon and Google faced controversy for UK tax avoidance earlier this year, they were not alone. Domestic companies including Barclays and Vodafone have faced negative press coverage and investigation by tax authorities both at home and abroad. NGO campaigns in the UK from ActionAid and ChristianAid have also targeted specific UK companies such as Barclays and SABMiller.

Tax breaks for relocation and establishing headquarters

However, despite such controversies and increased vocalism from the UK Prime Minister, a number of companies such as WPP, UBM and Google have actively located or are relocating their head offices in the UK, notably because of specific advantages related to taxation. The wider argument outside a potentially reduced corporate tax base includes national competitive advantages and job creation.

Public procurement and tax abuse - supplier disqualification

2013 UK regulation also allows for potential disqualification of suppliers for tax abuse. From 1 April 2013, companies bidding for government above-threshold contracts worth more than GBP2m have been obliged to self-certify that they have not been involved in certain types of tax avoidance.

This is a common concern of governments around the world, although in practice sanctions are seldom enacted. When producing statistics on company use of tax havens, the US Government Audit Office (GAO) used US government contract value as one of the five key indicators assessed.

General Anti-Avoidance Rule (GAAR)

The GAAR rule, when adopted in a country's legislation, means companies can be challenged on their tax contribution decisions even where they have followed the letter of the law but violate the "spirit", where for example a tax benefit is used in relation to a transaction of no commercial purpose.

The UK tightened its ability to navigate between tax avoidance and illegal tax evasion through this rule in July 2013. The law allows the UK tax authority to intervene on broader grounds than previously where it suspects rules have been applied aggressively against the spirit in which they were written.

Of note is that emerging markets including China, India and Chile, have raised the bar on the use of such measures.

UK Corporate and Individual Tax and Financial Transparency Bill 2013-14

UK legislation entitled **"Corporate and Individual Tax and Financial Transparency"** has been proposed that would require UK multinationals to publish accounts of all subsidiaries on public record with beneficial ownership. The UK authorities would have access rights to the companies' bank account data in all UK tax havens. If passed, the impact on both individual and corporate tax avoidance could be significant.

Tax reform can go both ways: New "controlled foreign company" rules

Governments have tightened definitions of a controlled foreign corporation or company to limit the setting up of companies in foreign jurisdictions for purposes of tax evasion. However these have been criticised as sending mixed signals as recent UK tax reform related to CFC rules will mean that financial income from tax havens will be 25% of the normal rate. A Treasury spokesman is quoted in the FT as saying, "We have got to have a system that is competitive so that businesses choose to locate in the UK".

Switzerland

We cite the view of our banks team from its report on private wealth management as a highly informed view of Switzerland's changing tax impacts;

For historical reasons, Switzerland is the biggest hub for international offshore money. The country has enjoyed long spells of political and economic stability, has remained consequently neutral during all global conflicts and offered its customers one of the tightest banking secrecy laws worldwide. In these circumstances, Swiss banks developed and nurtured a culture for private banking, which helped them become global market leaders. We believe a part of this business is breaking away and that this will alter the economics of Swiss wealth management.

Switzerland: estimated USD2.2trn assets held

The country holds an estimated USD2.2trn in assets and is one of the world's largest offshore financial centres.

The US reached a landmark deal with Switzerland in August 2013, requiring Swiss banks to cooperate with US authorities in relation to US nationals. UBS had already settled for USD780m with the US authorities in 2009. Another Swiss bank Wegelin ceased operations in 2012 after pleading guilty to assisting in the evasion of USD1.2bn in US tax-liable assets and paying USD57.8m in penalties. Fourteen other banks are currently under investigation including Credit Swiss, Julius Baer and HSBC.

A commitment by Swiss authorities to restrict tax breaks for foreign holding companies was reached mid October 2014 with pressure from EU finance ministers. This came in line with Ireland's commitment to phase out its double Irish loophole allowing Irish registered companies to domicile in tax havens. We expect further examples where multiple announcements of country restrictions of avoidance mechanisms lead by the EU– where the leverage of applying pressure to multiple countries simultaneously may strengthen the case for changes which more international in their scope and therefore more likely to be effective.

Weaker agreements like Rubik show the risk of becoming defunct quickly in the current environment

The Rubik project initiated by Swiss authorities currently involves British and German governments, but has not been successful, and has been widely attacked by campaigners. Ultimately, it allows secrecy to be preserved in return for the retention of a 50% withholding tax; however, a number of loopholes have meant that the actual revenue raised may be substantially lower than official estimates (e.g. The Tax Justice expects 10% of UK government estimates of GBP4-7bn).

Negotiations are ongoing in order to implement automatic information exchange agreements between Switzerland and the EU (mandate adopted by Federal Council October 2014) with a view to the first exchange of information in 2018.

Netherlands

The Netherlands is widely used by global organisations for tax planning through specific low-tax regimes related, for example, to intellectual property and hybrid loans.

Dutch NGO SOMO released a study in 2013 around double taxation agreements signed with developing nations. It argues that these DTAs are misused to go well beyond the intention of avoiding dual taxation and effectively fuel the use of tax avoidance vehicles for global enterprises locating subsidiaries or even "mailbox companies" in the Netherlands.

The country recently announced a proposal for the renegotiation of tax treaties with 23 developing countries with the introduction of provisions to increase transparency, information-sharing and fraud avoidance measures.

Table 13: Netherlands reforms proposed for less developed countries' tax treaties

1	Increased anti-fraud provisions
2	Information-sharing with developing countries for Dutch "tax rulings"
3	Crackdown on letterbox companies: all companies to meet "substance demands": i.e. have capital, board members, employees, etc., to use Dutch tax treaties

Source: Newswires

However it is the subject of EC fiscal state aid investigations based on the creation of harmful tax completion – its agreement with Starbucks Manufacturing EMEA BV is under scrutiny regarding transfer pricing assessments.

Ireland

Tax developments in Ireland since 2013 illustrate clearly how reputational risk is emerging at country level around tax haven associations and furthermore how these associations spill over into company impact (i.e. via potential liabilities for Apple as a result of EC state aid investigations).

Reputatonal risk can carry from country risk on to company business risk

Ireland has held parliamentary hearings into possible reforms of its corporate tax arrangements, following significant criticism. In May 2013, for example, Ireland was cited as having allegedly structured a deal with Apple in order for the company to avoid US taxes. Apple's rate of tax in the country is reportedly 2% (statutory rate is 12.5%) and an EC report has stated that the company paid 3.7% tax on non US profits overall in 2013.

Use of Irish subsidiaries by global business for tax purposes is well established...

...so the corporate fallout from the legislative changes in Ireland typify the complex and uneven movements in global tax reform

In September 2013, the EU began an investigation into alleged "sweetheart deals" by Ireland, Luxembourg and the Netherlands. If it rules against such structures, the companies involved could be forced to repay taxes - especially if competition is found to have been significantly distorted as a result of favourable tax treatments under "state aid" rules. Apple, Starbuck and Fiat are the subject of investigations into the use of Dutch, Irish and Luxembourg transfer pricing mechanisms. In September 2014, the EC opened a formal investigation into Apple's arrangement with Ireland for the period 1991-2007.

EU state aid investigations have the power to demand that companies repay tax if country agreements are found to be anti-competitive

In October 2013, Ireland's finance minister promised a new finance bill to ensure that Ireland-registered companies cannot be "stateless" for tax purposes (Apple had faced allegations of achieving the "holy grail of tax avoidance" in such a way). The proposal is expected to be implemented in January 2015. Faced with further EC investigations specifically into the Double Irish mechanism, in October 2014 the government announced new proposals to phase out the "Double Irish" loophole by deeming all Irish registered companies as tax resident in Ireland. The use of the Double Irish mechanism will be phased out over four years but new tax breaks around R&D will be introduced. A corporate tax rate of 12.5% however has been declared as remaining firmly in place by the Finance Minister.

Lichtenstein

The country promised to sign a global tax agreement, the OECD Multilateral Convention non Mutual Administrative Assistance in Tax Matters, in November 2013. The country would therefore also participate in a future automated exchange of tax information. The effect of the US FATCA has also been a potential motivator, with Lichtenstein being pushed to begin implementation on FATCA compliance by the end of this year.

Sweden

Corporate tax rates were lowered in this country 2013 to 22% from 26.3%. However a simultenous legislative change was passed to restrict intercompany interest payments. A common financing approach has been to put equity and cash stakes into Belgium and deduct interest against equity with Swedish operations making payments to the Belgian unit. As a result of these changes for example Husqvqrna has seen its effective tax rate increase. A proposal was submitted 2014 that interest should not be tax deductible at all but the corporate income tax rate could be further lowered still. Some of this movement in tax reform foregrounds simplification of regulation as well as closing avoidance loopholes.

NGO Swedwatch analysed in detail the tax disclosures of Ericsson, SKF, Atlas Copco and Sandvik in a 2013 report. Though not concluding any illegal tax evasion or unethical practice for these four major Swedish companies the study highlighted the difficulty of understanding specific tax practices and impacts in a country of concern - Zambia - where information was insufficient.

Domestically however Sandvik has felt cash flow impacts when it was the subject of investigation around profit shifting using allegedly under-priced intellectual property rights, and in Q3 2013 was required to pay 5.8bn SEK to Swedish tax authorities, following a dispute around its 2005 IP reorganisation.

European companies with disputes in India

India has been the source of a number of tax disputes involving foreign companies including Vodafone, Nokia, Shell and SABMiller, among others. While acquisitions have often been a source of the dispute – i.e. two foreign entities conducting M&A within the Indian market, royalty fees are also emerging as a potential area of risk.

For the large number of foreign companies that have established profitable operations in India, a recent trend has emerged with the Indian subsidiary paying increased royalty fees to the parent following a relaxation of India's laws. However, such fees can be subject to political decisions, which mean the payments are not sustained. A number of European companies, including Unilever, ABB, Bosch, GSK, AkzoNobel and Alstom, have significantly raised their royalty payments to the parent company in recent years. India announced in 2013 that royalty payments would be subject to increased taxes from 10% to 25%.

Estonia: Shifting taxation of profits to the moment of distribution

At the outskirts Estonia has introduced a unique corporate tax regime via its e-resident program which shifts the moment of corporate taxation from the accounting period in which it was earned to the moment of its distribution to shareholders.

But what's the *fiduciary* duty in regard to tax payments?

Responsibility to maximise shareholder return

Companies have long used the argument of fiduciary duty to emphasise that a primary obligation is to ensure taxes are minimised. A 2011 tax policy by WPP states this as a clear priority: it foregrounds the need to pay the "legal" amounts owed. Tax is not charity, even though we have seen a recent voluntary contribution by Starbucks to the UK government.

Tim Cook, CEO of Apple, stated at a US Senate Hearing in April 2013 on the company's tax practices that minimising taxes within the law was a fiduciary duty towards his company's shareholders.

Similarly in a recent case on pension funds' use of tax avoidance mechanisms, a spokesman for APG was quoted saying the following on fiduciary duty to beneficiaries:

"We have a fiduciary duty to our millions of pension scheme members to try to reduce our costs. [...] If we paid higher taxes than required, then we may be sued by them for breaching that duty."

This case stemmed from allegations by union syndicate UNITE (UK), which accused the Canadian CPP Investment Board (CPPIB) and APG of aggressive tax avoidance in a 50% holding in a shopping centres project – Westfield Stratford City in the UK – and of having an effective corporate tax rate of 0.5%. The funds state that the low rate was applicable for the first year due to tax deductible losses and point out that 1,000+ jobs were created through the project.

We would expect further challenges on the basis of fiduciary duty to come from civil society in future years, though shareholder suits may also emerge as a result of tax avoidance litigation.

There are numerous such examples of companies declaring responsibility to various stakeholders (including fiduciary responsibility) in reducing their tax payments. For example, in response to criticism of General Electric's tax practices, GE's 2010 Citizenship Report emphasised that the company "*fully compl[ies] with the law and there are no exceptions*," but at the same time acknowledged that it has "*a responsibility to [its] shareowners to reduce [its] tax costs as the law allows*."

These pleas are often accompanied by a reminder that no illegal acts have been committed and that the burden should be on the government in setting the legal frameworks. Counter arguments, primarily from civil society and the popular media are based on the asymmetry between the largest companies and the ability of nation states or indeed international agreements to cope with the amorphous and readily transferable capital of transnational corporate activity.

The NGO Tax Justice Network, in conjunction with law firm Farrer & Co, published a legal opinion stating that there is no fiduciary duty for companies to minimise taxes, as no obligation exists under English law for UK company directors to minimise tax payments on behalf of shareholders; and in fact good arguments exist for the reverse (see Companies Act 2006 s172 - page 77):

"The proposition that there might be a strictly "fiduciary" duty to avoid tax is wholly misconceived."

Nevertheless, the larger global legal practices might add that, although there's no fiduciary duty to minimise taxes, there's no "legal duty" to pay more than necessary either. The overall context of fiduciary duty, however, would need to adapt to a changing business environment where, as the concrete impacts on certain businesses emerge, the need to adapt to those upgraded regulatory and reputational pressures increases in the longer term. Walgreens is one such example where the board of the company has in fact faced shareholder consternation that it did not go ahead with a European inversion to minimise taxes as it reacted to a changing regulatory environment and consumer-facing risks of reputation over a time frame including the next couple of quarters and beyond.

Who defines tax havens?

Key characteristic: lower standards of transparency or less "red tape" depending on stakeholder view

A tax haven has one essential characteristic: secrecy. Visibility on an accountholder's identity in the territory is difficult to gain due to legal protections or lack of information-sharing agreements with other territories. A number of countries, international bodies and NGOs have their own definition of tax havens. Here are some of the key features:

Table 14: Characteristics of tax havens

1	Various low tax rates
2	Ease of company incorporation
3	Business-friendly regulatory environment and lack of legal challenges
4	Lower levels of financial transparency
5	Continued ability to use specific tax avoidance structures

Source: Kepler Cheuvreux

Table 15: A tax haven does not just mean tax avoidance

Reasons to use tax havens: an NGO angle	
1	Avoid tax (legal)
2	Evade tax (illegal)
3	Secrecy (avoiding transparency)
4	Regulatory (to side-step regulations controlling financial services or monopolistic practices)

Source: Christian Aid

Crucially, a tax haven can also be known as a "secrecy jurisdiction", meaning that a variety of other uses can be served outside tax avoidance; specifically, lower levels of regulation, administrative burdens and reporting. The social implications of all of the above are usually negative, as overall visibility and accountability in relation to stakeholders is vastly reduced.

An EU tax haven list: work in progress

The European Commission is currently working to consult with member states into 2015 with the objective of collating an EC-wide list of tax havens. Criteria will build on pre-existing OECD standards on transparency and exchange of information agreements but will add the EC Criteria for harmful tax competition applicable to countries.

The OECD lists: black, white and grey

Currently no countries on the black list, but three on the grey list...

Currently, there are no countries on the OECD's official black list. Three small territories remain on the grey list, which highlights countries where the implementation of bilateral tax agreements is not complete: Nauru, Niue and Guatemala. As a result, these countries reappear on a number of other lists despite having little known activity compared with other much larger secrecy jurisdictions.

The OECD has maintained different lists of tax havens but the key criterion for being removed from the list of "uncooperative jurisdictions" is to have at least 12 TIEAs (tax information exchange agreements) with other countries.

...while some European countries have faced embarrassing questions

Countries including Belgium and Luxembourg, have been briefly cited for categorisation as tax havens, but were able to avoid inclusion on an OECD list in 2010 through new commitments to OECD agreements (including information sharing). Although all are currently white-listed, their potential inclusion has caused embarrassment for the governments concerned.

A bank defines tax havens:

Société Générale, for example, in defining its tax policy noted four key characteristics of a tax haven and pledged not to operate in regions on the official French list. The Philippines and Brunei were therefore previously absent from its regions of activity. Such references are important in our view as when taken with any country reporting that may emerge to detail activities in all global locations (especially through EU CRD IV regulation), could lead to situations where such definitions are used by civil society to challenge banks.

Table 16: Société Générale's definition of a tax haven

1	Jurisdiction imposes no or only nominal taxes, whilst recognising that every jurisdiction has the right to determine its own tax rate.
2	There is a lack of transparency in the application of the law under similar circumstances.
3	There is a lack of any local, substantial activity.
4	There are laws that prevent the effective exchange of information for tax purposes with other governments.

Source: Societe Generale CSR Report

A company view: Stora Enso disclosure on tax havens

We also highlight Stora Enso's tax disclosure. Its sustainability report seeks to explain the use of certain tax breaks and secrecy jurisdictions to reassure stakeholders of their legitimacy. It takes a certain amount of confidence for companies to state such disclosures publicly – particularly when they declare that tax haven locations are not being used for tax planning purposes – as they leave themselves open to challenge. We therefore welcome such transparency as a starting point for investors to engage.

Table 17: Stora Enso's explanation of some tax breaks, and tax haven locations

	Stora Enso: transparency on favourable tax treatments
Enterprise zone tax break	Our joint venture Montes del Plata will start running a pulp mill in a Special Economic Zone in Uruguay in 2014.
Tax haven mechanism	Pulp from our joint venture Veracel in Brazil is traded via a pulp sourcing and marketing company based in Amsterdam.
Location in tax haven	Stora Enso owns 51% of a holding company in the British Virgin Islands. This holding company came into the group's ownership structure with the acquisition of the Inpac International packaging company in July 2011. The holding company does not practise any operating or financing activities, and Stora Enso does not make any tax savings by owning this company.
Tax haven location	Stora Enso holds two companies in Luxembourg and a company in United Arab Emirates. None of these companies is used for tax planning purposes.

Source: Stora Enso CSR Report 2013

Using the Financial Secrecy Index

The **Financial Secrecy Index,** issued by NGO Tax Justice Network, provides a comprehensive view of the major countries facilitating tax avoidance as the organisation includes a number of additional contextual factors in its index.

Most notably, the index includes the US, Germany and the UK despite neither being traditionally associated with tax havens (see the following section for explanation).

The FSI includes 15 questions to assess transparency (for beneficial ownership and corporates), the efficiency of tax and financial regulation, and international standards and cooperation. For this reason, in our view, it is particularly relevant for sustainable investors and can be integrated in any approach to country risk which takes into account ESG factors.

The final FSI score (first column below) includes both the secrecy of the jurisdiction and the relative size of the territory, which can serve as a useful approach for investors to measure the relative importance and risk.

Corporate tax rates do not tell the whole story

Although some countries have a zero corporate tax rate, we note that there may be no connection between a higher official corporate tax rate and the position of the country. For the US, which has the highest official CIT of any developed country, the effective tax rate is far lower due to the widespread use of a variety of legal tax avoidance mechanisms.

Table 18: Country indicators, the Financial Secrecy Index goes well beyond taxation - for good reason

Secrecy indicator	Summary criteria
1. Banking secrecy	Relevant information about the beneficial owners of bank accounts must be recorded, verified and maintained & is readily accessible
2. Trusts and foundations register	Jurisdiction publishes details about the various parties to trusts and/or private foundations in a central register which is publicly accessible
3. Recorded company ownership	Jurisdiction requires all limited liability companies to submit beneficial ownership information upon incorporation to the relevant governmental authority, and to keep it updated
4. Published company ownership	Company beneficial and legal ownership accessible over the internet for less than USD10/EUR.
5. Published company accounts	Reviews whether the financial statements of each type of company with limited liability are accessible online again for less than USD10/EUR.
6. Country by country reporting	Asks if countries require companies to submit and publish certain financial data on a country-by-country basis.
7. Fit for information exchange	Explores whether resident financial institutions and companies have to report to their local tax administration information on all interest and dividend payments to all non-residents
8. Efficiency of tax administration	Whether the local tax administration uses taxpayer identifiers for efficiently analysing information, and whether there is a dedicated unit for large taxpayers
9. Avoids promoting tax evasion	Indicates whether the jurisdiction facilitates tax avoidance and encourages tax competition. This is assessed through a special methodology
10. Harmful legal vehicles	Assesses existence of 1) protected cell companies - that contain within itself a number of cells which behave as if they are companies in their own right, but are not 2) 'flee clauses,' where a trustee can quickly relocate the trust from one secrecy jurisdiction to another as soon as anyone comes looking for information
11. Anti money laundering	Examines the extent to which the jurisdiction's anti-money laundering regime is considered effective by the Financial Action Task Force (FATF)
12. Automatic information exchange	Registers whether or not the jurisdiction participates in multilateral automatic information exchange on tax matters via European Savings Tax Directive (EUSTD)
13. Bilateral treaties	Signed and ratified the Amended Council of Europe / OECD Convention on Mutual Administrative Assistance in Tax Matters. Whether the jurisdiction has signed sufficient treaties conforming to the OECD's 'on request' standard of cross-border information exchange
14. International transparency commitments	Conventions signed: 1) Amended Council of Europe / OECD Convention on Mutual Administrative Assistance in Tax Matters 2) The 2003 UN Convention against Corruption 3) The 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 4) The 1999 UN International Convention for the Suppression of the Financing of Terrorism 5) The 2000 UN Convention against Transnational Organised Crime
15. International judicial co-operation	Measures the degree to which a jurisdiction engages in international judicial cooperation on money laundering and other criminal issues, based on FATF assessments

Source: TJN

Table 19: Financial Secrecy Index by tax justice network

RANK (out of 82)	Jurisdiction	FSI-Value	Secrecy score	Global scale weight	Corporate tax rate 2013
1	Switzerland	1 765,3	78	4,916	18.01
2	Luxembourg	1 454,5	67	12,049	29.22
3	Hong Kong	1 283,4	72	4,206	16.5
4	Cayman Islands	1 233,6	70	4,694	0
5	Singapore	1 216,9	70	4,280	17
6	US	1 213,0	58	22,586	40
7	Lebanon	747,9	79	0,354	15
8	Germany	738,3	59	4,326	29.55
9	Jersey	591,7	75	0,263	0
10	Japan	513,1	61	1,185	38.01
11	Panama	489,6	73	0,190	25
12	Malaysia (Labuan)	471,7	80	0,082	25
13	Bahrain	461,2	72	0,182	0
14	Bermuda	432,4	80	0,061	0
15	Guernsey	419,4	67	0,257	0
16	United Arab Emirates (Dubai)	419,0	79	0,061	55
17	Canada	418,5	54	2,008	26
18	Austria	400,8	64	0,371	25
19	Mauritius	397,9	80	0,047	15
20	British Virgin Islands	385,4	66	0,241	#N/A
21	United Kingdom	361,3	40	18,530	23
22	Macao	360,5	71	0,108	12
23	Marshall Islands	329,6	82	0,022	#N/A
24	Korea	328,8	54	0,978	24.2
25	Russia	325,3	60	0,318	20
26	Barbados	317,5	81	0,021	25
27	Liberia	300,9	83	0,014	#N/A
28	Seychelles	293,5	85	0,011	#N/A
29	Brazil	283,9	52	0,768	34
30	Uruguay	277,5	72	0,040	25
31	Saudi Arabia	274,2	75	0,028	20
32	India	254,6	46	1,800	33.99
33	Liechtenstein	241,0	79	0,011	12.5
34	Isle of Man	237,3	67	0,049	0
35	Bahamas	226,9	80	0,009	0
36	South Africa	209,8	53	0,260	28
37	Philippines	206,7	67	0,033	30
38	Israel	205,9	57	0,132	25
39	Netherlands	204,9	50	0,430	25
40	Belgium	199,3	45	1,031	33.99
41	Cyprus	198,9	52	0,264	12.5
42	Dominican Republic	193,8	73	0,012	29
43	France	191,0	41	2,141	33.33
44	Australia	168,2	47	0,394	30
45	Vanuatu	165,0	87	0,002	0
46	Costa Rica	157,6	71	0,008	30
47	Ireland	155,5	37	2,646	12.5
48	New Zealand	151,4	52	0,126	28
49	Gibraltar	147,8	79	0,003	10
50	Norway	142,8	42	0,667	28

Source: Tax Justice Network, KPMG&PwC for Corporate Tax Rates

Why are the US, Germany and the UK high on the FSI?

US

The US scores poorly for several reasons, but mostly due to its global scale weight, where it clearly has a dominant influence on trade and international transactions. The US scores especially poorly for its transparency on beneficial ownership and corporate disclosure. Further notes of concern are state level tax avoidance and secrecy facilities: Delaware state regulation, for example, allows a company to be incorporated in the state with a very

low threshold in terms of transparency, reporting requirements and ownership, according to Tax Justice Network.

UK

The UK would be at the top of the FSI list, if its offshore-related jurisdictions such as overseas territories were included.

As well as having a large global scale weight (the UK commands 18% of the global offshore services market), London, as a financial centre, frequently raises concerns about the international facilitation of tax avoidance, not least for forwarding low tax structures to key UK-related territories listed in the Top 20 above.

