Tax ESG

PwC Brasil

Companies have been consistently **investing in sustainability** as a core pillar of their strategies and working to communicate their intentions clearly. However, one key metric has remained largely absent from conversations about ESG (environmental, social and governance) issues: **taxes**.

A company's approach to taxation should not be viewed solely as a matter of compliance: in the context of ESG performance, taxes are becoming a powerful indicator of **how a company sees its role in society** and how committed it is to its purpose.

Taxes are often **a company's most significant contribution to society**, as it is through them that governments can fund the provision of essential public services and public works. This makes taxes a critical element of the 'S' and 'G' in ESG, with possible repercussions for the 'E' as well.

45%

of companies are committed to decarbonisation (partial or net zero).

81%

consider tax incentives relevant or very relevant to the implementation of ESG practices.

75%

do not publish tax information in their sustainability reports.

Tax transparency is an essential avenue for businesses to demonstrate their commitment to operating for the benefit of all stakeholders, instead of purely seeking to maximize shareholder returns. A tax strategy that is sustainable for both the business and the society in which it operates creates long-term value for all stakeholders.

The result is an **opportunity to reframe tax reporting as positive communication for business**. These disclosures need to reach increasingly broad audiences, including consumers and employees, and cover additional topics in addition to the usual 'raw numbers', such as tax strategy and governance.

Taxation and the three pillars of ESG:

E — Environmental

- Environmental taxes (*green taxes*) levied on products and services that pollute the environment
- Incentives for the generation and consumption of clean energy

S — Social

- Tax and social security benefits
- Total tax contribution – The amount of taxes paid by a company in a specific period
- Fair share of taxes – Compliance with the duty to pay taxes in accordance with the effective tax capacity of the company and its activity without hindering its ability to seek legal and moral economy in taxation
- Tax ethics – Demonstrating the adoption of corporate, operational, business and commercial structures with sufficient substance to ensure a legitimate reduction of the business' tax burden
- Tax narrative – Explaining the company's data and conduct concerning taxes in ways that strengthen its credibility and the legal compliance of its corporate and transactional structures, promote greater transparency, and make sense to investors and other audiences it interacts with

G — Governance

- Tax strategy
- Matrix of tax risks and how to address them
- Tax transparency reports

Decarbonisation commitments

Achieving the Paris Agreement targets of limiting global warming to 1.5 °C above pre-industrial levels and net zero carbon emissions will require a more than fivefold increase in the rate of global decarbonisation each year. This means governments and businesses need to go further and faster if we are to cap global warming at 1.5 °C. There is a path to success in which global emissions are halved by 2030, and net zero emissions can be achieved by 2050 at the latest, but it requires taking firm and decisive action now.

Our survey shows that the **pace of this transformation in Brazil is still slow**: less than half of participating companies have made decarbonisation commitments. The adoption of adequate tax incentives can be an essential instrument to accelerate this trend, benefitting society as a whole.

