INVESTOR GUIDE

Integration of tax in responsible investment

Practical steps to design and implement
a responsible tax strategy for investors

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Authors:
Rudy Verstappen (VBDO) | Manon van Aalst (PwC) | Dave Reubzaet (PwC)

With contributions from:
Ingmar Schuurmans (VBDO) | Robin Vroom (VBDO) | Eelco van der Enden (PwC) | Leonie Kamp (PwC)

For information:
Please contact Rudy Verstappen | Senior Project Manager Responsible Investment
rudy.verstappen@vbdo.nl

Dutch Association of Investors for Sustainable Development (VBDO)
Utrecht | the Netherlands

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Contents

1. **Introduction** 6
2. **Responsible tax** 8
3. **How to build a responsible tax framework** 13
4. **How to integrate tax in your responsible investment decisions** 26
5. **Final thoughts** 37

1. Introduction

Many institutional investors have been showing more responsible behaviour in recent years. This included more sustainable behaviour in both their own organisations (corporate social responsibility) and in their investments (socially responsible investment). However, tax seems to be lagging behind in this development, which is understandable as in most cases tax is not part of responsible investment and sustainability policies. Tax used to be only about compliance and tax optimisation (i.e. minimisation). Tax was seen as a cost that should be avoided. The main driver for this was the idea that one must create maximal value for shareholders via tax optimisation. Investors are now finding that, especially with regard to tax, there seems to be a difficult trade-off between return on investment and social responsibility.

Nowadays, shareholders are not the only stakeholders that need to be pleased. Employees, consumers and local communities should also be considered. Tax is part of the public discussion, with more stakeholders looking at companies' tax behaviour and expecting something from their tax profile and activities. Stakeholders are now able to easily access a lot of (trusted) financial information, draw conclusions from it and share it publicly. This makes tax also a reputational issue. As a result, more companies are taking stakeholder expectations into account. By paying taxes in the country where the actual business activities take place, by being transparent about the taxes they pay and by being compliant with all laws and regulations, companies contribute to societies and create additional stakeholder value.

Investors play a crucial role in responsible business conduct. Once responsible investment criteria are implemented, companies have a strong incentive to follow. This is clear from developments in the field of Environmental, Social and Governance ('ESG'), such as climate change or human rights. Once investments in lesser performing companies stagnate, companies will feel the need to change. Hence, this guide for responsible tax management is principally meant for investors, as catalysts for change.

Objective

This guide aims to provide investors with a practical roadmap for the design of a responsible tax strategy and the implementation thereof in business operations at the level of investors and their investee companies. It provides information on how to design a responsible tax framework that, in our opinion, stimulates responsible tax behaviour. With this guidance, we encourage you to make a conscious choice on how to deal with tax issues.

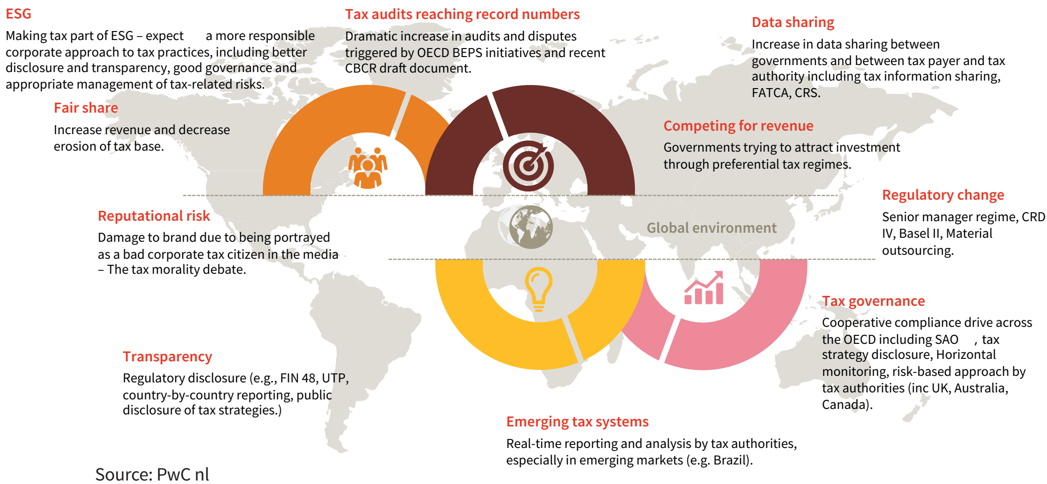
Since this document is intended as a practical guide for investors, we have not included too much background on the recent developments and trends in tax developments in the public debate, governance, legislation and risk management. We rather focus on providing guidance on how to deal with these developments.

We believe that the combined expertise of VBDO and PwC and the information VBDO obtained during interviews with business professionals ensure a balanced and practical approach towards incorporating tax in responsible investment that may inspire you to rethink your tax norm and the application thereof in your daily investment practice.

This study is structured as follows: in chapter 2, we will provide a global overview of the trends in responsible tax and why investors should incorporate tax in their decision-making processes. Chapter 3 elaborates on how to set up a responsible tax strategy framework. Chapter 4 focuses on how investors can implement tax in their responsible investment activities.

2. Responsible tax

Global trends and the pressure to evolve the tax function



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A. Setting the scene – important trends for tax

The revelations from Luxleaks (2014), Swissleaks (2015) and the Panama Papers and Bahama Papers (2016) indicate that the use of aggressive tax strategies to minimise the tax burden is common practice under multinational companies and individuals and intermediaries (trusts, banks and tax advisers). These publications have sparked a large public and political outcry, which resulted in a lack of trust in the international tax system and created a fertile ground for more engaged stakeholders. Generally speaking, three strategies can be identified to restore trust in taxation: (a) anti-tax avoidance initiatives and transparency, (b) tax governance regulations and (c) digitisation for tax data management and information sharing.

(A) Anti-tax avoidance initiatives and transparency

Anti-avoidance

The global tax and regulatory landscape has been changing rapidly with a focus on improving the international tax system, cleaning up artificial tax structures and enforcing tax transparency with the help of anti-tax avoidance initiatives and increased reporting obligations. On an international level, we see initiatives such as the Base Erosion and Profit Shifting project by the OECD (BEPS) and the Anti Tax Avoidance Package of the European Union (ATAP), which aim to prevent tax avoidance and to improve the international tax system. Locally, countries implement their own anti-avoidance legislation, though this is often based (in part) on BEPS and/or ATAP.