Besides the network of 20 global British crown dependencies, overseas territories and privy council jurisdictions, the key negatives for the UK in its secrecy rating stem from a lack of legislation requiring a register of beneficial ownership, the public disclosure of company ownership, and also the requirement to inform authorities of payments to non-residents.

Germany

Germany frequently surprises with its top-ten position, but the major driver is the size of its financial centre, Frankfurt. It also scores negatively on regulation related to beneficial ownership, corporate transparency regulation, information exchange and the efficiency of tax administration.

The above ratings could be used in ESG sovereign rating approaches as an indicator of the sustainability measure of tax approaches for the country; particularly on how global flows of illicit capital may be facilitated.

Tax avoidance: how it's done

A variety of tax avoidance mechanisms exist. We look at some commonly used ones including transfer pricing, hybrid instruments and intragroup transfers. These tend to have elements where a secrecy jurisdiction is used within a cross-border structure, and, in common with every avoidance mechanism, full details are not available to investors via disclosure.

Use of *tax havens* is systematic

Complex cross-border tax avoidance mechanisms

Furthermore, where information does exist – for example, through company registrars – the findings from another NGO survey suggest that even where issues regarding transparency over organisational structure can be overcome, use of secrecy jurisdictions is prolific. A survey by Action Aid in 2011 found that 98 FTSE100 companies used tax havens, with the banking sector holding the highest proportion of tax haven incorporated companies.

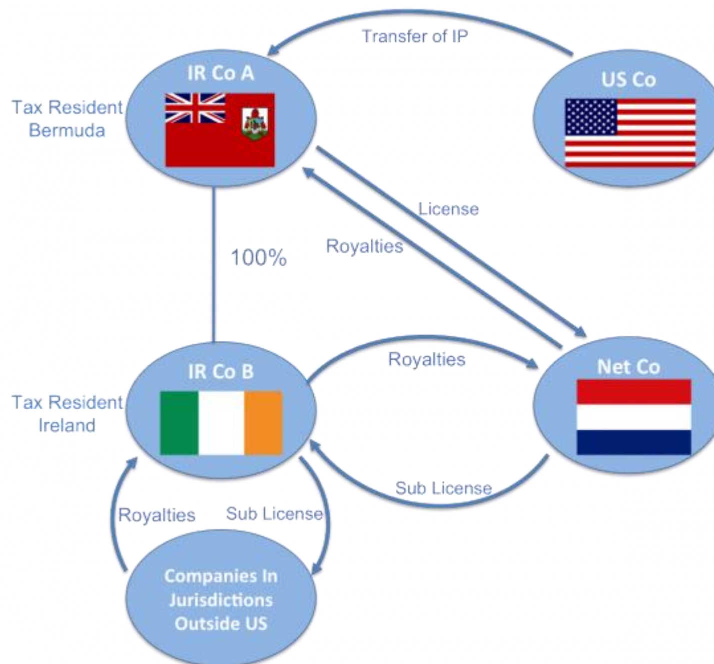
A number of cross-border tax avoidance instruments exist, many of them highly complex and administered by specialist tax avoidance divisions on behalf of corporates. The common factor in most of these is the shifting of profits from a higher tax jurisdiction to a lower one, almost always using a tax haven as an intermediary or final destination.

Table 20: Two common corporate tax avoidance structures dependent on tax havens

Ireland: "Double Irish" (phased out through to 2020)	Two companies are incorporated in Ireland, one of which is tax-resident in Ireland and pays royalties to the other for use of intellectual property. This royalty becomes tax-deductible for the Irish-resident company but the payment received goes to the company that is resident in another lower-tax jurisdiction such as the Cayman Islands
Netherlands: "Dutch Sandwich"	Additionally to the above scheme based in Ireland, the second company's revenues are booked in the Netherlands, to further reduce the tax payable

Source: Kepler Cheuvreux

Chart 2: Double Irish and Dutch Sandwich mechanisms



Source: CMS Bureau Francis Lefebvre

Intellectual Property: Tax planning is embedded in valuation

IP Holding companies are commonly created to reduce tax liabilities – where a parent creates a subsidiary in a tax jurisdiction with preferential treatment of IP. Assets are transferred at "fair market value" - however the assessment of FMV can be highly contentious particularly around the area of allocating relative profit contributions of IP and establishing comparable transactions in order to comply with the arm's length pricing conditions. This principle requires that pricing occurs at the level comparable to that between unrelated parties who are independent and knowledgeable.

Intragroup transactions can be problematic for investors due to the lack of transparency

Financial value attributed to brands includes its patents...

...and patent value often leverages tax minimisation

Licensing agreements are created so that royalties must be paid between the companies but the holding company should have "significant" business activity in order for the Group to benefit fully from the tax incentives. The royalty income for the IP Holding company can often be subject to 0% tax rates whilst simultaneously reducing taxable income for the parent.

Often intra-firm or intragroup transactions will have little visibility for the external stakeholder and can form the base for tax minimisation together with transfer pricing and a number of other mechanisms potentially used for avoidance. In practice, the charges are subject to challenge by state authorities and have resulted in a number of major global cases against corporates, including a USD3bn+ settlement by pharma company GSK in the US in 2006 and an ongoing dispute over USD2bn+ of payments in India by Vodafone, related to a major local acquisition in 2007. Most large US-based companies in the tech and software sectors have had disputes regarding under-pricing, including Amazon, AOL, Microsoft, Yahoo, Apple, Adobe, HP and Google but the litigation risk applies to any sectors (anything from retail to capital goods) which have IP asset portfolios.

Estimating "arm's length" transaction value can be highly contentious

However not all cases bought by governments are successful. A long running dispute over Fortum OYJ's use of transfer pricing in Belgium has resulted in a 2014 court of appeal ruling that authorities in Finland must return a disputed amount of 136m EUR to Fortum.

Table 21: Common factors underlying transfer pricing cases

Indicators	Tax minimization Mechanism
Significant Inter Company Transactions	Sales and purchases within the group using advantageous transfer prices
	Intercompany transactions very rarely publically disclosed – and therefore beyond scrutiny
	Sometimes transfer price references pre negotiated for fixed timeframes by tax consultants (often Big4) using Advanced Pricing Agreements (APA) with tax authorities
High Royalty Rates	A low tax country subsidiary receives royalty payments from a higher tax jurisdiction
Repeated losses - especially those in higher tax subsidiaries	Losses can be potentially used for further tax advantages

Source: Kepler Cheuvreux

Social Impacts of Transfer "mis"pricing are huge

The NGO Global Financial Integrity estimates that transfer "mispricing" practices costs developing countries USD100bn each year (Christian Aid puts it higher, at USD160bn) and although transfer mispricing can negatively impact mature economies, the systematic damage to infrastructure and governance development in underdeveloped countries is more obvious

Hybrid instruments

These allow loans to be transformed into equity under certain conditions. They can be structured specifically with the objective of reducing tax liability in multiple jurisdictions. Their use is widespread and EU proposals announced November 2013 seek to make their use to reduce tax through cross-border organisational structuring more difficult. If successful, it is estimated that corporate tax payments to EU countries would be increased by the billions. The OECD has addressed the use of these instruments in detail in an attempt to reduce the use of "double non taxation".

Hybrid mismatch arrangements are an OECD BEPS priority

Shell companies: a primary suspect?

Shell companies do not have substantive assets, operations or employees, but serve as vehicles for transaction flows. Although they are not intrinsically illegal, a variety of tax avoidance vehicles make use of such shell or letterbox companies (see Netherlands).

US tax avoidance cases against Swiss banks, including UBS and Wegelin, alleged that clients used shell companies in order to structure US tax avoidance vehicles.

Beyond this, corruption cases often reveal the use of shell companies in jurisdictions such as the Cayman Islands in order to leverage maximum secrecy. In a bribery case, it was alleged that BAE Systems used shell companies in the UK, including the British Virgin Islands, to complete illicit transactions.

Beneficial owners

In rare cases there is an overlap between fraud and tax avoidance: ENRON paid no income tax in four out of five years before its bankruptcy after fraud-related charges and created 881 subsidiaries, the majority of which were in Caymans and other tax havens. Part of the issue here is identifying the beneficial owner of certain subsidiary structures - especially where shell companies are used - that may carry off balance sheet assets and may never be declared in any public report and carry names unrelated to the underlying company that generates the structure. Although of primary interest in combatting fraud, corruption and personal tax evasion regulation from certain countries such as the US and the UK have recently proposed a tightening of registration and disclosure requirements. The criteria are central to country rankings on the Financial Secrecy Index.

Domicile: location of corporate headquarters

A number of Ireland-domiciled companies are attractive as acquisition as a result of the potential lower tax status they can bring to the acquirer – via for example "inversions". Medtronic's acquisition of Coviden is one such example. Similarly, companies such as WPP and UBM moved away from Ireland after initially locating there in 2008; going back to the UK after the new UK coalition government changed regulations on the taxation of foreign subsidiaries in 2012.

In a document entitled "Corporate Headquarters in Luxembourg", KPMG lists several favourable tax advantages in Luxembourg as well as companies such as ArcelorMittal, Cargolux, Intelsat, Metro, Microsoft, Pfizer and Tenaris which moved there. We highlight the key advantages in the document to indicate the extent of potential enticements.

Table 22: Why relocate to Luxembourg?

Taxation Area	Incentives
64 Double Tax treaties	Mitigation of taxation on foreign source income
90 Investment Protection Treaties	Economic and legal protection of Investments
Low exposure to withholding taxes	Low impact of withholding taxes
Low VAT rates	Low VAT rates and no VAT pre-financing
Investment tax credits	Luxembourg offers investment tax credits to encourage companies to invest in their fixed assets.
Customised incentives	By offering companies a full range of customized incentives, for local development strategies
Advantages of the Luxembourg participation	Favourable tax regime for dividends , capital gains and liquidation proceeds exemption
A tailor-made IP location	Exempting from Luxembourg income tax 80% of net royalties and capital gain derived from qualifying IP rights including, among others, patents, trademarks/service marks, design/models, internet domain names and software copyrights relating to standard software
Absence of capital duty and tax transfer	Capital duty was abolished in 2009 and had been replaced by a lump sum registration fee of EUR 75
Favorable tax regime for expatriates	Specific tax provisions related to highly skilled workers relocating to Luxembourg

Source: KPMG

Organisational and subsidiary structures

Where tax havens and corporate tax payments interconnect

Although legislation to reduce tax haven secrecy and the implementation of cross-border corporate tax structures can be entirely separate legal propositions, they do overlap in the specific tax mechanisms that a country allows to be used within its territories and its overall tax rate. Here, the two areas of corporate tax avoidance and tax havens come together.

Visibility on organisational structure is poor

Do companies deliberately locate subsidiaries in some countries solely for tax planning?

At the heart of this interconnectedness between the two is the deliberate location of subsidiaries in countries that explicitly allow, or even encourage, corporate tax avoidance mechanisms to be used or simply have low rates of applicable taxation. The vast majority of companies, for example, might have little actual economic activity in Luxembourg, but any sample of large-cap companies typically have at least one subsidiary located there. Beyond this, however, as there may be no explicit legal requirements to list all foreign non-material subsidiaries - let alone revenues, income, taxes paid and employee numbers - we may have no visibility on the actual number of subsidiaries and the real uses to which they are being put. The major controversies covered in the media including Starbucks, Google, Amazon, Apple and Microsoft all included reference to disproportionate use of Luxembourg as a low tax country.

A survey by the NGO Transparency International 2012 entitled "*Transparency in Corporate Reporting (TRAC)*" found that only 45 out of 105 of the largest companies globally do disclose material subsidiaries (i.e. using the SEC definition, those with 10% ownership or above); however, it is at the non-material subsidiaries, which are rarely disclosed, that tax avoidance issues may occur. Although this NGO specialises in corruption, these findings have very real implications for potential tax transparency.

More evidence that public NGO campaigning can influence regulators...

As a whole, the focus on subsidiary disclosure has tended to come from civil society – through NGOs such as Global Financial Integrity (GFI), the Tax Justice Network and ActionAid. The last of these, ActionAid, has been prominent in analysing UK companies' disclosure habits. And the findings of its FTSE100 subsidiary disclosure survey shows that despite the UK Companies Act 2006 requiring geographical domicile of all subsidiaries to be stated, this was often not done in practice, with over 50% of companies failing to publish full information (without which we cannot ascertain the potential harmful use of tax havens). Where this campaign demonstrated effectiveness was in the very specific regulatory follow up enlisted (as a result of political traction) where within two years of the initial campaign. By 2013, almost all of the 124 out of the 290 companies required to disclose that had not did so.

In the chart below we show an extract of the declaration from oil & gas company, Maurel & Prom. It flags "companies with no immediate activity" including for example one in the Netherlands and two in the Bahamas. However, these are also found in France – the home country of the company. Although an indication of the structure is critical for investors, in our view, as it shows the potential for routing of transactions for tax avoidance purposes, we cannot draw conclusions from such a disclosure, particularly as the use of some offshore jurisdictions and a number of "tax havens" is embedded in the corporate structure and financial operations of almost all multi-national companies and certainly in extractives.

The regulatory relevance of such disclosure is increasing - we note the OECD BEPS Country reporting template to be used in transfer pricing which requires the activity of a subsidiary to be stated.

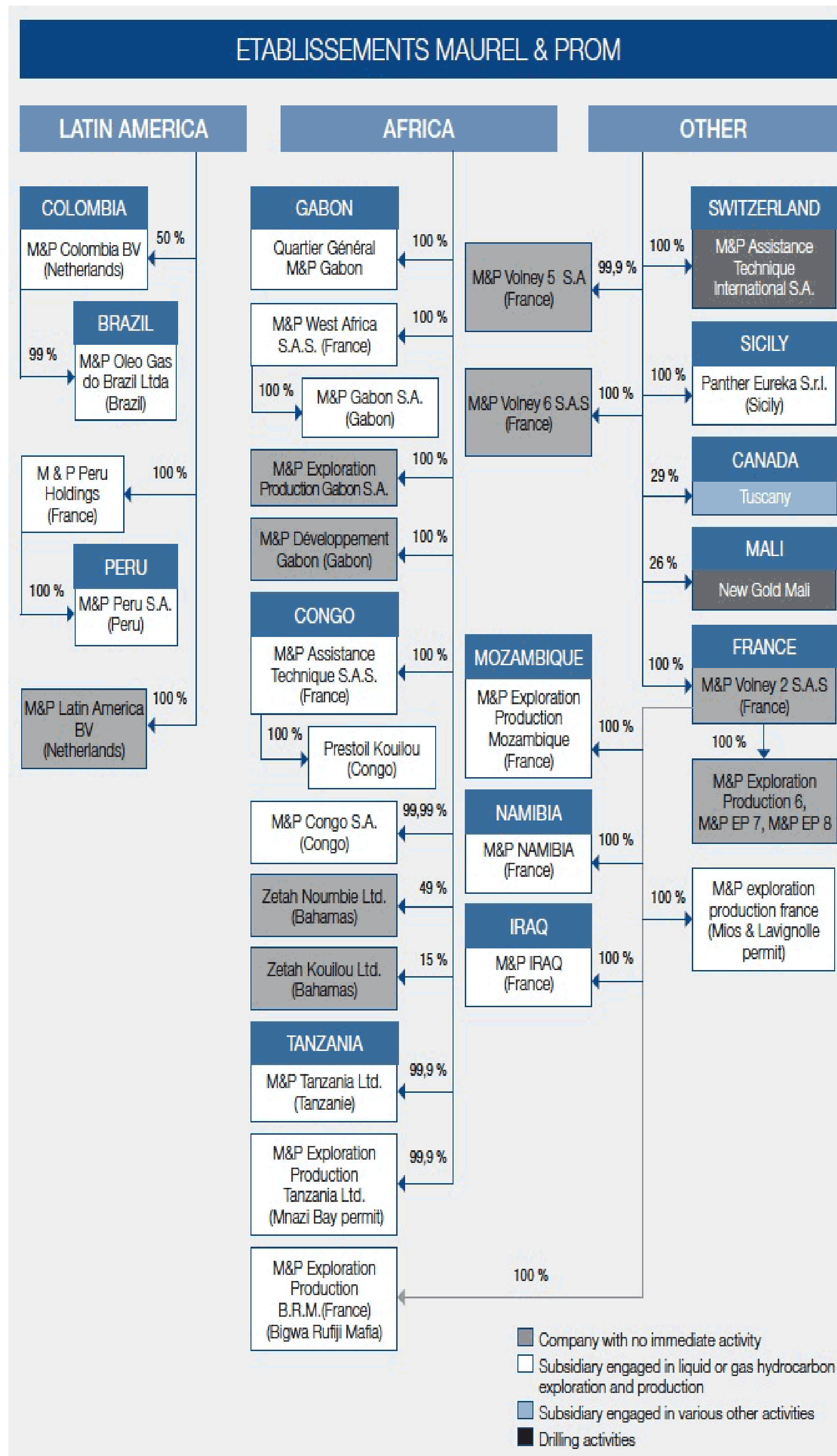
Table 23: OECD BEPS Transfer Pricing Country Reporting Template

Required Classification of Business activities	
A	R & D
B	Holding intellectual property
C	Purchasing and Procurement
D	Manufacturing and Production
E	Sales, Marketing and Distribution
F	Administrative and Support Service
G	Finance
H	Insurance
I	Holding company
J	Other

Source: OECD

There are obvious gains for investment analysis if such information is more readily available.

Chart 3: Understanding Organisational structure means distinguishing active & non active subsidiaries



Source: Maurel & Prom Annual Report 2012

II. The social impacts

The equality debate

Table 24: Threads of tax discussions for sustainable Investors

	Leading Stakeholders	Notes
Fairness	NGOs, unions, local communities, media, consumer groups	Controversy initiates from the discussion of fairness - explicitly inequality
Regulatory Risk	Legislators launching new propositions	Financial, reputational and increasingly operational risk generated from political mandate to increase corporate contribution especially against austerity budgets.
	Tax regulators enforcing existing regulation	This stems both from raft of future regulation in pipeline but also from increased enforcement of current rules
Fiduciary	NGOs and unions	The consensus thinking of the investment community has begun to be challenged around the fiduciary aspects of tax minimisation - both for corporates and investors

Source: Kepler Cheuvreux

Why tax is an issue: “fairness”… but for whom?

The resource curse

The extractive industry is a key sector where the disparity between global firms’ tax contributions to host countries and their overall profits is highly visible: a phenomenon which is part of the “resource curse”. This is exacerbated through endemic corruption in certain countries, syphoning off wealth that could otherwise have benefited local communities via government coffers. A recent report by former UN Head Kofi Annan’s Africa Group cites examples of multinationals in extractive industries being involved in illicit or unfairly low payments that have deprived countries of adequate tax receipts. In many less-developed countries, estimates from NGOs (e.g. Christian Aid, Global Financial Integrity) of revenues lost through commercial tax avoidance exceed the inflows of foreign development aid.

Tax and human rights

In kleptocracies around the world, monies paid to governments may end up in the hands of civil servants and heads of state rather than in public coffers. Corrupt payments drain public spending, which improves fundamental human rights through improved transport, education and healthcare. Similar issues arise from aggressive corporate tax avoidance in these countries. Governments of developed countries may have less leverage in extracting the maximum or even fair value of contracts with large corporates. Civil society studies (e.g. GFI, Oxfam, SwedWatch, Bread for All, etc.) have often pointed to clear arguments where foreign companies could be accused of exploiting loopholes at a direct cost to local infrastructure investment. To illustrate the rapidly increasing visibility of social tax impacts, we note that The Institute of Business and Human Rights places *‘Expanding collaboration between human rights advocates and movements seeking tax justice and revenue transparency’* among its top three priority issues for 2014.

An issue for both developing and developed markets

As multiple cases in developed markets have shown, the pressure on multinationals is becoming more widespread and moving well beyond an issue purely for developing countries. Though developing markets have borne the most attention regarding the impacts on local communities as a result of the deficit in tax receipts, developed markets have seen this issue becoming increasingly central as fiscal policy becomes dominated by austerity budgets.

A competition issue

"Unfair" tax avoidance – not just NGOs and media outlets...

...EC "state aid" investigations are on the case too

The fairness debate has intensified not just by NGOs and the media who may be concerned with social inequality. Tax avoidance can also be anti-competitive behaviour, with the potential for countries to act unilaterally with company agreements and national policies to create advantages which according to the EC amount to unfair practice. In fact, much of the drive for EC-level pressure on jurisdictions and companies is coming from the mandate to investigate anti-competitive behaviour:

"A limited number of companies actually manage to avoid paying their proper share of taxes by reaching out to certain countries and shifting their profits there. I intend to get to the bottom of this." Joaquín Almunia, EU competition chief - February 2014

Some countries don't play the game: SMEs lose out because they can't

While anti-competitive behaviour is licenced at country level with a transnational corporation as the beneficiary, implicit in the work of such international enforcement is the representation of SME business stakeholders, where medium to small enterprises argue, that they pay a disproportionately large amount of taxes, as they do not have the means to use the global tax avoidance mechanism available to global players. "Forum shopping" is the result of the combination of countries competing in terms of tax rates and companies' agility in moving their registrations.

SMEs are clearly disadvantaged by the largest companies using global avoidance mechanisms

As an example, in France, according to a national authority, CAC40 companies pay corporate income tax of 8% on average in France, compared to the nominal rate at the time of the survey of 33.3%, whereas SMEs pay a much larger 22%. This discrepancy has been central to the tax debate on "fairness" and is increasingly echoed in legislative proposals for tax reform. (In the Media Section we cite French media sector company Solocal's submission to the OECD BEPS consultation where it compares figures between its domestic tax payments and the largest global competitors as one of its biggest business challenges.)

Distribution of value added

Critics argue that the distribution of value added is distorted by the use of tax havens, transfer pricing and the gamut of aggressive tax avoidance mechanisms: NGOs in particular claim that significant amounts of money bypass the tax contribution system. Although in the short term there is a clear argument that less tax maximises shareholder value (as long as it is legal), the counter argument is that the infrastructure and human capital on which the same multinationals depend is being compromised through the reduced tax contribution.

Although "Economic Value Distribution" charts and figures have begun to appear in CSR reports, where companies justify holistic contributions – including indirect taxes, community payments, and employee collected taxes globally and to individual regions - the data is often unaudited and encompasses different time periods from the annual reports. Numerous examples exist where discrepancies can be found between the CSR and financials (see Extractives Sector section for examples – we note a reconciliation between the P&L and "CSR" figures as being a fundamental requirement).

There is also a wider issue around which stakeholders (employees, governments, investors and creditors) have coalesced – a decreasing contribution from corporate taxes. For example, in the US alone, corporate income tax take has remained level at around 2% of GDP, despite a significant rise in corporate earnings. We also note that while corporate tax take has been decreasing in OECD countries, indirect taxes have been significantly raised, burdening consumers.

Using a nation's infrastructure but not paying for it?

Some emerging tax campaigns attempt to highlight and reduce harmful "free rider" effects

This applies where companies are dependent on the infrastructure of the countries in which they operate. In the absence of tax contributions, a deterioration of infrastructure – including the resultant ability of human capital to function at its fullest – is a natural consequence. A recent report commissioned by the French Ministry of Finance concluded specifically that internet and data-intensive business models routinely leverage the domestic skilled workforce, broadband infrastructure investments and freely generated consumer data without commensurate economic inputs.

Sound fiscal policy combines increased corporate tax take and public spending

A frequent focus is put on education budgets; a report by UNESCO released in August 2014 states directly that educational policy in emerging nations must involve increasing tax revenue. A common thread that emerges is that while this certainly applies to the world's poorest countries, it also concerns the richest: recent Swedish Social Democrat proposals to raise bank taxes (up to USD600m) aim to provide funding for Swedish schooling projects.

Table 25: A sustainable development approach to tax justice no longer applies only to emerging markets

	NGO ActionAid Tax Justice campaign
Funding services	Tax revenues are the main source of funds for public services – schools, hospitals and clinics, roads, power and social protection
Reducing inequality	Tax is a crucial instrument of income "redistribution", both through financing services and development, and by ensuring that those who can afford to contribute more do so
Accountability	Development of a sound tax system fosters accountability between citizens and government and thereby encourages better governance.
Self-determination	The more a country can rely on domestic resource mobilisation for the public revenue it needs, the less vulnerable it will be to conditions attached to development assistance, and the more the country will be able to choose its own development path. Autonomy in policy-making is at the heart of national development strategies.

Source: ActionAid

This argument is clearly of interest to the sustainable investor, as the deterioration of infrastructure used by a corporation without adequate contribution results in a longer-term issue. A counter argument is that with the correct critical mass of corporate capital and job creation, with correct government policies, the tax intake can be maximised productively. Nonetheless, SRI funds may well see the argument for the need of greater responsibility from companies when using the most aggressive tax avoidance strategies.

Who pays the most tax?