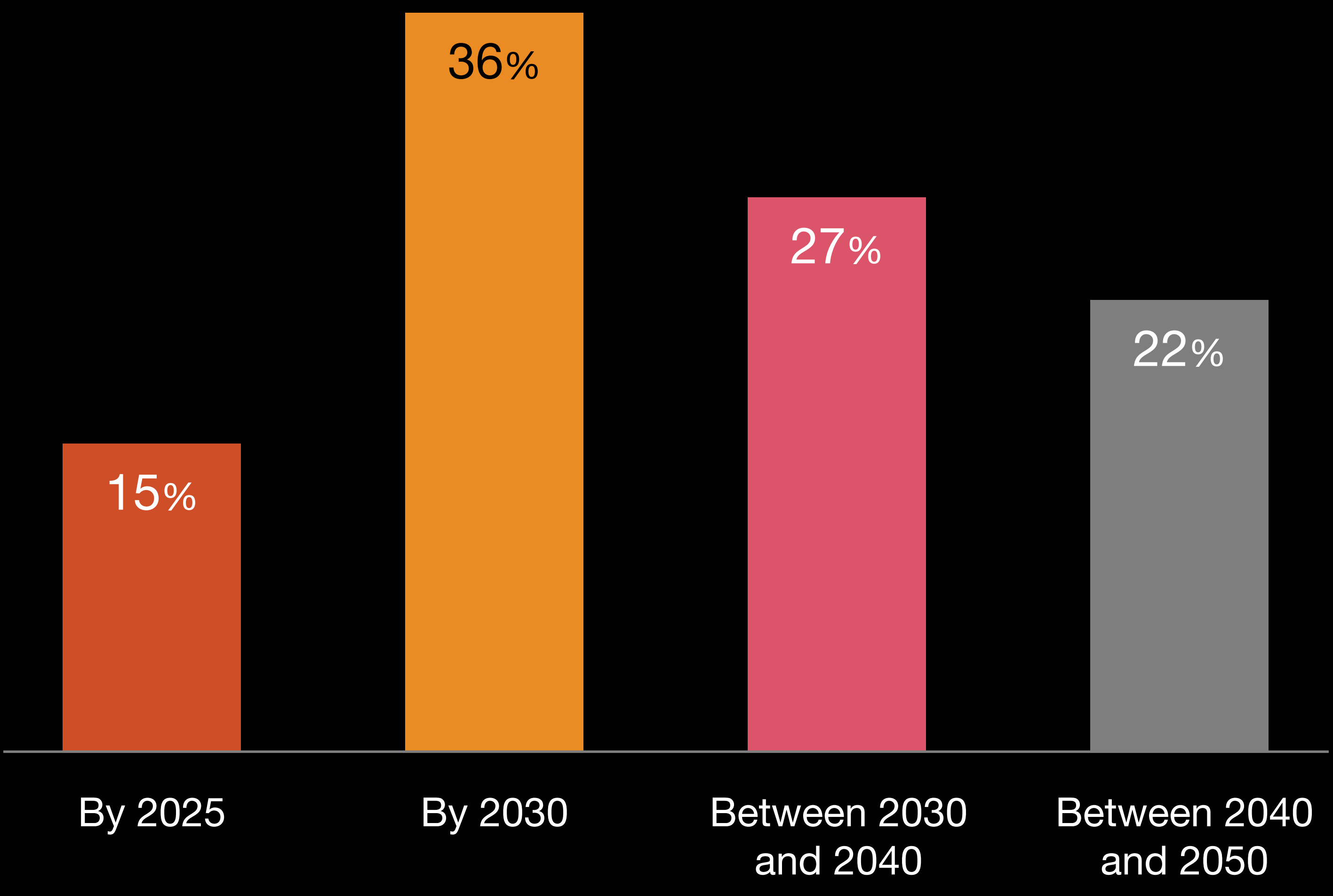
45%

of participating companies have a decarbonisation (partial or net zero) commitment.

51 %

aim to achieve it by 2030.

Reported deadline for achieving the goal



Maurício Colombari

Partner and
ESG Leader, PwC Brasil

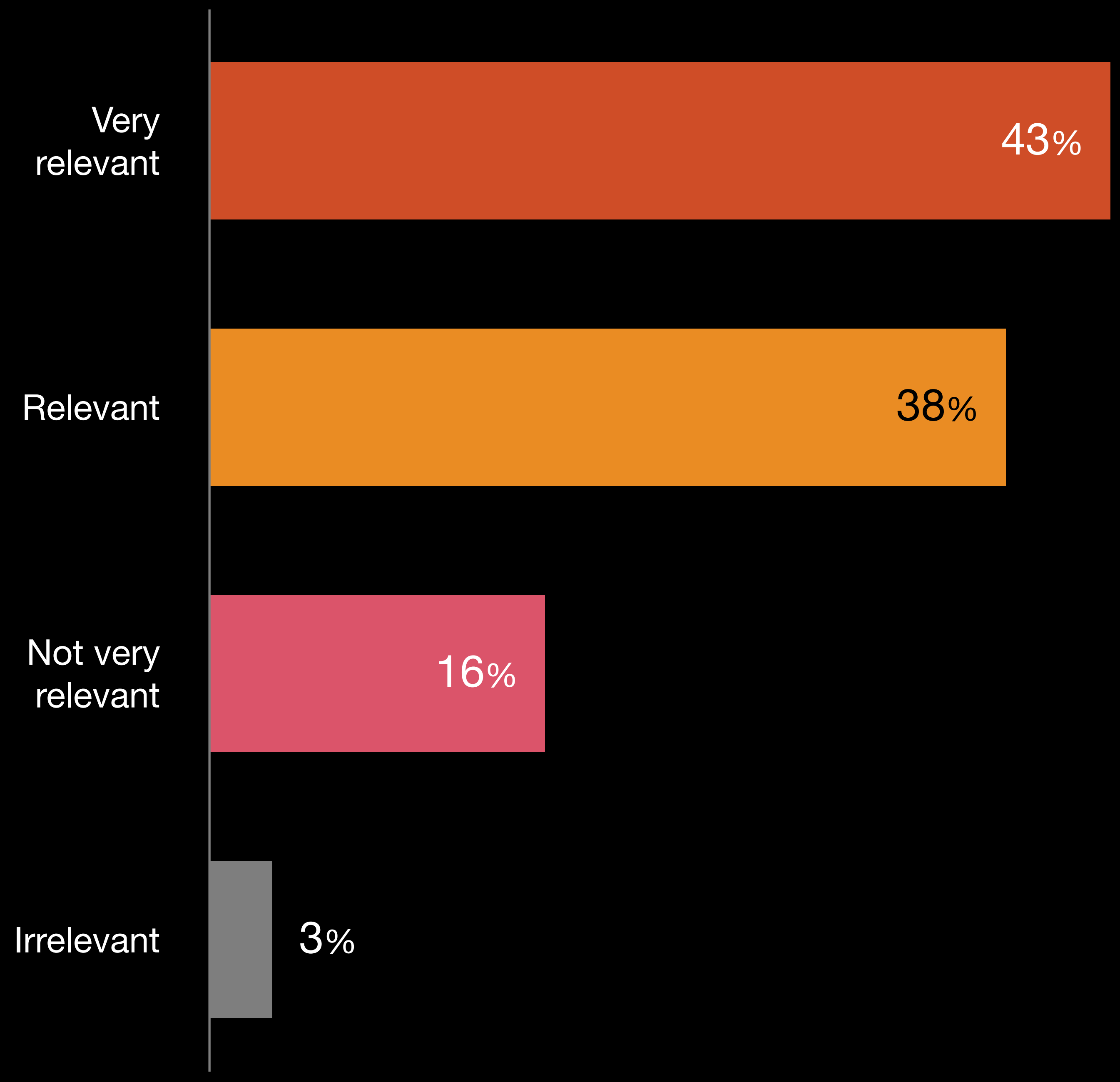
> *"Although still timid, this result shows that decarbonisation is on the agenda of many companies. Businesses that make more robust commitments tend to include emission reduction targets in their corporate strategies and senior executive compensation plans, as shown by the 25th CEO Survey, our most recent annual global survey of CEOs."*