Transparency

An important part of improving the international tax system and anti-avoidance mechanisms is boosted by tax transparency. If tax-relevant information is transparently available to various stakeholders in the international taxation ecosystem, the likelihood that taxes are determined correctly, including where these taxes should be paid, increases significantly. Transparency makes potential tax avoidance more visible and detectible and therefore contributes to the reduction of – aggressive - tax avoidance. Transparency initiatives come in different forms and shapes, both multinational and local, and vary from transparency towards tax and/or regulatory authorities, for example through the exchange of information treaties or CRS/FATCA, to public transparency on tax affairs, for example through public country-by-country reporting or publication of an organisation's tax strategy. A further development is transparency not only by tax payers, but also by tax intermediaries, who have to report cross-border arrangements which might indicate that the arrangement is set up to avoid paying taxes.

(B) Tax governance regulations

In addition to anti-avoidance and transparency mechanisms, regulators and tax authorities are more and more focused on the tax governance of companies. In many jurisdictions, tax governance and tax risk management regulations are being introduced asking tax payers to implement tax management systems in their organisation. These can be regulations on what is expected from tax payers as regards tax responsibilities at board level (e.g. Spain) and the content of their tax strategy (e.g. UK), but can also range from asking senior management to state that the organisation is in control of tax (e.g. Ireland) to extensive regulations and soft codes which describe what is expected from a control framework perspective (e.g. Russia, Australia, Germany, the Netherlands, China). Tax authorities are no longer solely looking at the end product (the tax return) but are increasingly auditing the system or tax control framework producing this return. Tax authorities will determine the appropriate tax risk level and corresponding audit approach (e.g. applying a risk-based approach) based on the quality of an organisation's tax control framework/tax management system.

(C) Digitisation for tax data management and information sharing

The world is rapidly digitising, and so is the tax landscape. Tax authorities and tax payers are digitising their tax environment to enable tax-relevant data management. This digitisation trend is speeded up by the above-mentioned tax transparency, reporting and governance initiatives. All these initiatives ask for more (detailed) information, information is necessary for strategic decision making, control, and reporting and compliance. Technology helps both authorities and tax payers to manage data and information in this regard. Tax authorities are deploying advanced technology landscapes for their communication with tax payers, enable online data reporting and information sharing with other tax authorities and perform data mining, big data analytics and more. Tax payers are implementing technology solutions to meet their organisation's digitisation agenda and respond to stakeholder (both internal and external) demands, including the digital tax authorities around the globe. Examples of countries with advanced digitised tax authorities are Estonia and Mexico, and to a certain extent also Portugal and Poland, who have introduced systems such as the Single Audit File for Tax.

B. The importance of conscious decision making for tax

In view of the rapidly changing regulatory environment, the fact that more stakeholders are looking at your tax behaviour and the fast digitisation (resulting in more comparable data, exchange of information and analytics), it is important that you make conscious choices with respect to your tax behaviour. A conscious choice means you have defined a tax norm, taking into account your business values, your business strategy and internal and external stakeholder views. By doing so, you ensure a solid foundation for all tax decisions your organisation has to make.

The defined tax norm determines the attitude towards tax optimisation, risk management, reporting and compliance, and communication. For tax risk management purposes, it is important to make the norm as concrete as possible. Without a detailed norm it is difficult to identify risks and manage these. It should be noted that tax risks are not only related to compliance, but also include financial risks in respect of tax planning, brand and reputational risks and even macroeconomic risks in terms of their ability to impair economic growth and thereby undermine long-term return on investment.

A conscious choice on your tax norm, based on business values and stakeholder interests, is key to building a responsible tax framework. Implementation and management of the norm in your organisation's daily practice is the next step. This can be achieved through the design and implementation of a tax control framework, which starts with embedding the tax norm in the tax strategy.

COSO (Committee of Sponsoring Organisations) has developed the building blocks for a well-functioning control framework. Comparable guidance for what this means for tax is also provided by the OECD.

C. Why responsible tax is relevant for investors

Investors, especially institutional investors, help to fund economic growth, which is important in the broader context of societal development. Tax is a crucial element thereof as tax finances society. Ideally, all stakeholders in the investment chain should benefit from investment activities. Such benefits could include an investee receiving funding to start or support a business and thereby enabling the investee to employ people in that business or obtain goods or services for that business, which could subsequently allow the (institutional) investor and its clients to gain a return on investment.

The concept of responsible investment is based on this ideal and is initially focused on responsible investments from an ESG perspective. At this moment, the investment community is increasingly embracing the ESG concept, and many (institutional) investors have implemented an ESG strategy, which has helped them make conscious choices regarding investments in companies that, for example, make use of child labour in the garment industry or severely affect the biodiversity in the areas where they operate. Investments in such companies may in some cases increase the short-term return on investment for the ultimate investor but, needless to say, also damage society in the short and longer term.

It is in this context that tax is also considered part of responsible investment. A positive return on investment does no longer outweigh the cost to society resulting from aggressive tax avoidance. Keeping in mind the public debate on tax and the anti-tax avoidance initiatives, it only makes sense that responsible tax should be taken into account by investors. Of course the role of tax in responsible investment is a story of nuance as a proper balance should be maintained between return on investment and contributing to society. It is, however, important to find this balance and integrate responsible tax in your investments. your investments.

Responsible tax for investors requires a twofold action plan. First, you start in your own organisation by setting and implementing your tax norm. It is the basis for all your tax behaviour, including the way you structure your investments from a tax perspective. For example, when investing responsibly from a tax perspective, you should not structure your investments in such way that you participate in treaty shopping.

Second, your tax norm should also be applied to your investee companies. This means that the tax behaviour of your investee companies should match your tax norm. For example, if you wish to obtain further assurance that the investee is compliant with tax laws and regulations, you may ask the investee for its implemented tax control framework.

