Corporate tax responsibility: a dialogue between companies and investors
1. Introductory Remarks – Valeria Piani – Associate Director, ESG Engagements, PRI

2. Investor Perspective – Robert Wilson, Research Analyst, MFS Investment Management

3. Company Perspective – Clive Baxter, Head of Corporate Tax – Maersk

4. Q & A – Moderated by Valeria Piani

5. Closing Remarks – Valeria Piani
Questions

Technical Difficulties: If you have technical issues, please let us know by typing a message in the Questions pane (A). You can raise your hand (B) if we do not respond.

Q&A: We will be taking questions on content at the end, but you can send them to us throughout the webinar by using the Questions pane (A). Please specify to whom the question should be directed.

Example: Question for John Doe: What are land rights?
PRI Guidance on Corporate Tax Responsibility

- Economic slowdown, growing inequality, increasing media and civil society scrutiny and upcoming legislation are increasing pressure on companies
- Tax is not a cost to minimise but a key systemic risk
- 11 PRI signatories involved to produce an engagement guidance to promote company-investor dialogue.
How to engage – step 1: identify the risks in your portfolio

- A large, persistent tax gap
- Large or growing unrecognised tax benefits balance (UTBs)
- Media stories or government inquiries
- Foreign effective tax rate
- Changes in language used in tax footnotes
- Opaque disclosure of geographic revenue mix
- Lack of tax policy
- Multiple subsidiaries in tax havens
How to engage – step 2: ask the right questions

- Tax policy
- Tax governance
- Managing tax-related risk
- The effective tax rate
- Tax planning strategies
- Country by country reporting (CbCR)
INVESTOR PERSPECTIVE

Rob Wilson
Research analyst, MFS Investment Management
Corporate Tax Minimization: Earnings & Governance Implications for Investors

AGENDA

• An overview of MFS' investment process
• Why we view aggressive tax minimization as a risk
• Our analysis of tax risks
• How we use tax analysis in our investment decision making process
• Our views on tax engagement and disclosure

*The views expressed in this presentation are those of the speaker and are subject to change at any time. These views should not be relied upon as investment advice, as securities recommendations, or as an indication of trading intent on behalf of any other MFS® investment product
MFS' INVESTMENT PROCESS

• History
  – Created first open-ended mutual fund in 1924
  – Over $400 billion in assets under management

• Long-term focus
  – Seeking companies that can produce sustainable return thru economic cycle

• Deep fundamental research
  – Analysts expected to be experts in all aspects of their industry coverage
  – Includes assessment of material environmental, social, and governance issues

• Risk awareness and controls
WHY TAX MINIMIZATION IS A RISK: HIGH DEBT

• Large government debt, alongside increasing social programs and infrastructure needs

• Tax revenue lost to avoidance appears substantial, although estimates vary considerably given challenge of defining tax "avoidance"

• Emerging countries impacted as well
  – "The secretary-general of the OECD… reckons that developing countries lose three times more to tax havens than they receive in international aid each year."\(^1\)

Not a zero sum game: Higher tax revenue can positively impact the ability of businesses to produce sustainable returns through increased investment in infrastructure and projects that grow the population of eligible consumers

\(^1\) The Economist, "Tax them and they will grow", July 2015
WHY TAX MINIMIZATION IS A RISK: "FAIRNESS"

While Irish Profits Soar, Tax Rates Fall

Meanwhile, the tax rate reported by those Ireland subsidiaries of U.S. companies plummeted to 3 percent from 9 percent over the decade ending in 2010. This is because much of the profit they report is attributed to units that say they are managed or “tax resident” in island havens like Bermuda and Grand Cayman, and thus don’t owe Irish income tax.

WHY TAX MINIMIZATION IS A RISK: MANY PATHS TO CHANGE

Different actors could follow many paths—either individually or collectively—to reduce tax avoidance.

- **Unilateral Change & Enforcement**
  - Examples: Increased scrutiny on tax audits in many jurisdictions, UK diverted profits tax

- **Collective Change & Enforcement**
  - Example: OECD's "Base Erosion & Profit Shifting" (BEPS) review and recommendations

- **Information Sharing**
  - Examples: Country-by-country reporting, tax policies published by individual companies

- **Stakeholder Pressure**
  - Examples: Elimination of certain Irish tax structures, responsible investor engagement
HOW MFS ASSESSES TAX RISKS: SEVEN FACTORS

1. **Analyze tax "gap":** Look for large, persistent gaps between weighted statutory rate and effective tax rate (ETR)

2. **Review property & other information:** Understanding value creation & business substance in different locations is critical

3. **Review tax footnote disclosures:** Changes in disclosure or brief mentions of asset movements or reorganizations are a red flag

4. **Assess unrecognized tax benefit balance:** A growing/large balance suggests recent adoption of higher risk strategies

5. **Calculate foreign effective tax rate:** Reviewing a firm's foreign ETR may be necessary for a jurisdiction with worldwide taxation systems (e.g. the US)

6. **Search for media coverage:** Media and government reviews of company tax positions can providing insight into specific strategies

7. **Speak to management:** Company responses aid in evaluating risk tolerance
We probably agree that most value is generated in the R&D stage. Why?

