



Tax: the silent T in ESG

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Introduction

Thank you for the opportunity to be part of this year's tax administration conference.

I will be offering an administrator's view about the role of environmental, social and governance (ESG) value drivers, and how tax is playing a critical role in the integration of ESG in businesses.

Since the United Nation's publication of the Who Cares Wins 2005 report, which first brought together financial institutions to examine the role of ESG in asset management and financial research, businesses have been embarking on a process premised on a deep conviction that ESG factors play a critical role to stronger and more resilient organisations, as well the sustainable development of societies. Eighteen years have passed since that report, and the integration of ESG issues in business and policy has become more urgent and expansive. Businesses are seeing ESG issues as playing an increasingly important role in value creation and are looking beyond the short-term risks and opportunities.

I will start with how tax plays a critical role in a well-functioning society (the 'S' and the 'E'), followed by how tax transparency provides

opportunities to support confidence around businesses and their social contributions (the 'S' again), then the importance of strong governance frameworks for businesses (the 'G'). Finally, I will share observations on how tax has already addressed many of the challenges associated with issues like ESG reporting and managing environmental impacts (using a global carbon pricing scheme as an example).

I speak to you from an Australian context, but I know from interactions with our counterparts from other revenue authorities that these are shared challenges and insights globally.

Tax pays for a lot of the 'S' and 'E' in ESG

Large corporate groups make a significant contribution to the Australian economy and play a critical role in the tax system. The number of large corporate groups in the Australian tax system is comparatively small, yet the impact they have on revenue is significant.

To put some figures around this, Australia's almost 1,800 large corporate groups contribute around 64% of all corporate income tax reported, which is about \$67 billion per year. This is more than 14% of total ATO tax collections. Company tax continues to be highly concentrated with the largest 10 corporates.

The taxes we pay are essential to fund the government and the services it provides to its citizens. The government requires taxes to pay for a range of public infrastructure and services that contribute to a functioning society. Paying tax is one way for individuals and businesses to contribute to the well-being of our communities. For businesses, paying tax is therefore a critical (albeit indirect) aspect of their social contribution and contract to operate within the community (the 'S'). Put another way, a company that avoids its compulsory contribution to 'S' has not truly achieved its ESG framework, no matter how much voluntary contribution it boasts.

Taxes are also used by government to fund infrastructure and services directed at reducing environmental damage and promoting environmental protection. The tax contribution of businesses will therefore have a similar indirect contribution to their environmental performance and sustainability within the ESG framework (the 'E').

Fortunately, in Australia, most large companies recognise the importance of their tax contributions to the society in which they operate. The ATO's latest estimates are that the largest companies are paying 93% of their tax voluntarily, increasing to 96% after ATO compliance activity. Our aspiration is to increase this to 96% correct at lodgment and 98% after ATO compliance activity.

Tax transparency gives confidence to a company's commitment to the 'S' in ESG

Consistent, meaningful and timely transparency and disclosures are key elements that facilitate the integration of ESG in business. Tax transparency is a key strategy in driving improvements in tax performance and underpins the integrity of the Australian tax and super systems. Tax transparency can help to promote social responsibility by ensuring that companies fairly contribute to the communities in which they operate. Importantly, it can also provide the community with confidence that large companies are appropriately contributing to the 'S'.

At a global level, the quantity and quality of companies' reporting of their tax strategy and compliance have increased rapidly. A few examples of the initiatives that have contributed, or are contributing to this, include the OECD base erosion and profit shifting (BEPS) project (in particular, Action 13 on country-by-country (CbC) reporting), the EU public CbC Reporting Directive, and GRI 207: Tax 2019.

In Australia, there is a high level of transparency between taxpayers and the ATO. Income tax returns and related schedules like the international dealings schedule and reportable tax position schedule mean that the ATO has significant insights into the tax affairs of large corporates. The provision and exchange of OECD CbC reports and other information help to address the information asymmetry between large corporates and the ATO. In addition to our comprehensive coverage of the largest companies through programs like justified trust, the ATO also has a range of information gathering powers to obtain relevant information from taxpayers.