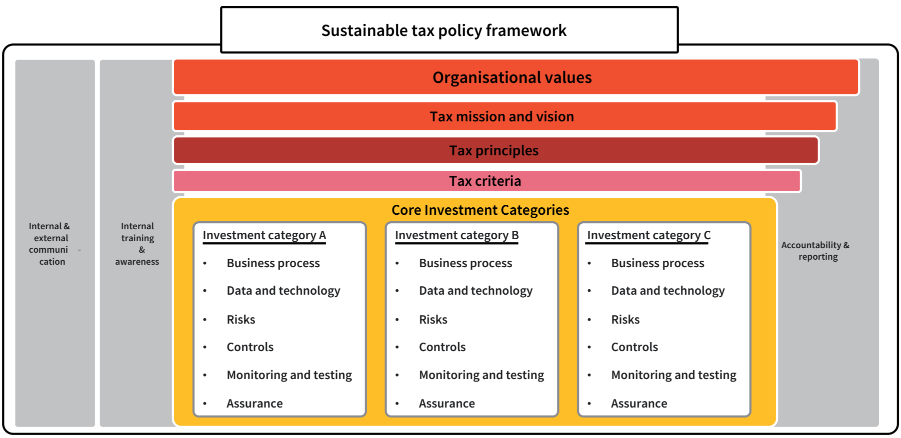
3. How to build a responsible tax framework

A. Adding value through a responsible tax strategy framework

This chapter provides a roadmap for (i) the design and (ii) the implementation of a responsible tax strategy framework that directly applies to your organisation as an investor and influences the tax behaviour of your investee companies. This chapter will mainly focus on your own organisation, whilst the next chapter will go into detail about your investee companies.

Simply put, an integrated responsible tax strategy framework is a powerful tool to add value and enable your organisation to achieve its strategic vision and mission on tax. It takes stakeholder expectations into consideration and helps to optimise tax strategy and performance. It enables strategic decision making and enhances the conversation on tax with management and stakeholders. It helps you to better understand the tax risks involved in your organisation and investments so that you can get ahead of these risks, make conscious choices and mitigate risks if needed.

We have identified seven steps in this roadmap. At the end of each section, we have included some questions you can ask yourself as a start to build your responsible tax framework. We have also included a practical example for each step.



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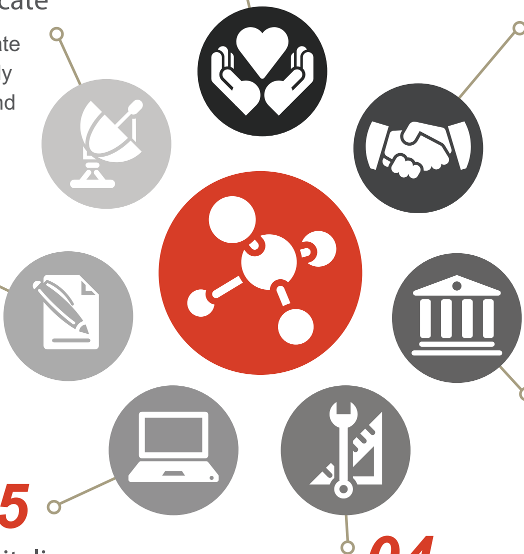
B. How to build a responsible tax strategy framework – a roadmap



01 Who are you

- Understand your values, business and strategic mission
- Engage with stakeholders

02 Your tax principles

- Refresh your tax policy and principles to:
- Align with stakeholders
- Address regulatory changes
- Respond to societal developments

03 Tax criteria

- Design concrete tax criteria for use in daily operations

04 Implement & control

- Implement and monitor the tax criteria in the business through a control framework

05 Digitalise

- Deploy a tax technology ecosystem to gather, analyse and prepare data and to steer tax operations

06 Report & comply

- Report and comply internally and externally

07 Communicate

- Communicate transparently internally and externally

Source: PwC nl

* DESIGN *

Step 1: Understand your organisational values, business and strategic mission

When designing the framework, it is important to not treat tax in isolation but to see tax as part of the broader business. The first step in this roadmap is dedicated to understanding who you are as an organisation and obtaining a clear view of where you want to be in the long term. In other words, to understand your organisational values, business strategy and strategic mission. This step is fundamental in creating a successful and responsible tax framework. A misalignment between the tax framework and the actual business makes effective implementation in the business nearly impossible as the tax strategy and corresponding behaviour simply do not resonate with the business strategy. Experience in the Netherlands shows that certain supervisory bodies also start their audit by looking at corporate values and the business strategy to see to what extent tax is aligned.

Examples
If your organisational values include integrity, this could be reflected and emphasised in your responsible tax framework with a focus on compliance and governance. If your values state that you are a front runner, it is not sufficient to just work with the laws currently applicable. Instead, you should also take into account future developments (as far as possible). For example, a BEPS action point which has not yet been regulated by law but whose goal is reasonably clear should be taken into account when the organisation considers itself to be a front runner.

Questions to ask yourself
- What are the organisational values and what could those values mean for tax?
- What is the organisation's business strategy and what kind of tax behaviour fits with this business strategy?
- Does the tax team really understand and communicate with the business or is tax still operating in a black box?

Step 2: Determine your tax norm and principles

Tax norm

The second step in this roadmap is to determine the organisation's tax norm. This starts with determining the tax principles. These tax principles should be based on the aforementioned organisational values, business strategy and principles applied within the business. Your tax principles 'carry' the tax norm you would like to apply and should therefore be chosen consciously. The tax norm could be application of hard law only, or also take into account the spirit of the law. In addition the tax norm could take into account good tax governance and codes of conduct d. Finally, you could ask yourself to what extent you would like to integrate anti-tax avoidance and transparency initiatives like BEPS and ATAD.Only insofar as these have already been incorporated in (domestic) law or also even if not yet legislated, because you appreciate the reasoning and spirit behind these BEPS action points.

Determining the tax norm is a nuanced exercise and often leads to various discussions on what it should be. It is important to engage stakeholders in this regard to ensure their views on tax are taken into account. This integration of stakeholder views in the beginning of the process is key as it will help the organisation and the tax department to later on explain tax behaviour and why certain choices were made.

Last but not least, we note that setting the norm is a fundamental exercise as it not only determines the tax behaviour of the investor itself and the way investments are structured from a tax perspective, but can even influence the tax behaviour of investees (chapter 4).

