

# NAVIGATING THE INTERSECTION OF TAX & ESG

APRIL 2022

Although tax credits as subsidies have been a cornerstone catalyst for advancing many ESG policies and technologies over the last several years, tax is often forgotten or minimized in the process of creating and implementing corporate ESG and value creation strategies. Ignoring the symbiotic relationship between tax and ESG is a losing strategy, given increased awareness of the importance of tax transparency among shareholders and other stakeholders as a mechanism for holding companies accountable to their stated ESG commitments. A rise in media and rating agency reports on the topic indicate tax will continue to be under scrutiny in the future and may increasingly have significant corporate reputational impacts as well.

As leaders of an organization's tax function, including as vice presidents of tax, tax directors, or CFOs among others, you are the stewards charged with ensuring tax strategy and operations appropriately intersect with the corporate ESG vision and meaningfully advance ESG commitments. However, the [BDO 2022 Tax Outlook Survey](#) found that while an overwhelming majority of senior tax executives expressed an understanding of the value of ESG, three quarters of those responsible for tax were not currently involved in the organization's ESG strategy. The findings indicate that tax leaders will need to insert the tax function into the ESG planning and execution process and take ownership of tax's role in ESG. Insights from the survey and BDO's tax professionals in the report below outline how tax fits into ESG, the core principles of an ESG-focused tax strategy and key considerations for transparent reporting.

“The tax department sits at the nexus of external tax forces and internal business strategy — a position that offers incredible value to company management. Every business decision has a tax implication, so tax should factor into the conversation to drive optimal business outcomes. As tax leaders strive to take on the role of strategic advisor to the C-suite, they need to find efficiencies in tax operations to manage their growing responsibilities.”

**MATTHEW BECKER**

National Managing Partner of Tax



## HOW DOES TAX OVERLAP WITH ESG?

Because there is some misunderstanding about how tax relates to environmental, social and governance issues, there is a high probability that tax may not be incorporated in responsible business strategy and planning. While not reflected in the ESG acronym, there is an element of tax that is central to each of these principles. For example, environmental behavioral taxes and incentives, such as carbon taxes on greenhouse gas emissions and tax incentives for green energy adoption, are crucial to driving behavior change toward more sustainable practices in the near term while many impacts of climate change are still experienced in indirect ways. In terms of the social element, taxes are a key mechanism for companies to contribute to the societies in which they operate and to build trust among members of the public as a responsible corporate actor. Finally, proper tax governance can ensure that there is appropriate oversight over an organization's tax strategy and decisions, ensuring they align with overarching business objectives and stakeholder communications around tax reporting.



### Tax in Environmental

- ▶ Environmental taxes
- ▶ Green subsidies and incentives
- ▶ Compliance and reporting requirements
- ▶ Carbon adjustment mechanism
- ▶ Electric vehicle incentives