Tax incentives and ESG practices

According to the Brazilian version of the 25th CEO Survey, published in January 2022, more than a third of Brazilian executive leaders are concerned about social inequality (38%) and climate change (36%) as threats to their business growth.

Our Tax ESG survey also confirms that government incentives could boost corporate action in these areas in the face of economic and population growth, providing meaningful contributions to environmental preservation and promoting access to rights, goods and services for the most diverse parts of society.

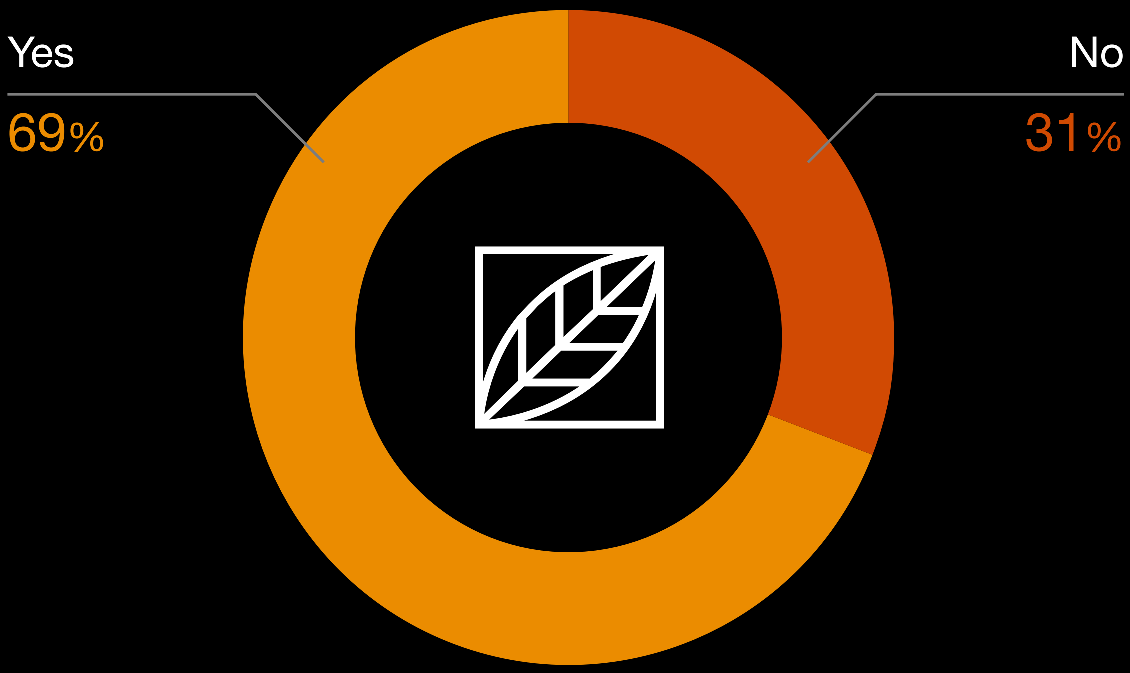
Over **80%** of survey participants consider tax incentives relevant or very relevant for implementing ESG practices in their industry.



Creating green taxes

More than two-thirds favor introducing “green taxes”, i.e. taxes levied on products and services to promote the preservation of the environment.

