Fair Tax Foundation®

Key Performance Indicators of responsible corporate tax conduct – and their green and red flags

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KEY PERFORMANCE INDICATORS OF RESPONSIBLE CORPORATE TAX CONDUCT – AND THEIR GREEN AND RED FLAGS

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About the Fair Tax Foundation

The Fair Tax Foundation was launched in 2014 and operates as a not-for-profit social enterprise. We believe that companies paying tax responsibly should be recognised and celebrated; and any global race to the bottom on tax competition should be resisted. Tax contributions are a vital part of the broader social and economic contribution made by businesses, helping the communities in which they operate to deliver valuable public services and build infrastructure that paves the way for growth.

The Fair Tax Mark accreditation scheme is the gold standard of responsible tax conduct. It seeks to encourage and recognise organisations that pay the right amount of corporation tax at the right time and in the right place. Accredited businesses include listed companies, co-operatives, social enterprises and large private businesses. Some 250 distinct trading businesses are currently Fair Tax Mark accredited, who between them employ over 275,000 and contribute more than US$2bn in corporation tax annually.

A Fair Tax Global Multinational Business Standard was launched in 2021, enabling multinationals headquartered outside the UK to be accredited for the first time. Companies have now been certified in Denmark, Finland, Germany, Italy, the Netherlands and Sweden.

'Tax' has come in from the cold and is now a hot topic in the boardroom

The world is on the verge of an explosion of corporate tax transparency. The voluntary disclosures of progressive businesses (such as Fair Tax Mark accredited companies) will soon be augmented by newly mandated disclosures from large multinational enterprises operating in the European Union, the United States and Australia.

Moreover, the race to the bottom on corporation tax that has been in play over recent decades may have finally stalled with the advent of the global minimum corporation tax. This diminishes some, but not all, of the advantages of tax havens to aggressive corporate tax avoiders.

Compared with other areas of corporate responsibility, responsible tax conduct has emerged as a priority relatively recently; but change is now afoot. A survey undertaken by Deloitte in 2023, of tax directors and tax managers from multinational companies around the world, found that:

- a large minority (39%) are concerned about the continuing interest of media, political and activist groups in corporate taxation;
- a similar number (40%) say that in the past 12 months, the tax authority in their ultimate parent's jurisdiction has become more rigorous in tax examinations; and
- three-quarters (75%) expect stakeholder interest in the tax behaviour of large corporates to increase over the next three years.[i]

Progressive corporations understand that it is no longer acceptable for a business to boast that their tax conduct is cutting edge as they are not breaking the letter of the law – in the same way that such a narrow framing of impact would be frowned upon if it were deployed with environmental and human rights considerations.

Investors want assurance that investees embrace responsible tax conduct

An increasing number of institutional investors and asset managers are now urging multinationals to embrace responsible tax conduct and tax transparency as a core element of their 'ESG' credentials.[ii] This includes the world's largest sovereign wealth fund,[iii] seven of Denmark's biggest pension funds[iv], the UK's default auto enrolment pension scheme[v], the US's largest public pension fund[vi] and many others.

In Europe, financial market participants may soon be forced to consider their investment exposure to low tax jurisdictions via an update of the Sustainable Finance Disclosure Regulation – via a proposed extension of the list of social indicators for principal adverse impacts.[vii]

This presents both an opportunity and a challenge – how to sieve the enormous pending data release and separate the wheat from the chaff. Not least as there is a growing understanding that poor tax conduct is a red flag for an overly negative attitude to compliance in general, and also weak corporate governance. A variety of stakeholders are wrestling with how best to navigate what is emerging, including politicians, procurers (private and public), the media and many sections of civil society. But, more than anyone, institutional investors, asset managers and financial service providers are ramping up their engagement levels – and in some instances are actually driving the call for progressive change (be that via their voting at company AGMs[viii] or their lobbying for improvements in accounting standards[ix]).

Investors look at the collapse of Credit Suisse after confessing material weakness in their financial reporting and recall the long history of tax controversies that preceded it. They look at the fraught finances of Thames Water in the UK and Adani in India and remember the prominent connections to tax havens over the years. Or take action against Glencore, which is being sued by 197 funds from across the globe for allegedly "untrue statements" in prospectuses and a cover up of corrupt activities, and which is also the subject of a long-running diverted profits tax investigation.