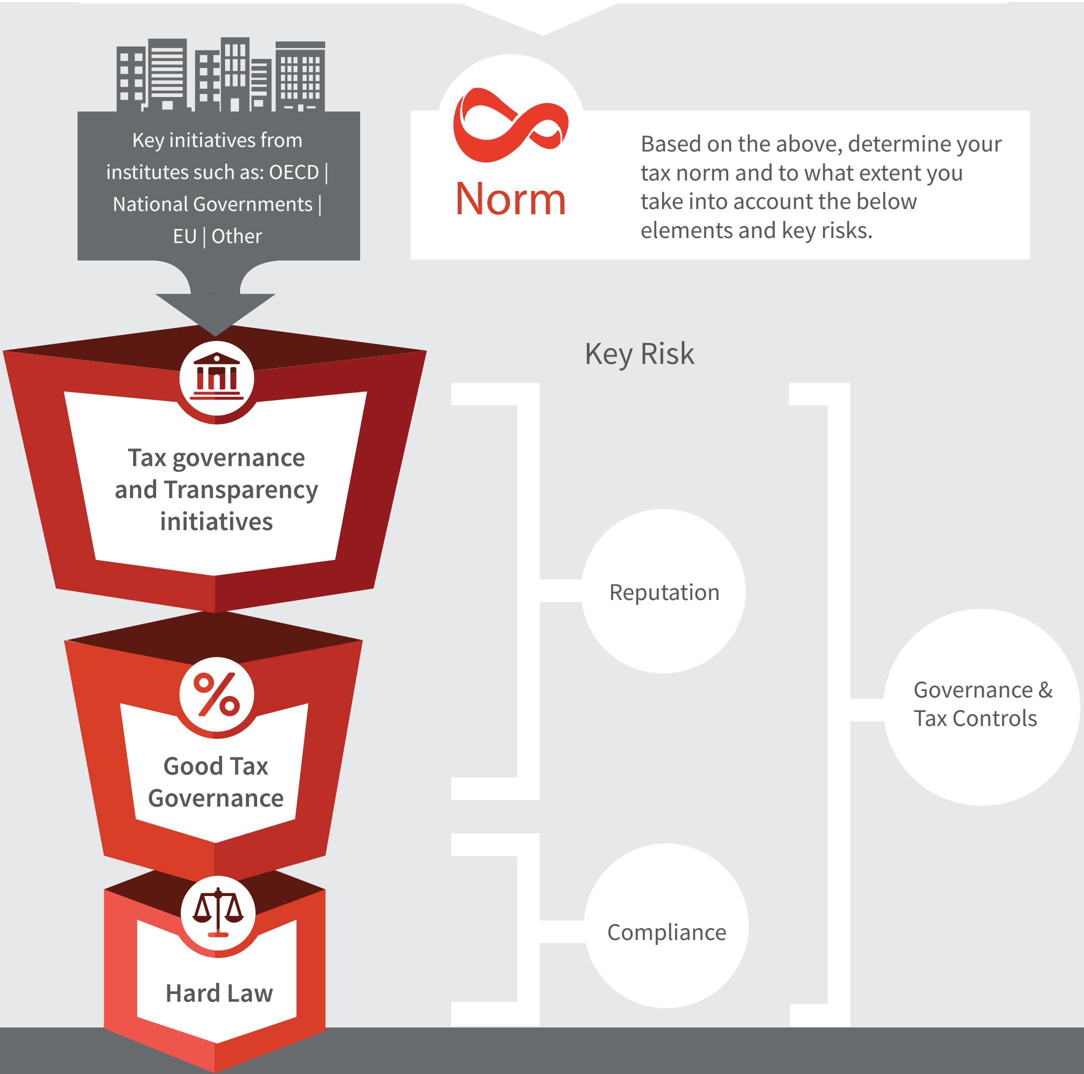
Examples
We comply with laws and regulations and also with the spirit of the law. We also keep track of future legislative developments (such as ATAP and BEPS) and good tax governance initiatives around the globe and include these in your policies. We ask from our investees that they comply with tax laws and regulations and formalise a tax policy. We monitor this compliance periodically.

Questions to ask yourself
- What is my tax norm? Do my stakeholders agree?
- Which principles do I consider important for tax?
- On which tax-technical issues do I need to take a stand, based on the tax norm?
- What is the impact of the tax norm on our investee companies?

Your tax norm = your tax behaviour

Norm is based on:

- Organisational values
- Stakeholder engagement
- Business vision and mission
- Tax vision and mission



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Step 3: Translate your tax norm and principles into concrete tax criteria

The final step of the 'design phase' is to translate the tax norm and principles into concrete tax criteria. Whereas tax principles can be quite abstract, tax criteria are very concrete for daily decision making. Tax criteria will determine behavioural dos and don'ts and should be designed in such a way that they can be used in daily business operations, tailored to your specific organisation and types of investment. Jointly, the tax norm, tax principles and tax criteria form the compass for the organisation's tax behaviour.

Examples
We do not use special purpose vehicles if their set-up is primarily tax driven.
We use the following debt to equity ratio in our investment financing: …
We do not invest in or via a jurisdiction that has the following characteristics: …
We do not invest in an investee company that shows the following behaviour: …

Questions to ask yourself
- Which criteria should I develop to make my tax norm and principles tangible?
- Looking at my stakeholder views and the public debate, what are my behavioural don'ts?
- What do I need to ask from the investee companies to ensure that their tax behaviour is not conflicting with my tax norm?

* IMPLEMENTATION *

Step 4: Integrate tax in the business

After design comes implementation. Implementation is key as without proper implementation the tax norm, tax principles and tax criteria remain a paper tiger.

An organisation can implement its tax norm, tax principles and tax criteria by incorporating them in its tax control framework, which is an important part of Good Tax Governance. This framework will help the organisation to integrate and manage its tax norm throughout the organisation and should consist of the following high-level steps:

1. Determine key business processes.
2. Determine key tax activities in these business processes.
3. Determine roles and responsibilities.
4. Determine tax risks.
5. Design and implement tax controls.
6. Monitor tax risks and tax controls.
7. Report and communicate to internal and external stakeholders (also for continuous improvement).

For further explanation on these control framework steps we refer to the extensive literature that is available. Below, we briefly touch upon two key processes.

