NORGES BANK

Norwegian Ministry of Finance
Akersgata 40, Postboks 8008 Dep
0030 OSLO

Date: 16. februar 2021
Your ref.:
Our ref.: 21/00399

# Tax and transparency – follow-up of the Storting's consideration of the white paper on the fund for 2020

In its letter of 21 December 2020, the Ministry refers to Recommendation 136 S (2020-2021) where the Standing Committee on Finance and Economic Affairs writes that it has taken note of the fund's risk-based divestments on the grounds of tax risks, and that it "believes it important that the fund contributes to transparency and reduced tax avoidance internationally, and asks the Ministry of Finance to consider how the fund's work in this area can be made clearer in connection with the white paper on the fund for 2021". The Ministry also refers to the expectation document on tax and transparency emphasising that "aggressive tax planning undermines tax systems and may give rise to reputational and financial risks". The Ministry asks Norges Bank to report on how the Bank is following up the expectation document on tax and transparency, including the operationalisation of the document in active management and ownership, the assessment of and criteria for risk-based divestments, and plans for future work.

We respond to the Ministry's questions below. We begin by summarising the point of departure for our work with the expectation document on tax and transparency, within the context of our financial objective. This point of departure is reflected in clear expectations of companies when it comes to governance and transparency, and in account being taken of the financial risks that follow from companies' tax behaviour when assessing risks and investments. At the same time, it means that the fund does not take a view on tax policy or play a role in tax enforcement.

## Point of departure for our work with the expectation document on tax and transparency

Our work on responsible investment and our expectations of the companies we invest in have their point of departure in our role as manager of a large, global fund with a long investment horizon. The expectation document on tax and transparency was published in 2017 after broad consultation with experts, civil society and companies.[1] Work on following up the document is carried out in the context of the principles for responsible investment management issued by the Executive Board in line with the Ministry's mandate

[1] The expectation document followed up the Storting's resolution on 3 June 2016 to "request the government to ask Norges Bank to consider developing an expectation document on tax for the companies the fund is invested in".

for the management of the fund. The aim of this work is to further the long-term performance of our investments and reduce the financial risks associated with environmental and social issues.

Matters concerning tax policy, tax rates and tax enforcement are the responsibility of relevant authorities. As a large, global, long-term investor, we are served by clear and stable regulatory conditions across industries and markets, and by economic, environmental and social sustainability.

The expectation document on tax and transparency is rooted in international principles, including the OECD Guidelines for Multinational Enterprises and the G20/OECD Principles of Corporate Governance. The expectations rest on three main principles: that taxes should be paid where the economic value is generated, that company tax arrangements are a board responsibility, and that public country-by-country reporting should be a key element of transparent corporate tax disclosure. The first principle is important in the work being done on taxation by relevant authorities at international level. The other two are related more directly to the risks we face as an investor, and it is primarily these principles that we follow up in our ownership work.

We expect multinational companies to have appropriate and transparent tax practices approved at board level. Aggressive tax behaviour can give rise to financial risks. There are a number of reasons for this. Companies may be more exposed to changes to tax rules, or may move in grey areas that present a risk of tax disputes, fines or loss of reputation. Limited transparency on tax practices may also be a sign of poor corporate governance. With our expectation document, we aim to contribute as a financial investor to responsible and sustainable tax practices.

It is important to emphasise that there are no clear and recognised indicators of the risk of aggressive tax behaviour that can be directly integrated universally or systematically into company dialogues, active management or risk-based divestments. Nor is it the case that all of the underlying information on aspects of companies' activities relevant to assessments of such risks is publicly available. This includes country-by-country information on operations, revenue and taxes, and specific information on activities in particular jurisdictions and the rationale for this.

Further detail on the background to the expectation document and our work with the document in the early years can be found in previous letters from Norges Bank.[2]

## Follow-up of the expectations on tax and transparency in active management and active ownership

In the following, we run through our work on tax and transparency in the light of the Ministry's questions. We look first at our dialogue with companies and our work with standard setters and in joint initiatives. We then respond to the specific questions about risk-based divestments.

