Chief Tax Officer Insights—Issue Spotlight

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Chief tax officers (CTOs) are expected to align tax with business goals, drive strategic value, increase transparency, and improve the efficiency of tax operations. *CTO Insights* is designed to highlight top-of-mind issues for tax executives and ways CTOs are addressing these opportunities and challenges. We are confident that you will find the information in each issue of *CTO Insights* practical and actionable in demonstrating the value you and your department bring to your organization.

Tax in the ESG era

At the forefront of today's business decisions is a demand that affects all populations of stakeholders across all sectors and geographies: the call to address Environmental, Social, and Governance (ESG) responsibilities.

In a world that continues to feel the aftershocks of a global health crisis—while also facing a climate emergency, social inequities, geopolitical turmoil, and erosion of trust—there is increasingly intense attention on the long-term impacts of corporate activities.

For all businesses, ESG is becoming a chief measure of corporate behavior. Organizations are being called upon to enact sustainable business strategies and policies that minimize their environmental impact and help support and sustain their communities.

Increasingly, tax is becoming a critical concern for stakeholders as they look to companies to demonstrate their commitment to a sustainable approach to tax.

Sustainable tax links to ESG goals

Perceptions about the role of the tax function are shifting alongside perceptions about the role of business in general. This is raising expectations on companies to do the right thing with their tax choices. Taxes are now viewed as more than just costs to be managed or revenue-raising tools, and corporations are expected to do more than just comply with the tax rules.

Tax plays a key part in the ESG movement through multiple linkages between tax and societal and environmental benefits.

By paying a fair share of taxes, companies can contribute to the health and betterment of the communities, economies, and societies where they operate: creating good and equitable jobs, investing in modern infrastructure, providing local services, and more.

Meanwhile, approaches to tax that consider and take advantage of green taxes and incentives help companies drive decarbonization in their operations and supply chains, a key tool in combatting the long-

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term effects of global warming.

Tax transparency steals the spotlight

As ESG continues to grow as a top priority for companies, CTOs and their tax teams face expectations to review and adjust tax planning and affairs in light of enterprise-wide mandates, targets, and goals.

While ESG touches many aspects of tax, one of the more significant effects is meeting increased demands for tax transparency.

Greater tax transparency is relevant to all stakeholders. Customers, workers, and investors are all impacted by the taxes paid by the businesses that serve them, employ them, control their capital, and operate in their communities. Scrutiny is increasing among all stakeholder groups on how companies are structured and what tax contributions they make to local and national governments.

Corporate attitudes toward ESG are advancing, too, especially since the COVID-19 pandemic laid bare the major sway businesses hold over economies and societies.

Regulators call for ESG reporting

As businesses seek to tell a more holistic tax story, adding urgency to their efforts is the fact that global regulators are calling for increased disclosures about ESG factors. Both government authorities and lawmakers are buzzing with activity, with lots of ESG-related legislation, guidance, and frameworks enacted and proposed.

As overall momentum for "more ESG" in the nontax regulatory sphere picks up, a key question facing U.S. organizations is if tax, too, will get swept up.

Currently, Europe is leading the charge for more transparency between taxpayers and governments, as it has for years. There, rules are being enacted for sustainable tax. The common theme in European Union regimes is more reporting on tax impacts on ESG factors, most notably mandatory public country-by-country reporting.

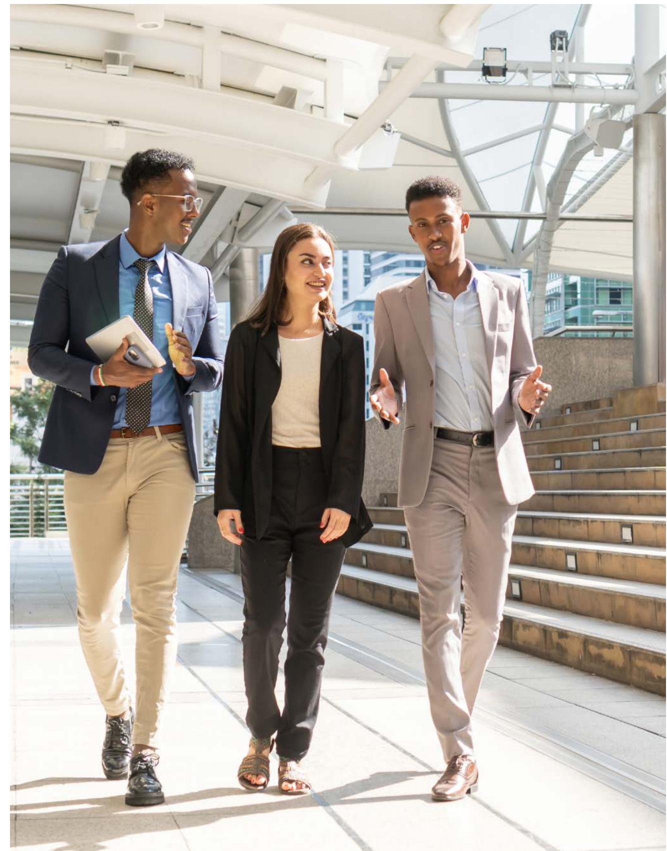
In the U.S., multinational companies currently fall under the umbrella of ESG reporting guidelines targeting tax from multiple nongovernment standard-setters such as the Global Reporting Initiative (GRI) and the World Economic Forum (WEF). However, U.S. government-led policy proposals designed to advance ESG objectives through the changing role of tax are in their infancy—at the very early stages of consideration—and there is real possibility they will never get enacted. If they do, then it is likely far out on the horizon.