The UN Principles for Responsible Investment (PRI), an international membership body of responsible investors, has supported responsible tax conduct for close to a decade.[x] PRI has 5,000+ signatories, who between them have more than US$120trn assets under management. PRI advocates for: a public tax policy that explicitly tackles positions on the use of low tax jurisdictions; board oversight of tax matters; public Country-by-Country Reporting of income, profit and corporation tax. PRI believes that a 'fairer tax system' is in the interests of investors at both a macro and micro level. They say that a fairer tax system would:

- level the playing field for all companies in portfolios;
- better realise the funding of critical public services that are necessary for investment returns;
- have a positive impact on economic growth, competition and sustainable development;
- help ensure that business profitability was not dependant on uncertain or volatile tax planning; and
- create greater resilience, increase customer trust and improve reputation.

But how do investors separate the wheat from the chaff?

Many institutional investors and asset managers will simply rely on the thinking and analysis of the big rating agencies (such as Moody's, Morningstar, Sustainalytics and S&P), some of whom have now integrated 'tax' into their rating framework. However, the scope and quality of consideration of these raters varies widely: from the crude 'has the business been on the receiving end of a tax controversy and some adverse press coverage', through to the finessed 'to what degree does the company's Effective Tax Rate and Cash Taxes paid deviate from their industry norm'.

Other investors will rely on their own proprietary frameworks to assess current and future holdings, and the more progressive of these want to develop bespoke Key Performance Indicators (KPIs) and analysis of their own. The Fair Tax Foundation is increasingly approached by institutional investors and asset managers and asked: "if you were in our shoes, what handful of KPIs would you focus on in order to factor 'tax conduct' into investment appraisal, bearing in mind that our analysts are already looking at a profusion of other ESG factors as it is."

To this end, the Fair Tax Foundation has been maintaining an evolving list of KPIs that we have freely shared as and when we receive enquiries from investors and related parties. We are now sharing these KPIs more widely and inviting feedback. We have also identified green and red flags associated with each KPI, given this is something that investors have expressed a strong desire for. The proposed KPIs are informed by Fair Tax Mark accreditation standards[xi] and 10 years of experience assessing financial statements and connected corporate communications. These KPIs are by no means finalised or 'SMART' as yet – i.e., Specific, Measurable, Achievable, Relevant and Time-Bound. They are also only applicable to the parent entity of large, multinational businesses. A small business or a large, single-country company would require different considerations.[xii]

An isolated green or red flag is not an urging for investors to invest or disinvest, but rather a prompt for it to adjust its risk-rating and to potentially raise concerns directly with a company – via private engagement or support for shareholder resolutions. However, a business exhibiting five green or five red flags could generally be considered, respectively, to be a substantially derisked investment or a high-risk investment from a tax conduct perspective.

Key Performance Indicators of responsible corporate tax conduct – and their green and red flags

1) Freely available, complete set of annual financial statements

This might initially seem to be a low bar, but many businesses don't publish a full[xiii] set of financial statements – preferring to register their parent entity in a secrecy jurisdiction, or taking advantage of leniencies afforded to their private equity status or smaller size. In such cases, not only is tax paid (or not) obscured, but also income and profit. You might even call this 'tax cloaking'.

► Green flag activities. Full set of financial statements in the public domain for the consolidated group; includes balance sheet, income statement and cashflow, together with a full set of explanatory notes. Cash taxes paid and current account tax charge for the year can be discerned, together with changes to deferred tax position. A current tax numerical reconciliation is provided, with an accompanying narrative.[xiv] A full list of subsidiaries is provided, along with their country of incorporation and (crucially) the tax residency of each.[xv]

► Red flag activities. Tax cloaking is evidential. A consolidated set of financial statements are not freely available in the public domain, or an abbreviated version only is available. Even if the Annual Report and Accounts are made available upon request and / or privately, it is concerning that a business should be averse to general public scrutiny and engagement.