One of the key processes for the investor is the investment process. Together with the business (e.g. dealmakers, legal team and responsible investment team), the tax department has an important role to play here as it has to ensure that the tax norm is applied during due diligence on new investments. The tax department has to verify that the way in which the investment is structured is in line with the tax norm, but also that the investee company's tax norm does not conflict with the investor's tax norm. In addition, the tax department has to ensure that the external parties the investor collaborates with in the investment chain (e.g. agent, fund manager) also comply with tax norm requirements, such as the requirement of data sharing during the lifecycle of the investment. Having a tax criteria checklist that takes such matters into account will help the tax department to check whether the tax norm is actually adhered to. This is one of the key controls the tax department could implement and monitor.

An other key process is the monitoring process. It may be that the tax department is only involved at the time of the investment itself (due diligence/acquisition phase), but to ensure ongoing compliance with the tax norm, monitoring of the investment during its lifecycle is equally important. This type of monitoring requires that periodic information is available.

Questions to ask yourself

- How do we actually apply our tax criteria in our daily operations? In an ad-hoc manner or do we use a checklist?
- Do we have an overview of key business processes and involvement of the tax department?
- Do we have clear roles and responsibilities?
- Is the tax department always involved or contacted during the investment process, also when something changes after the tax department has given its advice?
- How do we monitor our tax risks and effectiveness of controls?
- Do we monitor investments also during their lifecycle? Do we have sufficient information for such activities?

Step 5: Digitise

Technology is an important part of a responsible tax investment approach. It enables data and information management, which is necessary to manage a responsible tax strategy, increase control and enable reporting and compliance. Without the right information it is not possible to demonstrate internally and externally that you comply with your own responsible tax principles and criteria. Required data management includes data gathering, extraction, storage, analysis, visualisation and reporting, among other things.

This data management requires a tax technology ecosystem consisting of various types of technology solutions. To support the responsible tax strategy it is therefore important to analyse the required data and assess how far the organisation's existing technology landscape is capable of supporting the required data management. This technology assessment may show that it is necessary to add new solutions and/or upgrade the existing ecosystem with, for example, artificial intelligence and robotic process automation technologies.

Examples
To avoid the inclusion of hybrid financing instruments in your investment portfolio, it is important that you have data on all financing transactions. For example, you may need to have the following data available for every investment:

- What type of investment is it?
- Have (shareholder) loans been provided?
- What is the interest percentage?
- Are interest payments tax deductible?
- Is interest income taxed?

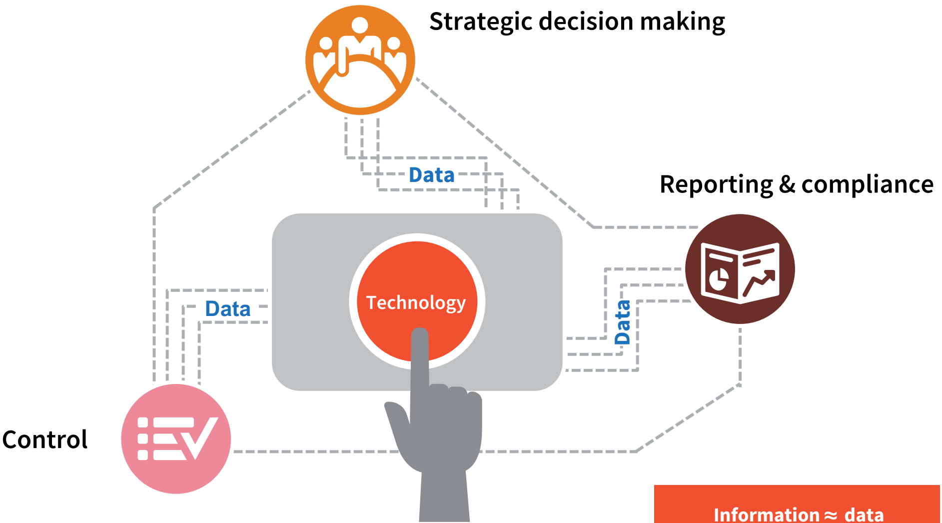
Questions to ask yourself

- Do you know, based on your tax norm, principles and compliance obligations, which internal and external reports you want or have to prepare? This includes reporting to tax authorities, management, clients, etc.
- Do you know which data you need to be able to complete these reports?
- Do you know the source of the data? Is the information internally available (own or other departments), do you need to obtain information from external parties, portfolio companies or fund managers?

- Is your technology ecosystem providing you with all the required data in an efficient, secure and effective manner?
- Do you use tooling that provides you with workflow management, a risk and control register, key document storage, tax status per investee and more?

Why technology for responsible investement for tax?

Because you need information



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Step 6: Report and comply

Your organisation needs to report and comply with tax laws and regulations, both externally and internally. The tax norm, laid down in principles and criteria, determines how and to what extent you report and comply with these laws and regulations, and positions and views taken in these reports depend on your norm. The sum of all reports, internal and external, mandatory and voluntary, is the end product of your tax norm.

It is therefore important to take a fresh look at the various tax-related reports you currently produce and to check whether these reports still sufficiently reflect your tax norm. Especially your internal and external transparency reporting may need a closer look to determine whether it is still up to societal standards.

Example
If your principles mention that you would like to be transparent in your tax affairs, it makes sense for you to report on tax matters more extensively (for example, in the annual accounts or on your public website).

Questions to ask yourself
- Are the tax positions we are taking in our reports in line with our tax principles?
- Do we report sufficiently to our stakeholders on tax matters?
- Do we also report on tax value instead of only tax compliance?
- Do we report on tax performance?
- Do we report on tax matters of investee companies (e.g. how the investee companies fit within our tax principles)?

Step 7: Communicate

The last step of the roadmap towards a responsible tax strategy framework is communication.