For example, the Financial Accounting Standards Board (FASB) has added greater disaggregated tax disclosures to its agenda, but not yet signaled a preference. Meanwhile, the U.S. Securities and Exchange Commission (SEC) has not mandated anything on ESG tax disclosures, despite being asked by some stakeholders.

More than a compliance exercise

For corporate tax functions, addressing transparency demands is not just about compliance. As formal ESG rules develop and evolve, the issue today remains primarily about reputation, with significant effects on public trust.

As shareholder activism becomes prominent, many CTOs are taking steps to stay ahead of the curve on responsible tax policy. Although many tax functions have yet to take formal action, forward-looking CTOs have at least started to uncover their total picture, developing a strategy to embed ESG principles into tax policies and practices, communicate tax impacts as part of regular disclosures, and put governance mechanisms in place to ensure tax decisions are sustainable moving forward.



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Some companies are now publicizing their tax strategies and policies more openly than in the past, beyond mandatory disclosure requirements. This type of reporting is mostly still voluntary, depending on industry, market, and ownership structure. However, continued pushing by activist leaders and the public indicates it may become more frequent—a useful tool for companies to build confidence, loyalty, and goodwill with their many stakeholders. In fact, some leaders—particularly in industries and jurisdictions less affected by the push for ESG reporting—voluntarily share their tax strategy to prove that the company does not engage in abusive tax planning and has appropriate internal governance.

Most multinational companies in the U.S. have not taken (and are not considering) the next big leap towards tax transparency—disclosing actual tax payments and contributions they are not required to reveal. A major concern of these public disclosures is the possibility that reports will be misunderstood by the public, potentially damaging the brand. Since most people are not tax experts, it can be challenging for companies paying low cash tax—the most visible and important to those focused on ESG reporting—to convey a positive tax story.

For example, consider a business that pays near zero in income tax due to large federal subsidies, but billions in property and payroll taxes to the local jurisdiction. Activists with little tax experience may get hung up on a minimal income tax payment figure, overlooking the reason behind it or the other taxes paid to the community. Similarly, companies could be accused of underpaying on tax when nuances in their tax payment disclosure reports—such as net operating loss carryover or investments in low-income housing credits—are not considered.

On the flip side, in some instances there are potential benefits of disclosing tax payments above and beyond compliance requirements. For example:

- Clearly disclosing other taxes hidden in the financials—such as elements of capital investment and tax credits—in a way that shows the full scope of tax payments can help businesses support a case of paying a fair share of tax and feed into a strong tax story.
- Incorporating qualitative transparency around tax—beyond numerical financial payments—can enable companies to detail the bigger picture of how tax activities advanced ESG goals, such as through investment in the local community.
- The data can be used as a tool for the government affairs teams to guide conversation around contributions made to the local economy when arguing for policy changes.

Dealing with ESG reporting disconnects

Meeting increased tax transparency demands is not easy but disconnects between government tax policy and the interests of ESG rating agencies—such as the S&P Global Sustainability Index—make it harder.

While the main global ESG ratings agencies almost always take some form of tax-related criteria into consideration, there are fundamental differences between ESG standards and prevailing tax law. This lack of reconciliation drives confusion in the tax disclosure space.

The way rating agencies engage with companies varies widely among agencies. Some agencies dive deep while others focus on surface-level financials. Quality of analysis varies, too.

Certain taxes in the financials are not considered or credited by rating agencies in their methodologies, either. For example, some standard setters are interested in total tax paid per type, while rating agencies do not consider total tax.

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Context is crucial

No matter the audience, CTOs can increase their odds of success in the ESG era by carefully fine-tuning how tax data shows up in their financial statement footnotes and sustainability reports. Truthful information is the first priority. Context is the close second.

Publicizing tax practices can be a chance for companies to leverage tax as a brand enhancer. However, expert care is required. With the business reputation on the line, there are both risks and benefits of voluntary tax disclosure. Navigating what tax information to disclose and how to tell the tax story is becoming a specialized skill in the tax function.

As the narrative around corporate tax decisions becomes intertwined with brand image, CTOs are increasingly committing resources to the art of ESG messaging. Defining what to say and how to say it requires collaboration and coordination between tax and other business functions across the enterprise.

Questions to consider

- How does tax intersect with ESG in your organization?
- How can you understand your total tax picture?
- How can your tax policies, practices, and governance help achieve enterprise-wide ESG objectives?
- What qualitative information can help your organization convey a positive public tax story?
- How will you navigate inconsistencies in criteria used by ESG rating agencies?

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