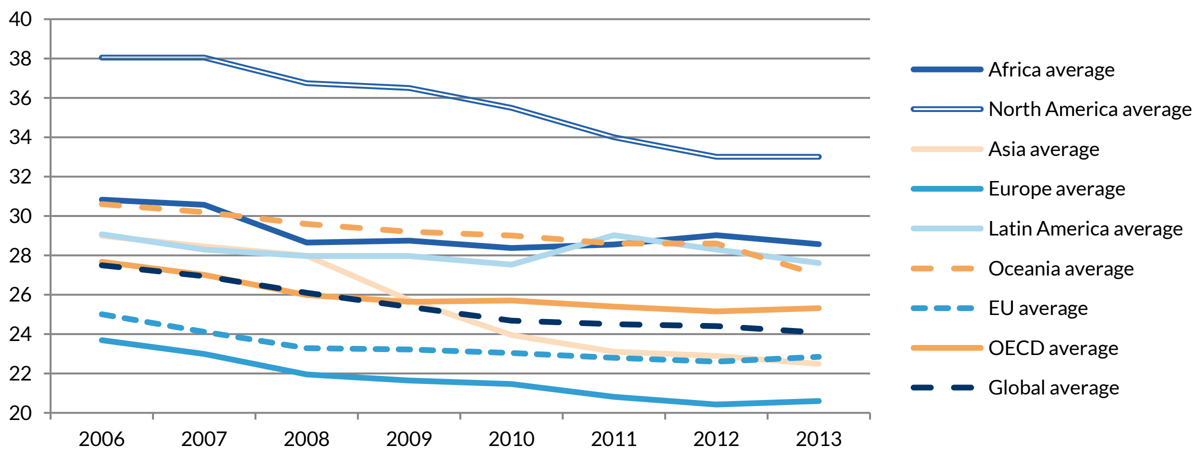
In the series of charts that follow, we note that corporate tax rates have decreased as countries compete to attract foreign investment. For certain stakeholders, this is not perceived as healthy competition but a "**race to the bottom**", i.e. gradually declining public spending threatening the long-term ability of companies to function at all, since those with the lowest taxes may be less able to maintain infrastructures and the personnel required by business in those locations. By the same argument, social inequality is also potentially exacerbated through reduced spending affecting those who are least socially mobile and those with the lowest income the most.

Tax incentives encourage foreign investment...

Business lobby groups have sometimes argued the exact opposite: that lower taxes invigorate local investment and infrastructure spending, particularly when this takes place in large volumes. However where profits are repatriated local benefits are clearly diminished.

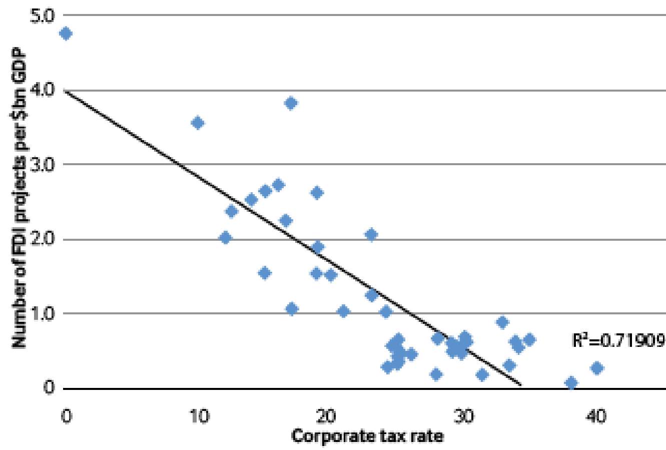
...but profits can easily take a "round trip" and be repatriated to a foreign parent

Chart 4: Corporate tax rates have been decreasing globally...



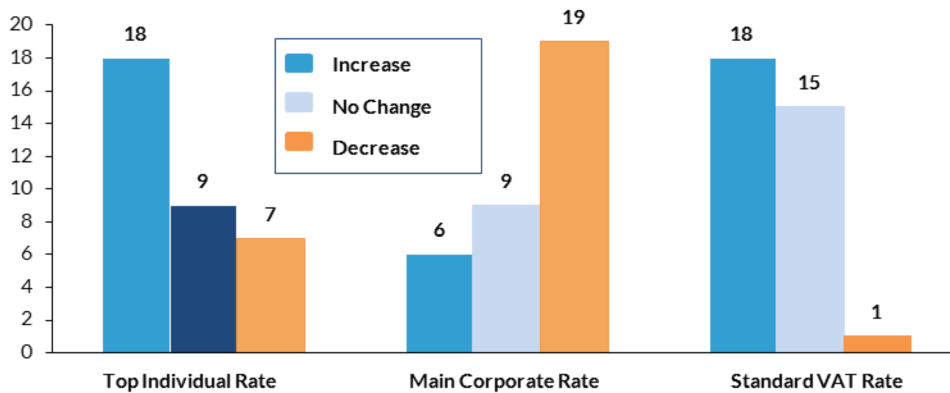
Source: KPMG

Chart 5: ...primarily as lower corporate tax rates mean higher FDI



Source: fDi Intelligence

Chart 6: So who pays? Corporate tax reduction at expense of VAT and highest individual rates



Source: Pierre LeBlanc, Stephen Matthews and Kirsti Mellbye, "The Tax Policy Landscape Five Years after the Crisis," OECD Taxation Working Paper No. 17, Sept.4, 2013.

Source: OECD

Moral hazards, remuneration mechanisms and tax

Most companies tacitly acknowledge that it is the board responsibility to reduce tax payments. One example is with pharma company Novartis – where tax is one of four criteria with corporate cost, financial income & expenses which form the CEO Business Performance Factor for the "Corporate net result" defined as "those financial elements *controlled* by the Group".

Certain criteria for variable pay incentives may push management to view tax as a cost focus area to be minimised. For example, Vodafone's Global Long Term Incentive Plan (GLTI) excludes major payments for tax settlements.

Taxes avoided can contribute to cashflow-based incentives, whereas tax settlements paid do not impact the measure if the basis is "*adjusted* free cash flow" where the negative impact of such payments as exceptional items are not considered. The usual considerations of potential moral hazard and use of claw backs therefore apply, particularly as time frames for tax litigation are long – typically five to ten years or over.

Consumer expectations

Concerned consumers are starting to flex their muscles…

Although the overall power of consumer boycotts originating specifically from tax controversy is variable and has so far not proven significant beyond local pockets, it is a phenomenon driven partly by social media, which is emerging as a concern for consumer-facing companies. Consumers' ability to call for boycotts to overshadow or tarnish advertising efforts or branding (mocking and altering logos and marketing campaigns are a central feature of such campaigns: see Amazon) is increasing. Companies' social media presence may also be diluted when such interaction increasingly invites the discontent of those campaigning on sensitive issues with media reach, such as tax avoidance.

Boycott campaigns inflict reputational damage…

…not just due to a few lost consumers…

…but also ongoing negative media coverage, increased PR costs, loss of employee morale and leverage for tax regulators and competitors

Boycotts

In some cases we have seen boycotts launched against consumer-facing companies when tax controversies are widely aired in the media.

The UK became a flashpoint of tax avoidance controversy, when it was revealed that a number of US consumer-facing companies such as Amazon, Starbucks and Google had paid very little UK corporate tax, despite revenues potentially in excess of GBP1bn in each case.

Chart 7: Amazon boycott

'Boycott Amazon' campaign launched

19.12.12 | Lisa Campbell

The *Ethical Consumer* magazine and campaign group has launched a campaign to persuade customers to choose high street alternatives to Amazon for their Christmas shopping, following revelations of the company's tax avoidance.

Source: Ethical Consumer

Another call to boycott Amazon originated in the US, with allegations of unfair competition with bricks-and-mortar competitors (including SMEs), given that each state sets its own sales tax rate. The risk is that with a critical mass of tax controversies, the company will suffer from more permanent association with unfair practices.

Chart 8: Amazon boycott

Group seeks Amazon boycott over sales tax fight

August 15, 2011 05:16 PM EST | AP

Compare other versions »

SACRAMENTO, Calif. — A coalition of nonprofit groups is calling on customers of Amazon.com to cancel their accounts unless the Internet retailer stops resisting a California law that requires more online retailers to charge a state sales tax.

Source: Huffington Post

Starbucks reaped the most controversy in the UK and took the unusual decision to pay GBP20m to the UK tax authorities voluntarily, after strong criticism; there was speculation that the company took this move to reduce the chances of an active boycott, as criticism spread across the social media.

Chart 9: Starbucks tax avoidance

Starbucks pays up to avoid boycott

By Vanessa Houlder, Barney Jopson, Louise Lucas and Jim Pickard

Starbucks' groundbreaking decision to volunteer higher tax payments in the UK was a response to a "loud and clear" message from customers that they expected a bigger contribution to the Treasury. ...

Source: FT

The company also revised and published certain technical aspects of its tax policy, as shown below.

Table 26: Starbucks UK position revised

	Starbucks UK will not claim deductions
1	For the royalties it pays
2	For the intercompany profit on the coffee it purchases
3	For interest paid on intercompany loans
4	For capital allowance deductions nor our carry-forward losses

Source: Starbucks

The recent behaviour by Starbucks in the UK is a good example of the corporate approach to taxation. When making its voluntary contribution to the UK government, it laid great emphasis on the fact that there was no legal requirement for such a contribution. But a corporate tax payment disguised as generosity did not go down entirely well with the coffee-consuming public. The firm's contribution of GBP20m would not be out of place in a CSR report on philanthropic contributions.

Although Starbucks, under pressure, revealed new UK tax payments, no other company has thus far repeated such a gesture in consumer-facing sectors. Reputationally, the danger of treating payments to governments as "charity" is clear. For regulators though the legal obligations may have been fulfilled, for the public social and moral obligations were not.

Chart 10: Consumer-facing companies and tax scandals: paying tax can be good publicity

Source: Kepler Cheuvreux

Consumer taxpayer versus corporate taxpayer expectations

Clearly, the options for transnational business, particularly where IP is involved, are significantly more lucrative than that available to any consumer taxpayer. In their defence, companies will readily state their overall contributions to a country. Of these, we find that the argument that large amounts of non-corporate tax are being paid is difficult to stomach for non-business stakeholders. Civil society might argue that, in personal tax liability, arguing that one has paid a lot of VAT on goods purchased and a variety of other taxes on daily activity such as driving a car, watching TV, smoking cigarettes and drinking whisky are not acceptable but certain businesses are making an equivalent argument in their tax disclosures. Furthermore the social effects when companies with discretionary power over the level of tax payments are many times larger when compared to individuals that will have little legal leeway in deciding the level of contributions.

However, companies would sometimes argue that their non-corporate tax liability is far higher and, therefore, should be taken into account. In the case of Vodafone, the figure disclosed is that non-corporate tax payments are 1.6x larger (see table below for the list the company disclosed to support this argument). Business lobbies and a variety of recent tax disclosures also argue that taxes collected on behalf of governments are significant. Again, the same defence does not work for other types of taxpayer, such as consumers. However, it is perhaps in the area of job creation and the economic stimulus provided by large companies where the corporate argument is most persuasive for governments looking to attract business capital; particularly foreign inflows in order to stimulate local economies, where increased employment is central, even if the resulting profits are not retained locally.

Expect country reporting tax figures to be larger than the P&L figure

Companies are keen, particularly in their CSR reports, to emphasise that when fairness and taxation are invoked, the debate should not be limited just to net corporate tax payments. For example, a number of companies include indirect taxes in their sum total for tax contributions. Vodafone presents a long list of 48 taxes it is subject to in its tax statement report to clarify the extent of its burden (see following table).

Similarly accounting firm PwC ranks countries according to its Total Tax Contribution metric which splits labour tax and other tax payments alongside profit taxes before aggregating and ranking all countries in order to give a fuller picture of contributions required by businesses operating there. Telefonica uses this index to provide a ratio of its full tax contribution – claiming for example that of 100 euros of Total Value distributed amongst stakeholders (shareholders, employees, creditors) 51 euros is paid to governments in taxes.

Table 27: PwC Total Tax Contribution– simplicity and compliance resources required taken into account also

Economy	Overall ranking (189 countries)	Total tax rate (%)	Time to comply (hours)	Number of payments
United Arab Emirates	1	14.9	12	4
Hong Kong SAR, China	4	22.9	78	3
Ireland	6	25.7	80	9
Denmark	12	27.0	130	10
United Kingdom	14	34.0	110	8
Luxembourg	15	20.7	55	23
Switzerland	16	29.1	63	19
Norway	17	40.7	83	4
Finland	21	39.8	93	8
Korea, Rep.	25	27.9	187	10
Netherlands	28	39.3	123	9
Estonia	32	49.4	81	7
Cyprus	33	22.5	147	30
Croatia	34	19.8	196	19
Australia	44	47.0	105	11
France	52	64.7	132	7
Greece	53	44.0	193	8
Russian Federation	56	50.7	177	7
United States	64	46.3	175	11
Belgium	76	57.5	160	11
Austria	79	52.4	166	12
Germany	89	49.4	218	9
China	120	63.7	318	7
Japan	140	49.7	330	14
India	158	62.8	243	33
Brazil	159	68.3	2600	9

Source: PwC

Anglo American goes further still in its approach and is keen to emphasise overall contributions which extend beyond even all kinds of taxes in its CSR report:

"It is important to reiterate that tax payments only part of the total economic contribution that we bring through our mining operations to both local communities and to the national economy." Anglo American CSR Report 2012

Table 28: Not just corporate income tax: Vodafone lists taxes it is subject to

1	Advertisement tax
2	Air passenger duty
3	Airtime excise tax
4	Business rates
5	Capital gains tax
6	Climate change levy
7	Commission levy
8	Communications services tax
9	Construction tax
10	Corporation tax
11	Customs duty
12	Donations tax
13	Economic activity tax
14	Education tax
15	Employers' national insurance contributions
16	Environment tax
17	Excise duty
18	Expatriate tax
19	Fuel duty
20	Garbage tax
21	ICA/turnover tax
22	Import duty
23	Insurance premium tax
24	Interconnect tax
25	International inbound call termination surtax
26	Irrecoverable VAT
27	Judicial tax
28	Mobile telecoms services VAT
29	Mobile telecoms VAT (higher rate)
30	Municipal and city rates
31	Municipal tax on immovable property
32	Municipal waste tax
33	National health insurance levy
34	Numbering tax
35	PAYE settlements
36	Site rental tax
37	Social security tax
38	Special communications tax
39	Special consumption tax
40	Sprint payments
41	Stamp duty land tax
42	Stamp duty reserve tax
43	Tax on public domain/fixed lines
44	Technology tax
45	Universal service tax
46	Vehicle excise duty
47	Withholding tax
48	Workers' compensation insurance levy

Source: Vodafone

III. Sector approaches

For taxation sector exposure comes in multiple forms. As well as reputational risk and litigation risk resulting from the business models of industries the structure of taxation payments required and leeway available in terms of tax minimisation can vary greatly.

Banking – a European Wealth Management secrecy model in decline

We highlight the banking sector as having been the most affected by changes in tax regulation, partly driven by a hardening of both regulatory and social attitudes towards tax avoidance by high net worth individuals accelerated by the economic climate and resulting austerity budgets.

Consumer facing companies – protests, social media and equality debate

Consumer-facing companies (Starbucks, HSBC, Vodafone, Amazon, Google, Microsoft, nPower) have traditionally received the highest amount of news coverage on tax avoidance controversies, driven in part by NGOs and equality debates.

The digital economy and the digital (tax) divide

In the long term, in our view, any sector exposed to data-driven digital transactions is likely to be subjected to tighter legislation i.e. from the OECD BEPS. The implications of beginning to tax digital data-driven transactions are unknown, but a large variety of recent technologies, including cloud computing, and high-frequency trading could be affected as well as global internet media applications.

Sector average effective tax rates partly demonstrate ease of avoidance

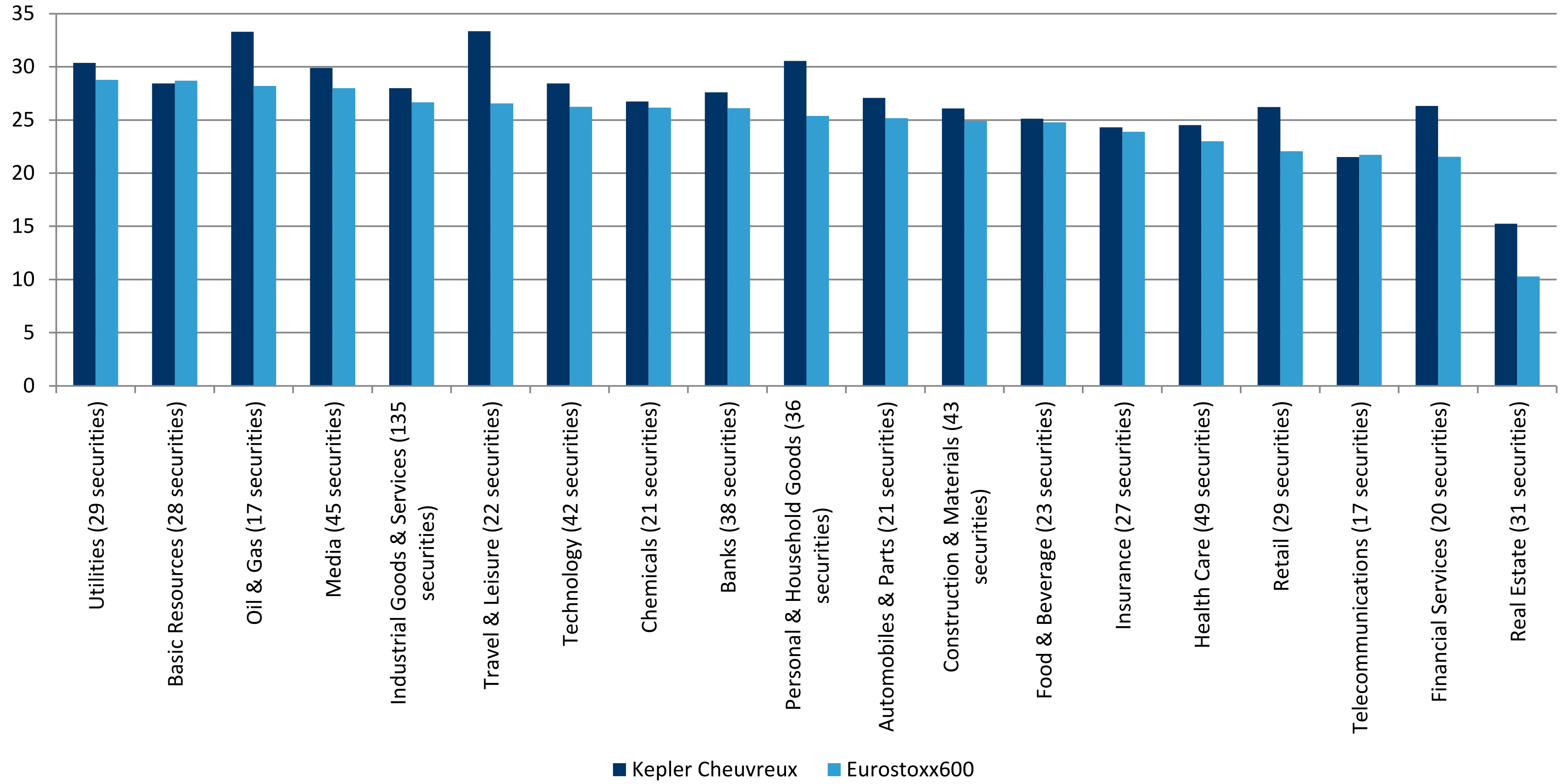
We also include broad sector grouping averages as a general indicator of taxes paid under Eurostoxx600 vs Kepler Cheuvreux company coverage (most recent filing according to Bloomberg data).

Two contributing factors for KeplerCheuvreux coverage having higher sector medians is due to a large number of stocks in:

- the small and mid-cap range which on average pay higher effective tax rates
- France & Italy where average tax rates are higher (see country tax table below).

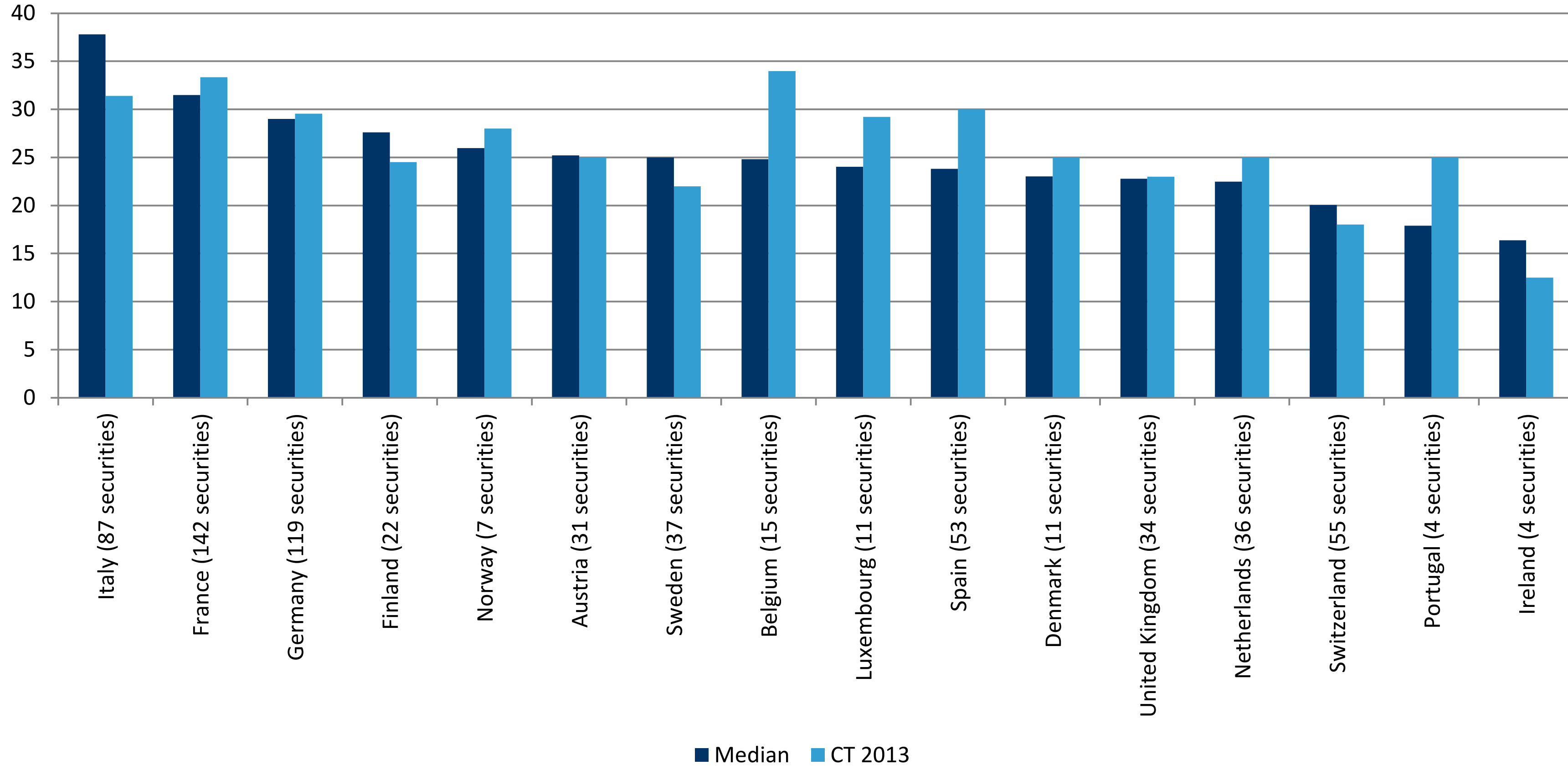
Fundamentally the sectors with higher rates can be partly due to less flexibility to shift profits internationally – i.e. where a predominance of national business which takes place physically, an inability to relocate R&D and manufacturing and an absence of IP intensive processes may limit tax minimisation. Certain industries like Oil & Gas are also subject to higher rates of taxes payable (and those other than profit taxes such as high production levies) in many countries of operation. Sectors such as Healthcare where manufacturing and IP can be shifted to lower tax jurisdictions show lower comparative rates also. Finally in sectors such as real estate very specific structures exist to encourage investment by lowering tax exposures under certain conditions.