In favor of implementing green taxes



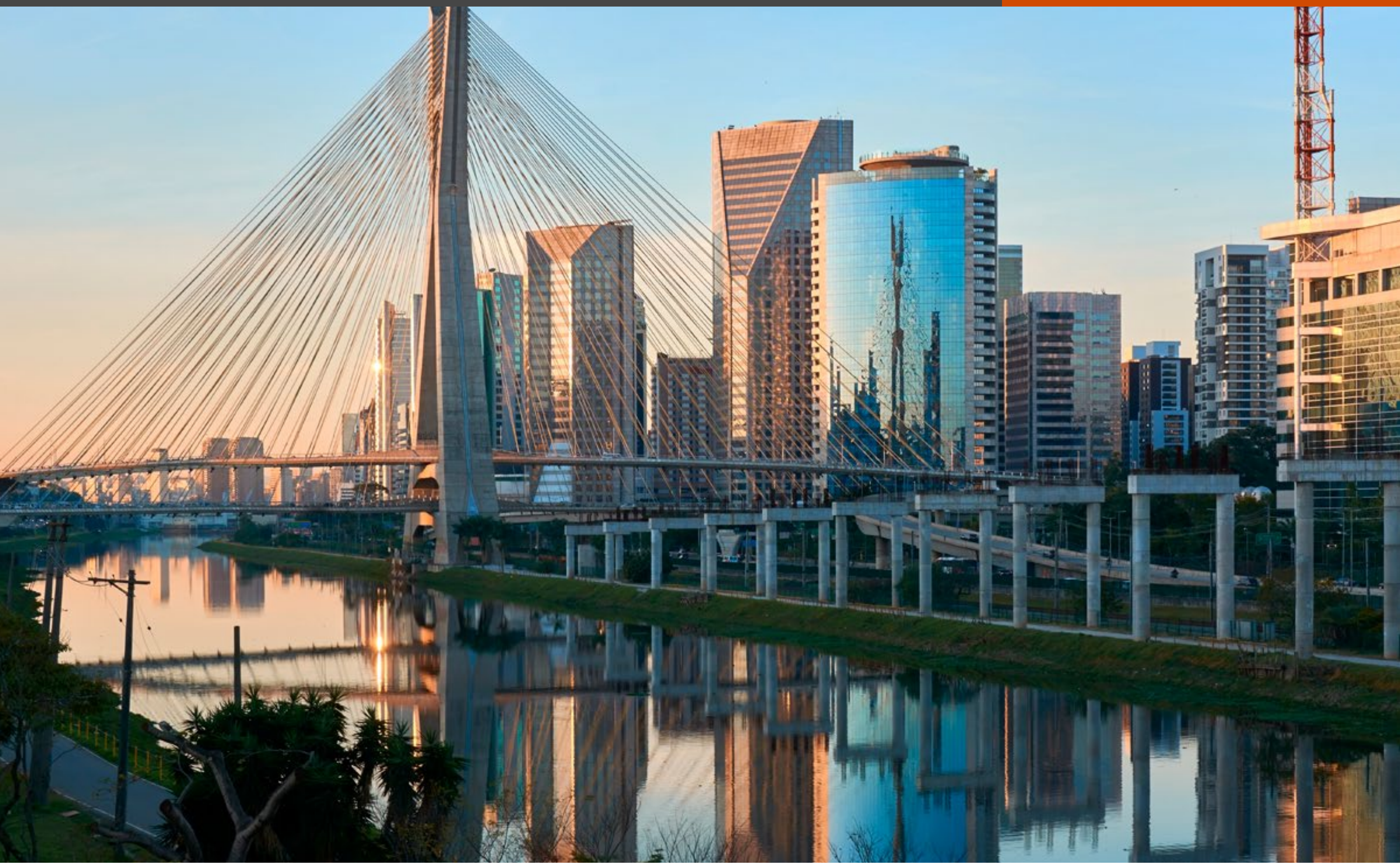
If provided with tax incentives, companies report they would mainly invest in the following ESG initiatives:[1]

77%
preservation of the environment

58%
fighting social vulnerability

54%
inclusion and diversity

[1]Only “high priority” responses were included.



Examples of tax incentives

The segment is recent, and regulation is not yet fully mature since it has been developed "on the fly" as the segment evolved. Currently, tax incentives for renewable energy apply to five Brazilian federal taxes: IRPJ (Corporate Income Tax), CSLL (Social Contribution on Net Profits), ICMS (Tax on the Sale of Good and Services), PIS (Social Integration Program) and Cofins (Contribution for the Funding of Social Security). ICMS exemptions are available throughout the country in transactions involving items such as wind turbines, solar heaters, PV generators and others.

In Bahia, one of the 26 states of Brazil, located in the Northeast Region of the country, for example, in addition to federal tax benefits, state legislation also allows deferred ICMS levying on the import of parts, equipment and components produced by wind turbine manufacturers or entities that maintain and repair wind turbines and other clean energy generation equipment.

Also, Brazil's National Congress is currently discussing bills that would provide tax incentives for the correction of social inequities, such as those that exempt companies that hire vulnerable women (i.e. women who were victims of domestic violence or are the primary earners in low-income families).

Mariana Carneiro

Tax Partner, Indirect Taxes Specialist, PwC Brasil

> *"To drive social and environmental change at the pace and scale required by society, governments have a crucial role in promoting an environment that catalyzes the advancement of ESG issues. This can be done not only through regulatory reforms and investments but also through appropriate tax policies and incentives."*

Tax governance maturity

When a company's tax responsibilities are managed and formalized in line with its general governance structure, tax area managers have additional encouragement to mitigate risks and develop more strategic partnerships with other business areas, facilitating tax compliance and identifying sustainable alternatives for tax savings.