1. Logic/intuition/knowledge of fabless semi co’s
2. Stock comp mix (70% goes to R&D)
3. 78% of employees in R&D

At the highest level, taxes are generally paid based on where value (aka profit) is generated.

How do we know where value is generated? Start with a simplified value chain…. We need to know where their R&D employees are based to know where profit should be booked (note that 72% of tangible LT assets are in the US and "principle design facilities" are in California per 10-K).

- What % of your non-exec stock comp goes to US vs. OUS employees?
- Can you provide a geographic breakdown of your employees?
- Roughly, what % of your R&D is done outside the US? In Singapore?

But, R&D value is a function of two factors:

1. Employees doing new R&D work
2. Pre-Existing intellectual property

Research & Development designs chips

In general, was the IP developed in the country where it resides?
- If not, when was it xfer’d?
- Have you established any advanced pricing agreements with the IRS regarding your transfer pricing?

Other Questions:
- Start with: Where is the majority of the value created in your organization (e.g. R&D, Sales, Other)?
- Can you outline the details of your tax deal in Singapore? One expired in 2014, have you signed another? Do you have similar deals in other jurisdictions?
- Has anything about your tax structure changed since 2007?

Key Questions

- Intellectual Property — IP can be transferred around the world, but it must be sold in an “arm’s length” transaction.
  - Are there specific countries that house a majority of your IP?
  - In general, was the IP developed in the country where it resides?
  - If not, when was it xfer’d?
  - Have you established any advanced pricing agreements with the IRS regarding your transfer pricing?

- Other Questions:
  - Has anything about your tax structure changed since 2007?

Key Caveat: Management may be “bending the rules” to create these low tax rates. Management has many options to push profit to locations where value is NOT truly created. Many companies do this, but this activity is at risk — and it’s a management quality indicator.

HOW MFS ASSESSES TAX RISK: AN EXAMPLE
HOW MFS ASSESSES TAX RISK: AN SECOND EXAMPLE

1. **US SUB**
   - Request Goods for Shipment on Local Basis
   - Payment of Royalty for IP and/ some Services

2. **Interco Debt**
   - Request Goods Shipment & Payment for Services/ Goods

3. **Interco Int. Exp.**
   - Request Goods Shipment & Payment for Services/ Goods

4. **Trading Co.**
   - Receive Orders
   - Inventory planning
   - Cash Management
   - Place orders w/ 3rd Party Manuf.
   - Review Demand
   - Own Inventory
   - UNDISCLOSED LOCATION- w/ building, ppl & sr. mgmt meetings
   - Payment for Services and Products (Includes Quality Control)

5. **Mexico Sub/ Warehouse**

6. **France Sub/ Warehouse**

7. **Germany Sub/ Warehouse**

8. **Customer**
   - Goods Sold On Local Basis
   - Goods Sold by Direct Import

9. **US Warehouse**

Sales people can be agents of trading co. (for direct import) or US Sales staff.

Payment for some Shared Services

Payment for some Shared Services

FOR INSTITUTIONAL AND INVESTMENT PROFESSIONAL USE ONLY.
TAX IN INVESTMENT DECISION MAKING

• Typical ways we integrate tax analysis into our financial models:
  – Most analysts make direct adjustments to base case ETR modeling assumption
  – In cases where we have a lower level of concern, a higher ETR will be used in scenario analyses
  – For US companies with "trapped cash", we may "haircut" the value of the cash
  – Some portfolio managers have reduced the weight of aggressive tax avoiders

• We also use our tax analysis to assess governance
  – Different approach to governance: we assess board culture & risk tolerance
  – We will adjust our discount rate or multiple for companies that are pursuing very high risk tax strategies or are unwilling to discuss tax issues in transparent way
  – In one instance, we specifically avoided purchasing a mining company security due to aggressive tax minimization in combination with other major red flags
TAX ENGAGEMENT & DISCLOSURE

- MFS focuses on system-wide rather than company "engagement"
  - Taskforce member on the PRI's Tax Working Group
  - Ongoing dialog with IASB regarding insufficient tax disclosure in annual reports
  - Met with SEC regarding insufficient tax disclosure in 10-Ks
  - Educating proxy advisory firms
  - Led discussion on the topic at multiple US-based and international conferences

- Our engagement stems from poor state of tax disclosure; we desire:
  - Explanation of the foreign tax rate differential
  - Change the tax reconciliation schedule to begin with the weighted statutory rate
  - Provide an overview of what is driving Unrecognized Tax Benefit changes
  - Increase disclosure regarding intracompany debt
  - Improved transparency related to special tax incentives
COMPANY PERSPECTIVE

Clive Baxter
Head of Corporate Tax
Maersk
Setting The Scene – The Triggers

- Corporate tax payments have become a topic of public interest as a result of a few major companies' ability to achieve by legal means a very low rate of corporate tax in countries where they have significant revenues.