Chart 11: Median % Effective Tax Rates by Sector for EuroStoxx600 Index (against Kepler Cheuvreux coverage for reference)



Source: Bloomberg (Latest Filing), Kepler Cheuvreux

Chart 12: Median effective tax rates by country of Kepler Cheuvreux coverage against Corporate Tax Rate %



Source: Kepler Cheuvreux, Bloomberg (2013)

Table 29: Sector issues

Sector	Notes	Key Legislation with Global impact	Examples	Key Penalties
Pharma	Pharma frenzy to use US tax inversions	Stop tax inversion/ US budget	Pfizer & AstraZeneca, AbbVie & Shire, Medtronic & Coviden, Meda & Mylan,	
	History of transfer pricing disputes related to use of cross-border IP valuation - increased risk due to state healthcare customers	OECD BEPS Transfer Pricing		GSK (USD3.4bn 2006) AstraZeneca (USD1.1bn 2011/ UK GBP550m 2010)
Consumer Facing/ Retail	Popular media interest heightened, effects on consumer habits still to be tested	NGO/media-driven risk greater in short term than regulatory risk but OECD BEPS addresses variety of avoidance mechanisms which are currently common practice for firms including the use of intra group payments for brand usage	Starbucks, SAB Miller	
Banks	Private Wealth subject to large increases in compliance, staffing and IT costs	FATCA/ SEC & US IRS criminal investigations, AEOI agreements	UBS, Credit Suisse	Credit Suisse USD2.8bn USD (2014), UBS (US 2009 USD780m/ Germany 2014 EUR300m)
Internet Media & Software	Privacy Debate fuels same demand for transactional country level data that could be used for taxation	OECD BEPS recommendations on digital economy & transfer pricing	Google, SAP, Facebook, Microsoft, Apple, Linkedin	In 2013 Denmark alleges 5.8bn DKK taxes owed on 2002 sale of Navision (to Irish subsidiary) and French authorities demand 52.5m EUR adjustment payment from Microsoft
Extractives	The most long-established campaigns in this sector, with emerging markets focus and overlap with debate on corrupt payments	EC Accounting Directive, Dodd Frank 1504 (on hold)	Glencore (NGO allegations), Tullow Oil (NGO allegations & Uganda government dispute), RD Shell (India government Dispute	
Staffing Companies	Extensive use made of financing hubs		Analyst estimate up to 2% increase in effective tax rates due to tightening of rules. Eg Randstad - financing holding in Belgium	
Capital Goods	IP organisation can result in tax litigation		Sandvik	Dispute around underpriced IP transfers with Swedish authorities, 5.8bn SEK penalty
Luxury Goods	Use of tax havens and offshore structures		Bulgari (for allegations prior to LVMH acquisition)	Italian tax police seize 46m EUR assets investigating domestic avoidance on 3bn revenue 2006-11 through trading companies in Switzerland, Ireland and Netherlands for Bulgari.
				Dolce & Gabbana 343m EUR penalty for alleged evasion on 1bn royalties using Luxembourg holding co
Telco	Risk from consumer-facing brand divisions	OECD BEPS recommendations on Digital Economy	Vodafone (UK media allegations, India tax dispute), Nokia India transfer pricing dispute	See Vodafone list of settlements

Source: Kepler Cheuvreux

Real estate: less public, but tax regimes are central

As a predominantly non-consumer-facing business, property companies have not been in the limelight of tax controversy, or indeed the primary focus of legislative tax avoidance tightening either. Real Estate is the sector which experiences the lowest taxes both for Kepler Cheuvreux coverage and Eurostoxx600 (and indeed most other benchmarks globally) – due to the widely used property investment tax structures available and actively encouraged within government policy.

The long-term nature of tax breaks is an integral part of business and investment strategies, as they are rewarded by governments that would like to incentivise property sector investment. For example, in France the SIIC structure allows companies to have a zero rate of tax on rental income if all their assets are in the SIIC perimeter. Therefore, companies pay taxes on property development and services businesses if applicable (i.e. Icade) or on non-French assets (i.e. Klepierre and Unibail.)

The REIT (Real Estate Investment Trust) structure is present in over 30 countries globally and was introduced in Germany recently, which allows for commercial real estate companies a zero tax rate if they comply with conservative balance sheet ratios and distribute over 90% of German GAAP earnings to shareholders. Considering these typical conditions of the structure, REITS in themselves are not in our view vehicles of aggressive tax avoidance and we expect further countries including emerging economies to implement them in the future without significant resistance from wider stakeholders.

Banks and the death of secrecy

"In our view, investors still underestimate the pressure from the demise of the European offshore business" KeplerCheuvreux Banks Team

Banks' negative exposure to tax litigation and reputational impacts has been through facilitating tax avoidance for clients rather than their own use of corporate tax reduction measures.

Private Wealth Management and European Banks with large exposures to this business have been a case study in the paradigm shift of attitudes to taxation - encompassing ongoing debates around the legality of banking secrecy, compulsory disclosure mechanisms, whistle blowing, cross border tax cooperation, the nature of the most appropriate settlements and penalties, social inequality and corruption.

Our banks team notes that regulatory changes to reduce secrecy and raise the tax base that have been led by the US have meant the end of business as usual for private banking in Europe, particularly for Swiss Banks.

As background context we note that since 2009, EUR37bn has been collected by governments from offshore accounts, according to the OECD, which has been establishing systems for automatic information exchange between states.

It's not a secret anymore...

Offshore wealth management is a clear example of a business model at risk from relying on tax avoidance as a business driver. We provide extracts from our banks team's report European Investment Banks from August 2013, which addressed structural changes in the private banking sector:

Table 30: The demise of Swiss secrecy - private banking impacts

Lower total assets, lower margins and higher costs	
Margins	The demise of banking secrecy and the geographical shift to emerging markets could bring gross margins structurally down by 10-20bp
Legal & regulatory costs	Both moving up
Reputational Damage	Clearly increased negative association for both clients and corporate brand image
Cost drivers	
Staffing	Need for greater staff contact, now that assets must be declared
Increasing client expectations on returns	More demanding on investment performance as a result of tax regularisation
IT Systems	Multi-country tax reporting documentation/client report generation
Double Tax Treaties/ Witholding Tax Agreements	Swiss Banks 2013 Q2 costs - losses for double tax treaty UBS CHF106m, Credit Suisse CHF100m Min guarantee requires CHF1.3bn to be raised from UK before Swiss banks reimbursed for upfront payments
Tax Evasion Investigations	UBS Germany (EUR300m in 2014) and France (ongoing) Credit Suisse 2.8bn USD in 2014, and EUR150m in Germany Q3 2011 Julius Baer 50m EUR in Germany 2011 LGT 50m EUR (incl. 3.6m employee fines) in Germany 2010

Source: Kepler Cheuvreux Banks Team

Fifteen banks have been classified as "Category 1" by the US regulators pursuing tax avoidance. Of these, Wegelin, Neue Zurich Bank, Bank Frey, and Liechtenstein Landesbank, although having various exposures, have shut at least the parts of their business most exposed to US litigation. UBS and Credit Suisse have reached major settlements with the US, as detailed below. HSBC and Julius Baer are the two listed intuitions with remaining unclosed investigations.

The leaks model: alive and leaking

There have been cases of employees at a number of banks providing lists of private clients to the regulators. Whistle-blowers have long been incentivised (the UBS case whistle blower is eligible to a USD104m reward from IRS) and informers from within the private banking sector are finding that there are an increasing number of institutions ready to pay for information.

The leaked databases have formed part of the prosecution's case, and have so far been used by the US and Germany. Currently, France is said to be using the leaks from HSBC Private Bank to investigate potential claims of tax evasion.

Table 31: Private banking client data - a history of leaks

Year	Bank	Jurisdiction	Number of clients leaked
2014	Kleinwort Benson	Jersey	20,000
2010	Julius Baer	Switzerland	2,000
2012	HSBC	Jersey	8,474
2009	HSBC	Switzerland	24
2008/12	UBS	Switzerland/ US/ Germany	20,000+
2007	LGT Bank	Liechtenstein/ Germany	1400+

Source: Newswires

From WikiLeaks to offshore leaks

The role of banks in assisting clients in tax avoidance, particularly in the US, was a pivot point for Web 2.0 activism through WikiLeaks whistle-blower allegations against Bank Julius Baer. The ICIJ (The International Consortium of Investigative Journalists) Offshore Leaks Database, although no relation to WikiLeaks, continues in this area, selectively disclosing certain ownership information about companies in offshore jurisdictions including the activity of banks.

UBS: multiple allegations, multiple territories

UBS reached a USD780m settlement with the US authorities in 2009. In September 2014, UBS requested Paris courts overturn a demand for EUR1.1bn in bail money related to criminal proceedings in which the bank was accused of having solicited clients in France for illegal tax evasion schemes in 2004-12 with press reports of a potential 4.9bn EUR penalty (overstated according to our analyst view). The bank paid EUR300m in Germany in July 2014 to settle similar claims. Its offices in Belgium were raided in June 2014 and the head of UBS Belgium was held for questioning as part of another probe into tax fraud.

Julius Baer

Julius Baer faces significant outstanding litigation risk in the US. CHF300m has so far been included in our equity analyst's estimates for H2, and penalties of over CHF1bn could result in a rights issue. While the Credit Suisse settlement potentially sets a precedent for Julius Baer litigation (the size of their US assets may be in the same ballpark), there are reasons to think the fine may be smaller: unlike Credit Suisse, Julius Baer has no physical presence, ongoing business or listing in US, which reduces the US regulator's leverage.

Credit Suisse

Credit Suisse posted a loss of USD779m in Q2 after settling for USD2.8bn in May for assisting US clients in tax evasion. In our view, the Credit Suisse case (the first major bank to plead guilty to *criminal* charges of aiding tax avoidance) may have set the tone for future litigation.

Operational handcuffs

Credit Suisse's guilty plea may be seen as a turning point in terms of the potential operational intervention powers of various US regulators

Acknowledgment of guilt in criminal (as opposed to civil) cases can have numerous impacts on operations including some forms of exclusion from state licensed activity.

An example is in asset management, where a US state pension fund can automatically suspend dealing with any financial institution that has pleaded guilty. For some weeks after the settlement the Texas state pension fund temporarily suspended brokerage activities with Credit Suisse. Although this had no material impact, it gives an idea of the potential repercussions for the future where government reach is increasing exponentially with each

settlement: the next major banking settlement after Credit Suisse was BNPP's USD8.9m fine for sanctions violations in Sudan, Cuba and Iran using US dollar transactions. This charge also led to a guilty plea in the criminal case but, in addition to the monetary penalty, a further suspension of its dollar clearing licenses for the oil & gas unit for a period of one year. The precedent for the use of operational handcuffs in future has been clearly set and future tax settlements are clearly not immune from this trend.

Non client tax avoidance by banks

"Dividend Stripping"

In November 2012, German authorities raided the offices of **UniCredit's** HVB unit as part of a tax evasion probe in relation to share transactions over 2006-08. Tax credits related to dividend stripping activities (allegedly claiming tax refunds for domestic investors several times by illegally producing documents that "prove" this tax had been paid) are also under investigation after changes in the law in 2012. The sum in question is said to be approximately EUR124m. The former CEO of UniCredit was accused of tax fraud in 2012 for "Project Brontos", a tax avoidance vehicle provided by Barclays. In October 2011, EUR245m of assets were seized from the bank as disgorgement of the profits of the scheme.

"Basket Options" for hedge fund clients

In 2014 a US Senate hearing centred on a scheme by Deutsche Bank and Barclays Bank to sell "basket options" (lowering long-term capital gains tax on trades) to over a dozen hedge funds, which allegedly allowed Renaissance Technology Corp to avoid paying USD6.8bn in taxes.

Barclays: multiple controversies

Barclays is highlighted as the bank with numerous controversies and litigations around tax avoidance including allegations of poor governance which created an employee culture which allowed unethical practices to thrive.

Table 32: Multiple recent tax controversies for Barclays

Salz Review notes that Barclays tax avoidance division (closed in 2013) generated GBP1bn of revenues a year in 2007-10, totalling GBP9.5bn between 2000 and 2011, despite GBP82m paid in corporation tax
2013: Germany launched a 2013 tax avoidance probe into dividend stripping, which allegedly allowed Barclays to avoid EUR280m in taxes a year in the decade to 2012
2012: Barclays was instructed by the UK Treasury to pay GBP500m, initially avoided through tax structures

Source: Kepler Cheuvreux

UK tax shelter vehicles

Barclays received an order in 2012 to pay GBP500m to the UK HMRC tax authority, which had previously been avoided through tax shelter vehicles. Two specific vehicles were questioned, the first involving no corporate tax payments for the repurchase of the banks IOUs, the second pertaining to investment funds reclaiming UK tax for non-taxable income.

The bank was also criticised in the Salz review in 2013 which addressed multiple governance failings; "Barclays appears to have been insensitive to changing political and public expectations around tax and to the UK regulators' expectations"

Publically disclosed tax policies tend to be introduced after controversies

While the tax policies of Unicredit and Barclays include some level of declaration to avoid some of their prior practices, some areas could be addressed in more detail such as the use of tax havens.

Tax policies usually leave major areas unaddressed...

Barclays' tax disclosure includes a statement on rewarding employees for an appropriate consideration of tax risk over the long term. Such declarations are rare, but the use of a long-term time frame can alleviate some risks, and fits well with the expectations of sustainable investors. However, the details related to the implementation of this promising policy are not available.

...even if introduced after substantial tax controversies

Chart 13: Barclays reviews tax approach

Barclays tax principles

We believe that tax planning, for clients and on our own account, must…

- Support genuine commercial activity
- Comply with generally accepted custom and practice, in addition to the law and the UK Code of Practice on Taxation of Banks
- Be of a type that the tax authorities would expect
- Only take place with customers and clients sophisticated enough to assess its risks
- Be consistent with, and be seen to be consistent with, our purpose and values

Should any of these principles be threatened, we will not proceed – regardless of the commercial implications

Our tax professionals will be subject to clear standards to ensure that they uphold these principles

- All tax planning must be subject to the robust review and approval process outlined in our Tax Risk Framework
- We will maintain transparent disclosure in our relationship with the tax authorities, recognising that early resolution of risks is in everyone's best interest
- We will routinely seek feedback from the tax authorities on the quality of our relationship with them
- Any litigation necessary to resolve a difference of opinion will be handled professionally, efficiently and in a way that is consistent with our values
- We will reward employees based on a balanced scorecard approach to measuring performance, which includes an assessment of behaviour and appropriate consideration of tax risk over the long-term

Source: Barclays Strategic Review, 12 February 2013

Barclays' country reporting – it's a start

The bank also provides some elements of country-by-country disclosure in 2013 - which remains unusual and is a step forward. However, despite the global rate of tax remaining at 28.9%, we can see that Luxembourg had a GBP1380m pre-tax profit, producing a GBP20m corporation tax payment (with 14 employees). A large intragroup elimination of over GBP6bn also appears, the bulk of which is "accounted for by the UK". However, the UK produces a turnover of GBP10,437m, but a pre-tax loss of GBP1339m, with a headcount of 54,595.

The key question would be whether profit shifting has potentially taken place between the UK and Luxembourg and Jersey subsidiaries. Without further details from the company, it is impossible to judge exactly; further information on country assets and more guidance on the nature of intragroup eliminations particularly at a country level would be welcome.

Tax fraud and carbon trading by banks

Deutsche Bank was raided several times after illegally reclaiming VAT refunds on carbon trading transactions, although this VAT had never been paid. The company carried out a writedown of EUR310m in Q3 2011. Six employees received jail terms in Germany in 2011, and the ongoing investigation reached board level staff including the CFO and co CEO. Legal action has therefore targeted the individuals concerned rather than the corporate entity. Julius Baer is also undergoing an investigation into alleged carbon VAT fraud and failing to perform client due diligence. The total alleged loss in tax receipts is EUR5bn for the EU from all activities from all players in the ETS markets.

A virtual economy but no virtual taxes…

Media, technology and the digital economy

The biggest long term innovations in legislation may come from the way that internet-based transactions and data usage are taxed. A number of proposals from nations including Spain and France, but most importantly OECD BEPS, have specifically targeted such business models, motivated by the widespread use of tax avoidance structures through cross-border organisational structures, transfer pricing and intellectual property and intra group licencing mechanisms.

Table 33: The digital economy: long-term tax changes on the radar

	France's digital economy taxation report: January 2013
1	Growth in the digital economy is driven by global tax optimisation
2	Data generated without cost by end users and applications are central in value creation
3	Tax frameworks have not kept up with the pace of globalised technological change
4	Without an adequate fiscal framework there are serious implications for the national economy

Source: Ministere du Redressment Productif (France)

Normally "permanent establishment" i.e. a physical presence in the country, is one minimum requirement to trigger potential tax liability, but online business processes, both via sales channel and as a value creation mechanisms via data collection and aggregation, mean that any concept of location itself is far more fluid and multi angled for internet-based media business models.

Table 34: Challenges to taxing the "digital economy"

	An unparalleled reliance on intangible assets
1	The massive use of data (notably personal data)
2	The widespread adoption of multi-sided business models capturing value from externalities generated by free products
3	The difficulty of determining the jurisdiction in which value creation occurs

Source: OECD BEPS Digital Economy Proposal

Small and mid caps complain of larger competitors' ability to optimise globally

In its response to the OECD BEPS' digital economy legislation proposals, the French company Solocal states its principal challenge as being the fiscal optimisation of its global competitors. Its states that as a French player with 95% of its turnover generated in France (EUR1bn), it pays three times as much as the GAFAM group of internet giants (Google, Amazon, Facebook, Apple and Microsoft), who have a minimum French turnover of EUR40bn. Indeed, Solocal's effective tax rate comes in at 41.63 % for 2013 and 41.49% for 2012, far higher than that of the global players mentioned.

Smaller local players like Solocal are clearly disadvantaged by the tax optimisation practiced by the largest internet players

Complex digital value chains encompassing multiple sectors

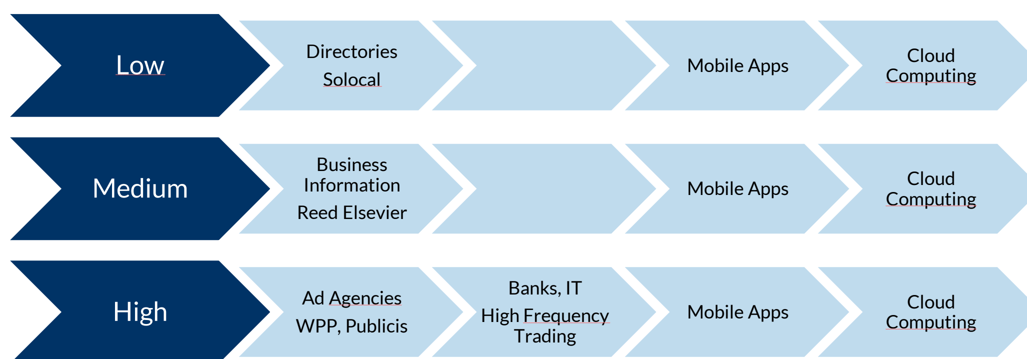
The potential reach of new regulation could comprise anything from ad agencies, search optimisation in internet media, multiple forms of online retail to high speed trading in financial services. A company's ability to add value within data ecosystems is thus a potential future criteria of tax liability.

Table 35: Cyberspace…the last tax haven - taxing digital value generation

	Examples of sectors affected
1	Any internet media located supranationally which is data intensive
2	Cloud computing
3	Apps leveraging geolocation, personal data and payment systems
4	High frequency trading

Source: Kepler Cheuvreux

Chart 14: Data intensiveness is potentially tax exposure: new proposals centralise data in measuring value creation



Source: Kepler Cheuvreux

Inversions

Regarding US tax inversions in the media sector, we also note the aborted merger of Omnicom with Publicis, where the merged HQ would have been the Netherlands, tax savings were said to be potentially USD80m a year, but tax issues with regulators were

stated as part of the decision to abandon the merger. John Wren, CEO of Omnicom, was quoted as saying the "politically charged tax environment" contributed to the breakdown of merger talks.

Internet, online retail and IT: US versus ROW?

Dominant US based global internet players such as Google, Microsoft, Facebook, Amazon, have all come under fire for tax avoidance, both at home and abroad. Though the major players to have come under scrutiny are of US origin, German software maker SAP has been in the spotlight following a September 2013 Reuters article alleging it also uses aggressive tax avoidance structures. Any global company with digital or software exposure will have a larger range of tax minimisation techniques available to them – due to the ability to shift profits particularly via allocation of royalty fees and IP rights.

As the US is the leader in the area of internet media it has via lobbies aired objections to the BEPS proposals on digital taxes.

However the US economy is also vulnerable to tax avoidance both from domestic and foreign entities. Increasingly the privacy and tax issues are surfacing in partnership and it is no surprise that Google has ramped up its lobbying activity around legislative proposals since 2013 as these two issues increase in visibility both in its home market and multiple foreign ones.

Telecoms

The telecoms sector was not selected for reporting requirements for taxes paid by country under the EC Accounting Directive, but its inclusion in the proposals makes it a clear sector contender for future legislative enhancements. However as an IP intensive sector with a large number of globalised players and readily usable tax incentives it is clearly exposed to tax litigation risk. The consumer facing nature combined with dependence on government licenses means that reputational risk from tax avoidance is also present and growing.

Vodafone: multiple controversies and settlements

Vodafone has been typical of the consumer-facing examples of controversies, with a proliferation of boycotts, protests outside retail stores and press allegations of unfairly low UK domestic tax payments. However we have noted settlements with tax authorities not just in the UK but also Ireland, Luxembourg, and reference the India dispute below.

Some media reporting arose around the disposal of US Verizon Wireless in 2013, where the company registered zero tax payments – via a 2014 tax credit on continuing operations of 16.6 bn GBP (vs 0.5bn GBP tax charge 2013). The company's history of tax controversies perhaps accelerated media interest in the tax angle –despite no suggestion of any litigation or wrong doing from any authority. There has been little disclosure on the use of tax structures by the company, but the multiple settlements suggest that they have been used aggressively. The current year also registers a deferred tax asset of 18,150m GBP (2013 1,325m GBP) in relation to losses relating to tax groups in Luxembourg.

For companies with aggressive avoidance strategies tax controversies have a snowball effect...

...once they are out they tend to grow rapidly

Chart 15: Increased costs of tax disclosure? Vodafone UK controversy

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Vodafone pays no UK corporation tax for second year running despite earning £5 billion in sales

In its annual report published today the company revealed it made an operating profit of £294 million but paid no corporation tax

Source: The Independent

Table 36: Multiple recent tax controversies for Vodafone

Unknown settlement amount with UK HMRC tax authority regarding Irish subsidiary (with no staff 2002-7) collecting royalty payments widely reported in press
2010 Luxembourg settlement with UK HMRC of 1.25bn GBP
UK press criticises Vodafone for paying no UK corporate tax 2012
Press noted a lack of UK tax payment in the 2013 US Verizon disposal deal
Ongoing USD2.2bn tax dispute since 2007 over local acquisition of Hutchinson Whampoa Ltd, India unit registered in Cayman Islands

Source: Kepler Cheuvreux

Although Vodafone explains some of the use of tax haven locations in its organisational structure many will find its explanations incoherent in the light of its history of controversies and litigation, particularly as non-material subsidiaries in countries such as Luxembourg and Switzerland are commonly used to accommodate aggressive tax reduction vehicles:

"The Swiss office is a branch of our Luxembourg subsidiary and plays no significant role in the financial management of the Group, and has not done so for a number of years.

Furthermore, there has never been any reduction in Vodafone Group's tax contributions to the UK Exchequer as a consequence of these arrangements. Her Majesty's Revenue and Customs has always been entirely aware of our operations in Switzerland and all other territories of relevance."

In the eyes of some tax justice campaigners, Vodafone has failed to address the real question of its tax payments.

Vodafone provides largest amount of country detail but also most tax controversies

Vodafone though providing detailed reporting on certain country elements has been heavily criticised for its low tax payments. As seen above Luxembourg groups within the organisational structure claim large tax reliefs, however we do not have transparency on revenues, employees, assets and net income in that country.

Furthermore there are clear discrepancies in the statements responding to tax controversy and the actual accounting figures reported. This is the case in the UK taxes paid, where widespread reputational impacts occurred due to the company paying no tax in 2012 (2013/14 amounted to 24m GBP and 17m GBP respectively). The companies statement on its UK tax payments enlargens the scope to "275m GBP in *direct taxes*" for 2012/13.

Vodafone also mentions the tax position of a that buys a new computer in comparison with its own tax practices around using tax reliefs. Of course the social responsibilities and impacts are much larger when a global telecoms company uses tax reliefs aggressively and the options open to MNCs are significantly more flexible in terms of tax minimisation.

Tax policies can be the home of some highly defensive and downright dubious justifications

India

Vodafone, Nokia and AT&T have had major tax disputes with India, highlighting the difficulty of acquisitions and sales of business units in the country - particular where offshore entities and transfer pricing are used.

Table 37: Telco tax disputes in India

	Origin	Allegations	Value of disputed tax
Nokia	USD7.5bn sale of global handset business to Microsoft	Transfer pricing on IP related to software downloads	USD985m to USD3.4bn including possible penalties/ interest payments
Vodafone	USD11.2bn 2007 acquisition of Indian unit	Withholding tax on sale not enforced for a controlling interest	USD2bn+
AT&T	USD300m sale via Mauritius based unit	Offshore transaction structured to avoid taxes	20% capital gains

Source: Newswires

In October 2013, the Nokia devices acquisition by Microsoft was jeopardised in India, where the government threatened to sell assets after freezing them as a result of a tax liability dispute. The company is seeking international arbitration (as Vodafone also has in its dispute with India over taxes due on a 2007 Hutchinson acquisition).