*Dialogue with companies*

Norges Bank attaches importance to company dialogue where ownership and investment matters are integrated. The aim of our dialogues with companies when it comes to tax is

[2] Letters of 30 January 2017 and 24 January 2018 respectively.

to contribute to responsible and sustainable tax practices. When the expectation document on tax and transparency was published in 2017, we wrote to more than 500 companies about this. We have also raised tax specifically at around 200 company meetings since 2018. In 2020, we raised the topic with companies accounting for 11 percent of the value of the equity portfolio. At these company meetings, we talk about our expectation document in general terms, but also raise specific challenges faced by the companies. This might mean tax disputes or other specific events, but also more general issues with the company's approach to tax or reporting on tax. These last dialogues often take place over a long period, enabling us to build knowledge and perform assessments of companies' practices and any changes over time.

We began early in the operationalisation of the expectation document to have dialogues on one of the principles in the document: the board's responsibilities and policies. Our reasoning was that it was important to impress this principle upon companies. We were also keen to learn more about corporate governance and tax, a topic that was relatively new in terms of investor dialogue. These dialogues have given us a greater understanding of how boards approach tax matters and of companies' tax management policies and assessment of tax risks. Since 2018, we have had dialogues with 21 companies specifically to encourage them to develop and publish policies on how they manage tax risks. Tax management policies give us an opportunity to understand and follow up companies' principles and goals when it comes to taxation, and to assess these against our expectations.

The other main principle that we follow up in company dialogues on tax is transparency and reporting. Corporate tax disclosure is relevant to our assessment of investments, helps us identify companies we want to have further talks with, and enables us to prioritise which specific tax issues our ownership department and portfolio managers raise. Since 2018, we have assessed tax reporting and transparency at selected companies with extensive international operations where we have a substantial investment. The companies' reporting is assessed against a number of indicators, such as tax management policies, attitude to tax planning, management of tax risks, the board's involvement in tax matters, and country-by-country reporting.

Our expectations of companies' reporting include openness about activities in closed jurisdictions and low-tax environments. Information on this is relevant to assessments of tax risks. There may be commercial reasons for a company to be present in such environments, but the purpose may also be tax avoidance or tax management. We initiated dialogue with 31 companies with activities in such jurisdictions in 2020. The aim of the dialogue is to learn more about the factors behind the choice of jurisdiction, and to encourage the companies to be transparent about the commercial rationale.

These dialogues help us gain a better understanding of the risks faced by these companies. Over time, this provides a basis for assessing whether the companies' approach to tax is moving more into line with our expectations.

### *Work with standard setters and joint initiatives*

There is still a need for more effective frameworks and standards for corporate tax reporting. For example, we responded to consultations by the OECD in 2019 and 2020 on taxation in the digital economy and country-by-country reporting. Among other things, we stressed the need for well-functioning and predictable frameworks for tax disclosure. We have also expressed our support for the Global Reporting Initiative (GRI), which presented a new standard on tax reporting in 2020 covering both disclosures on governance structure and strategy, and public country-by-country reporting. This is information which is useful for our analyses and for our ownership work.

Sometimes, we see that companies face more general or sector specific challenges that we consider best resolved through a form of collaborative dialogue with multiple companies. We have organised or participated in initiatives of this kind for more than a decade. In 2018, we hosted meetings for companies supplying consumer goods and services. Both consumers and investors have asked questions about the sector's approach to tax. We held four workshops with such companies in 2019, where we raised topics such as effective corporate governance, country-by-country reporting and the development of standards in the tax field. Both company representatives and external experts contributed to the discussions. The aim of the initiative was to encourage the companies to be more open about their tax practices.

Together with Dutch pension fund ABP, we have also set up a network where we meet 20 other investors twice a year to discuss investors' expectations of companies when it comes to tax, and to exchange experience from our ownership work in this area. This kind of knowledge sharing and collaboration can help give companies a clearer understanding of different investors' views and interests when it comes to taxation. In addition, we have participated since 2018 in a working group on responsible tax practices led by The B Team together with around 20 companies.[3] The aim of our participation in the group is to get more companies to endorse The B Team's responsible tax principles, which align well with our own expectations on tax and transparency.