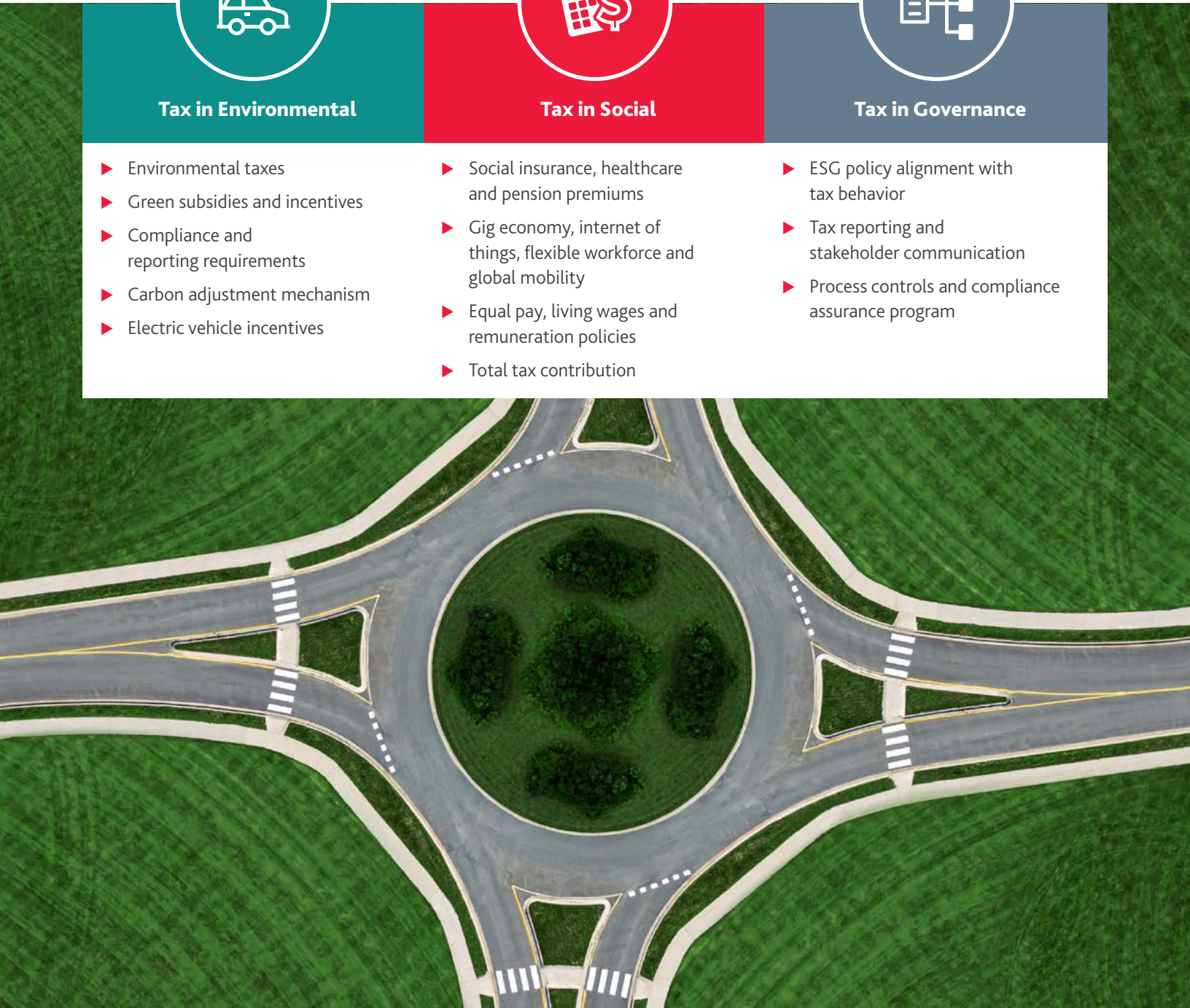
### Tax in Social

- ▶ Social insurance, healthcare and pension premiums
- ▶ Gig economy, internet of things, flexible workforce and global mobility
- ▶ Equal pay, living wages and remuneration policies
- ▶ Total tax contribution