The assets were said to be worth USD321m relating to income tax payments for licences for mobile software between the Finnish head office and India. Assets affected include a manufacturing site. The company is appealing the decision and has denied any wrongdoing. Royalty payments are at the heart of the dispute, with allegations that transfer pricing was used incorrectly, also in relation to the Microsoft acquisition of Nokia's handset assets. As a US company with a significant cash pile based abroad – Microsoft's 7.2bn USD acquisition of Nokia devices was itself perhaps partially motivated by tax incentives as one alternative of repatriation of the cash to the US which would face significant domestic taxes up to 34%.

Telefonica

Like Vodafone, Telefonica also issues a section on taxation in its CSR reporting. The tax figures it quotes are all encompassing – quoting a 2013 total tax contribution of 14,060m euros, the bulk of which is taxes "collected" (i.e. on behalf of other tax payers) at 9267m EUR. Its reference to "Taxes on profits" acknowledges that these are only 38% of taxes borne. Telefonica defines its taxes on profits as those taxes paid by Telefonica that have been a cash cost to the company – i.e. cash paid for taxes for the year (1806m EUR). These amount to 12.8% of the total tax contribution mentioned. If the 2013 P&L figure was taken of 1311m EUR the percentage would be smaller still at 9.3% of the total. The country reporting discloses 19 countries (out of a presence in 24) broken down with the same split of taxes borne & collected.

Expect the taxes paid figure in the CSR report to be a large multiple of tax expense in the P&L...

...In Telefonica's case its ten times larger

This approach is common and not restricted to the Telco sector by any means. However in our view one risk of country reporting and the tax policy statements which use this approach of aggregating figures - especially those that comprise taxes collected (including employee taxes) risk creating confusion in the eyes of certain stakeholders such as civil society, media and consumer associations who may not agree with such a wide definition of taxes. Where the disparity between an income statement and a CSR report tax figure is a large multiple, reconciliation is particularly needed.

Pharma

Pharma is the sector with the largest increase in media interest around tax exposures. In this section we highlight the multiple reputational and regulatory risks based on:

1) **Sustainability issues around healthcare and its direct and indirect use of public funds**
2) **Two separate tax avoidance issues that have been present in this sector and look set to remain financially material: inversions and transfer pricing litigation.**
3) **The position of widely used patent box tax breaks for R&D and intellectual property**
4) **European large pharma as a prototype to launch a basic screen on tax practice & transparency that can be used for engagement with companies.**

Healthcare is dependent on public funds:

Healthcare is clearly an industry with the potential for significant positive social impacts. It is one however where a skilled workforce and a high level of technological infrastructure are essential to maintain not just innovation but safe and effective operations. The central argument of civil society has been that systematic aggressive tax avoidance jeopardises all of these. For sustainable investors the dependence on public funded aspects of a company's activity will therefore be particularly relevant:

- Public Funds: Reimbursement including sections of vulnerable, economically disadvantaged and elderly segment of population from state managed health insurance schemes
- Even private health insurance schemes can carry tax advantaged contributions
- Phase II-IV Clinical Trials: Dependence on university partnerships and academia

- Highly Skilled Personnel: Particularly in R&D national higher education systems are the basis for providing talent needed to maintain innovative pipelines

Healthcare employment has also had several tax related threads:

- Locating manufacturing jobs in low tax jurisdictions such as Puerto Rico, Ireland and Singapore have been a common trend.
- M&A cost cutting can lead to job losses including destruction of R&D posts. Swedish finance ministers referred directly to further potential job cuts particularly in life sciences research as an objection to a tax motivated Pfizer acquisition of AstraZeneca.

Sector examines "use by date" of inversions carefully

The Healthcare sector has been the main focus of tax inversions – particularly where a US company looks to acquire a foreign company or assets in a lower tax jurisdiction in order to avoid a high US rate (up to 34%) and to use foreign cash piles through cross border M&A - rather than subject them to domestic tax at such a rate if repatriated. Pharma has been the sector where tax inversions have been most central to M&A rationale in recent years and at the forefront of media coverage. Our pharma team analyse the implications of inversions for our sector coverage in detail in their report The great (tax) escape.

The full impacts of the varying complex legislation being proposed to limit inversions are unclear and are expected to continue changing rapidly. Actual legislative changes compared to the amount of press coverage have been slim due to bipartisan resistance where broader corporate tax reform is favoured. Similarly any proposals implemented may well meet with their own legal challenges from industry bodies and companies affected by them.

However the main risks of legislative change at the time of writing relate to restricted access to offshore cash (new rules introduced September 2014) , the minimum percentage ownership required in order to benefit from the tax advantages of offshore domicile and most of all the timeframe of application to any of these elements, including retroactively. Though retrospective legislation affecting any of the completed inversion deals seems unlikely at the time of writing those deals that have yet to could be affected by legislation, not because the inversions would be prohibited but due to the tax rationale of the M&A becoming distinctly less attractive (see AbbVie & Shire example). The breakup fees negotiated for various scenarios in both these cases may also face more complex legal interpretations around the precise conditions agreed as new legislation is enacted. Overall this year's M&A deals with inversion elements therefore have a higher element of regulatory risk attached to them.

Though consumer healthcare units could be susceptible to reputational risk especially in products directly purchased by consumers, one of the few instances of a company in this sector mentioning the risk explicitly (rather than experiencing it in financially material terms) has been Walgreens in its move to acquire AllianceBoots and invert its domicile. The transaction was aborted – with some explicit acknowledgment of the climate of tax reputational risk for a high street chain. A Walgreens press release on 6 August 2014 acknowledged this explicitly when rejecting an inversion through an acquisition of the

remaining 55% holding of Alliance Boots GmbH and potential relocation to Switzerland: *"The company was mindful of the ongoing public reaction...with a major portion of its revenues derived from government funded reimbursement programmes."*

We would however add that public acknowledgements of the reputational tax perspective can also be used opportunistically. In the above case concerning Walgreens also coincided with a 1.1bn USD downgrade to a pharmacy unit earnings forecast and the resulting departure of the CFO.

From a shareholders point of view the regulatory uncertainty has lead to volatility of key stocks – such as Covidien and Shire.

Chart 16: Shire gives up its gains: a 25%+ drop on announcement that AbbVie abandons tax inversion

Source: Bloomberg

European large pharma: three USD1bn transfer pricing disputes

For some years, European large pharma has been the sector that has seen some of the largest investigations by governments for transfer pricing disputes (i.e. GSK USD3.4bn in 2006) and more recently AstraZeneca and Novo Nordisk. Where governments (i.e. national insurance schemes) are also the purchasers of healthcare products and services, it seems transfer pricing disputes may arise more readily as a result of the leverage that governments may have over pharma companies.

Seller beware? For healthcare the government is both the customer and the regulator….

Table 38: Pharma: main issues have related to inversions & transfer pricing disputes

Tax avoidance mechanism	Notes	Company examples
Inversions	Pharma has become the flashpoint for use of M&A inversion – a sector with high IP dependence, global mobility and existence of European takeover/ asset targets. Risk of uncompleted inversions rendered less attractive as a result of new regulations. Some reputational risk.	New rules could affect 2014 inversion announcements: Medtronic & Coviden (Ireland), Mylan & Abbott (Netherlands) Aborted: Pfizer & AstraZeneca AbbVie & Shire (UK) Potential US Acquirers (according to Kepler Cheuvreux Pharma Team): AmerisourceBergen, Humana and UnitedHealth Group
Transfer pricing disputes	Government tax authorities bring cases against companies who they believe have used the"arm's length" principle unfairly. This requires certain intragroup transactions to be valued as if taking place between two unrelated and independent parties. In the case of IP such as patents this is highly complex and no external precedent for valuation reference may exist. Usually out of court settlements are reached.	Prior Settlements: GSK US Settlement USD3.4bn (2006) AstraZeneca US Settlement USD1.1bn (2011) Current Litigation : Novo Nordisk Denmark DKR3 .6bn / USD975m (2013)

Source: Kepler Cheuvreux

Patent box: real tax reductions intended for real activity

Tax breaks via "patent box" schemes that encourage R&D are favoured by a few nation states and widely used by pharmaceutical companies. GSK, for example, in its 2013 tax reconciliation statement states a 2.8% reduction in its tax rate is achieved globally via "benefits of intellectual property incentives". Although these initiatives can encourage development of key medicines, local community development, create employment (especially skilled) and sometimes a long-term presence, they are still the subject of unfair completion allegations, as some IP booked may not fit a "substance" test of "real activity" (i.e. loading of patents into one location via mailbox company or subsidiary with few employees) and may not conform to globally accepted OECD norms.

Intellectual property and R&D tax incentives are embedded into healthcare financial strategies

The EC is assessing the patent box schemes of EU countries through to the end of 2014, including the UK, Netherlands, Spain, Belgium, France, Hungary, Luxembourg, Malta, Portugal and Spain. The OECD BEPS action plan (item 5) is also looking at the compatibility of patent box schemes with its proposals. (In the meantime Ireland has announced it will launch its own patent box scheme at the same time as retiring its infamous "Double Irish" tax break.)

The UK is expected to provide almost GBP900m of tax reductions through to 2017 via its patent box programme, which allows a reduced rate of corporation tax of 10% (far from the lowest compared with other national schemes) on new patents (phased in to 2017). GSK relocated GBP500m of R&D to the UK with a further GBP200m announced.

As a result of the UK patent box, Germany claims to have seen a large outflow of IP applications from its companies into the UK. Its domestic loss has reportedly led Germany, together with other countries, to launch complaints via the EC of harmful tax competition. Although Germany has received calls from industry to introduce its own scheme to encourage innovation, the country's finance minister is quoted as saying that such patent boxes are contrary to the European spirit.

Corporates would emphasise that the tax reductions achieved are in fact a real, substantial and socially useful activity around research and development. In this respect, our view is that greater clarity is needed on the extent of patent box usage by the pharmaceutical industry, but it generally is not in the same category as the most aggressive tax avoidance practices based on artificial accounting transfers designed solely with tax minimisation as the objective. There is also a risk that should the EC act more or less unilaterally in establishing stricter harmonised criteria for patent box tax breaks non-European countries will simply introduce / amplify their own.

A tax screen model using European large pharma peers

In the screen below we take indicators for four major themes around fair tax contribution which can serve as a model for sustainable investors wishing to engage with companies on the subject. We illustrate it in the following table using European large pharma as an example with further guidance.

Table 39: Kepler Cheuvreux tax screen for sustainable investors

Theme	Indicator	Explanation
Tax Rates	Three-year average effective tax rate	A consistently low effective rate for non loss-making companies over a rolling three year period can be a starting point for further analysis
	Effective tax rate	Latest fiscal year rates provide context for current position viewed alongside three year rolling averages, peer group means and statutory rates as reference points
	Statutory corporate rate in country of domicile	A pointer for the incentive to profit shift away or into the home country and sometimes the basis for media reported allegations for tax underpayment
Allegations	Litigation	Previous legal issues serve as an indicator for engagement on potential reforms in tax approach
	Controversies	Though media reports may not give a full and fair view clear reputational risk emerges from them
Transparency	Taxes paid by country	Country reporting of taxes paid can clarify location of potential mismatches between income, assets, employees vs tax (though mismatches are not evidence of malpractice in themselves). Very few companies report: this is the central area for investor engagement
	Country reporting	Other line items are reported where considered material under accounting guidelines, giving some indication of extent of geographical presence.
	Tax policy statement	A minimum policy should outline approach to abiding by the spirit of the law, structuring transactions only as a result of genuine commercial activity and explain the use of tax havens
Lobbying	EC	Note on the tax if declared as "field of interest" in EC Register
	US	Using opensecrets data we note if tax has been declared as a distinct lobby issue in US

Source: Kepler Cheuvreux

Table 40: European large pharma: tax screen

	Tax rates			Allegations	Tax transparency			Lobbying	
Company	3YR average effective tax rate 2011-13	Effective tax rate 2013	Statutory corporate rate in country of domicile 2013	Litigation/ controversies (see following table for full details)	Taxes paid by country	Country reporting	Tax policy statement	Lobbied on tax issues in 2014 (US)	Tax declared as "field of interest" (EC)
Sanofi	13.9	16.5	33.3%		Not disclosed	Revenue China, US, Japan	No	Yes	Yes
Novartis	13.9	13.4	18%		Not disclosed	Revenue: US, Japan, Germany, France, Switzerland	No	Yes	Yes
Astra Zeneca	19.4	21.3	23% 2013 (21% 2014)	Transfer pricing US, UK	Not disclosed	Revenue US, Canada, Japan, China, UK	No	Yes	Yes
Roche	20.9	22.5	29,60%		Not disclosed	Revenue: US, Germany, Switzerland, Japan, China	No	Yes	Yes
Novo Nordisk	22.5	22.6	25% (24,5% 2014)	Transfer pricing Denmark	Not disclosed	Revenue: China	Yes	Yes	Yes
GSK	24.5	15.3	23% 2013 (21% 2014)	Transfer pricing US, Canada	Not disclosed	Revenue: US & EM Pharma : China, India, Korea	Yes	Yes	Yes
Bayer	24.5	24.3	18%		Not disclosed	Revenue by Origin: US, Germany, China	No	Yes	Yes

Source: Kepler Cheuvreux, Bloomberg

An explanation of the indicators

We review rolling three year average tax rates, litigation and tax disclosures and potential lobbying involvement in order to highlight four key areas which are of interest for sustainable investors looking to establish indicators which can provide a starting position from which to engage with a company on its tax approach. However in our view relevant disclosures of tax risk around country reporting and intra group pricing are by and large entirely deficient from all companies.

Rolling three-year average tax rate

As a starting point we take a three year rolling average tax rate. Of these Sanofi and Novartis are below peer group averages and have been so consistently over 2011-13. However a low tax effective rate over three years alone may not give any indication in itself of tax risk. Similarly as is the case with global effective tax rates an in line or even above average effective tax rate may tell us nothing about the potential for tax disputes based on sub normal payments at a country level. Indeed many controversies (including Novo Nordisk) show us that a global effective rate in line with expected statutory averages or peer group rates mask that only certain countries may contain risk due to profit shifting resulting in abnormally low national rates.

For a meaningful starting point for analysis we need country reporting – i.e. taxes paid, revenues, net income, assets, employees and nature of activity at each country and subsidiary unit level. None of the companies provide it and as of yet no legislation requires it. OECD BEPS propositions under transfer pricing are pushing for such information to be made available non publically to tax regulators. If this first step is successful we may in the long term see heightened political pressure some public disclosure may follow but this is uncertain.

We note also the statutory tax rate in the country of domicile for each company. The accounting norm is for a weighted average expected tax rate to be declared by each company based on its geographical presence in a reconciliation which bridges these figures with the effective tax rate achieved. Reference to the country of domicile corporate tax rate can serve as a pointer for the incentive to profit shift away or into the home country. Similarly where controversy does arise – particularly in media reported allegations – the argument will often look at the differential between the statutory rate and that effective rate. Where information has been found through national accounts the controversy is usually exacerbated, rightly or wrongly, through direct reference to amounts "lost" via the underpayments compared to the national statutory rates on national profits.

Litigation

We look in more detail at litigation cases on the following table – of these GSK, AstraZeneca have prior transfer pricing settlements and Novo Nordisk a current one. With Novo Nordisk the company does not have a tax rate which could be considered abnormally low.

Tax policy statement

As with other sectors the publication of a tax policy may be reactive – i.e. an exercise after controversy - this is perhaps the case with GSK. Without real supporting data (including country reporting, intragroup transfers and more detailed reconciliation between the statutory rate expected and the actual effective tax rate) their uses, as with all sustainability policies, are limited and can in our view serve to increase reputational liability.

Tax policies are in their infancy and are to be welcomed but...without supporting evidence of implementation may invite reputational risk over the longer term

Lobbying

Corporate capture of the regulatory system is according to some NGOs one reason for which tax systems are unfairly skewed towards global business. Though, in our view, the debate is rather more complex we do address tax lobbying as an issue to be addressed. For sustainable investors taking into account the social impact of their investments it's a key area to engage with companies on.

As with other areas, information is highly limited. The sources we use are the EC Transparency Register for Europe, OpenSecrets (Centre for Responsive Politics) for US data and company-disclosed information when available. OpenSecrets sources official lobbying reports – as required by the US Lobbying Disclosure Act. It aggregates the themes where political influence has been declared: in the resulting database tax is included as a lobby theme for all large pharma companies. The table below shows the total number of lobby "reports" where tax is listed specifically as an issue and the overall ranking of tax

Sustainable investors with concerns around corporate capture of the legislative process for tax should pay special interest in the influence of healthcare

among all the issues declared as being lobbied for. We include two major pharma industry organisations also where lobbying occurs on behalf of pharma companies. For the biotech lobbying body tax has been the priority issue in 2014.

Similarly for the EC Register tax is declared as a "field of interest" by all companies below. Better disclosure on exact tax legislation lobbied for, amounts spent and persons and institutions involved would be a step forward for shareholders.

Table 41: US Healthcare tax lobbying (2013-14)

Company	US Revenue USDm	Revenue US %	No of reports related to tax lobbying	Priority of tax lobbying among all issue
Amgen Inc	14,529	77.8	21	2nd
Sanofi	10,433	31.7	14	3rd
Pfizer	20,274	39.3	16	2nd
Roche Holdings	18,211	38.9	18	3rd
Medtronic Inc	9,209	54.2	11	1st
Merck & Co	18,246	41.4	11	2nd
AbbVie Inc	10,181	54.2	11	3rd
Covidien Ltd	5,209	50.9	10	1st
AstraZeneca	9,691	37.7	10	4th
Novartis	18,924	32.7	8	3rd
Bayer	9680	24.1	6	5th
Novo	39,024	46.7	6	5th
GSK	8,143	30.7	3	5th
Biotech Industry Organisation	All large pharma are members, 1,427 companies total membership of which 314 non-US		18	1st
PhRMA (Pharmaceutical Research & Mfrs of America)	35+ global large pharma are members		4	8th

Source: OpenSecrets

Specific areas in Europe of lobbying are Patent Box regulations. In the US large pharma has been most heavily involved in tax legislation proposals around R&D credits, but also corporate tax reform (both domestic and international). US companies have been active in lobbying against the Stop Corporate Inversion Act of 2014. Medtronic for example paid 200,000 USD to lobby against this bill – with specific concerns on the retrospective applications. Historically the industry body PhRMA has had strong links to Washington lobbying bodies that have represented the sector in the legislative process.

GSK: the largest-ever settlement at USD3.4bn in 2006

Transfer pricing disputes relate to the use of valuation to price intragroup transactions. The disagreement between companies and tax authorities often lies in the companies allocation of an "arm's length" price (i.e. that which an unrelated party would pay) of products and services.

The largest ever settlement for any company/sector was paid by GSK, which in 2006 settled for a sum of USD3.4bn to end a claim by the US Internal Revenue Service (IRS). The disputed sum was significantly larger, with a claim that the group could potentially owe USD8.3bn to the IRS. As with most claims, this was settled outside official court judgments.

Had the claim gone through the full trial system, the company estimated it could have been liable for a maximum of USD14-15bn.

China

Chinese government allegations against GSK in 2013 related to bribes (resulting in a 492m USD penalty September 2014), also include "tax crimes" as one of the charges. China's government run newspaper carried allegations in May 2014 that 16m USD of import taxes had been avoided on HIV treatment drugs.

GSK tax policy

Tax governance policy should be approved by the board

GSK dedicates a page in its 2013 CR report to its approach to tax and as the board approves group tax policy – greater accountability is present. In the tax section of the sustainability report GSK directly cites new UK beneficial tax regulations related to IP investments, but emphasises that the net effect is to pay more taxes in the UK as a result. Sensible to the controversies of UK tax sentiment it justifies in detail that in its country of domicile it pays "a considerable amount of tax" given 5% UK revenue due to global corporate functions (HQ) and manufacturing in the country. Although GSK writes of its participation in OECD BEPS Country Reporting consultations we see no significant country reporting from GSK.

Sanofi

Sanofi is one of the two European large pharma companies with the lowest three-year rolling average effective tax rate. In its 2013 annual report reconciliation of the standard tax rate of 34.4% applicable in France to the effective rate of 16.6% the major items reducing the rate are:

- -7.4% reduction for differences between the French rate and those applicable in foreign subsidiaries (mostly lower than France).
- -6.5% for re-estimates of tax exposures (no further explanation given)
- -3.1% Impact of reduced rate income tax royalties in France

Regarding the first item, wherever an IP intensive company is subject to high corporate tax rates in its country of domicile, the incentives to use profit shifting away from the domestic country may be obvious, and vice versa for shifting profits into the home country of domicile where rates are low (see Swiss-based Novartis).

Sanofi has been involved in a capital gains tax dispute in India over its 2009 acquisition of domestic drug maker ShanH via a majority purchase from a French company. A High Court ruling in favour of Sanofi stated the taxes payable were due in France, but the Indian national income tax department has challenged this outcome. The CEO of Sanofi cited this case, where retrospective tax legislation was threatened as a reason for falling foreign direct investment in India. However Sanofi is by no means an isolated case as numerous foreign companies have had large scale tax litigation in India.

Novartis

No tax policy is publically available, but Novartis reports under GRI Criteria EC4 to disclose US grants of USD330m and a reconciliation of the expected statutory rate and effective tax rate from its financial report. The expected tax rate used by the firm of 12.1% arises as Novartis is a Swiss-domiciled entity. A total 48.6%, or USD5219m, of the income before taxes for 2013 is foreign, although Switzerland net sales were 1% of the total in 2013. Profits are booked in Switzerland, where 43% of the company's selected noncurrent assets (property, plants, equipment, goodwill, intangible assets and investments in associated companies) are based. We have not found significant tax avoidance controversies or litigation against the company.

Use of "tax havens"

GSK is one of the few companies that addresses tax havens - *"we do not engage in artificial tax arrangements- those "without business or commercial substance"*. It adds that its policy is to use locations where there is substantial business presence, and that the board approves the tax strategy and management. In its survey of FTSE100 companies, the NGO ActionAid found that, in common with peers, GSK used a number of low-tax jurisdictions – with 91 subsidiaries domiciled in tax havens out of 440. The reason for domicile may not be in any way related to tax minimisation, but in the absence of country reporting with employee numbers, gross revenues, taxes paid and net income for the countries, it is impossible for stakeholders to be certain. Similarly, as the table below shows even taking the widest definition of tax havens available GSK with 21% of subsidiaries is only a median for its sector within FTSE100 companies.

Table 42: FTSE100 UK Healthcare: tax haven use according to NGO ActionAId

Company	Tax haven subsidiaries	Grand total	% Tax haven subsidiaries
AstraZeneca	47	232	20%
Croda International	10	83	12%
GlaxoSmithKline	91	440	21%
Johnson Matthey	32	119	27%
Shire	54	115	47%
FTSE100 Average = 25%			

Source: ActionAid

AstraZeneca paid a total of USD1.1bn in the US in 2011 as part of a long-running dispute over transfer pricing between the UK and the US.

In 2010 it raised its earnings guidance after settling with the UK authorities for GBP505m: "*AstraZeneca has increased its 2011 target for core earnings per share from USD6.45-6.75 to USD6.90-7.20 per share to reflect this revised guidance for the 2011 tax rate*" demonstrating earnings volatility for a company in having to manage tax disputes.

CEO Pascal Soriot, in challenging Pfizer's bid for the company, stated publically that he thought AstraZeneca could be damaged by Pfizer's tax avoidance methods.

Novo Nordisk was accused in June 2013 of transfer mispricing in Denmark, and currently faces a DKK5.5bn (USD975m) claim from the state. The background is that certain products are produced in Denmark while the patents are held in Switzerland. The dispute

lies in the declaration of the fair market value of the intellectual property. Novo Nordisk has denied the allegations of mispricing. The statutory corporate tax rate in Denmark is 25%, reduced to 24.5% in 2014, the company's rates have been only 2-3% below this in recent years.

Novo Nordisk states in its tax policy that it is "*pursuing a competitive tax level in a responsible way… This means paying tax in jurisdictions where business activity generates profits. As a general rule, Novo Nordisk affiliates pay corporate taxes in the countries in which they operate*." However, it also seeks a "competitive tax level", which may imply achieving a level below typical reference points such as the statutory rate or weighted average rate.