2) Robust responsible tax conduct commitments that are subject to annual compliance confirmation

Progressive corporations understand that it is no longer enough for a business to pledge to forego tax evasion and to adhere to the 'letter' of the law. Even the OECD Guidelines for Multinational Enterprise explicitly grasp the importance of demonstrably complying with the spirit, as well as the letter, of tax laws.[xvi] Businesses needs to have a public tax policy that details their commitments on responsible tax conduct in all material areas – ideally this would cover their approach to all taxes, not just corporation tax.

► Green flag activities. The business has a public tax policy (or strategy) that explicitly commits it to: shun tax avoidance and the artificial use of tax havens; declare profits in the place where their economic substance arises; adhere to the spirit as well as the letter of the law. The policy applies to the parent company and all entities therein. The policy is publicly 'owned' by a named board director, with compliance confirmed annually.[xvii]

► Red flag activities. A boiler-plate tax policy exists, but goes no further than pledging legislative compliance. Policy avoids discussion of tax avoidance, tax havens and profit-shifting, and the importance of complying with the spirit of the law. Governance and compliance are simply referred to as being within the remit of 'the board'.

3) Public Country-by-Country financial disclosures, with narrative to explain unusual positions

Comprehensively implemented public Country-by-Country Reporting (pCbCR) of corporation taxes paid[xviii] provides a strong indication of the economic footprint within a jurisdiction and can signal emerging financial and reputational risks. Crucially, it also provides essential insights into whether a business is complying with the commitments detailed in their public tax policy (e.g, in relation to profit-shifting and aggressive tax avoidance). Where mandatory pCbCR has been introduced (e.g., in connection with large European banks and extractive industries), there is evidence of reduced use of tax havens, reduced profit shifting, increased effective tax rates and increased domestic tax revenue mobilisation.[xix] Voluntary publishing rates may currently be low, but they are steadily increasing, especially across Europe where new regulation is pending.

► Green flag activities. Business embraces pCbCR in connection with corporation tax, and possibly also other taxes. Discloses for each jurisdiction in which it operates: revenues, profit/loss, current tax provision, deferred tax provision, cash taxes paid, assets, employees – with numbers reconciled to consolidated annual reports and accounts. A narrative is provided to explain any apparent asymmetries (such as substantial income in a country, but few staff and assets). Disclosures fully aligned to Fair Tax Mark[xx] or GRI 207[xxi] standards.

► Red flag activities. Tax cloaking and tax washing is evidential. Business refuses to provide a country-by-county breakdown of its economic footprint. May even seek to hide behind selective 'total tax contribution' reporting and seek to obscure corporation tax payments – e.g., Amazon, with their highly selective total tax contribution reporting in countries such as the UK and Canada. The misrepresentation of total tax accruals (or effective tax rates) as cash tax paid is another concerning tax washing behaviour. Takes advantage of the "safeguard clause" within the EU pCbCR Directive (which allows deferred disclosure for up to five years on the basis of 'commercial sensitivity').[xxii]

4) Disclosure of uncertain tax positions, with narrative to explain significant tax disputes

When a business files its corporate income tax returns, it will apply judgements relating to the tax treatment of specific elements. An uncertain tax position (UTP) – sometimes referred to as an unrecognised tax benefit – arises where there is uncertainty over whether the relevant tax authority will accept the tax treatment. This could impact the value of deferred tax assets and liabilities, and eventually current tax and cash tax positions. Accounting standards now require that UTPs be considered and reported in many parts of the world.[xxiii] A business with high UTPs might indicate an aggressive approach to tax planning – for example, Facebook. Conversely, it might be a reflection of the law being ambiguous in relation to a given activity, or a national tax authority interpreting tax law erroneously.

► Green flag activities. The total numerical value of the UTP is disclosed and explained. Significant tax disputes are discussed and the business' position in each instance outlined. If UTPs have been considered and none are considered to exist, then this is stated.

► Red flag activities. No material discussion of consideration of UTPs, or quantification of size and impact on financial statements. Where quantification is provided, no narrative on tax disputes that these relate to and the basis of the point of difference with a tax authority.