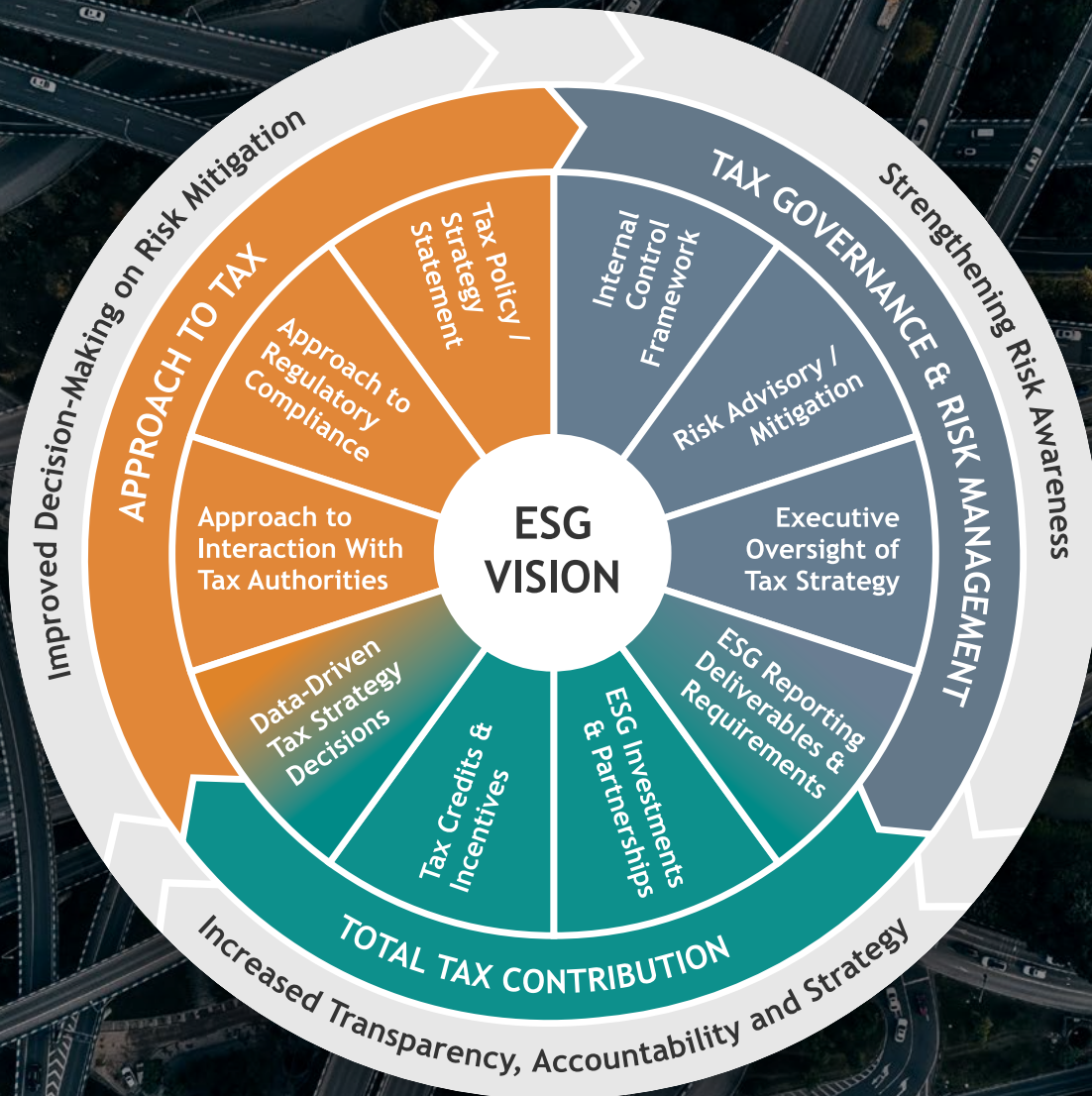
### Tax in Governance

- ▶ ESG policy alignment with tax behavior
- ▶ Tax reporting and stakeholder communication
- ▶ Process controls and compliance assurance program



## USING THE BDO TAX ESG CIPHER TO UNLOCK A SUCCESSFUL ESG-DRIVEN TAX STRATEGY

Aligning the tax function with an overarching ESG strategy across the business is a heavy lift. To build and implement a responsible tax program will take time and requires careful consideration of an organization's overall approach to tax, tax governance and total tax contribution. Each company will have a unique tax strategy based on its business and stakeholder considerations and may be at varying points along its responsible tax journey. Whether you are just beginning or at the stage of reassessing your approach based on changing market conditions, updates to your ESG strategy, or regulations, the cypher below can be used to guide these critical considerations and help ensure tax is meaningfully incorporated in ESG strategy. The process should be iterative over time and when implemented successfully, will drive improved decision-making on risk mitigation, strengthen risk awareness and increase transparency and accountability.





**CORE PRINCIPLE 1:  
Approach to Tax**

The first step to meaningfully incorporating tax in ESG strategy is understanding and articulating the purpose and values that guide the tax function. This process includes defining the organization's approach to regulatory compliance and the interaction with tax authorities. Writing a tax policy and strategy is an important way to articulate the company's tax priorities and educate all team members across the organization about the function's principles. The statement may include commitments to communicate transparently with regulators and disclose more information than required by law in some cases, for example.