Australia also has a range of measures aimed at increasing tax transparency to the public. Examples include the corporate tax transparency measure, the Board of Taxation's voluntary tax transparency code, and the provision of general purpose financial statements. More broadly we also provide significant information to

the public about the overall health of Australia's tax system and our role as administrator in our annual report each year.

Under the Tax Avoidance Taskforce, the ATO was funded to ensure multinational enterprises, large public and private businesses, and associated individuals pay the right amount of tax in Australia. The Taskforce funding established the justified trust program in 2016. This program is our flagship measure that seeks to build community confidence and knowledge about the tax performance of large business. The justified trust program involves the ATO providing positive assurance that the tax paid was correct on a case-by-case basis (rather than confirming certain risks do not arise). To date, we have assured more than \$197 billion in income tax under the justified trust program.

These assurance results complement our other measurement tools, including the traditional metrics of revenue collections, audit yield and efficiency measures, and the less traditional metric of active prevention measures where it can be demonstrated that a taxpayer has changed their position through the influence of the ATO. These results ultimately contribute to our whole of system tax gap measure and reporting on the health of our tax system.

The release of the 2019–20 tax gap program demonstrates that large business income tax performance is improving. Voluntary compliance is at its highest level since we started measuring the large corporate groups income tax gap. This is in part due to our justified trust program because we know more about these taxpayers than ever before. Our efforts continue to focus on driving higher levels of voluntary compliance and reporting on system health.

Our tax gap or tax performance program therefore demonstrates that the current state of the tax system in Australia is in good shape. We have one of the strongest corporate tax compliance levels in the world. However, a key driver of tax performance is the attitude of the Australian community, and less than half of Australians believe that large companies are paying the right amount of tax. There is also some disquiet about the role of advisors as enablers of tax avoidance by large businesses and wealthy individuals. The community's perception of fairness, and its trust in how the tax system is administered continue to drive societal attitudes towards paying tax in Australia. Boosting tax transparency is key to providing confidence of a company's social contributions, and sustainably improving tax performance across all markets.

Tax transparency helps stakeholders within the Australian tax system assess the level of tax compliance of large corporates, and whether the taxes reported and paid are fair compared to the taxes required to be paid by others. Such assessment is necessary to promote a better-informed public debate regarding fiscal policies. Transparency also provides safeguards for the protection of investors and other third parties, and therefore contributes to building trust and confidence in the tax system and how it is administered. More specifically, these safeguards facilitate more responsible corporate behaviour by allowing investors to better assess portfolio risks and opportunities, greater visibility of high-risk transactions/arrangements, and to raise questions where tax practices, structures and strategies do not align with the company's stated risk appetite, the policy intent or best practice.

We have also seen the advisor community providing transparency over the way in which the firms govern their tax advisory practices. In recognition of the important role of advisors in large business tax compliance, the ATO and the Tax Practitioners Board have worked with the Big 4 to support them to produce and publish the Large Market Advisor Principles. These principles provide a credible standard for the firms to apply and provide annual attestations relating to the performance of their tax advisory practices. This ensures that they are not enabling tax avoidance or other high-risk arrangements.

Publication of these governance principles provides confidence to clients, the ATO and the broader community about the quality and standard of tax advice. The firms' annual attestations will further support tax functions, risk committees and Boards in business planning, building capability, managing risks, facilitating compliance, and ensuring accurate financial reporting and integrity of business records. The Large Market Advisor Principles are not limited to the Big 4 and are able to be adopted and followed by other accounting and law firms that provide tax advisory services.

Corporate tax governance is a very important component of the 'G' in ESG

Voluntary compliance requires fundamental behavioural change in how corporates view their tax obligations, including their tax governance frameworks and decision-making around aggressive tax planning strategies.

Tax governance has always been a feature of our tax risk management and compliance strategy. When the Annual Compliance Arrangement (ACA) program was introduced in 2008 as our premium cooperative compliance arrangement for large corporate taxpayers, the program was built on the premise that taxpayers would have sound tax governance arrangements.