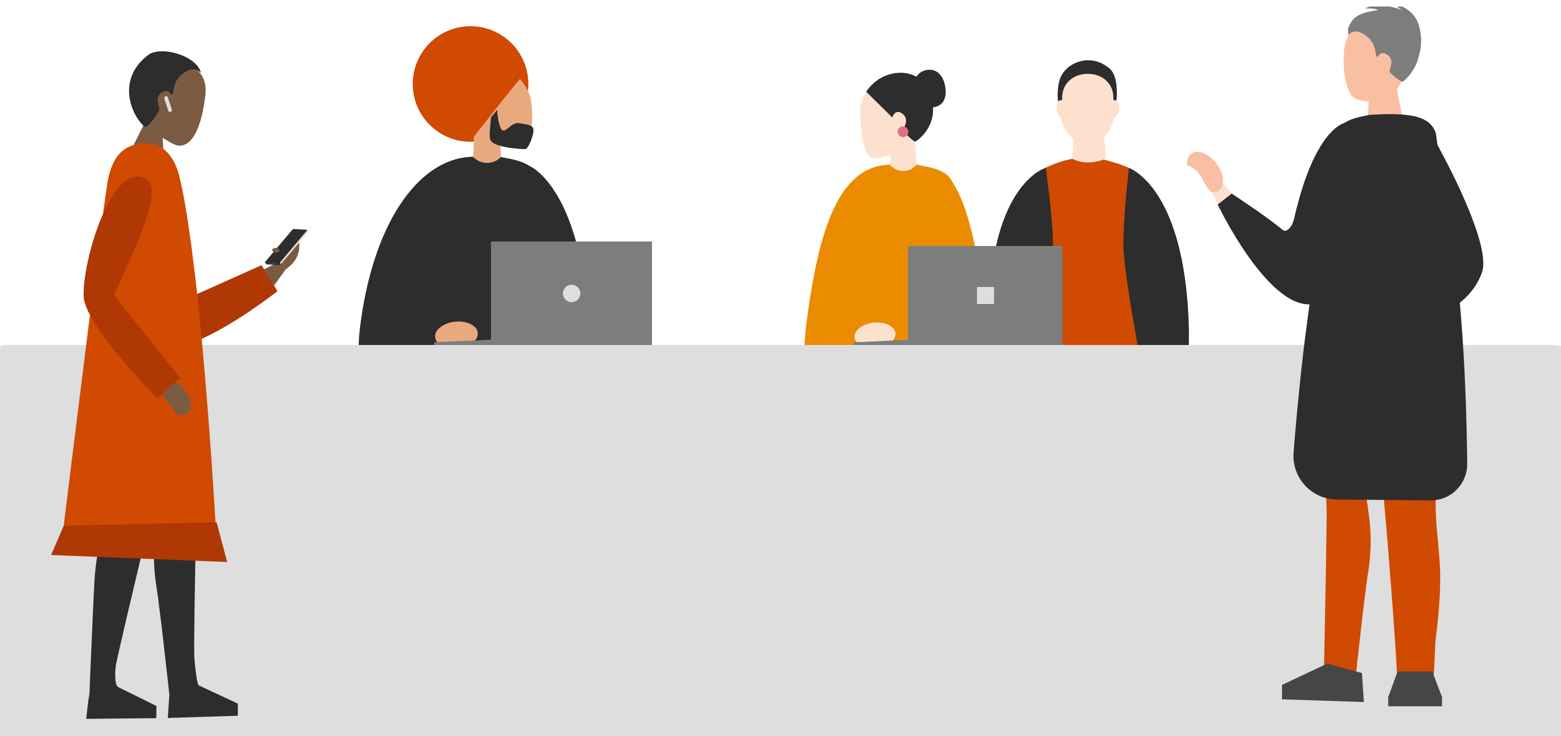
Over half of the companies participating in our survey told us they have a tax governance body – an area responsible for defining corporate tax strategy and policies, which are then validated by the general governance body. However, only one-third of respondents reported that the business areas actively participate in this body.

78%

of companies adopt procedures for review that include external experts or the tax department itself.