As the organization evolves due to changes in the industry, overall ESG commitments and sustainability strategies, the tax strategy statement should be updated accordingly. Regulatory changes will also necessitate continuous assessment and consideration of whether the strategy meets the current understandings of transparency, risk mitigation and accountability based on new information. Through this set of guiding principles, the tax function can help improve decision-making and reporting actions to align with changes in the broader corporate ESG strategy, purpose and values.

**CORE PRINCIPLE 2:  
Tax Governance and Risk Management**

Establishing a robust governance, control and risk management framework provides comfort and assurance that the reported approach to tax and tax strategy is well embedded in an organization's substantiable business strategy and that there are mechanisms in place to effectively monitor its compliance obligations.

However, it's important to remember that tax governance and risk management have broad considerations that go beyond the traditional frameworks governing internal controls over financial reporting (ICFR). A common pitfall for many is a narrow focus on governance strategies. Generally, ICFR focuses on accurate and complete reporting in financial statements. While this is an important area of governance, it does not account for or represent the many objectives included in a tax ESG control framework, which is typically broader as it focuses on how and why decisions regarding tax approaches and positions are made.

The objective of this core principle is to demonstrate to stakeholders how the organization's tax governance, control and risk management frameworks function are in alignment with the values and principles outlined in the Approach to Tax statement. This can include establishing a risk advisory council, guidelines for including tax in ESG reporting deliverables and any corresponding regulatory requirements, and communications to relevant stakeholders on executive oversight activities related to the tax strategy.

However, many organizations have not taken the time to document and define their risk mitigation and executive oversight strategy. Often this is left merely to control procedures that are mechanical and regulatory in nature. Instead, a tax governance and risk management strategy should aim to establish a framework focused on strengthening risk awareness and transparently communicating governance activities to both internal and external audiences when appropriate.

### CORE PRINCIPLE 3: Total Tax Contribution

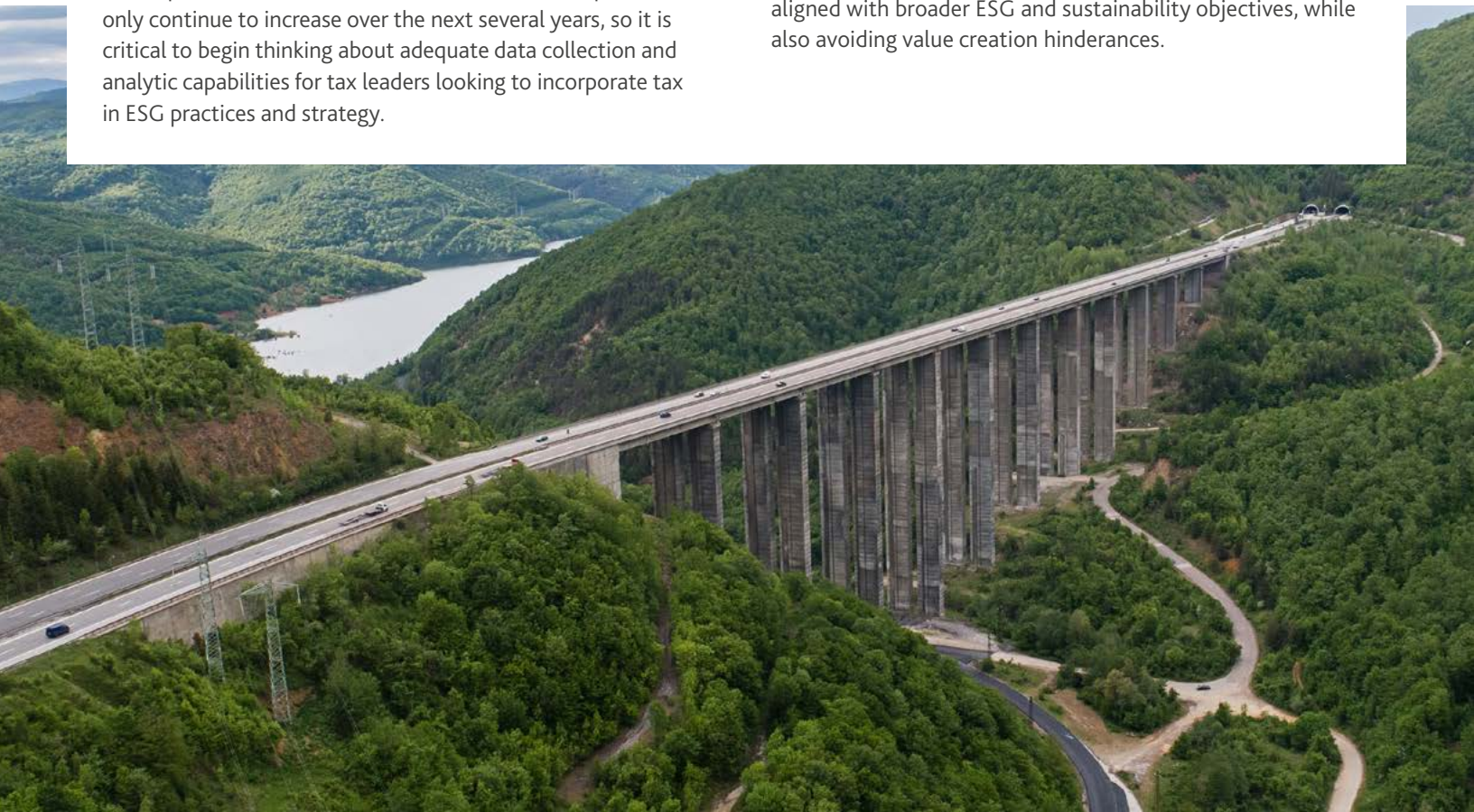
While quantifying and providing necessary qualitative context around an organization's total tax contribution is not an easy task, today, stakeholders from employees and customers to investors and regulators expect transparency around tax strategies, tax-related risks, total tax contribution and country-by-country activities. Recently, tax has received increased scrutiny from these stakeholders because it is a core component of many ESG metrics used to evaluate a business's tax behaviors and ensure there is accountability across its tax practices. The result is that how a company shares tax information with stakeholders and what it includes in reports has a significant impact on reputation and perceptions of corporate ESG statements.