IV. Tax transparency

Breaking down tax disclosure

Currently most stakeholders, except some companies themselves, would agree that greater disclosure of tax payments and policy would be beneficial. This is surely true for investors struggling to carry out any real analysis requiring details of tax practice and country-level disclosure. **The main obstacle to assessing tax practice is the lack of transparency on tax practice itself.**

In this section we address tax screens through three different focuses:

1) **A pioneering label approach from NGO Fair Tax Mark to address policy, key indicators and narrative reporting elements for companies and encourages companies to engage in a collaborative process to improve disclosure**
2) **A Kepler Cheuvreux screen which addresses a sample company – Reed Elsevier - to highlight some of the difficulties and conflicting signals from indicators even for companies where greater disclosure is present.**
3) **Extractives Country Reporting Screen: The extractives sector is addressed in this section as we believe new country reporting regulation may present new challenges for the tax approach of the European Oil & Gas, Mining and Forestry sectors due to new EC Accounting Directive regulation. We highlight key indicators which can form the grounds for engagement with companies in this sector.**

Fair Tax Mark (UK)

The UK launched the "Fair Tax Mark" in February 2014, with transport operator Go-Ahead Group plc being the first FTSE350 company to be awarded the certification and SSE the first FTSE100 company (so far only those with UK parent considered).

Although in its early stages, the Fair Tax Mark concept - which echoes in some way the idea of Fair Trade certification – presents concrete criteria for "fairness" and a label process which companies would have to engage with in order to reach the required standards.

In our view some or all of the Fair Tax Mark standards can serve as engagement goals (i.e. a standard to be reached) for investors looking to push companies to improve reporting.

Country reporting is a key area which is included and we think this should be a priority for investors given the emergence of regulation and its importance in establishing tax risk and fair tax practice. **It is often in the area of disaggregated data that the most useful investor information can lie but also where transparency is poorest across the board.**

Can an ideal tax policy exist?

We highlight the work of the Fair Tax Mark in listing 10 key areas of policy that can be used in disclosure:

Table 43: Fair Tax Mark UK: model policy for medium to large-sized companies

	Taxation area
1	We consider taxation to be an important contribution to wider society rather than a cost to be minimised.
2	We will seek to pay the right amount of tax at the right time and in the right place according to the letter and the spirit of the law in each country in which we operate.
3	We will take into consideration all stakeholders when tax planning including consumers, investors, our staff and the governments and communities in the countries in which we operate.
4	We will not structure transactions in a way that does not reflect genuine commercial activity with the intention of reducing a tax liability.
5	We will not have any connections with tax havens unless it is necessary for the purposes of trading within those jurisdictions.
6	We will be open and fair in our negotiations with HM Revenue & Customs and any other tax authorities we deal with and will seek to discuss with them in advance how any significant transactions whose tax treatment is open to interpretation should be treated for tax purposes.
7	We will not use marketed tax avoidance schemes or arrangements that fall foul of current regulations (UK HMRC tax regime examples listed)
8	We will be open and transparent in our lobbying on taxation matters and will not seek to influence government tax legislation in any way that is detrimental to our stakeholders' best interests.
9	We will monitor compliance with this policy on a regular basis and report on that compliance in our annual reports in future.

Three items from the above list that, in our view, are particularly useful for sustainable investors are the following:

1) *"We will not structure transactions in a way that does not reflect genuine commercial activity with the intention of reducing a tax liability."*

A disclosure to the spirit rather than the letter of tax law can be a significant commitment. If adhered to in practice it will likely be less risky in both regulatory and reputational terms. However as with all areas of policy we need to take such declarations in the context of the accompanying reporting elements which present the numbers to support the words.

2) *"We will be open and transparent in our lobbying on taxation matters and will not seek to influence government tax legislation in any way that is detrimental to our stakeholders' best interests."*

Tax lobbying is an area where almost all global companies fall short in terms of declaration. We would highlight it as a priority area for improved disclosure. Wherever specific topics of regulatory reform are being advocated, for or against, either by the company directly or via third-party agents including law firms, specialist lobbyists and trade bodies – lack of transparency in these areas can be a signal of future risk for investors.

3) *We will monitor compliance with this policy on a regular basis and report on that compliance in our annual reports in future.*

One-off declarations that are not updated for years or expanded with information on ongoing implementation are not unusual in reporting around policies in the CSR domain. Disclosure of compliance and monitoring is essential, particularly in an area such as tax where multiple stakeholder expectations are evolving so rapidly.

Below we also list the indicators so far referenced by Fair Tax Mark. The items in bold are those in our view most applicable to large global multinationals: country reporting, a tax policy, a statement on use of tax havens and a numerical and narrative reconciliation bridging the difference between what has been paid and the statutory amount that might

be expected. Fair Tax Mark is also working on standards for foreign owned multinationals in the UK.

Table 44: A template for tax transparency UK medium to large companies – The Fair Tax Mark

		Area
I		*Transparency*
	1	Accounts (public)
	2	Company activity
	3	Company location
	4	Beneficial ownership
	5	*Management*
II		***Country-by-country reporting***
	6	**Subsidiary information: basic data**
	7	**Subsidiary information: net asset/ equity value and income**
	8	**Disaggregated tax data by subsidiary or by country**
	9	**Disaggregated employment data by subsidiary or by country**
	10	UK segment data
	11	**Consolidated and reconciled country-by-country data**
III		*Tax policy, implementation and compliance*
	12	Public statement on tax policy
	13	Named director responsible for tax policy
	14	Report on compliance
	15	**Tax policy statements**
	16	**Use of tax havens**
IV		*Tax rate and disclosure*
	17	Average tax rate
	18	**Numerical tax reconciliation**
	19	**Narrative reconciliation**
	20	Deferred taxation
Bonus questions		
	21	Does the company separately disclose its corporation tax and other tax liabilities owed or owing in its accounts, as required by company law?
	22	Does the company separately disclose its corporation tax paid or received in the year in its accounts, whether required to by law or not?

Source: Fair Tax Mark 2014

Tax transparency: regulatory goodwill?

We also note that in tax disputes the overall approach of a company may impact decisions by regulators. As Ernst & Young put it, "*an increased level of tax transparency reporting may also represent a key building block in building stronger relations with tax authorities…. leading to much earlier decision-making and greater certainty*."

Some countries' tax regulators categorise companies' tax risk. The UK, for example, classes companies as low, medium or high risk. However, although a few low-risk companies publicise this status, it is otherwise impossible for shareholders to gain information on such indicators without engagement.

Certain NGO campaigns, such as that by ActionAid in the UK, have also been successful in directly pushing the regulator to enforce pre-existing laws, for example, related to the disclosure of the location of subsidiaries through UK Companies House filings, in order to better identify the use of tax havens. The result in the UK was a vast increase in disclosure in this area, and a clear signal to the regulator as to which companies complied (and which

did not) with the NGO acting as a de-facto watchdog, given teeth by a series of successful media campaigns.

Reed Elsevier

Below, as an illustrative example of some of the challenges facing investors who rely on tax disclosures to identify potential tax minimisation, we look at an extract of a dual-listed (UK and Netherlands) media company Reed Elsevier. It is by no means selected as an example of tax risk or potential tax avoidance and in several areas analysed overall disclosure is ahead of peers.

Table 45: Illustrating some elements of tax disclosure

	Tax Theme	Explanation
1	Effective tax rate(s)	Several measures of tax payment are available to investors, these can send conflicting signals
2	Tax notes	Details of tax credits, carry forwards etc., should give us a clue as to the nature of tax exposure, particularly exceptional items.
3	Country reporting	Taxes paid in most material countries of operation are optimum in terms of transparency but rarely disclosed. Particular interest in revenue, income, assets and employees in "tax haven" countries and if commensurate real "economic" activity is being carried out.
4	Organisational structure	This complements country disclosure and provides a further clue on potentially riskier locations i.e. tax havens. Cross border routing of profits at centre of litigation and controversies.
5	Tax policy	Sustainable Investors may be looking to screen for companies that clearly state that they minimise tax avoidance risk, i.e. by only booking profits in territories where real economic activity is generated.
6	Tax Controversy	Prior controversy or litigation can be a signal of a company's approach / risk culture regarding taxation
7	Lobbying	A position from the company detailing lobbying activity both directly and through industry bodies is best practice, we would like to see more detail on targeted regulation/ amendments and lobby spend/location
8	Product Exposure	Primarily financial services sectors will be at risk via tax avoidance products and services. By contrast some companies such as Citi, Reed Elsevier or SAP may be exposed to opportunities in the sector from increased spend on their tax payment portal, anti-avoidance and KYC/ data/ audit trail products.

Source: Kepler Cheuvreux

The effective tax rate: a starting point but it's a meaningful reconciliation that counts

1. Global Effective tax rate

Understanding tax is currently an overly technical endeavour. Businesses have a clear point when they call for tax systems and accounting reporting standards to be harmonised and simplified. However corporate tax reporting can sometimes hide behind an impression of complexity when simple narrative explanations in reconciliations between expected statutory and actual effective tax rates are needed. And beyond the publically disclosed tax information even investors may have difficulty in understanding the full impacts of elements referred to in tax disclosures.

We highlight the differing possible approaches and the difficulty usually encountered in reaching conclusions around tax risk based on potential minimisation as evidenced through the publically available figures.

What is evident in a number of tax controversy cases is that the global effective tax rate was not always abnormally low. So the difficulty with taking the effective tax rate of a company is that in a number of cases the global amount may well be in line with the rates of

its country of domicile but some countries may account for disproportionately small payments compared with income/revenue if we have visibility over them via local accounts (not so freely available). Although low rates (versus national rates) even when identified in certain countries may be a signal of tax avoidance structures in use, it is by no means always the case.

A variety of legitimate reasons may exist for certain tax rates in countries to be low - including tax credits and bona fide incentives, for example, which in themselves can be fluid and highly variable year on year. However, without full data on the tax base this is unlikely to be transparent.

A low effective rate is by no means evidence of avoidance....

...and an effective rate above statutory references is also no indication that riskier or socially harmful forms of avoidance have not taken place...

We note also that UK company SSE plc– holds an effective tax rate of 15.3% for its latest annual reporting (2014) – which may seem somewhat low against the UK statutory rate of 23%. Yet it is the first FTSE100 company to be awarded the Fair Tax Mark label in the benchmark index (UK parent only). What counts is the multiple detailed disclosures– including the bridge from the expected to the actual figure. Meaningful reconciliation exists to justify the figure – showing that a fair and correct amount of tax may be significantly lower than a national or weighted average multinational reference rate.

Meaningful reconciliations between actual and expected rates are a necessary addition to begin to make judgements

Focusing on Reed Elsevier - taking the effective tax rate alone by dividing income tax expense by pre-tax income signals a low rate over the last three years at 11.6% compared with 2013 statutory rates for the UK (23%) and Netherlands (25%). However, though deferred taxes have an effect on lowering the P&L income tax expense, cash taxes paid provide a reality check since they have been consistently higher, averaging 20.9% of pre-tax income in the last three years.

Reference is included to the weighted average rates and adjusted rates also, which provide some guidance of the companies' view on relevant rates payable through allocating statutory rates according to presence in countries of operation and adjusting the tax rate according to items used in adjusted profit figures. Finally, the most recent non annual period gives some indication of the potential direction of the rates.

Table 46: Reed Elsevier Tax Rates

Rate	Calculation	Source	Three-year average	2011 (restated)	2012 (restated)	2013	S1 2014
Effective tax rate	Tax expense (includes current & deferred)/ pre-tax income	Bloomberg	11.60%	19.10%	8.90%	6.80%	24.80%
Cash effective tax rate (Bloomberg)	Cash taxes paid/ pre-tax income	Bloomberg	24%	23.00%	18.80%	30.30%	20.90%
Weighted average applicable tax rate	Weighted average of tax rates applicable to accounting profits and losses of the consolidated entities	Reed Elsevier	23%	18% (restated)	21% restated	23%	N/A
Adjusted effective tax rate	Tax effects of adjusting items including deferred tax movements & various tax credits/ charges	Reed Elsevier	23.50%	23.60%	23.50%	23.50%	23.50%
Tax rate used in KC analyst model	Analyst view for valuation	Kepler Cheuvreux	21%	19%	22%	22%	22.50%

Source: : Kepler Cheuvreux, Reed Elsevier, Bloomberg

Though not applicable to Reed Elsevier, where three year average effective tax rates (for both tax expenses and cash effective tax rate) are significantly lower (>5%) than the statutory rate of the country of domicile and the company is profitable, this could be a red flag.

However the reverse, i.e. an effective tax rate consistently in line or higher than either the statutory rate of domicile or weighted average statutory rate, does not mean an absence of tax risk. The most common litigation and controversy risk has been around the national information that is NOT disclosed, hence the requirement for country reporting.

2. Tax notes

In the company's 2013 Annual Report an "exceptional prior year tax credit" of GBP96m tax credit appears for 2012 but without further information on the nature of the credit apart from a statement that the company had *"resolved a number of significant prior year tax matters and reassessed its exposure to other tax matters"*. No further details were found in the 2012 Annual Report, nor were we able to get clarification from the company on the exact origin. The 2013 notes also include reference to a deferred tax credit of GBP221m arising on the "alignment of certain business assets with their global management structure".

3. Country reporting

In trying to assess the extent and locations involved in profit shifting, the figures which accompany taxes paid are all essential

Some areas of Reed's disclosure, such as a breakdown of current taxes in the two countries of listing, are to be welcomed but, in common with peers, further country-by-country detail is not available as it is not considered material or required according to accounting standards. Employee breakdown is given by broad geographical segmentation. While the Netherlands accounts for 22.7% of 2013 current taxes, its employee base is 5.7% and revenue 2.8% and revenue by origin 10.9%.

These discrepancies between taxes paid in a country and the other indicators of the level of active operations can sometimes be as a result of profit shifting for tax minimisation causes. Hence in our view, country by country reporting with disclosure on revenues, net income, taxes paid, assets, employees and nature of activity together with disclosure on intra group transactions is critical investor information and forms the basis of being able to assess tax related risks and a variety of other exposures more accurately.

Table 47: Reed Elsevier tax (note 9 from annual report 2013)

	2013 £m	Restated 2012 £m
Current tax		
United Kingdom	**(50)**	(73)
The Netherlands	**(80)**	(68)
Rest of world	**(222)**	(12)
Total current tax charge	**(352)**	(153)
Deferred tax	**271**	51
Tax expense	**(81)**	**(102)**

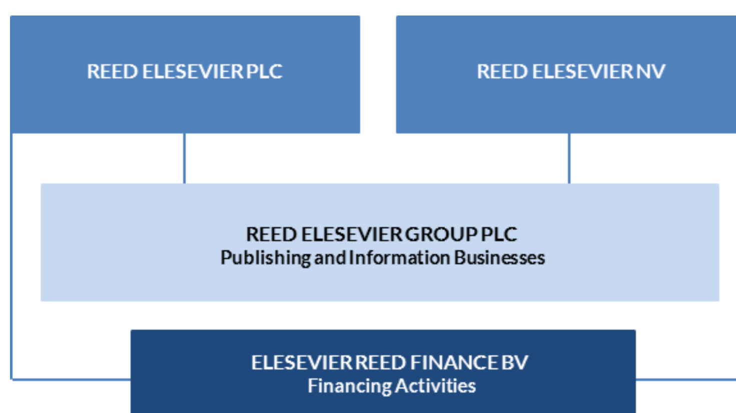
Source: Reed Elsevier

4. Organisational structure and subsidiaries in tax havens

According to the last available survey by NGO ActionAid, 101 of Reed Elsevier Group's publicly declared 448 subsidiaries were in tax havens in 2013, according to its definition. We cannot conclude that there has been tax avoidance merely on the basis of the group's presence in these locations, and according to the same survey Reed is at the median level of tax haven location at 18.4% for the peer group of BSB, ITV, Pearson and WPP.

Regarding the Netherlands, which is also a tax haven by many NGO definitions, it is not surprising for Reed as a dual-listed company to have a number of subsidiaries there; however, it is the Dutch-registered Elsevier Reed Finance BV that owns the firm's financing activities.

Chart 17: Reed Elsevier organisational structure



Source: Reed Elsevier

5. Tax policy

In its 2013 Corporate Responsibility Report, Reed Elsevier describes its tax position, with an emphasis on both responsible tax payments and policy engagement:

"Reed Elsevier is a responsible corporate taxpayer. We conduct our tax affairs to ensure compliance with all laws and relevant regulations in the countries in which we operate. We maintain an open and positive working relationship with fiscal authorities and tax policymakers, and actively engage with policymakers, tax administrators, industry bodies, and international institutions. In the UK, the Head of Group Taxation is also a member of the Business Tax Forum, a joint business/HM Revenue and Customs committee, on the operational aspects of the tax system. We also participate in consultations with the OECD and support the OECD Business & Industry Advisory Committee Statement of Tax Principles for International Business which sets out widely agreed principles on tax planning and transparency."

Detail on the groups and business organisations with which a company engages on tax issues is a step towards lobbying transparency. The expression of an active intent to maintain a positive working relationship is, in our view, best practice.

A commitment to maintain positive working relationships with tax authorities is a statement of accountability

Sustainable investors may be interested in a further positon statement regarding locations in low-tax jurisdictions and a commitment not to use them for artificial tax structures. A

broader commitment to abiding by the spirit of tax laws rather than compliance would also be welcomed.

6. Tax controversy

Reed has not been the subject of any public controversies around its tax payments.

Its tax department has been active in debates about business tax contributions, including giving its views to the UK Parliamentary Economic Affairs Committee. In our view, it has been neither for aggressive tax avoidance to support shareholder value, nor proactively on the side of more focus on socially "fair" taxation (as defined by tax justice movement).

The company admits the complexity of the tax debate from the point of view of corporates. The tax declaration in its CR report shows that, like most corporations, if taxation is to be seen as a proxy for societal contribution, then Reed Elsevier wants its wider societal contribution to be included in the debate as it mentions "employment related, sales, VAT and other taxes". Regarding these, however, we would note that the argument for them being pure costs of doing business and less discretionary that corporate tax payments is significant. For employment taxes, there may be very little room for manoeuvre for a company, and large parts will be sourced from employee salaries at an identical level regardless of the employer.

7. Lobbying

According to third-party data site opensecrets.org, tax is one of top three themes on which Reed Elsevier has lobbied in the US. In the EU, taxation is a declared field of interest on the EC Transparency Register. Specific figures regarding spend on tax lobbying are not available but, in our view, could be helpful for sustainable investors – particularly when assessing conflicts of interest in the lobbying approach and also the accuracy of company declarations on social contribution. However, the company does clearly state its involvement in the Business Tax Forum and OECD consultations and it has been a visible presence in key business tax debates.

8. Product exposure

Reed Elsevier is one of the few companies that has a product to assist tax authorities. Through LexisNexis Risk Solutions it offers an identity check product, currently being purchased by numerous states in the US, to verify tax claims where for example tax refund fraud may be suspected.

For financial services companies the provision of aggressive tax avoidance products would clearly carry additional regulatory and reputational risk.

Conclusion: An effective cash tax rate which is more in line with national statutory rates than P&L income tax expense, some country level granularity, a commitment to maintaining a productive relationship with tax authorities, visible participation in the tax debate and some disclosure on membership of lobbying organisations are all positive indicators, and no "red flags" are produced. However, real "tax risk" exposure remains difficult to establish based on the information provided.

Country-by-country reporting: the investor benefits

Country reporting is, in our view, an essential element of disclosure. It serves not just sustainability analysis but, as we note in our analyst survey, a variety of financial valuation needs also. In our survey of Kepler Cheuvreux sector analysts, country disclosure was one of the most common responses to the question “What Key Disclosure is Missing?”.

To illustrate the urgent need for better country exposure data we take the example of the most widely used benchmark to assess corruption risk: the CPI or Corruption Perceptions Index by NGO Transparency International. Each country in the world is given a specific score based on a wide variety of aggregate data. This is an extremely common approach in mapping – but as with any country index score, unless we have company exposures to those countries the indices cannot be used to maximum accuracy by investors.

This applies not only to social sustainability issues such as corruption, but also to environmental themes such as climate change and pollution and corporate governance agendas including diversity and remuneration. Furthermore, in our view, there is a clear appetite beyond sustainability and SRI demand from mainstream financial analysts to benchmark country performance, not just in terms of establishing the tax base of companies but also in the assessment of business performance more generally, which could be vastly improved with detailed country data on, for example, at least revenues, profits, taxes paid, assets and employees.

In extractives industries, companies are beginning to report on country and project level payments ahead of country legislation proposed through Dodd Frank 1504 (now temporarily on hold) and the EC Accounting and Transparency directives (where first reports are due in 2016). However, even with best-practice companies, reporting tends to be limited to taxes paid by country (as per upcoming regulatory requirements).

Outside extractives and the reporting items of taxes paid, we have seen very little detailed country reporting. A report is due by the European Commission on 21 July 2018 on non-financial reporting, and will consider the possibility of introducing country-by-country disclosure legislation on taxes, profits and subsidies for larger companies across all sectors.

Dodd Frank 1504

Statoil created a lobbying best practice by publically dissociating itself from an API campaign against Dodd Frank 1504

A partial form of country-by-country reporting, intended primarily as a tool to combat corruption, was introduced via Dodd Frank 1504 in the US in 2011. The law mandated payment transparency by country for oil & gas and mining companies listed in the US. However, a legal challenge by the American Petroleum Institute, of which all the major global oil & gas companies are members, was upheld in a Court of Appeal, meaning that the law is currently delayed and that the SEC will have to reconsider a variety of factors such as confidentiality and competitiveness, and probably resubmit the proposal. As all the major European oil companies are members of the API, with a large number public doubts about regulation, the legal challenge mounted by the API is being directly funded by the members of the trade body. A notable exception is Statoil, which has publicly committed to non-involvement in lobbying against DF1504.

EC Accounting Directive

The EC has taken the lead from Dodd Frank 1504 and has reached the final stages of legislating for its own requirements on country-by-country reporting. The industries targeted include oil & gas, mining, but also forestry, and not just for listed but also for the largest European private companies.

In both Dodd Frank 1504 and the EC proposals, only payment data is required; however, accompanying data on revenue, profits, assets, production and employees is not required, so gaining a full picture of a country tax contribution would still be far from easy.

CRD IV (Capital Requirement Directive)

For the banking sector, a more comprehensive form of country-by-country reporting has been proposed by the EC. It would include not just tax data by country but also revenues, profits, subsidies and number of employees. The 2013 data will be considered by the EC in 2014 for a competitiveness test. If it is decided that European banking competitiveness is not affected, the data would become public under the law from 2015.

Table 48: Country reporting requirements for banks under CRD IV from 1 January 2015

	CRD IV country reporting requirements
1	Name(s), nature of activities and geographical location
2	Turnover
3	Number of employees on a full time equivalent basis
4	Profit or loss before tax
5	Tax on profit or loss
6	Public subsidies received

Source: EC

The EC guidance states that institutions will be required to publicly disclose the information from 1 January 2015, and from 1 July 2014 they must disclose name of entity, nature of activity and geographic location as well as turnover and number of employees on FTE basis.

Furthermore, certain “global systematically important institutions” will be required to disclose additional information such as their pre-tax profit or loss, their taxes paid and any public subsidies received by 1 July 2014. Should this disclosure not be deemed to be prejudicial, all credit institutions and investment firms will have to disclose this information from 1 January 2015.

OECD BEPS

The OECD BEPS programme under its guidance for transfer pricing has a proposal that includes a non-public country reporting template for tax authorities equity, revenues, total payroll expenses, number of employees, book value of tangible assets, EBIT, income and withholding taxes paid, and certain intra-group payments (inbound and outbound), such as service fees, interest and royalties.

Unitary taxation

Based on "formulary apportionment", this approach to allocating taxes is held to be fairer by tax campaigners and NGOs, as it takes into account activity by allocating tax according to, for example, group sales, payroll and assets.

Critics argue that real economic activity can no more be ascertained through this approach than any other, as assets that are intangible or moveable are still subject to manipulation. Furthermore, all territories globally would need to agree on a specific formula and its application.

In our view, if the underlying data by country was available, this would be a start in allowing differing groups of stakeholders to engage further.

Table 49: Country reporting: key sectors

Sector	Legislation	Industry level of preparedness	Risk	Country Reporting Examples
Oil & Gas	EC Accounting Directive first disclosures due from late 2016; US Dodd Frank 1504 timeframe and scope revised due to oil lobby legal challenge. Uncertain outcome	Increasing country disclosure is visible from large caps	High risk from new disclosures, in our view, which could drive civil society campaigns/ reputational pressures/ licence to operate risks/ legal challenges and increased accountability with regulators & governments globally	Tullow Oil, Statoil
Mining	As above	Increasing country disclosure is visible from large caps	High risk from new disclosures, in our view, which could drive civil society campaigns/ reputational pressures/ licence to operate risks/ legal challenges and increased accountability with regulators & governments globally	Rio Tinto, Anglo American
Forestry	EC Accounting Directive first disclosures due from late 2016 (forestry not covered by US Dodd Frank)	Few examples of country reporting yet	Historically fewer controversies than other extractive industries, but the global players will come under increased scrutiny	Stora Enso provides some country and unit reporting
Banks	CRD IV disclosures beginning 2015 for turnover, employees, profit before tax, tax on profit or loss, public subsidies received - uncertainty over further scope	Surprisingly few examples of complete country reporting yet	Reputational risk is high, regulatory scrutiny likely to remain high after disclosures begin	Barclays, Banco Santander reveal a variety of country measures, HSBC disclose taxes paid by priority country
Construction	Proposed in EC Accounting Directive but not accepted	Very few examples of country reporting yet	Fewer tax scandals, bribery has been a focus	N/A
Telco	Proposed in EC Accounting Directive but not accepted	Few examples of country reporting yet	Greater scrutiny from media, numerous tax global controversies, e.g. Vodafone in UK and India	Telefónica, Vodafone
Retail	Less focus legislatively but pressure from civil society/media and consumer groups	Some companies reporting tax policies and data as a result of allegations	Greater scrutiny from media, political committees	Tesco
Utilities	Less focus legislatively but pressure from civil society/media and consumer groups	Few examples of country reporting yet but national bias in business model	Greater scrutiny from media, political committees (e.g. UK - water)	SSE

Source: Kepler Cheuvreux

Extractives: the prototype for country disclosure regulation

We include extractives in the country reporting section as in our view it could be the most material regulatory factor for sustainable investors looking at taxation in the sector in the long term.