1/3

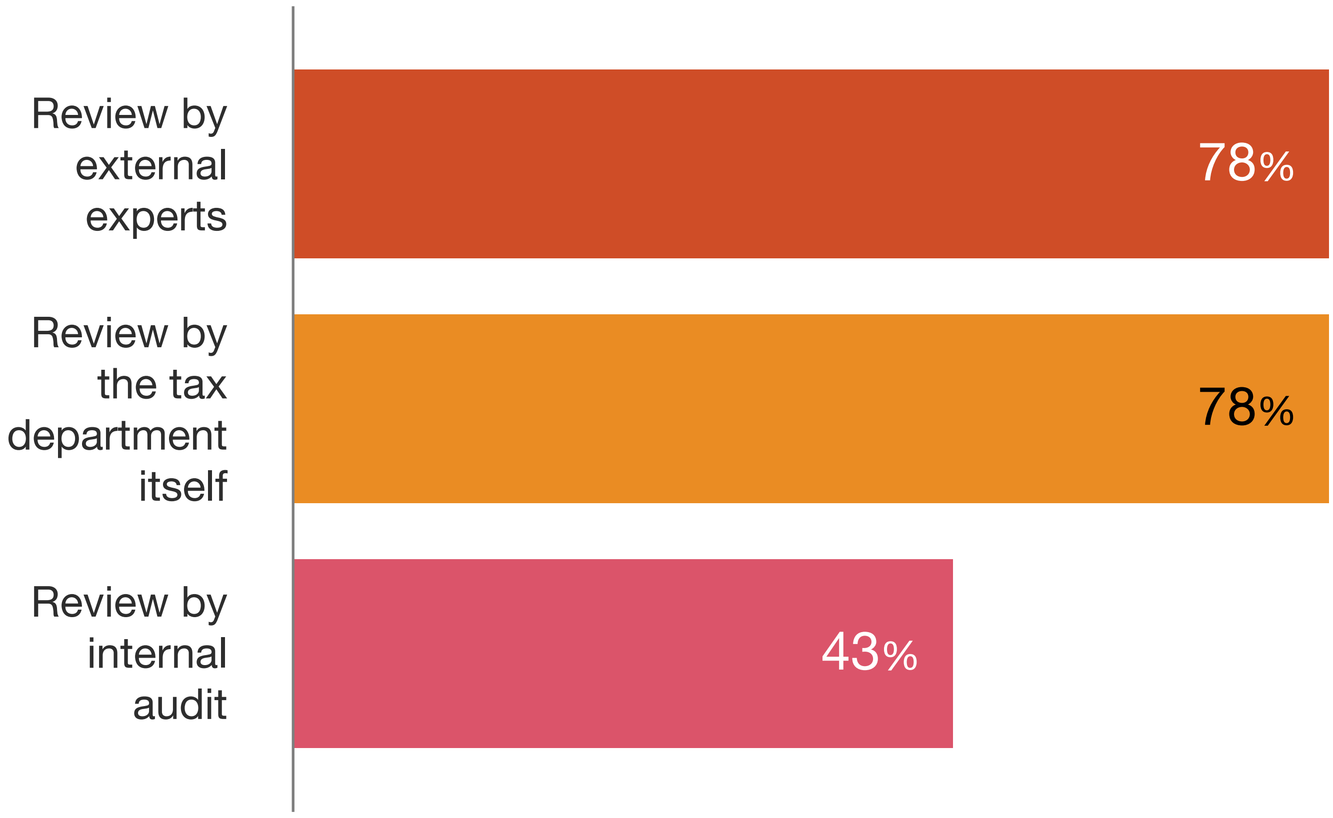
of businesses carry out the review in three instances (external experts, tax department and internal audit) to make sure they properly comply with their tax obligations.



Procedure for reviewing tax obligations

Reviewing tax obligations is essential to ensure compliance with constantly evolving legislation and the proper payment of taxes. It makes it possible to identify, measure and mitigate risks, identify new tax credits, prevent the collection of unnecessary taxes and better define the prices of products and services.

A total of 78% of companies reported they adopt review procedures by external experts or by their tax department to ensure that their fiscal obligations are being properly met.



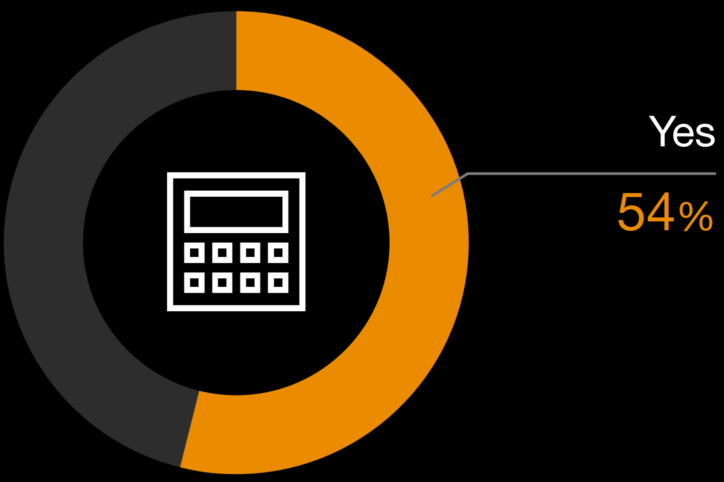
Percentage of companies that conduct one to three reviews of their tax obligations

34% Triple

30% Double

36% Single

Does the company have a tax governance structure?