However, the increased demand for tax transparency is not without its challenges. Nearly two-thirds of respondents in the [BDO 2022 Tax Outlook Survey](#) (62%) said data collection and analysis (the quantitative component of ESG-focused tax) is the greatest challenge of tax transparency reporting efforts, pointing to an underlying issue of tax data governance and fragmented systems. Often this is an area where tax leaders require outside assistance to establish automated processes that can collect tax data on a periodic basis for regular analysis. The importance of ESG and attention around the topic will only continue to increase over the next several years, so it is critical to begin thinking about adequate data collection and analytic capabilities for tax leaders looking to incorporate tax in ESG practices and strategy.

For those just beginning the process, BDO's advice is to partner with in-house IT functions or external consultants for assistance and support.

Collecting relevant tax data on a regular basis is a critical early step because it affords tax leaders the opportunity to determine which information will be disclosed to various stakeholders and which information can help shape and support broader ESG narratives being developed by corporate leadership. While determining data collection processes, it is also important to consider and seek counsel on communication and information delivery strategies that will best reach and address the concerns of priority stakeholder groups.

Although this task can be a heavy lift, it may also result in significant business advantages. A key benefit is that the data and information gathered will help tax leaders further define and evolve ESG-driven tax strategies through tax monetization structures and company core value items, among others. Ultimately, organizations that better understand their total tax contribution across various taxing jurisdictions and country-by-country activities are best equipped to make data-driven tax strategy decisions that are aligned with broader ESG and sustainability objectives, while also avoiding value creation hinderances.





## KEY REPORTING CONSIDERATIONS

Once the quantitative data have been collected, the next step is to consider how you report the information. Communicating the numbers themselves is not enough. Communicating the narrative behind the numbers – the qualitative component of reporting – is extremely important. The narrative should always aim to communicate the company’s approach to tax, values guiding decision-making and the impact of the tax strategy to key stakeholders in a straightforward and transparent manner. However, qualitative reporting can vary by organization depending on several factors, from choice of standards to company philosophy.