- At the same time, well publicised leaks of confidential documents regarding Luxembourg and Panama have brought “tax havens”, “secrecy jurisdictions” and “sweetheart deals” into the public eye.

- NGOs have focused on the concentration of a large proportion of wealth in the hands of a small number of people with 62 individuals having the same wealth as half the world.

- NGOs have also focused on the low cash tax payment from multinationals compared to individual taxpayers in the developed economies as evidence of underpayment of taxes.
Setting The Scene – Confusion Reigns

- Who are the MNEs?
  - The Fortune 1,000 listed companies?
  - Any company with activities in more than 1 country?
- Who owns the multinational corporations?
- Which countries are tax havens?
- Are the Fortune 1,000 committing tax fraud in Panama or engaged in aggressive tax planning in Luxembourg – or both? Is there any difference?
- Is an activity in Panama or Hong Kong proof of tax evasion?
- Can multinationals have secret cash hoards – or is that just high net worth individuals?
- Why do individuals pay more tax than corporates in the developed countries? Who decided that?
Setting The Scene – The Fallout for Corporates

- General atmosphere of mistrust of multinational corporations
- Tightening up of international principles by G20 including massive increase in reporting requirements to tax authorities
- Pressure for more public reporting on tax
- Pressure from NGOs for corporates to take over the role of development funding by paying a “fair tax” in developing countries
- Lack of recognition of the role of corporates in funding capital investments in manufacturing plant, equipment, infrastructure, training and education
Where does Business stand on Social Responsibility and Tax?

- No need to engage
- Responsible tax as part of a company's purpose
- Provide explanations when required
- Use tax to promote CSR image
- Embrace Transparency
Judge Learned Hand

“Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one’s taxes.

Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible.

**Everyone does it**, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands.”

– Gregory v. Helvering 69 F.2d 809, 810 (2d Cir. 1934), aff’d, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935)
Pope Benedict and Pope Francis

The actions included on the agenda of the British G8 Presidency, ... as well as the consequent commitments to deal with tax avoidance and to ensure transparency and responsibility on the part of governments – are measures that indicate the deep ethical roots of these problems, since, as my predecessor Benedict XVI made clear, the present global crisis shows that ethics is not something external to the economy, but is an integral and unavoidable element of economic thought and action.

The long-term measures that are designed to ensure an adequate legal framework for all economic actions, as well as the associated urgent measures to resolve the global economic crisis, must be guided by the ethics of truth.

– Pope Francis Letter to the British Prime Minister on the eve of the G8 Summit June 2013
Who decides what is “responsible tax”?

• Governments and legislatures set the regulations and decide what is fair tax – the allocation of the tax burden across society.
• Tax authorities assess whether corporates have obeyed the regulations.
• Journalists, NGOs and political commentators express their opinions on fair taxation with a view to influencing policy and behaviour.
• Corporations and other stakeholders do not decide what is the fair tax.
• Corporations decide what principles they will follow in managing their tax obligations and payments.
Where are the investors in all this?

- The Maersk Group receives almost no questions from investors on tax policy or disclosure – only one during the last year.

- I have not encountered any awareness of PRI’s Engagement Guidance On Corporate Tax Responsibility in tax circles: corporate tax staff, advisors, academics and tax officials.

- We do receive many questions from journalists, NGOs and politicians and have experienced a heightened Board level interest in tax risk management.

- It is possible that more investor interest will be forthcoming in future years, but the pressure seems to be coming more from the NGOs and CSR circles.
PRI’s Engagement Guidance On Corporate Tax Responsibility

- Generally, the guidance is an excellent handbook for investors wishing to evaluate the corporate tax strategies of investee companies and a useful indication to corporates of the information that may be of interest. In a few cases, PRI has jumped onto the NGO bandwagon uncritically, in my view.

- There is an assumption of increasing expectation from investors and beneficiaries investors and beneficiaries that companies find a balance between controlling their tax bill and paying a “fair” share, which we have not seen in practice.

- Ethical funds and investors may wish to include corporate tax behaviour in their list of ethical parameters, but to date these are not major sources of investment in our Group.
PRI’s Engagement Guidance On Corporate Tax Responsibility

- Some of the principles advocated in the guidance would lead to lower profits in the short term, which more financially driven investors with a short term perspective might find unacceptable.