Communication entails many aspects but in essence is about the communication around the design, implementation and operationalisation of your tax norm. Communication helps the tax department and the organisation as a whole to pull tax out of the black box. During the design phase, it is important that you engage with stakeholders and maintain your dialogue with them to obtain and understand their viewpoints and discuss the desired tax norm. This will help you to increase buy-in. During the implementation stage, communication is needed with the relevant business partners (including dealmakers, legal advisers, responsible investment team) to ensure tax is embedded in a correct and practical manner. Training is part of this communication, for the tax department as well as for other departments and investee companies. Such training should, for instance, increase awareness about tax, create an understanding of the rationale behind certain choices and lead to a better understanding of the behavioural dos and don'ts. External communication is needed during the entire process to inform the 'outside' world of the organisation's tax viewpoint, activities and added value to society. This external communication also includes communication with the investee companies on tax matters. It is especially important that all communication is understandable for non-tax specialists, too. Help from the communication department could be welcome here.

Example
More extensive examples can be found in annual reports and sustainability reports of companies. An increasing number of these reports provide not just the numbers, but also explain in more detail what they mean and why certain choices have been made.

Questions to ask yourself
- Do we have a communication plan?
- What are our communication goals? Do we communicate about compliance only or do we want to include more topics?
- What is our message on tax to the outside world including investee companies?
- Do we publish our tax strategy or tax principles on our public website?
- Do we regularly inform the organisation of tax activities and results?
- Do we train or provide tax awareness sessions to investee companies?

Summary

Your responsible tax framework starts with setting the norm for your organisation and then implementing that norm not only in your tax principles, but in all relevant business processes. However, the norm is also the basis for your expectations of your investee companies. In the following chapter, we will further describe how you can influence your investee companies and how they can also become part of your responsible tax framework.

4. How to integrate tax in your responsible investment decisions

Besides having an impact on your own business operations, tax will also affect your investment portfolio. It is therefore paramount to extend the applicability of your responsible tax framework to the assessments of investee companies. This chapter focuses on which steps you have to take to assess investments on tax-related risks and which responsible investment instruments provide opportunities to tackle tax-related risks within the different asset classes.

You can have different motivations to include responsible tax into your investment decisions. Investee companies that are not in control of their tax risks, for example, or that have an aggressive tax risk appetite can create earnings risks and governance problems and can also damage their own reputation and brand value, which can reflect on you as an investor in that company. Furthermore, such tax risks can cause undesired macroeconomic and societal distortions. Finally, your stakeholders can also ask from you to take a (more)
responsible taxation approach. It is important that you identify your main drivers for extending the responsible tax strategy framework towards your investments.

It is important that you know how to set up a process to address tax-related issues with portfolio companies Such a process enables you to act in line with your own tax norm and tax strategy framework. Except for step 4 (Integrate tax in the business), each step of the tax strategy framework, which is described in chapter 3, can also be applied when extending your tax policy towards the investment portfolio. We have identified three steps to implement responsible taxation in your investment portfolio:

A. Include tax in the responsible investment policy.
B. Determine the applicable scope of the policy.
C. Implement tax in the responsible investment policy.

A. Include tax in the responsible investment policy

- **Include a tax chapter in your responsible investment policy**

As is described in chapter 3, you should formulate the organisational values, business and strategic mission and tax norm of your company in a responsible tax strategy framework. The tax norm represents the investor's standpoints in respect of taxation and therefore represents the role you prefer to play. Investment strategies should be aligned with your responsible tax strategy. It can be wise to include a tax chapter in the responsible investment policy. This tax chapter should have strong ties with the responsible tax strategy.

- **Select an asset manager with sufficient expertise in this topic**

In most cases, the asset manager has more knowledge of specific responsible investment topics than the asset owner. It is important for the asset owner to select an asset manager who has sufficient expertise in the field of responsible taxation, because this topic requires a specific skill set or knowledge base which is not comparable to other responsible investment topics. Not all ESG analysts are educated to assess fiscal and financial data sufficiently and interpret tax controls or tax risks correctly.

It is furthermore important that your internal tax department is included in the discussions regarding tax in the investment portfolio. This is because the tax department understands the selected tax norm and tax principles and can assist in translating these into applicable responsible investment principles.

- **Monitor and evaluate the asset manager**

In order to be able to critically monitor and evaluate how the asset manager implements the responsible taxation policy of the asset owner, the asset owner should preferably not be fully dependent on the asset manager. It is advisable that the asset owner includes responsible taxation in the asset management contract. The contract should state specific and measurable key performance indicators (KPIs). For example, the asset owner could require the asset manager to implement responsible taxation in its ESG integration models within a six-month horizon or demand that responsible taxation be one of the focus areas in the engagement programme of the asset manager in the subsequent year. The asset owner can hire internal or external experts to monitor and evaluate the asset manager.

The KPIs should encompass both the investment vehicles used by the asset manager (no tax-avoidance routing in the selection of investment funds) and the responsible investment regarding the investee companies. Furthermore, they should apply to the direct investments made by the asset managers and the assets that are being managed by the sub-managers.

Questions to ask yourself

- How can I incorporate the tax norm in my portfolio?
- Does my asset manager have sufficient knowledge of tax risks and controls?
- How can I stay in control as an asset owner?

B. Determine the applicable scope of the policy

Your approach will be different for various types of investments. For example, your approach towards a fund manager of a fund in which you have a limited share would likely differ from your approach towards a portfolio company in which you have a 30% shareholding and a board seat. During the process of data gathering and investee analysis (next steps), it is important to keep in mind the type of investment that is targeted. The impact you can make and the best way to achieve your goals is dependent on the level of influence you can exert.

Similarly, your approach will be different for different asset classes. For your listed equity portfolio, several different ESG instruments are applicable, such as exclusion, engagement and ESG integration. This, however, is not the case for other asset classes, such as hedge funds or government bonds. It is important to make a materiality assessment for the different types of assets and the different asset classes. Furthermore, in your approach toward the investee, it is advisable to determine the most effective strategy for each asset class.

Influence on different types of assets

In the case of a *direct non-listed investment* (such as private equity), you often have the possibility to enter into direct dialogue with the portfolio/target company. A high percentage of shareholding or the availability of a board seat for the investor increases the influence on a portfolio company's tax strategy.

In the case of *listed investments*, the relationship with the portfolio company is often more distant as you would generally be part of a larger group of unknown investors and shareholdings are often smaller.

In the case of *fund investment*s, you only have a direct relationship with the fund manager, not with the portfolio companies, and your sphere of influence reaches only as far as the fund manager. Once you have invested in a fund, you as an investor are not in a position to make decisions about how a fund's assets should be invested. This gives you three options to exercise influence on tax-related issues in a fund context.