5) Corporate cash taxes paid, over five-year period

When looked at over time, corporate cash taxes paid (termed the 'long-run cash effective tax rate' in academic studies) provide the best available data for tracking tax rate and deviation from the expected headline rate of tax.[xxiv] Over time, cash taxes paid are a far more accurate means of measuring 'contribution' than total tax accounting accruals (i.e., what is commonly referred to as the 'effective corporate tax rate'): not least as the latter includes deferred tax provisions that may never materialise as cash taxes paid. Even the current tax charge may differ substantially from cash taxes ultimately paid in connection with a reporting period, given the impact of: management estimation; unsettled disputes with tax authorities; and, the requirements of accounting standards in areas such as discontinued operations and employee share options. Cash tax payments are 'net' and may not be precisely aligned with the relevant reporting period, but when looked at over five years this discrepancy becomes marginal. The cash taxes paid data can be ascertained from the cashflow statement, and compared with the profit / loss over the same five-year period.[xxv]

The green and red flag thresholds presented below need to be revisited regularly, especially for businesses impacted by the 'Pillar 2 Global Minimum Tax' from 2025.

► Green flag activities. The business' average tax rate (in terms of cash taxes paid) over the past five years is greater than 20% of profits. This would indicate that the business is contributing taxes close to the average headline rate for corporation tax around the world (c. 23%), and also the effective average tax rate (c. 20%).[xxvi] Lower thresholds may need to be considered within sectors that are characterised by large, tangible capital expenditure, such as energy generation (perhaps 17.5%).

► Red flag activities. The business' average tax rate (in terms of cash taxes paid) over the past five years is less than 7.5%. Higher thresholds may be applicable within sectors where intangible assets are characteristically booked in low tax jurisdictions (perhaps 12.5% or even 15%), such as technology and pharmaceuticals. The absence of substantial tax payments could be entirely appropriate and reflective of genuine losses and / or large capital expenditure – in which case detailed pCbCR disclosures and narrative explanation are warranted.

Feedback and onward development

Our suggested KPIs for investors, and associated green and red flags, are very much a work in progress.

We would be delighted to receive feedback on our suggestions, be that refinement of what we have proposed, or entirely new areas of consideration. For example, we suspect that financial service providers, unlike institutional investors, might be interested in consideration of beneficial ownership disclosure.

We are also open to working with individual institutional investors and asset managers on bespoke projects where this is mutually beneficial and hastens the advancement of responsible tax conduct.

Feedback and suggestions can be sent to info@fairtaxmark.net or provided via our contact form.