- In Maersk and in many other MNEs, we have been acutely aware of the risk of triggering unfavourable legislative action if tax planning is perceived as aggressive. The point is fully taken that this is a risk investors should take into account when analysing profits after tax.
PRI’s Engagement Guidance On Corporate Tax Responsibility

- It is interesting to note that contrary to the claims of some NGO’s, the prima facie evidence presented by PRI is that a significant majority of major multinationals are paying taxes corresponding to the headline weighted effective tax rate – “243 out of 1,093 companies in the MSCI World Index had a large tax gap (p11)”. From this statistics, the NGOs conclude that MNEs generally are not paying their fair share of tax. I would contend that 850 do not have a large tax gap, so we are talking about a minority.

- In my view the message of PRI and indeed other stakeholders is a wake up call to the 850 corporates which are paying taxes at the headline rates – we are not making our voices heard. The NGOs could, of course, find this information by analysing our financials in depth, but it is clear that this passive approach from our side has not been successful.
PRI’s Engagement Guidance On Corporate Tax Responsibility

• The 3 stage process described by Arisaig Partners for evaluating the tax risk profile of MNEs seems to me spot on.

  “We select companies in three stages:
  ■ Stage one is using company reports and other data to find out the weighted effective tax rate and how much this deviates from the actual rates.
  ■ Stage two is broadly looking at what sort of tax policies these companies have.
  ■ Stage three is looking at publicly reported cases of inappropriate tax practices within our portfolio companies.”
  Steven Bryce, Arisaig Partners (Asia) Pte Ltd
PRI’s Engagement Guidance On Corporate Tax Responsibility

“It is important for investors engaging with companies on tax matters to build a common understanding of what responsible tax planning means and what are good corporate practices.”

Hear Hear!
How is Maersk Group responding to the increased attention on responsible tax?

- The Maersk Group has a prominent position in Danish society and consequently our tax affairs have always been under public scrutiny. This has increased in recent years.

- We have always had an approach of following the requirements of tax law, steering clear of artificial structures and aligning our tax strategies with our commercial drivers.

- In 2010, our tax policy was formalised and approved by the Executive Committee and the Audit Committee, to whom the Board has delegated financial oversight.

- We report quarterly to the Group CFO and annually to the Audit Committee on tax risks and processes and controls to ensure tax compliance and also to the Audit Committee Chairman on an ad hoc basis.
How is Maersk Group responding to the increased attention on responsible tax?

• In 2012, we first included a chapter on tax in our Sustainability Report, which presented our tax policy in summary form, our views on disclosure and relevant tax financial data. This chapter has continued since then and will be expanded this year.

• In February 2012, I was interviewed in our Group magazine, Maersk Post, where our tax principles were presented to all our staff throughout the Group.

• We are currently looking at publishing geographical data on tax payments and may choose to await the EU regulations on this.

  ➢ On the part of business, there is a real concern about giving details of country level revenues and profit per employee to our competitors particularly in view of the wide-ranging views on which "tax haven" countries must be included.
How is Maersk Group responding to the increased attention on responsible tax?

- During 2014 – 15 we established 11 country tax centres across the globe to improve compliance capabilities.
- In 2015 we appeared before the Danish Parliamentary Tax Committee in a discussion of tax treaties in relation to developing countries.
- In 2015, we began a review of the Group’s tax policy in light of the developments of international taxation and the OECD’s Base Erosion Profit Shifting project (BEPS). The policy will be updated as needed to ensure compliance with best practice as reflected in BEPS. To ensure that our practice is in alignment, a comprehensive review of the Group’s more than 1,000 companies in approximately 130 countries was initiated. Corporate structures will be modified as required following this review and in accordance with our tax policy. We do not expect major restructurings.
How is Maersk Group responding to the increased attention on responsible tax?

• Disclosure of tax payments on a country-by-country basis in the annual report will be mandatory for Maersk Oil for the financial year 2016, in accordance with the EU Accounting Directive.

• Finally, the Group is preparing for country-by-country reporting to tax authorities for all our business units, which will also become mandatory for the financial year 2016 (and potential requirements to disclose to the general public).

• We shall continue to engage in relevant dialogues regarding tax principles and tax transparency with fellow corporate tax professionals, advisors, academics, officials and NGOs in the EU Joint Transfer Pricing Forum, the ICC Tax Commission, the shipping industry sub-committee of the UN Committee of Tax Experts, BIAC, TEI, IFA and NGO sponsored tax dialogues.

• Our increased transparency has been well received in the social media.
CLOSING REMARKS
Valeria Piani, PRI
Thank you!

Paloma Aguirre- UN Global Compact LEAD
aguirre-larraz@unglobalcompact.org

Valeria Piani- Principles for Responsible Investment
valeria.piani@unpri.org