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Tax and ESG

Proponents of enhanced environmental, social and governance ("ESG") disclosure have identified corporate income tax as a relevant metric. While it is premature to predict how ESG standards in this regard will evolve, a key area of focus is tax arbitrage, including profit-shifting among jurisdictions. Boards should be aware of the possibility of detailed country-by-country public disclosure intended to reveal scenarios involving high profits in jurisdictions with little economic activity and low profits in jurisdictions where a company has a significant presence.

Inspired by the Action Plan on Base Erosion and Profit Shifting of the Organisation for Economic Co-operation and Development, the standards put forth by the Global Reporting Initiative ("GRI") in 2019 (GRI 207: Tax 2019) and the Consultation Draft of the World Economic Forum in 2020 would require (effective January 1, 2021, in the case of the GRI standards) public disclosure, by jurisdiction, of, among other things, third-party sales revenue, number of employees, profit or loss, corporate income tax paid on a cash basis and revenue from intercompany transactions. ESG initiatives also contemplate disclosure of a company's tax policy or "approach" to tax, as well as governance and risk management processes relating to tax.

Arguments cited in support of greater engagement include that aggressive tax planning can create corporate governance risk, lead to material fines, damage corporate and brand reputation and, alone or in combination with competition among jurisdictions to attract businesses through tax incentives or holidays, deprive governments of funding needed to provide services to communities. Indeed, enhanced corporate income tax disclosure could itself lead to changes in tax laws, perhaps as a result of governments gaining insight into tax practices or public reactions to ESG disclosures. The public reaction to corporate "inversions" cannot be discounted as a factor that led to increasingly strict Internal Revenue Service rules relating to such transactions.

We are monitoring these developments, and Boards should consider whether to seek a proactive role in shaping the standards, whether their organization should (if voluntary) or could (if mandatory) meet such standards with respect to corporate income taxes, and whether the possibility of such disclosures should inform the organization's current policies, risk controls and strategies with respect to corporate income tax matters.

Apart from disclosure, the possibility of carbon taxes, and carbon tariffs on imports from countries with less stringent carbon-related regulation, remains of interest to ESG-minded governments and constituencies. We are monitoring these developments as well.

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