The global effective tax rates of extractives can typically be much higher than for other sectors (see chart), but as the litigation declarations of Shell, Vale and Repsol attest, the sector is not immune to disputes despite higher rates and varied bases for taxation. The amounts due also vary according to the upstream/downstream mix, with upstream activities more heavily taxed due to production as well as profit-based liabilities. For example, Norway in particular has high tax charges and, as a result, Statoil's effective tax rate came in at 71.6% in 2013 (66.4% in 2012).

As a result of Dodd Frank 1504 (although currently undergoing legal challenge) and the EC Accounting and Transparency Directives, oil & gas, mining and (EU) forestry companies will need to declare a variety of payment types by country. Although the legislation was designed primarily as an anticorruption tool – as a range of taxes paid have to be declared – there are very clear implications for any future tax avoidance strategies.

The disclosure required by the EC Accounting Directive, the first of which is due in 2016, will be used by a variety of stakeholders. These could include not just civil society and local communities but also SRI investors analysing a variety of ESG risks and mainstream investors benchmarking a number factors for valuation purposes.

The extractives sector is the leader of all sectors in terms of country disclosure from large-cap European players. As this sector has been the primary target of regulation for country-by-country payment disclosure, it is more sensitive to issues related to the perception of fair payments, particularly in developing countries, where in future licence-to-operate may be increasingly affected through the perceived underpayment of taxes.

In our view, the introduction of full country-by-country reporting is essential for investors and at the heart of assessing a variety of risks well beyond taxation. For too long country-level data, which is intrinsic to measuring exposure, has been completely absent. When presented at all, the attempts at transparency have often been cursory. They sometimes entirely lack comprehensiveness, comparability, external assurance, standardisation both year-on-year within the company and across the sector and geography.

Transfer pricing is common in the industry and, in our view, its aggressive use to lower certain tax liabilities may present increased risk with the proposed introduction of country-by-country reporting in the EU and US due to the potentially increased visibility of such practices.

Lobbying

Many business organisations are highly influential in the consultation process for new tax legislation whether nationally, at the EU or via the OECD. The Business Roundtable is one example, with some members expressing aversion to the implications of country reporting. This is a US-led lobby group represented by hundreds of the largest global companies with a presence in the US. For US companies, group CEOs represent their firms and for foreign corporations primarily US unit CEOs. A letter written in September 2014 clarifies that any

country-by-country reporting obtained under OECD BEPS-led initiatives must remain confidential. Any future adoption of partial public disclosure, for example, is clearly going to be fought very hard. We also address lobbying against Dodd Frank 1504 below in more detail.

The case for confidentiality is overstated

The NGO coalition Publish What You Pay has summarised its case against the confidentially argument widely used by extractives companies:

Table 50: Responses to the confidentiality argument against country disclosure

Argument against disclosure	NGO counter argument	Examples
Companies cannot disclose confidential information as it is anti-competitive and regulation disallows it	Model Confidentiality Agreements have existed for 20+ years as the norm, where otherwise confidential information can be disclosed if required by stock exchange requirement or any form of government regulation It is accepted extractive industry standard for contracts to allow companies to disclose Contract terms are widely known within the industry As more companies begin to declare (See Tullow Oil), the argument will be self-evidently outdated The confidentiality approach is itself anti-competitive	Angola & Cameroon include such clauses specifically to attract investors - since these clauses protect investors from regulatory risk
Several countries referenced as evidence of the need for "exemption requirement" in country reporting regulation where government non-disclosure obligations exist	Angola, Cameroon, China & Qatar do not, in fact, prohibit disclosure Allowing for an exemption clause would actively encourage autocratic regimes with high levels of corruption to introduce legislation to prohibit disclosure	**Petrobras** cited as example; "We are active in 29 countries outside of Brazil and we are not aware of such a prohibition [against payment disclosure] in any of those countries" **Angola** - Statoil reports on payments **Cameroon** as an EITI implementing country does not allow it to have disclosure prohibitions in place **China** - based on single legal opinion commissioned by Shell but legal opinion is not conclusive **Qatar** - JV and PSA agreements include standard exemptions to confidentiality according to a letter submitted by Exxon to the SEC, the "commercially sensitive information" which is prohibited is not required to be disclosed under EC regulation

Source: Kepler Cheuvreux, Publish What You Pay

NGOs and regulatory pressure for disclosure

It has been the extractives sector which, as a result of civil society, has increased disclosure the most drastically in the last five years. However, NGOs continue to include the misuse of transfer pricing in developing countries (where corruption is high and infrastructure poor) as a major criticism against the sector – particularly within debates about equality and sustainable development. *Publish What You Pay* Norway released a report in 2012 alleging that over USD110bn was mispriced in EU and US trades in the 2000-10 decade to the benefit of the oil sector.

Examples of activism against specific companies for tax avoidance include Glencore in Zambia (NGO Sherpa and Bread for All – see section on country reporting) and Tullow Oil & Heritage Oil in Uganda (NGO Platform) and Shell's use of Swiss subsidiaries (SOMO).

Extractives exposed to varied taxes over project lifecycle

The extractives sector, in particular, encounters significant production-based taxes as opposed to purely profit-based taxes. All companies in the sector are keen to identify this factor in the fair taxation and local community contribution debate (see table below). Specific taxes arise in all upstream, midstream and downstream stages and each country may exhibit significant variations in the amounts levied and the degree to which they can be negotiated. Tax disputes can introduce substantial volatility at their extremes - such as that with Vale, which suffered a decade-long USD10bn dispute with Brazilian authorities for its treatment of foreign subsidiary transactions.

Table 51: Evolution of mining taxes according to Anglo American

Stage	Profitability	Taxes
Exploration	Operating and capital expenditure	Employee taxes, indirect taxes, and taxes paid by suppliers
Development	Operating and significant capital expenditure	Employee taxes, indirect taxes, and taxes paid by suppliers
Early production	Recovery of investment	Plus royalties
Full production	Net profit	Plus taxes on profit
Closedown	Closure and rehabilitation costs	As per exploration and development above

Source: Anglo American

Extractives tax litigation & controversies

Oil & Gas

Tullow Oil: Uganda asset sales and unsubstantiated bribery allegations

Bribery is a pervasive issue which can overlap with allegations of tax avoidance. British-based Tullow Oil faced a USD407m claim from the Ugandan government in 2011 for capital gains from the USD2.9bn sale of assets in that country to CNOOC and Total. Tullow paid 30%, and the dispute was sent to the country's appeals court.

A side effect of tax investigations in some countries, particularly emerging markets, can be that when corruption has been a factor in some negotiations, these become public allegation. Tullow encountered an indemnity claim from Heritage Oil regarding unpaid

capital gains tax from the sale of Ugandan assets. Bribery claims against Tullow were made in court during the tax dispute, but Tullow was cleared of all claims of corruption.

Shell India: complex transfer pricing arguments

Shell (like Vodafone) received a claim from the Indian government regarding the under-pricing of shares in 2009-11. The Indian subsidiary is accused of selling local shares to a parent company at significantly undervalued prices. One argument used by companies is that the shares were created, not sold, and thus should not be considered under the same tax legislation. Prior to this request Shell India had received a request for USD1bn in taxes on an equity infusion for USD160m related to a 2009 transaction with Shell Gas BV.

Repsol best practice: disclosing tax litigation

Repsol provides a summary of tax lawsuits in its annual report for a provision corresponding to “a large number of cases”. The amount is recognised in the balance sheet as EUR1,471bn for 2013 under “other provisions”. Details are provided below:

Table 52: Repsol - best practice: disclosure of tax litigation

Country	Entity/partner	Repsol ownership	Description of dispute
Brazil	Petrobas	25%	Tax documentation on onshore & offshore movement of materials/ equipment Personal Income Tax and economic activities tax 2008-09 for payment to foreign companies for chartering of exploration platforms/ services
Boliva	Repsol E&P Bolivia/ YPFB Andina	48,92%	Deduction of royalties and hydrocarbon interests for income tax liability
Canada	Repsol Energy Canada & Repsol Canada	100%	Use of accelerated tax depreciation 2005-08
Equador	Various	-	Income tax deductions for crude oil transportation
		Repsol Equador 35%	Calculation of crude sales benchmark price
		-	Tax treatment of subordinated debt
Spain	Repsol Spain	100%	2013 ruling to cancel 90% tax liability/penalties to date on income tax returns 1998-2005 2009-09 various income tax, VAT, hydrocarbon and other duties/ withholdings inspection assessment still open to appeal
Trinidad & Tobago	BP Trinidad & Tobago	30%	Pre-litigation investigations into various taxes including petroleum profit taxes, VAT/ withholdings and tax years

Source: Repsol Annual Report 2013

Mining sector controversies

Lonmin: allegations related to taxable income and labour commitments

Longstanding labour rights issues and the relationship with mining unions were exacerbated in September 2014 when allegations of tax avoidance were released in the South African press. Specifically, the allegations of use of profit shifting via its Bermuda subsidiary in order to reduce taxable income and thereby used in wage demand negotiations were denied by the company. Although we cannot confirm the allegations, we highlight how sustainability issues such as labour can give rise to secondary allegations related to the use of tax avoidance, adding to reputational loss.

Glencore: poor transparency, civil society activism and complex global operations

Within the extractives sector, Glencore has faced a number of investigations and allegations related to tax avoidance. In 2013, the Italian authorities opened an investigation alleging tax avoidance worth EUR120m related to Glencore's Portovesme unit; inquiries are focusing on transactions between a Sardinian zinc and lead smelter and the group. The allegation is that above-market prices were paid to other units within the Glencore Group to reduce tax liabilities.

NGOs have pinpointed Glencore's operations in Zambia (a country that has been the subject of a number of NGO reports on transfer pricing abuse) as another area of potential tax avoidance. The amounts of tax lost have been estimated in the hundreds of millions, and there have been allegations of a British Virgin Islands subsidiary being used as a channel within the controlling organisational structure of the Mopani mines.

Table 53: Glencore NGO report filed as taxation violation of OECD Guidelines for MNEs

2009 Audit by Grant Thornton at request of Zambian government
Unexplained increase in 2007 operating costs USD380m
Very low reported volumes of cobalt extraction compared with peer group
Manipulation of copper selling prices in violation of OECD "arm's length principle"

Source: Mining Watch

Suspension of operations: Glencore and First Quantum Minerals

Glencore suspended operations in Zambian copper projects in September 2014 after the government withheld over USD200m of tax refunds. Strategic goals included a 50%+ increase in copper output over 2-3 years, and over USD2bn had been invested in the country. First Quantum froze USD1.5bn of investments in the same year, also due to disputes regarding tax refunds.

Glencore Australia: "taxes paid" memo to staff

Reputation is not just about consumers...

...employees are on the front line particularly in competitive markets for skilled personnel

In July 2014, Australian media carried allegations that the company paid virtually no tax in the country for three years despite revenue of AUSD15bn. The stakeholders that Glencore targeted in its response were in fact domestic employees. In a memo, it stated royalties paid and corporate income taxes of AUSD8bn, or USD7.5bn, since 2007. Reputationally, the impact on mining companies may be highly visible in the interaction with employees via the effect on employee morale, retention and recruitment.

Best practice for country reporting: mining – Rio Tinto

Rio Tinto provides detailed disclosure at country and project level. Like many companies, it includes disclosure beyond income tax payments, which are relevant to the company's holistic contribution. However, where Rio Tinto has few peers is in the reconciliation between the aggregate taxes reported at country level and those in the P&L. In our view, such reconciliations are essential to ensure greater comparability between the differing standards used in financial statements and CSR reporting.

Indicators for a country reporting screen for extractives

The following items comprise the screen on country reporting for extractives on the basis that they form a rough guide to how far the companies will need to progress in order to report according to the EC.

Country reporting content

Where a CSR or standalone "taxes paid" report is available, we give the total number of countries where data is given and the measures reported. Where no such reporting is available, we highlight any country information contained in the annual report filing.

Number of countries of operation

This is based on a company's own disclosure of the total number of countries of operation, contained in the company description on the website. It gives an indication of the gap between the level of country reporting in the prior column and the optimum level.

Tax paid by country

Any disclosure of taxes paid is highlighted. Note that we exclude references to separate EITI reports. These are not equivalent to EC Accounting Directive standards and the time lag of reporting and discrepancies between the items included in different country reports can be significant, even in the rare cases (see ENI) where the company aggregates them in its own CSR report or website to make the information more easily accessible.

Reconciliation between country payments and P&L

Where taxes paid are disclosed, timing differences may account for discrepancies between country reporting and the P&L figures. However, differences between income tax expense on the income statement and the total income taxes paid figure in country reporting totals need to be reconciled. Failure to do so will, in our view, enhance reputational risk, despite the fact that the differences may be entirely legitimate. A bridge between the figures is readymade evidence that a company has nothing to hide.

Intragroup transactions

These types of transactions are purchases or sales from within the network of a group's organisational structure and have been the root cause of the majority of both government tax litigation and media reported tax controversy. 60% of world trade is said to originate from such transactions but almost no companies report this by country. Earnings quality can under some circumstances also be better assessed by understanding profit shifting practices which aggressively use taxation as a "booster". Though relevant for all sectors we note this in any screen for extractives companies in particular as EC legislation may increase the focus on trying to establish the location and local impacts of its use.

Project reporting

The EC Accounting directive requires project level payments to be declared. These are defined as "the operational activities which are governed by a single contract, licence, lease, concession or similar legal agreement, and form the basis for payment liabilities with a government". We highlight which companies have already started reporting this.

Externally audited

The EC Accounting Directive requires independently audited figures. We believe that for credibility such an audit is vital, even for those companies not subject to the directive.

EITI members

The Extractives Industry Transparency Initiative (EITI) has laid the foundation for the sector's current reporting and also for further regulation in this area. However, the vast majority of companies that are EITI members actively lobbied against, for example, US regulation on country reporting of taxes paid - Dodd Frank 1504. Investors may feel that companies who are EITI members should be held to account according to the spirit of the EITI to make fuller declarations. They may also wish to take a position that there is a mismatch in EITI members actively lobbying against country reporting regulation – especially via industry bodies such as the American Petroleum Institute, which successfully bought a lawsuit against the SEC (US Securities and Exchange Commission) to delay and weaken Dodd Frank 1504 implementation, which is still on hold.

Table 54: Trade Associations in Court Case against SEC on Dodd Frank 1504 payments reporting

Trade Association	Description
American Petroleum Institute	500+ Global Oil & Gas Industry Members
US Chamber of Commerce	The largest spending lobby group in the US, 7000+ US Chambers, present in 100+ countries, includes SME representation
Independent Petroleum Association of America	Represents Exploration and Production segments in US
National Foreign Trade Council	Cross Sector US companies' interests represented - with focus on foreign legislation

Source: Kepler Cheuvreux

Table 55: Mining sector: country reporting

Company	Country reporting content	No. of countries of operation	No. of countries tax paid disclosed	Reconciliation between country payments and P&L	Intragroup transactions	Project report	Ext audit	EITI
Glencore	No country reporting, only reference to EITI	50+	None	N/A	No	No	N/A	Yes
BHP	Annual report discloses China, Japan, Australia, India, UK revenues & employees, LT assets in Australia, UK. CSR contains EVA report with five broad global segments only including "gross taxes and royalties"	25	14	No	No	No	N/D	Yes
Anglo American	"Payments to governments" reporting in countries in CSR report. Annual report discloses only South Africa as single entity for revenue, op income, assets, liabilities, employees	7	7	No	No	No	N/D	Yes
Rio Tinto	Country reporting at national and detailed local level with some disclosure for business units. Annual report discloses revenue for China, Japan, US , Canada, Australia, UK	40+	28	Yes	No	Yes	Yes	Yes
Boliden	Annual report discloses revenue for Germany, UK and Sweden. Assets, capex, employees for Sweden, Finland, Ireland and Norway. EVA references total gross taxes in GRI report	7	None	No	No	Production Data & Employee numbers	N/D	No, but reference to EITI obligations for business partners in CR Principles
Eramet	Annual report discloses revenue, assets, capex, employees for France only	20	None	No	No	No	N/A	Yes
Lundin Petroleum	Annual report discloses income taxes for Norway, Netherlands, Indonesia, Russia - split by current and deferred tax Revenue/assets/equity & liabilities per country Norway, Indonesia, Tunisia, Malaysia, France, Netherlands	9+	5	No	None	Yes	Yes	Yes
Norsk Hydro	Annual report discloses revenues/non-current assets/investments in : Norway, Germany, UK, Italy, Spain, Poland, France, Netherlands, Switzerland, US, Canada, Brazil, Qatar, Japan, Singapore, South Korea, Saudi Arabia	18+	None	No	No	No	N/A	Yes

Source: Kepler Cheuvreux

Best practice: oil & gas – Tullow Oil

In the oil & gas sector, Tullow Oil provides detailed reporting at country and project level. According to its disclosure, this is prepared on an EC Accounting Directive standard basis.

Super majors: a big gap between EC standards and current reporting

We analyse the European super majors below for key items of country reporting disclosure. They are far from the level of EC requirements, and in our view the danger is that some of the arguments used to justify confidentiality may become eroded if smaller companies begin comprehensive reporting for countries where confidentiality has been held as an issue for the super majors. To the screen (used for the mining sector in prior section) we add one item related to lobbying for the oil & gas sector - API membership:

American Petroleum Institute (API) member

Although various lobbying bodies exist, and function to increase shareholder value through a variety of legislative involvements, in our view lobbying against country regulation is not one of them. Shareholders stand to benefit from increased transparency in order to assess a variety of material financial and non-financial risks, despite overstated claims that confidentiality is undermined. Statoil has been the only API member to publically disclaim involvement with the organisations lobbying work against Dodd Frank 1504.

Table 56: An overview of super majors country reporting

Company	Country reporting Content	No of countries of operation	Tax paid by country	Reconciliation between country payments and P&L	Intra group transactions	Project reporting	Ext audit	EITI member	API lobby
RD Shell	CSR reports "largest amounts by country", excludes countries "whose governments have prohibited or have otherwise indicated we should not make such a disclosure"	70+	Partial (14 countries)	No	No	No	No	Yes	Yes
BP	Annual report only splits revenue & operating income for US & UK	Approx 80	No	N/A	No	No	N/A	Yes	Yes
Total	Annual report discloses France revenue and capex	130+	No	N/A	No	No	N/A	Yes	Yes

Source: Kepler Cheuvreux

Table 57: Other oil & gas

Company	Country reporting content	No of countries of operation	No of countries tax paid disclosed	Reconciliation between CSR country reporting and P&L	Intragroup transactions	Project report	Ext audit	EITI member	API
Tullow Oil	Aligned with EU Directive standards	24	22	No	No	Yes	Yes	Yes	No
BG Group	Website reference to EITI reporting with figures for taxes paid for Norway, Tanzania, Trinidad & Tobago	20+	No	No	No	No	N/A	Yes	No
Statoil	Eleven measures reported, via online spreadsheet. Annual report discloses revenue and sector-specific indicators for Spain only	36	29	No	Total of Eliminations of intra group sales only	No	No	Yes	Yes but DF1504 lobby disclaimed
Repsol	Income tax and other charges reported for 13 countries	50+	13	No	No	No	No	Yes	Yes
ENI	Only via EITI reports Norway, DRC, Trinidad & Tobago, Indonesia, Nigeria, East Timor, Kazakhstan, Rep Congo, Mozambique, Iraq and Gabon	85	No	No	No	No	N/A	Yes	No

Source: Kepler Cheuvreux

Forestry: no "taxes paid" disclosure from major companies yet

The EC Accounting Directive applies specifically to companies engaged in logging activity, i.e. extraction from primary forests. Although the largest European players in the sector provide above-average country detail on items such as revenue, no company breaks down taxes paid by country.

Table 58: Forestry: country reporting survey

Company	Country reporting content	Number of countries of operation	No of countries tax paid disclosed	Reconciliation between country payments and P&L	Intragroup transactions	Project reporting	Ext audit
Stora Enso	Annual report discloses revenue in corporate income tax by region, employee numbers by country	35	No	No	No	No	N/A
UPM	Annual report discloses revenues, in Germany, US, Finland, UK, China, France, Canada, Uruguay, also assets, capex in eight countries, employees in 22 countries	65	No	No	No	No	N/A
Holmen	Annual report discloses revenue for Sweden, Germany, UK, Spain, Italy, Netherlands, France, and non-current assets for Sweden, UK and Spain	10+	No	No	No	No	N/A

Source: Kepler Cheuvreux

Analyst survey

In our ESG analyst survey of taxation, common themes were echoed regarding the use of tax breaks such as relocation to lower-tax jurisdictions, tax loss carryforwards, the longevity of sector-specific tax schemes, as below:

Table 59:Tax screen

Indicator	Explanation	Source
Tax rate	Last effective tax rate	Analyst
Statutory rate	Based on country of domicile rate	Bloomberg
Short to medium term risk from tax optimisation	Visibility on perception of company tax practices	Analyst
Potential earnings impact from future tax normalisation	How tax normalisation could move earnings	Analyst
Key disclosure missing	An analyst view on what's missing	Analyst

Source: Kepler Cheuvreux

We include screens both for companies with effective tax rates above and below peer group. Inclusion on the list does not necessarily mean that a controversy has occurred or that a tax risk is not being managed. However, the list aims to highlight where tax is a visible issue. Certain company approaches, with for example domicile in a low-tax jurisdiction when it is evident that this has been done as a tax minimisation strategy (e.g. SES in Luxembourg) may mean some element of exposure either to regulatory change or potentially to controversy.

In other cases involving intellectual property, analysts have highlighted the use of special tax regimes such as the UK Patent Box (e.g. by Arm Holdings and GSK). Similar regimes exist in other countries such as the Netherlands (see ASML). These are widely considered entirely legitimate and can prove constructive drivers for economic stimulus in areas where governments have prioritised it. However, if the tax regimes are removed, in some cases there may be a potential impact.