*Risk-based divestments and analyses of tax risk*

The Ministry asks for a detailed account of the Bank's assessment of and criteria for risk-based divestments on the grounds of companies' tax behaviour. We would begin by stressing that risk-based divestments are not a main tool in our work on tax and transparency. As discussed above, company-specific analysis and ownership dialogues are more important tools.

We made risk-based divestments on the grounds of tax and transparency for the first time in 2020. Our analyses were based on six indicators of tax risk which are fairly readily available across the portfolio. The indicators we looked at were: share of revenue from abroad; presence in low-tax environments and closed jurisdictions; number of subsidiaries there; effective tax rate below 10 percent; average effective tax rate over time; and the average for companies in the same sector.

Applying this method left us with around 130 companies. To assess the risks further, we looked more closely at these companies, including information in their annual reports and other corporate communications that could explain their performance on these indicators. We also checked third-party data for tax controversies and our own assessments of these companies' tax reporting against our expectation document. This gave us an impression of whether companies with high underlying risk exposure had taken steps to manage this risk. The outcome of these assessments was divestment from seven companies which paid very little tax and made very little information publicly available about their tax affairs.

[3] The B Team is an industry initiative working partly on promoting responsible tax practices. In 2020, this work focused on three issues: corporate tax disclosure, dialogue between investors and companies on tax, and responsible tax practices among tax advisers.

Risk-based divestments are made within the overall limit for deviation from the benchmark index and follow a wide-ranging assessment of the consequences of these decisions for the portfolio’s risk characteristics. As a result, this tool will, in principle, only be deployed for small companies where the risk is considered to be high and where we believe that active ownership will not be appropriate or economical. The decisions to divest from these companies were made on the basis of this risk-based approach. We will monitor the risk/return implications of these decisions.

In parallel with the analyses that led to these risk-based divestments, we developed a database of tax information. We are also working with other methods to assess tax risks, and tax risks are included in our annual process for portfolio assessments against our expectation documents. The core element in this process is that we evaluate companies with elevated risks and prioritise ownership measures on that basis.

## Future work on tax and transparency

Standards, analyses and reporting on tax are all evolving, and this will result in more consistent information across markets and sectors over time. Data and information on tax practices and tax risks will nevertheless remain a major challenge.

We plan to expand the tax analyses that we perform. We will work on gaining access to more information on holding structures and subsidiaries. We will also consider broadening the scope of our analyses of companies’ tax disclosures and whether we can use new technology to gain an overview of concrete indicators such as tax policies and country-by-country information. We will develop new visualisation solutions to make information and analyses available to portfolio managers and so pave the way for an integrated approach to active management and ownership.

We believe that there is still a long way to go before public country-by-country reporting becomes standard. We will continue to contribute to the development of knowledge and practices in this area by working towards common standards. We will continue our dialogues with companies on aggressive tax behaviour, including companies with activities in closed jurisdictions and low-tax environments, and on tax reporting in general. We will also conduct further assessments of the possibilities for risk-based divestments as we gain experience from the decisions implemented.

## Summary

Tax and transparency has been a priority topic in our responsible management of the GPFG since 2017. Our approach to the topic in the expectation document and in the use of the tools available to us is based on our mandate to achieve the highest possible return within applicable constraints, including the requirement to invest responsibly. Matters concerning tax policy, tax rates and tax enforcement are the responsibility of relevant authorities. For the GPFG as a financial investor, however, stable regulatory conditions across sectors and markets is important, as is good corporate governance and good corporate tax disclosure. By focusing on these areas, we can contribute to responsible tax practices while simultaneously obtaining information on companies’ tax risks which is important to us as a financial investor.

We will further develop our work in keeping with our interests as a financial investor. We have a long-term horizon for this work.

Yours faithfully

Øystein Olsen | Nicolai Tangen