It should be noted that there are also types of funds where an investor has more influence on the content of the mandate of the fund.

Influence on different types of assets

1. You can include tax strategy as part of the selection process for a fund manager, just as other requirements (e.g. no investments in cluster bombs, respect of sanction lists) are part of the selection process.
2. You can engage with fund managers to urge them to integrate tax considerations in their setup of the investment structure and the fund mandate.
3. The last option is to engage directly with the portfolio companies held by the fund through an engagement service provider.
   It should be noted that there are also types of funds where an investor has more influence on the content of the mandate of the fund.

It should be noted that there are also types of funds where an investor has more influence on the content of the mandate of the fund.

The tax chapter of your responsible investment policy should be able to deal with the different characteristics of the different asset classes and investment types.

Questions to ask yourself
- How are our investments structured (funds, direct, indirect investments)?
- Over which types of assets can we exert the most influence?
- On which asset class is tax most material?

C. Implement tax in the responsible investment policy

Once you have included tax in your responsible investment policy and have determined the applicable scope for the policy, the policy can be implemented. We have developed an escalation model to help you implement responsible tax.

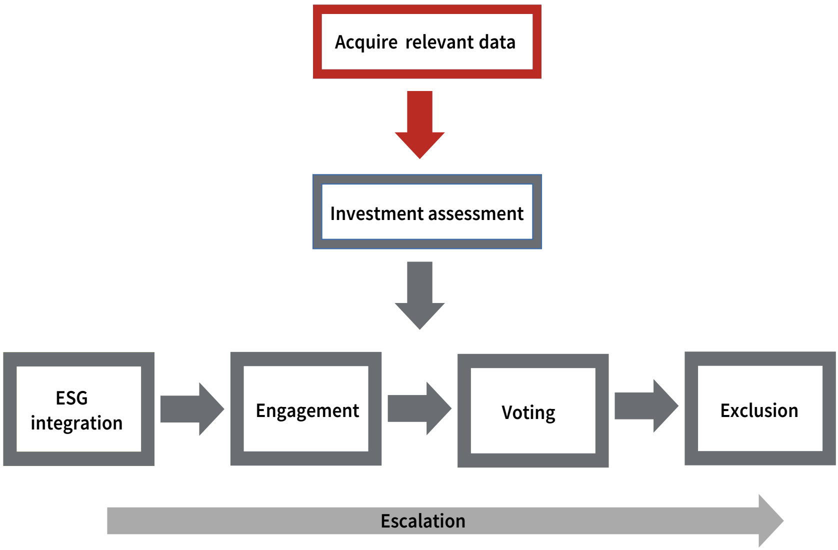

Figure 4.1: *Responsible tax implementation escalation model*

• Acquire relevant data

The first step in the escalation model is to obtain the necessary data and knowledge about how the investee companies deal with tax. This information can be acquired from investment reports or through publicly available documentation, such as annual or sustainability reports.

Several ESG data providers have recently included several tax-related indicators in their company analyses (some examples are MSCI and RobecoSAM). Furthermore, VBDO publishes its yearly Tax Transparency Benchmark, which reflects research findings on the fiscal transparency of Dutch listed companies.[1] The outcomes of this study are relevant for investors. In general, it is a positive sign that the field of research in responsible taxation is developing rapidly as this means that more sources will become available.

[1] For a more detailed guide on how to assess companies on the above-mentioned principles, please consult the appendix of the Tax Transparency Benchmark (VBDO 2016) for a comprehensive list of questions per principle.

Questions to ask yourself
- Do I have sufficient information on how investee companies are dealing with tax?
- Which information and data is relevant to have for my tax norm?
- How do I obtain this data?
- Do I have a clear overview of which sources are available regarding responsible tax?

• Investment assessment

After acquiring the relevant data, you should evaluate and monitor your portfolio companies on their exposure to tax risks. This evaluation should be based on your own tax norm and principles as pointed out in step A. It is important that the assessment is aligned with your own tax norm. Some points that can be addressed in such an evaluation are: the tax jurisdiction in which the portfolio company operates, the company's tax considerations (or lack thereof) within the overall strategy or its level of fiscal transparency.

If information is not available (this may also differ per type of investment or type of asset class), you should determine which information you want to receive to gain a true and accurate picture of the potential mismatches with your own tax strategy in your investment portfolio. More importantly, this evaluation will indicate potential risks and/or focus areas related to responsible tax practices that need further attention. These topics could be discussed during engagement meetings, for example.

In our earlier publication on Good Tax Governance, we listed six principles which form an indication of a company's responsible attitude towards taxation. These principles can be used as a starting point to assess portfolio investments in relation to tax. However, as was described above, the requirements you formulate to assess the tax behaviour of portfolio investments should always be aligned with your own tax strategy.

Good tax governance principles

In 2014, VBDO (with contributions from Oikos and input and support from PwC NL) published 'Good Tax Governance in Transition'. This study found that some companies were already making efforts in their reporting on tax. However, a general cohesive approach on good tax governance from a strategic, risk management and CSR perspective was still lacking. We therefore 'crafted' six principle-based guidelines on what we think good tax governance could be:

1. Companies should define and communicate a clear strategy on tax governance.
2. Tax must be aligned with the business and is not a profit centre by itself.
3. Respect the spirit of the law. Tax-compliant behaviour is the norm.
4. Know and manage tax risks.
5. Monitor and test tax controls.
6. Provide tax assurance.

The first three principles are especially essential for investors as they provide an indication of an investee's responsible tax practices. The last three principles could be used for a more rigorous analysis of an investee's commitment to responsible tax.

The investment assessment could be performed as part of due diligence on new investments, but also during the lifecycle of the investment as part of the monitoring process, as was pointed out in step 4 of the previous chapter.

Questions to ask yourself

- How does the company assessment align with my tax norm?
- Can I use the Good Tax Governance principles or another relevant framework to assess a company's attitude towards taxation?
- Is the acquired information sufficient to receive a true and accurate picture of company tax behaviour?

• ESG integration

The assessment will be used as input for implementing ESG integration, which is the first instrument in our escalation model.