The [BDO 2022 Tax Outlook Survey](#) also found that challenges and variance in tax transparency reporting are driven by a lack of universal reporting standards and clarity around which ESG frameworks to follow. In the meantime, the best reporting framework for any company is one that drives a deep understanding of the organization’s ESG philosophy and vision, which may require more investment in terms of time and effort. When determining a reporting approach, it is important to consider the goal of the report or disclosure and which data best demonstrate ESG progress and strategy. Because the ESG-related tax reporting is not a mandated process and is currently a voluntary disclosure in the U.S., it can often be helpful to review tax reports related to ESG from other companies already making these disclosures as a baseline.

Keep in mind that one of the main reasons businesses are electing to publish comprehensive ESG and Sustainability Tax Reports and Global Tax Footprints is to articulate their broader total tax contribution to ensure that the tax narrative speaks to the needs and demands of their stakeholders. Each report must

be unique and relevant to the company in terms of content and method of disclosure. Currently, there is a relatively small number of companies electing to make such disclosures, based on the findings of the [BDO 2022 Tax Outlook Survey](#) outlined below. Of the 150 senior tax executives polled, less than a quarter (23%) are implementing both qualitative and quantitative disclosures:

### Tax Transparency Reporting Disclosures

**51%** Qualitative Disclosures



**21%** Quantitative Disclosures



**23%** Both Qualitative & Quantitative Disclosures



**74%** Total Qualitative Disclosures



**44%** Total Quantitative Disclosures



Today, tax is an essential component of the ESG metrics that determine how stakeholders perceive an organization. Despite this fact, the movement to incorporate tax in ESG planning and strategies is still in its infancy. This means leaders of tax functions still have time to begin the process of implementing ESG-driven tax strategies and operations to ensure the function evolves with the importance of ESG. While there is no simple one-size-fits-all solution, given the nuances and complications of the tax function for each organization, the general framework in BDO's Tax ESG Cipher can help guide tax leaders at any point on the journey. The cipher outlines key considerations to ensure an organization's ESG vision is well-structured and appropriately includes tax strategies. While the process requires long-term effort and dedication, it generates high returns in terms of accountability, transparency, and reputational and sustainable value.

*Corporate purpose statements and ESG achievements will fall flat with key stakeholders and in the court of public opinion if an organization does not also uphold the principles of tax transparency. Tax executives are already highly engaged on sustainability issues as they relate to tax planning, and companies that incorporate this critical perspective and expertise into overall long-term business strategy will be best positioned for maximum impact and success.*

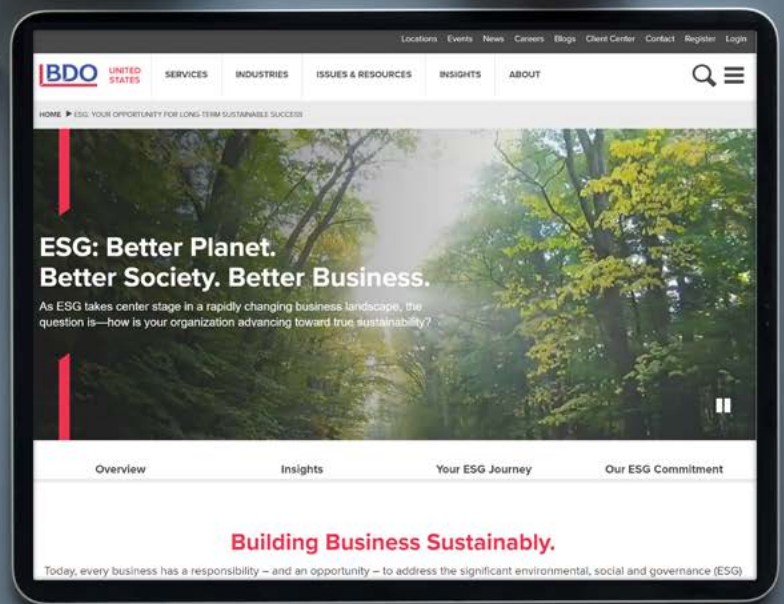
**DAN FULLER**

Managing Partner and ESG Tax Services Leader



As ESG takes center stage in a rapidly changing business landscape, how is your organization advancing toward true sustainability?

Visit our [ESG Center of Excellence](#) for information on building business sustainably and how we can help at every stage of your ESG journey.



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