Table 60: Tax issues most often noted by analysts

Tax Issue	Country	Company examples
Use of lower tax jurisdictions/ domicile	Luxembourg	SES
	Ireland	Informa, CRH
	Switzerland	DSM
	Netherlands	Thales
	Monaco	SBM Offshore
Unused Tax Loss carry forwards	Basilea Pharmaceutica, Telenet	Basilea Pharmaceutica, Telenet
Emerging Markets presence	China rate at 15%	Schneider Electric/ Vossloh
Reduction in country corporate tax rate	Sweden	see also AstraZeneca
Patent Box	UK	ARM Holdings
	Netherlands	ASML

Source: Kepler Cheuvreux

Table 61: Analyst comments - tax rates below peer group

Company	Tax rate % 2013	Statutory rate	ST – MT risk from tax optimisation	Earns impact from tax normalisation	Analyst comments	Sector	Country	Key disclosure missing
Cobham	9.60%	20%	Med	Med	The company has a quite low tax rate (15.8% in 2012, 9.6% in 2013), generally between 15% and 20%. However, this is not really due to tax optimisation policy. The company has many of its sites in the UK and in the US. Any tax normalisation would be quite neutral for the company's earnings. A slight decrease in earnings has yet to be taken into account. Therefore, there is no particular momentum, positive or negative, from the company in normalising and mitigating any past strategy on tax optimisation.	Aerospace & defence	United Kingdom	None.
Air France KLM	148.30%	33%	High	High	In 2012 the group had deferred tax assets of EUR1645 for the French fiscal group and EUR455 for the Dutch fiscal group. The recoverability horizon is 11 years for the French perimeter and 6 year for the Dutch perimeter. The non-realisation of these assumptions could have a significant impact on the recoverability horizon for these deferred tax assets. The income tax expense for 2013 was EUR957m.	Airlines & airports	France	
Intesa Sanpaolo	51%	N/A	High	High	Tax rate was very high in 2012 because of the Italian regulator's cap on deductibility of loan loss provisions. As soon as loan loss provisions normalises, tax rate should do likewise (-23.8% in 2013). The tax rate is also burdened by temporary banking levies applied in several CEE countries.	Banks	Italy	Clear enough.
Unicredit	11.10%	N/A	Med	High	A number of European countries have introduced temporary banking levies (EUR147m charges in 2012 accounts of UniCredit) which are set to be cancelled in the coming years. The high level of provisions in Italy is negatively affecting the tax rate because of the cap on provisions deductibility.	Banks	Italy	Breakdown by country.
Schneider Electric	25%	34%	High	High	The effective tax rate has increased from 22.8% to 23.1%, and the corresponding tax expenses have increased from EUR547m to EUR568m. Exposure to China (tax rate at 15% under certain conditions) and some emerging countries could explain this situation. To a lesser extent, exposure to the US is also an optimisation factor.	Capital goods	France	
Imtech	3.30%	25%	Med	High	After the losses in 2012 and 2013, Imtech will have a large amount of tax loss carryforwards, split between Poland, the Netherlands and Germany. Only in the latter country can these be used indefinitely; in the others they will evaporate over time.	Capital goods	Netherlands	
Deutz	13.30%	30%	Low	High	The company's low current and future tax rate is due to huge tax loss carryforwards. These amount to EUR1.5bn. More than 90% of them will not expire. There is no tax evasion strategy by the company.	Capital goods	Germany	The information provided is comprehensive, in our view.
Zurich Insurance Group	24.90%	N/A	Low	High	Zurich benefits from a below-average Swiss corporate tax rate, as well as from some hubs in low-tax countries (e.g. Ireland).	Capital goods	Germany	The different tax rate of the main subsidiaries
Vossloh	34.40%	30%	Med	High	The company's tax rate was below average in 2012 because it generated a significant share of earnings in China where it received a limited tax holiday as an incentive to invest in local production. This tax holiday will gradually expire over the next couple of years, hence we would expect the group's tax rate to approach peer group average. The 2013 effective tax rate was 34.3%.	Capital goods	Germany	

Source: Kepler Cheuvreux

Table 62: Analyst comments - tax rates below peer group

Company	Tax rate % 2013	Statutory rate	ST – MT risk from tax optimisation	Earns impact from tax normalisation	Analyst comments	Sector	Country	Key disclosure missing
Syngenta	14.70%	18%	High	High	We assume Syngenta enjoys tax benefits in Switzerland given its high R&D expenses in this country. Should this system change, tax rate could rise materially. We expect the tax rate to rise to 20% in the medium term due to rising exposure to emerging markets and absence of one-off tax benefits in 2012.	Chemicals	Switzerland	Tax payment by country, pre-tax profit by country and average tax rate paid by companies in individual countries.
DSM	22%	25%	Low	Med	The company's tax rate was low in 2012 (15%) as it benefits from tax benefits in Switzerland on R&D spending in this country. The tax rate is likely to be 18% going forward (vs. 15% in 2012). Little risk of a substantial increase is expected short-term. But that might change if the tax regime changes in Switzerland. The group tax rate was 25% in 2010, which was seen as a year of normal business conditions.	Chemicals	Netherlands	Details on tax payments by country plus pre-tax profits by country would make the group's tax rate easier to understand.
Lanxess	29.70%	30%	High	Med	Lanxess uses tax holidays in Singapore in synthetic rubber, which will run out in a couple of years. We see a risk of tax rate rising from 23% in 2012 to 30% by end of this decade.	Chemicals	Germany	Tax payment in each country, pre-tax profit in each country and average tax rate in the respective countries for companies.
CRH	37.20%	21%	Med	Med	The Irish corporate tax rate (12.5%) is quite low compared with that of France. 17.8% effective tax rate for 2012.	Construction & materials	Ireland	
Bouygues	40%	33%	High	Med	As the group relies to a great extent on the international business, the complexity of tax would raise some issues.	Construction & materials	France	
Smurfit Kappa	10.5% cash tax	13%	Med	High	The company has a tax loss carry forward, and is innovative in its tax treatment; over time it is probable that the tax rate will start to creep up towards the sector average. (33.3% in 2013).	Forestry, Paper and Packaging	Ireland	
SES	12.90%	33%	High	High	As SES is a Luxemburg-based company with affiliates in some "exotic" places, the group benefits from significant tax advantages on which we have a poor visibility and understanding as to their sustainability. Over the past years and years to come, SES expects an income tax rate of 10-20%.	Media	France	
UBM	10%	23%	Med	High	UBM's tax domicile returned to the UK (from Jersey) following a shareholders' vote in November 2012.	Media	United Kingdom	Although the tax optimisation practices are not at risk, UBM is still benefiting from material tax-loss carryforwards (upon past writedowns) that are likely to reduce in 2014-16 leading the tax rate to align with professional publishing industry standards of >25%.
Informa	21.50%	23%	Med	High	This adjusted tax rate benefits from profits generated in low-tax jurisdictions, including Switzerland. The group's tax credit on statutory profit before tax was negative 35.4% (2011: group tax charge of 16.1%). Of the corporate taxes paid of GBP45.5m (2011: GBP44.0m), c. GBP33m (2011: c. GBP28m) was paid in the UK.	Media	United Kingdom	Effective earnings and taxation by country, etc.

Source: Kepler Cheuvreux

Table 63: Analyst comments - tax rates below peer group

Company	Tax rate % 2013	Statutory rate	ST – MT risk from tax optimisation	Earns impact from tax normalisation	Analyst comments	Sector	Country	Key disclosure missing
Basilea Pharma-ceutica	0	18%	Low	High	In 2012 the company an unused tax loss carry forward of CHF357m, compared with a pre-tax loss of c.CHF 52m and revenues of CHF58.3m. We believe the tax loss carry forward is one of the main attractions of Basilea as a takeover target.	Pharma & biotech	Switzerland	
Astra Zeneca	21.30%	23%	Low	High	Company's 2012 annual report validates multiple strands of tax approach: "*The tax rate of 18% for the year ended 31 December 2012 is lower than the UK Statutory Corporation Tax rate of 24.5% mainly as a result of the USD230m adjustment to deferred tax balances following substantive enactment of a reduction in the Sweden Statutory Corporation Tax rate from 26.3% to 22% effective 1 January 2013, the USD240m release of a tax provision following the settlement of a transfer pricing matter and the difference in effective overseas tax rates as discussed below. Excluding the effects of the one-off benefits totalling USD470m mentioned above, the tax rate is 24.1%.*"	Pharma & biotech	UK	
Novartis	12.90%	21%	Low	High	Novartis has a very active tax optimisation policy that has enabled it to have a tax rate below its peers. A potential normalisation of the tax rate is not a real downside risk, in our view, because its tax optimisation is implemented through optimal geographical allocation of products and resources.	Pharma & biotech	Switzerland	
Actelion	5.30%	N/A	Med	Med	A higher proportion of sales being generated in emerging markets.	Pharma & biotech	Switzerland	
Deutsche Wohnen	2.40%	N/A	Low	High	The company has a low effective tax rate due to high tax loss carryforwards.	Property	Germany	Not applicable
TAG Immobilien	2.86% (2014)	N/A	Low	High	The company has a low effective tax rate due to high tax loss carryforwards.	Property	Germany	Not applicable
LEG Immobilien	14.20%	N/A	Med	High	The company has a low effective tax rate due to high tax loss carry forwards. 2.1% in 2012	Property	Germany	Not applicable
ARM Holdings	35.50%	23%	Low	High	Tax rate benefitting from UK patent Box. Patent box legislation just enacted, valid for coming five years.	Semis	United Kingdom	
ASML	1%	25%	Low	High	Tax rate benefitting from Dutch patent box, with virtually no taxes on profits made from patents	Semis	Netherlands	
Infineon	7.80%	30%	Med	Med	Huge tax loss carryforwards may be usable to a lesser extent going forward, or may expire after a certain time.	Semis	Germany	
Telefónica	20.80%	N/A	Med	High	There is a moderate risk of higher effective tax rates as governments try to raise their tax revenues. Changes to the rules on tax credit may have a material impact on Telefónica.	Telecom services	Spain	None

Source: Kepler Cheuvreux

Table 64: Analyst Comments - Tax rates above peer group

Company	Tax rate % 2013	Statutory rate	ST – MT risk from tax optimisation	Earnings impact of potential tax normalisation	Analyst comment	Sector	Country	Key disclosure missing
Renault	38,40%	38%	Low	High	For the first time in 2013, more than 50% of the company's units were outside Europe. A future tax normalisation would be unlikely to affect Renault's operations.	Auto	France	
Plastic Omnium	25%	33%	Med	Med	The group's tax rate is below the 33% average in France, but its increasing exposure to developing countries reduces the tax rate.	Auto Parts	France	
Brembo	14,60%	31%	Med	Med	We do not have evidence of rising company-specific risk for Brembo. We merely highlight the generic risk of fiscal harmonisation in the long run.	Auto Parts	Italy	None in particular.
FLSmidth	34%	25%	Low	Med	Considering that the company pays a fairly high tax rate due to its geographical exposure, we do not see a risk of tax rates rising further if any tax optimisation actions were to be restricted.	Cap Goods	Denmark	Tax paid by region would have been useful.
UBI Banca	42,90%	N/A	Med	High	The cap to tax deductibility of loan loss provisions in Italy is negatively impacting the tax rate in current tough times with worsening of credit quality requiring massive provisions.	Capital goods	Italy	UBI Banca has very comprehensive annual report and presentations.
Cargotec	29,60%	26%	Low	High	There seems to be a fairly low tax planning activity. However, with a separate listing of a business area in Singapore, the company has warned that its tax rate may increase.	Capital Goods	Finland	Tax paid in different countries.
Holcim	25%	18%	Med	Med	In 2012, it included several provisions for risks related to direct and indirect taxes of CHF51m (2011: 32).	Cement	Switzerland	
Heijmans	0,35	N/A	Low	Med	Tax rate is currently high due to some operations making losses with no possibility to compensate.	Construction	Netherlands	
Thales	30%	33%	Med	Med	Thales may be present in the Netherlands, via a holding and thus a tax optimisation scheme. Consequently, the company gathers a lot of its foreign revenues in the Netherlands in order to avoid excess taxes. Nonetheless, this remains totally legal and is based on bilateral agreements.	Defence	France	None.
Eurazeo	7%	34%	High	High	As a private equity investor and a listed company on a regulated market, Eurazeo could be adversely affected by changes to the legislative, regulatory and tax environments. For instance, a reinforcement of prudential rules applicable to the banking industry could reduce the availability of financing for private equity transactions.	Financial Services	France	
Pernod-Ricard	25,20%	33%	Med	High	PR is doing a good job in optimising its tax rate (large production in Ireland). Risk on tax is to the upside, in our view.	Food & Bev	France	Geographical split of the production base.
Metro	95,20%	30%	Low	High	Its high tax rate is due to the fact that the company can no longer capitalise loss carryforwards (Germany).	Food retail	Germany	
Hermès	31.7% (vs 32.3% in 2011)	33%	Low	High	In the short to medium term, the impact of tax normalisation would be rather limited since we think that Hermès is very cautious on fiscal optimisation.	Luxury Goods	France	

Source: Kepler Cheuvreux

Table 65: Analyst Comments - Tax rates above peer group

Company	Tax rate % 2013	Statutory rate	ST – MT risk from tax optimisation	Earnings impact of potential tax normalisation	Analyst comment	Sector	Country	Key disclosure missing
SBM Offshore	41.2% (Bloomberg)	25%	Med	High	In the past, a tax rate of only a few percentage points was applicable. The very international business of SBM coupled with its Monaco HQ were the main reasons for this.	Oil Services	Netherlands	Difficult to see how income streams are really going, in terms of regions and how this could change in time, given the rise in tax pressure in recent years.
Icade	0% in France	N/A	Med	High	Most companies in the French real estate sector are under the SIIC regime and do not pay tax on their rental income from their French portfolio, while shareholders pay taxes on their dividends. The tax rate is generally below 5% considering that some parts of the firm may not be under the SIIC regime (non-French portfolio, non-rental business).	Property	France	Tax rates not relevant criteria for property companies. Importance lies in likelihood of seeing French government amend SIIC regime (French REIT).
Klépierre	0% in France	N/A	Med	High	Most companies in the French real estate sector are under the SIIC regime and do not pay tax on their rental income from their French portfolio, while shareholders pay taxes on their dividends. The tax rate is generally below 5% considering the fact that some parts of the firm may not be under the SIIC regime (non-French portfolio, non-rental business).	Property	France	Tax rates not relevant criteria for property companies. Importance lies in likelihood of seeing French government amend SIIC regime (French REIT).
Gecina	2,60%	N/A	Med	Med	Most companies in the French real estate sector are under the SIIC regime and do not pay tax on their rental income from their French portfolio, while shareholders pay taxes on their dividends. The tax rate is generally below 5% considering the fact that some parts of the firm may not be under the SIIC regime (non-French portfolio, non-rental business).	Property	France	Tax rates not relevant criteria for property companies. Importance lies in likelihood of seeing French government amend SIIC regime (French REIT).
Mercialys	0,60%	N/A	Med	Med	Most companies in the French real estate sector are under the SIIC regime and do not pay tax on their rental income from their French portfolio, while shareholders pay taxes on their dividends. The tax rate is generally below 5% considering the fact that some parts of the firm may not be under the SIIC regime (non-French portfolio, non-rental business).	Property	France	Tax rates not relevant criteria for property companies. Importance lies in likelihood of seeing French government amend SIIC regime (French REIT).
Unibail-Rodamco	<2%	N/A	Med	Med	Most companies in the French real estate sector are under the SIIC regime and do not pay tax on their rental income from their French portfolio, while shareholders pay taxes on their dividends. The tax rate is generally below 5% considering the fact that some parts of the firm may not be under the SIIC regime (non/-French portfolio, non-rental business).	Property	France	Tax rates not relevant criteria for property companies. Importance lies in likelihood of seeing French government amend SIIC regime (French REIT).
Telenet	34%	34%	Low	High	Within the company there are around EUR250m of NOLs that can be used to offset future taxable profits. We expect the company to pay taxes as off mid-2015.	Telco	Belgium	

Source: Kepler Cheuvreux

Kepler Cheuvreux

Research ratings and important disclosures

Disclosure checklist - Potential conflict of interests

Stock	ISIN	Disclosure (See Below)	Currency	Price
ABB	CH0012221716	nothing to disclose	CHF	20.31
ABBOTT LABORATORIES	US0028241000	nothing to disclose	USD	42.46
ABBVIE	US00287Y1091	nothing to disclose	USD	60.29
ADOBE SYSTEMS	US00724F1012	nothing to disclose	USD	67.01
AkzoNobel	NL0000009132	nothing to disclose	EUR	51.14
Alstom	FR0010220475	nothing to disclose	EUR	27.08
AMAZON.COM	US0231351067	nothing to disclose	USD	287.0598
AMGEN	US0311621009	nothing to disclose	USD	147.26
Anglo American	GB00B1XZS820	nothing to disclose	GBP	1,308.00
AOL	US00184X1054	nothing to disclose	USD	41.77
Apple	US0378331005	nothing to disclose	USD	105.22
AstraZeneca	GB0009895292	nothing to disclose	GBP	4,327.50
Atlas Copco	SE0000101032	nothing to disclose	SEK	202.6
Barclays	GB0031348658	nothing to disclose	GBP	302.63
Bayer	DE000BAY0017	nothing to disclose	EUR	105.75
BG	GB0008762899	nothing to disclose	GBP	1,043.00
BHP Billiton	GB0000566504	nothing to disclose	GBP	1,825.00
BNP Paribas	FR0000131104	nothing to disclose	EUR	49.51
Boliden	SE0000869646	nothing to disclose	SEK	115
BOSCH	INE323A01026	nothing to disclose	INR	15003
BP	GB0007980591	nothing to disclose	GBP	432.85
BRISTOL MYERS SQUIBB	US1101221083	nothing to disclose	USD	53.63
Bulgari	IT0001119087	nothing to disclose	EUR	12.23
Chevron	US1667641005	nothing to disclose	USD	115.91
CISCO SYSTEMS	US17275R1023	nothing to disclose	USD	23.78
CITIGROUP	US1729674242	nothing to disclose	USD	51.8
COCA COLA	US1912161007	nothing to disclose	USD	41.03
COVIDIEN	IE00B68SQD29	nothing to disclose	USD	89.64
Credit Suisse Group	CH0012138530	nothing to disclose	CHF	24.59
Deutsche Bank	DE0005140008	nothing to disclose	EUR	25.1
ELI LILLY	US5324571083	nothing to disclose	USD	66.05
ENI	IT0003132476	14, 16, 18	EUR	16.4
Eramet	FR0000131757	nothing to disclose	EUR	74.24
Ericsson	SE0000108656	nothing to disclose	SEK	82.75
Exxon Mobil	US30231G1022	nothing to disclose	USD	94.49
FACEBOOK CLASS A	US30303M1027	nothing to disclose	USD	80.67
FIAT CHRYSLER AUTOS.	NL0010877643	nothing to disclose	EUR	7.485
Fortum	FI0009007132	nothing to disclose	EUR	17.84
GENERAL ELECTRIC	US3696041033	nothing to disclose	USD	25.64
GlaxoSmithKline	GB0009252882	nothing to disclose	GBP	1,415.50
Glencore Xstrata	JE00B4T3BW64	nothing to disclose	GBP	316.95
Goldman Sachs GP.	US38141G1040	nothing to disclose	USD	168.01
GOOGLE 'A'	US38259P5089	nothing to disclose	USD	548.8999
HEWLETT-PACKARD	US4282361033	nothing to disclose	USD	34.93
Holmen	SE0000109290	nothing to disclose	SEK	236.7
HSBC	GB0005405286	nothing to disclose	GBP	380.6
INTERNATIONAL BUS.MCHS.	US4592001014	nothing to disclose	USD	162.08
JOHNSON & JOHNSON	US4781601046	nothing to disclose	USD	103.13
JP MORGAN CHASE & CO.	US46625H1005	nothing to disclose	USD	58.74
Julius Baer	CH0102484968	nothing to disclose	CHF	40.15
LLB 'B'	LI0030195247	nothing to disclose	CHF	39.65
Lundin Petroleum	SE0000825820	nothing to disclose	SEK	100.1
LVMH	FR0000121014	nothing to disclose	EUR	128.25
Maurel & Prom	FR0000051070	nothing to disclose	EUR	9.72
MEDTRONIC	US5850551061	nothing to disclose	USD	66.56
Merck KGaA	DE0006599905	nothing to disclose	EUR	70.95
MICROSOFT	US5949181045	nothing to disclose	USD	46.13
NORSK HYDRO	NO0005052605	nothing to disclose	NOK	36.42
Novartis	CH0012005267	nothing to disclose	CHF	85.75
NOVO GROUP	SG2C46963931	nothing to disclose	SGD	0.14
ORACLE	US68389X1054	nothing to disclose	USD	38.73
PEPSI-COLA PRDS.PHILPS.	PHY6837G1032	nothing to disclose	PHP	4.69
PFIZER	US7170811035	nothing to disclose	USD	29.11
Procter & Gamble	US7427181091	nothing to disclose	USD	85.16
QUALCOMM	US7475251036	nothing to disclose	USD	76
Reed Elsevier	NL0006144495	nothing to disclose	EUR	17.35
Repsol	ES0173516115	nothing to disclose	EUR	17.43
Rio Tinto	GB0007188757	nothing to disclose	GBP	2,337.05

Continued on next page...

Disclosure checklist - Potential conflict of interests...continued

Stock	ISIN	Disclosure (See Below)	Currency	Price
Roche	CH0012032048	nothing to disclose	CHF	278
Royal Dutch Shell	GB00B03MLX29	nothing to disclose	EUR	27.88
SABMiller	GB0004835483	nothing to disclose	GBP	3,357.50
Sandvik	SE0000667891	nothing to disclose	SEK	80.85
Sanofi	FR0000120578	nothing to disclose	EUR	84.6
Santander	ES0113900J37	nothing to disclose	EUR	7.04
Shire Pharmaceuticals	JE00B2QKY057	nothing to disclose	GBP	4,050.00
SKF	SE0000108227	nothing to disclose	SEK	146
Société Générale	FR0000130809	nothing to disclose	EUR	38.84
Solocal Group	FR0010096354	nothing to disclose	EUR	0.49
SSE	GB0007908733	nothing to disclose	GBP	1536
STARBUCKS	US8552441094	nothing to disclose	USD	75.81
Statoil	NO0010096985	nothing to disclose	NOK	155
Stora Enso	FI0009005961	nothing to disclose	EUR	6.43
Telefonica	ES0178430E18	14, 16, 18	EUR	11.45
Total	FR0000120271	nothing to disclose	EUR	44.86
Tullow Oil plc	GB0001500809	nothing to disclose	GBP	494.6
UBM	JE00B2R84W06	nothing to disclose	GBP	541
UBS	CH0024899483	nothing to disclose	CHF	15.58
Unicredit	IT0004781412	2, 14, 18, 19	EUR	5.89
Unilever	NL0000009355	nothing to disclose	EUR	29.28
United Technologies Corp.	US9130171096	nothing to disclose	USD	103.82
UPM	FI0009005987	6	EUR	10.92
Vodafone	GB00BH4HKS39	nothing to disclose	GBP	200.5
WALGREEN	US9314221097	nothing to disclose	USD	62.65
WPP	JE00B8KF9B49	nothing to disclose	GBP	1,178.00
YAHOO	US9843321061	nothing to disclose	USD	43.5

Source: Factset closing prices of 24/10/2014

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Source: Kepler Cheuvreux
A: % of all research recommendations
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Kepler Capital Markets, Amsterdam branch	Autoriteit Financiële Markten	AFM
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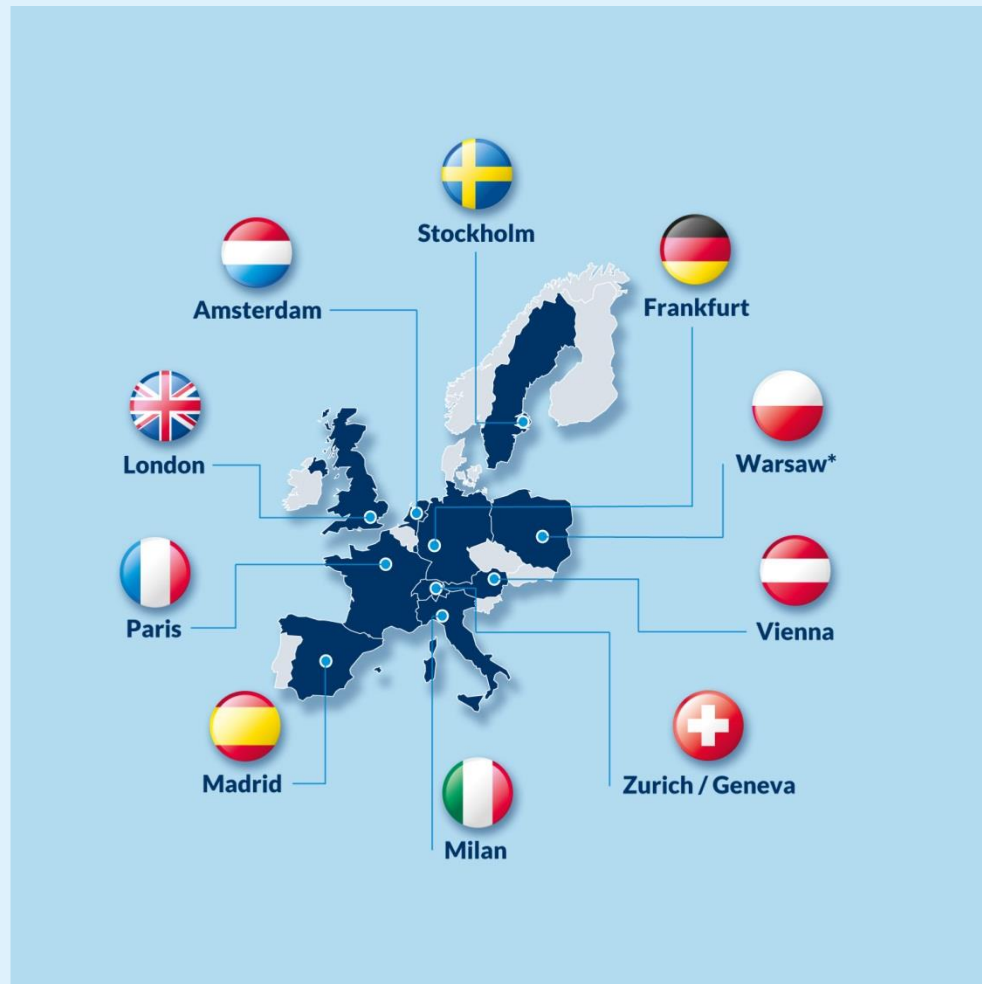

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