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Endnotes

[i] See Global corporate tax trends – is the glass half full or half empty? (August 2023). At https://fairtaxmark.net/global-corporate-tax-trends-is-the-glass-half-full-or-half-empty/
[ii] We have a produced an exhaustive analysis of the history of the Essential Elements of Global Corporate Standards for Responsible Tax Conduct' (to June 2020) here
[iii] Norges Bank Investment Management. See Tax and Transparency - expectations towards companies
[iv] AP Pension, Lægernes Pension, MP Pension, PenSam, Pædagogernes Pension, P+ and Velliv have joined the joint tax code of conduct laid down by ATP, Industriens Pension, PensionDanmark and PFA. See https://www.atp.dk/en/news-and-insights/new-signatories-joint-tax-code-conduct
[v] Nest. See https://www.nestpensions.org.uk/schemeweb/nest/nestcorporation/investment-approach/investment-principles.html
[vi] CalPERS.supported the resolution tabled at Amazon's AGM for public country-by-country reporting. See https://www.responsible-investor.com/european-investors-get-behind-tax-transparency-proposals-at-us-energy-giants/
[vii] The following mandatory social indicator, which aligns with the EU pCbCR Directive, has been proposed: 'Amount of accumulated earnings in non-cooperative tax jurisdictions applying to investee companies where the total consolidated revenue on their balance sheet date for each of the last two consecutive financial years exceeds a total of €750mn'. See https://www.esma.europa.eu/sites/default/files/2023-12/JC_2023_55_-_Final_Report_SFDR_Delegated_Regulation_amending_RTS.pdf
[viii] See Shareholders up tax scrutiny at AGMs (January 2024). At https://fairtaxmark.net/shareholders-up-tax-scrutiny-at-agms/
[ix] For example, the Financial Accounting Standards Board (FASB) in the United States is on record as saying that a large part of the reason that they will newly require companies to be more transparent about the taxes they pay is due to the urgings of lenders, creditors, and other allocators of capital. See https://aboutblaw.com/bbUl
[x] See https://www.unpri.org/sustainability-issues/environmental-social-and-governance-issues/governance-issues/tax-fairness
[xi] See https://fairtaxmark.net/wp-content/uploads/2022/10/Global-MNC-standard-criteria-print-version.pdf
[xii] For example, pCbCR is irrelevant to a single-country entity, and consideration of cash taxes paid would made be against the domestic rate (not an international mix).
[xiii] For example, "full", as set out in IFRS' International Accounting Standard (IAS) 1. At https://www.ifrs.org/issued-standards/list-of-standards/ias-1-presentation-offinancial-statements/
[xiv] Many businesses set out a 'total tax' reconciliation as per IAS 12, but a 'current tax' reconciliation provides much greater information - detailing the difference between the actual current tax charge and the current tax provisions that might be expected if the headline tax rate in the parent entity's local jurisdiction were to be applied to the business's accounting profits.
[xv] The term 'subsidiary' is used broadly, and refers to all legal entities encompassed within the consolidated financial statements, not just those that pass threshold activity levels for individual disclosure– e.g., encompasses companies that are currently dormant or not actively trading. It includes permanent establishments with a taxable presence (such as branches). Together with associates and joint ventures.
[xvi] See https://www.oecd-ilibrary.org/finance-and-investment/oecd-guidelines-for-multinational-enterprises-on-responsible-business-conduct_81f92357-en
[xvii] The Fair Tax Foundation provides template text for a model tax policy. See https://fairtaxmark.net/resources/#standards-and-guidance
[xviii] Some businesses will go further, and provide a country-by-country breakdown of not just corporation tax, but also all other taxes paid (e.g., labor taxes). This is to be welcomed, as long as these 'total tax' disclosures are not used instead of 'corporation tax' disclosures.
[xix] For further detail and rationale see Public Country-by-Country Reporting – why and how multinationals should lift the lid on their taxes (Fair Tax Foundation, December 2023). At https://fairtaxmark.net/wp-content/uploads/Pcbcr-explainer.pdf
[xx] See https://fairtaxmark.net/wp-content/uploads/2022/10/Global-MNC-standard-criteria-print-version.pdf
[xxi] See https://www.globalreporting.org/standards/media/2482/gri-207-tax-2019.pdf

[xxii] Applies to MNCs with consolidated revenues over €750m for each of the last two consecutive years. Jurisdictions to be disaggregated are restricted to a) EU Members States, b) countries on the EU list of non-cooperative jurisdictions for tax purposes (referred to as the 'black list') and c) countries listed for two consecutive years or more on the list of jurisdictions that don't yet comply but have committed to reform (referred to as the 'grey list'). The Directive allows for Member States to introduce (or not) deferred disclosure for up to five years in relation to certain countries if they deem the information to be 'commercially sensitive' – although this 'safeguard clause' does not cover data related to the EU's list of non-cooperative jurisdictions (both 'black' and 'grey' lists). Hungary and Slovakia have opted not to introduce the safeguard clause, and Germany's will run for four (not five) years. See DIRECTIVE (EU) 2021/2101 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 November 2021, amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches
[xxiii] As set out in IFRIC 23 and ASC 740.
[xxiv] For example, focussing on this metric allows for a better understanding of factors that give rise to 'book-tax differences' over a period, such as employee stock options and movements in the tax contingency reserve. See Dyreng, S., Hanlon, M., & Maydew, E. (2008). Long-run corporate tax avoidance. The Accounting Review, 83, 61–82.
[xxv] Cash taxes paid will include: domestic, foreign and state and local payments; withholding taxes paid; as well as settlements relating to prior years.
[xxvi] Average statutory corporate income tax rates for OECD countries were 23.6% in 2023, and for all non-zero rate jurisdictions across the world were 23.1%. The average Effective Average Tax Rate was 20.2% in 2022. See Corporate Tax Statistics 2023 (OECD). At https://doi.org/10.1787/f1f07219-en