Large differences can exist between the different portfolio companies in terms of their responsible tax strategy and implementation. Where one company may only abide by the letter of the law and is non-transparent on its tax practises, another company may actively try to pursue compliance with the spirit of the law and explain the position of tax in the overall company strategy in its annual report. Institutional investors should integrate tax into their overall investment decision making processes and should give preference to companies that perform well in relation to responsible tax as this may have a significant impact on the risk-return profile of a portfolio.

One way to integrate tax criteria is for an ESG analyst to perform an in-depth analysis of the risks associated with tax avoidance techniques used by investee companies. As a result of this exercise, investors could choose to minimise certain equity investments or decide not to purchase securities that have potential tax risks that are believed to not be properly managed.

Questions to ask yourself

- At which companies has irresponsible tax behaviour the largest material impact on the risk/return profile of our portfolio?
- How can I integrate tax into my company valuation model?

• Engagement

After analysing the investee companies and implementing tax in your ESG integration models and processes, you can influence company behaviour by actively engaging the investee companies. The use of engagement is an important instrument for you to support companies in achieving the right balance between controlling the tax bill and mitigating related risks. You can actively exert influence over companies in whichinvestments are made by entering into dialogue with them. It is advised that you formulate an engagement policy, actively seek dialogue with companies, and monitor and report positive changes in corporate social and environmental management. The type of questions will differ depending on the reported tax profile of the company, the investor's own tax strategy, the existing relationship between the company and investor, and the stage of the dialogue (PRI 2015).

For example, your requirement could be to ask for an implemented tax control framework. Engagement can be held at the time of issuance or during the investment period. As regards fund investments, engagement with fund managers could also give investors a way to discuss tax-related issues and potentially create corresponding investment criteria. Another approach could be that you send an expectation document to all companies in your portfolio or within a specific sector. This ensures that the investee companies are aware of the tax-related behaviour that is expect of them. These expectation documents could be a starting point towards further engagement. An example is the expectation document of the Norges Bank Investment Management. The PRI Tax Guidance 2015 could be consulted for more information on how to structure the engagement dialogue based on tax-related issues and provides sample questions on six broad themes (tax policy, tax governance, risk management, the effective tax rate, tax planning strategies and country-by-country reporting).[2]

Finally, it is also possible to ask questions to the board of directors of a company at the annual general meeting (AGM). This raises awareness amongst the board members and the shareholders about the addressed topic. The Dutch corporate governance platform Eumedion has made improved transparency on tax policy and associated risks one of their key focus areas of 2016.

Questions to ask yourself

- Which companies will be open for engagement on tax?
- Where can I work together with other investors/stakeholders to convince a company towards more responsible tax behaviour?
- Which person within the company will be most relevant to discuss tax risks with?

[1] Investors are advised to consult the PRI report (2017) on corporate tax disclosure for more guidance on what information investors could ask for in order to get an accurate picture of their portfolio investments' tax risks.

• Voting

The next instrument which can be used is voting. Investors can actively exert influence over companies in which they invest by voting during shareholder meetings. Usually a clearly defined voting policy is required, one that explicitly emphasises social and environmental issues. By proactively introducing or supporting resolutions about sustainable development and corporate social responsibility, companies can be pushed towards improvement and corrective action.

Topics covering responsible tax practices have increasingly become part of discussions during the AGMs of investees, but voting on the topic has so far been rather uncommon. The regular agenda of an AGM does not leave much room for voting in favour of responsible tax, but with a shareholder resolution (a group of) investors can move the board of a company towards more sustainable business practices. This could also be an escalation measure within a longer engagement process.

On another topic: during 2016's AGM, a collective of Shell shareholders, Follow This, placed a proposal on the agenda that was to make Shell invest its profits from fossil fuels in renewable energy. Even though it was voted down, this example highlights how shareholders can actively participate during AGMs. Whilst voting on tax-related topics is currently not common, it should be noted that the instrument does hold the potential to become more applicable in the future.

Questions to ask yourself

- Which resolution on the regular agenda of an AGM might offer room to include responsible tax?
- How can we collaborate with other investors to bring forward a shareholder resolution?

• Exclusion

When a company did not want, or was not able, to make any changes to its tax strategy or activities, a company can be excluded from the investment universe. For instance, if the tax behaviour of companies is at odds with international agreements and treaties, they should be excluded from the investment portfolio (VBDO 2014). However, when it comes to tax avoidance practices, we do not expect this instrument to be used frequently as it
is a tool that removes the possibility for improvement. Moreover, excluding companies solely based on their tax behaviour is unlikely; although investors could resort to exclusion when a company incurs fines for its tax behaviour.

Questions to ask yourself
- Which company in portfolio is showcasing such irresponsible tax behaviour and cannot be influenced any further via engagement or voting?

Even though the different instruments in the model are described separately, they do feed into each other. For example, the outcome of an engagement meeting can ensure that the company is in control of its tax risks, which could feed into the ESG integration model, or an engagement process could lead to the introduction of a shareholder resolution at the AGM of the company.

Summary

Your responsible tax framework should also apply to your responsible investment policy. It starts with selecting the right asset manager and setting KPIs to steer the asset manager's behaviour. It is advised to then determine the applicability of tax norms for the different asset classes and investment types. During implementation, the suggested escalation model could be used. Once the relevant data and investment analyses have been acquired, the different ESG instruments can be applied: ESG integration, engagement, voting and exclusion.

5. Final thoughts

The global perception on tax and governance is changing extensively and rapidly. With a consciously designed responsible tax framework you integrate responsible tax behaviour in your organisation and investment activities. At the same time you contribute to a more sustainable society.

We understand that the full development of responsible tax may take some time and therefore advise to start early and rethink your position towards tax. We hope this document provides you with a starting point to create your own responsible tax strategy.

Investors play a crucial role in responsible business conduct. Once responsible investment criteria are implemented, companies have a strong incentive to follow. This is clear from developments in the field of Environmental, Social and Governance ('ESG'), such as climate change or human rights.

VBDO (Dutch Association of Investors for Sustainable Development)

Pieterstraat 11, 3512 JT Utrecht | the Netherlands
T +31 (0) 30 234 00 31 | info@vbdo.nl | www.vbdo.nl