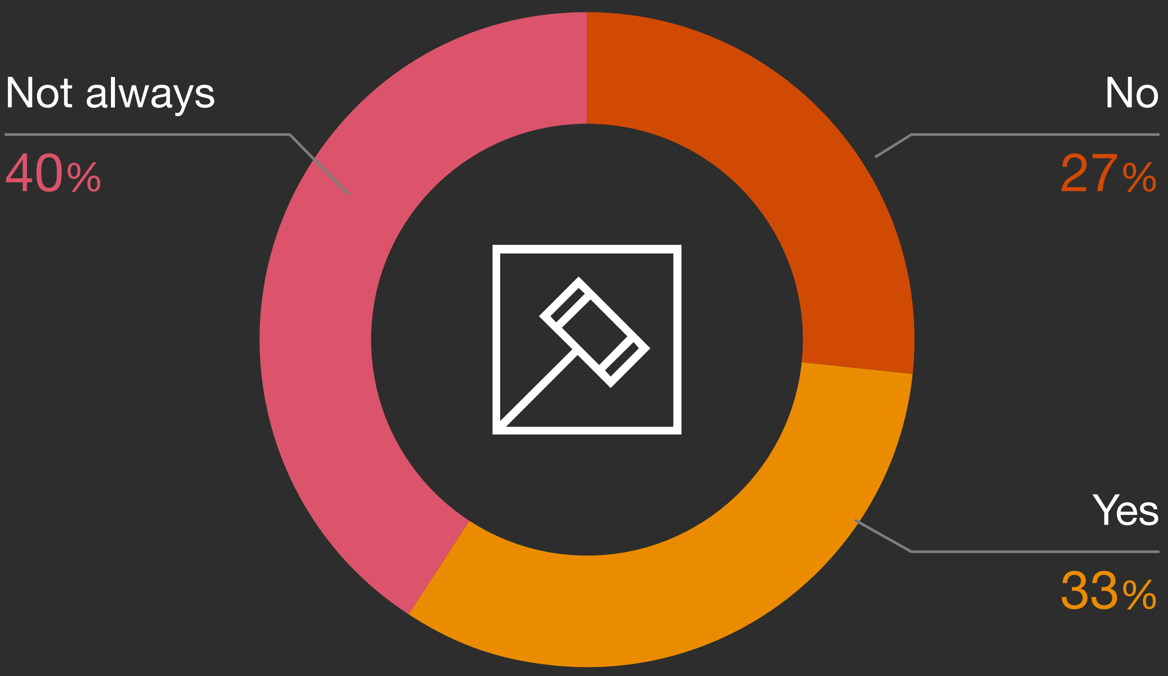


Of this group,

95%

said it is part of their tax organization's scope of action to verify if there is a business purpose and economic substance in its corporate structures or operating models that result in tax savings

Do business areas actively participate in the tax governance body?



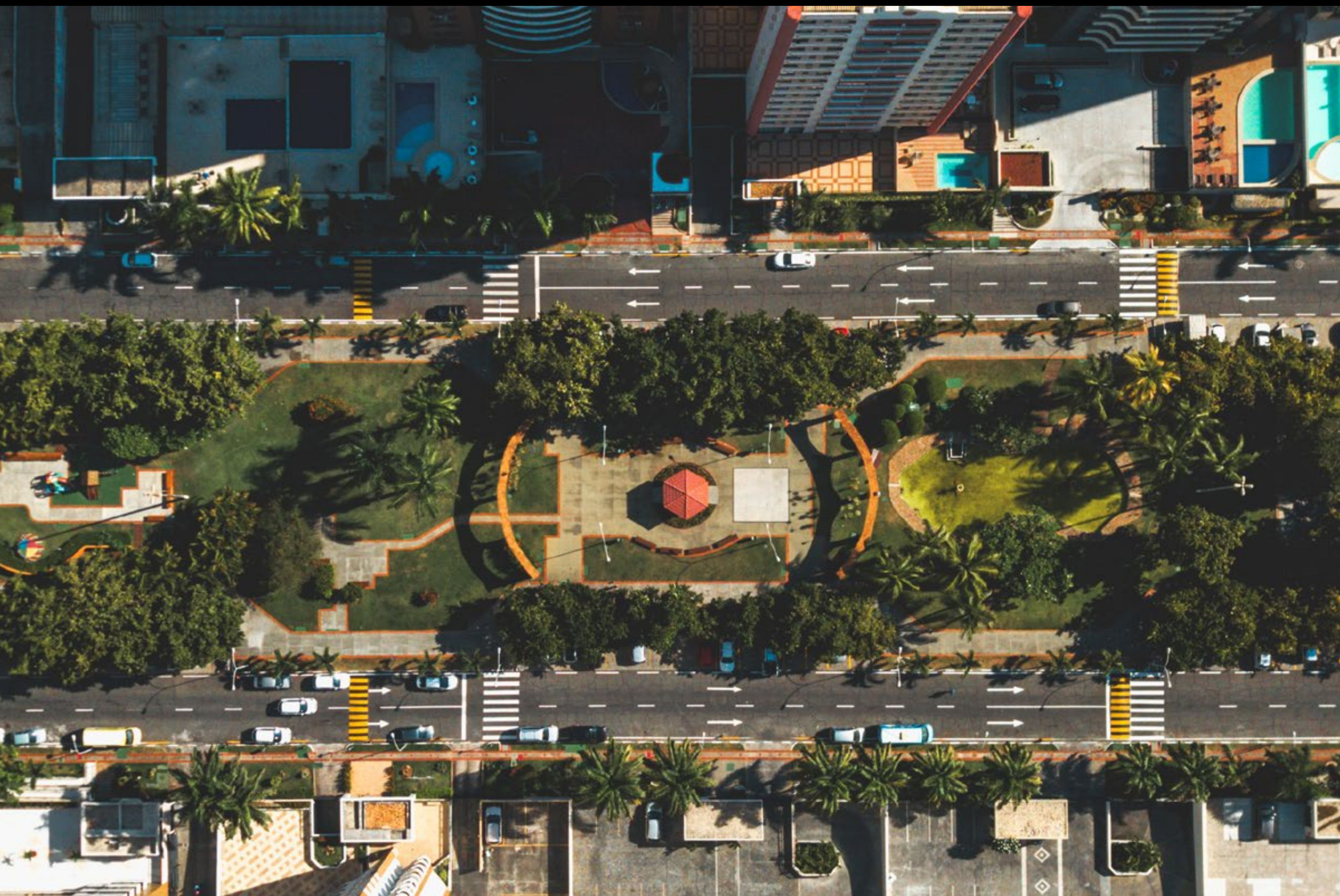
The public wants more information

Even before Covid-19, companies were under increasing pressure to be more transparent about their tax practices and be seen as good citizens who contribute part of their revenue and profits to society through tax payments. This is a trend that has only grown since, as governments worldwide continue to grapple with pandemic-induced fiscal deficits.