Since then, the ATO has introduced the justified trust program and published the Tax Risk Management and Governance Review Guide (Guide). Tax governance is a key focus area that we review under the justified trust program. The Guide sets out best practice principles for board-level and managerial-level responsibilities. It also has examples of evidence that taxpayers can provide to demonstrate the design and operational effectiveness of their control framework for tax risks. These principles provide an objective and transparent mechanism for organisations and the ATO to test and assess the effectiveness of tax governance processes.

We have seen through the justified trust reviews, the efforts of many taxpayers to enhance their tax control frameworks, provide objective evidence in support of their governance policies and processes, and undertake independent, regular testing of their tax control frameworks. We see this investment as indicative of tax governance being an ever-increasing focus area at the Board level. Having a well-designed and effective tax governance framework that is lived in practice provides a strong foundation for Boards to be confident that tax risks are identified and managed, and the organisation is complying with its tax obligations. It reduces the likelihood of inadvertent positions being taken due to errors or risky positions being taken which are inconsistent with the company's risk appetite (or indeed their desire to contribute to the 'S').

As there continues to be calls for organisations to be more transparent about their operations and tax contributions, and to demonstrate that they are participating fairly in the economy, we expect to see taxpayers continuing to invest in their tax governance through the justified trust program. We also expect to see our ratings for governance (and assurance) being increasingly used and leveraged by organisations to demonstrate their community and ESG credentials as part of their broader social licence to operate. Positively, in what has become a signal of the tide turning when it comes to social responsibility of large business, more and more companies now have key performance indicators linked to attaining the ATO's highest

assurance ratings, and about half of the Top 100 taxpayers who have achieved high assurance have published their ratings.

Tax has already addressed many of the challenges of the 'E' in ESG and ESG reporting

There is currently a patchwork of local or regional environmental solutions, but ultimately addressing the world's environmental issues is a global challenge. We can anticipate a range of issues associated with a global carbon pricing approach for instance. These issues can include 'double carbon pricing', 'non carbon pricing', cross-border pricing avoidance (arbitraging different schemes), carbon havens, organisations responding by moving operations to low or no carbon pricing jurisdictions, the difficulty of carbon competitive neutrality (such as the unique challenges associated with state-owned entities) and dealing with the challenges of regressivity and inequity.

I would posit that tax has tried to deal with these challenges (with various degrees of success) which really came to the fore with the BEPS project.

- Prior to BEPS, the international tax framework was primarily a domestic one, with treaties designed to address the problem of double taxation. Increasingly, we also saw a movement away from crediting taxes in other jurisdictions, towards assumed taxation (participation exemptions). This was on an assumption of comparable tax rates, and comparable tax regimes. These assumptions had broken down, which led to the BEPS project (both 1.0 and 2.0).
- The BEPS project has been a significant step towards a more coordinated global approach to preventing tax avoidance by multinational companies. It has helped to close tax loopholes, improve tax transparency, strengthen tax treaties and promote international cooperation between revenue authorities. The proposed rules under the OECD two-pillar solution are intended to provide a coordinated, global approach to tax reform that address the challenges of digitalisation of the economy. These initiatives offer examples of how international cooperation and harmonisation can work to help address the challenges associated with the

assortment of national climate policies which currently exist, and which will continue to evolve.

- 'Double carbon pricing' can occur when the same emission or carbon content is subject to carbon pricing in more than one jurisdiction. This can happen when different jurisdictions have their own carbon pricing instruments or when a carbon pricing instrument is imposed on top of an existing one. Double taxation is a familiar concept in tax, and there are a number of well-known measures aimed at eliminating double taxation such as the treaty framework, mutual agreement procedure (MAP), foreign tax credits, participation exemptions, and GST-free exports.
- On the other hand, 'non carbon pricing' can occur when emission or carbon content is not subject to carbon pricing at all, or where carbon pricing policies may include exemptions for certain industries or activities. Turning to tax, there are many examples of measures which are aimed at addressing non-taxation such as the anti-hybrid rules, the Pillar Two model rules, the 'subject to tax' rule, and the reverse charge GST on offshore goods and services purchases.
- Businesses, particularly those in emissions-intensive industries, may respond to a pricing regime by moving their operations to jurisdictions with lower carbon prices or weaker environmental regulations. This is the last thing that a country wants from a carbon pricing regime as global emissions will not reduce, they may even increase, and local economic activity is lost. In most value-added taxes (VATs), this problem is addressed through making exports GST-free. However, this shifts the taxation requirement to the next country. This will give rise to a challenge in ensuring that embedded emissions are captured. For example, if aluminium manufacture is not locally carbon priced (to ensure export neutrality and to address that manufacture simply moving offshore), where is the carbon price charged for aluminium embedded in a car made from that aluminium?
- Other measures to counter tax havens, low-tax or non-cooperative jurisdictions include controlled foreign company (CFC) rules, various transparency measures (such as CbC reporting, exchange of information, and the Common Reporting Standard), the Pillar Two model rules, diverted profits tax, exclusions from participation exemptions, higher withholding rates, and treaty source rules.

- Emission reduction policies can raise complex issues around fairness, population impacts and social inclusivity. For instance, carbon pricing may have a greater financial impact on lower-income households, as they may be relatively more affected by the higher costs of energy and other goods that are produced with carbon-intensive processes. In addition, the stated benefits of carbon pricing may not be distributed equally among different groups of people and communities. Again, we are familiar with the complex challenges faced by policymakers to create a fairer and more equitable tax system, including public finance and governance associated with the distribution of tax money, as well as integration with transfer systems.
- Finally, emitters which are state-owned entities can present challenges. State-owned entities may have multiple objectives. Where they do not bear a carbon price, the carbon price is paid to the local state, or the penalty for not sufficiently reducing is paid to the local state, the economic incentives may fall away. This is particularly challenging when in many countries significant emitters (eg. electricity networks) are state-owned. Levelling the local playing field between private and state-owned entities is a local problem. However, the effective non-pricing of these emissions could then distort the global playing field.
- Again, similar policy issues about competitive neutrality have arisen in the context of tax between government-owned entities and their privately-owned competing counterparts – how do you create a level playing field? In Australia, the National Tax Equivalent Regime ensures that selected government business entities are subject to paying tax equivalents. However, it is unclear whether all such business entities truly operate as if the tax equivalent payments are truly a cost, or whether the relevant government simply sees the payments as 'left pocket, right pocket'.

From the above, it is clear that an understanding of how tax has dealt with some of these challenges, and in particular the insights from the BEPS 1.0 and BEPS 2.0 initiatives, will be of great benefit in this emerging area.

I will make a few final general observations about tax transparency and its relevance to ESG reporting:

- The benefits to users of disclosures cannot be fully realised when the information is hard to find, opaque or disparate. For instance,

sub-groups of an economic group may have a variety of reporting approaches, or different bases/methods for calculations, and there is no over-arching bridge to explain the overall operations. Users of the information need robust, verifiable and comparable information.

- Tax transparency and its intersection with ESG is about long-term value and should not be seen as the primary responsibility of the marketing or public relations area.
- Transparency is complex and carries with it the risk that information may be misinterpreted or misused. However, this should not be a reason for inaction. The integration of ESG in business means that companies are investing in high quality internal controls and systems to managing risks and opportunities, and ensuring that they are complying with the law, regulations and other standards. Companies are also building brand reputation, trust and transparency with stakeholders, and attracting a sustainable employee and customer base.
- Transparency benefits those who are doing the right thing by providing recognition, differentiation and access to capital. It makes it more difficult for companies with poor ESG performance to hide their practices. Transparency creates incentives for companies to improve their performance, and commitment to sustainability and social responsibility.

Conclusion

In conclusion, it is clear that tax is relevant across all three components of ESG and plays a critical role in businesses meeting their ESG credentials. Tax pays for a lot of the 'S' (including funding the 'E') and corporate tax governance is a very important component of the 'G'. Tax transparency also gives confidence around a company's contribution to the 'S'. The risks and opportunities associated with environmental and social trends, together with stakeholders' and the broader community's expectations for better accountability and corporate governance, mean that businesses need to approach tax through an ESG lens. Finally, tax can also offer some important lessons for dealing with the range of challenges associated with a global environmental scheme, and ESG reporting more generally.

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