94%

of survey participants take image and reputational risk into account in the company's tax management when considering procedures and structures that may lower the tax burden.

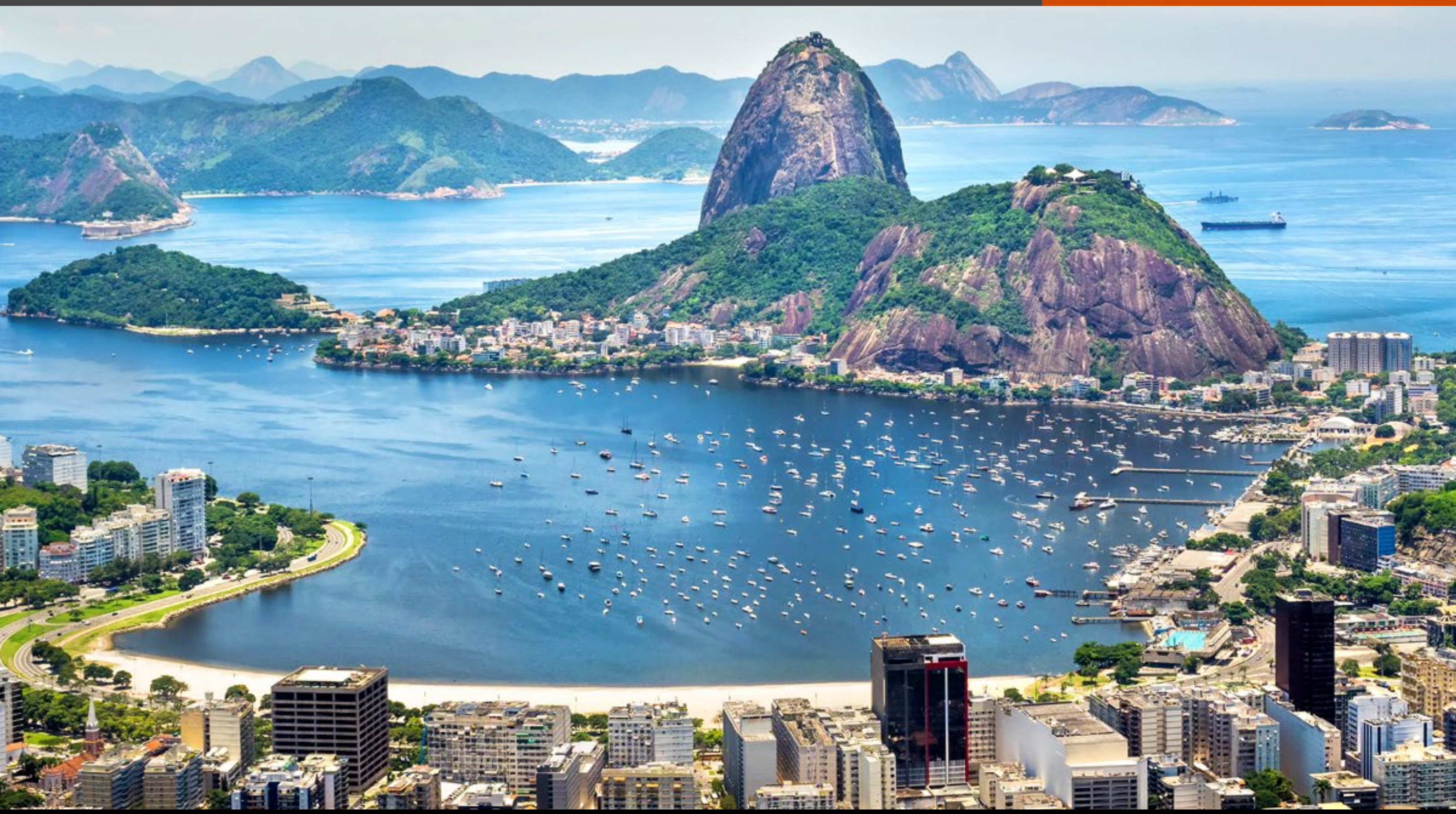
Fiscal transparency is a core tenet of several global and multilateral institutions' initiatives, including the United Nations, with its Principles for Responsible Investment (PRI), the Organization for Economic Co-operation and Development (OECD), and the European Union. The UN's Sustainable Development Goals (SDGs) describe taxes as an **essential metric when determining an organization's contribution to their fulfillment.**



Hadler Martines

Partner and Tax ESG Leader, PwC Brasil

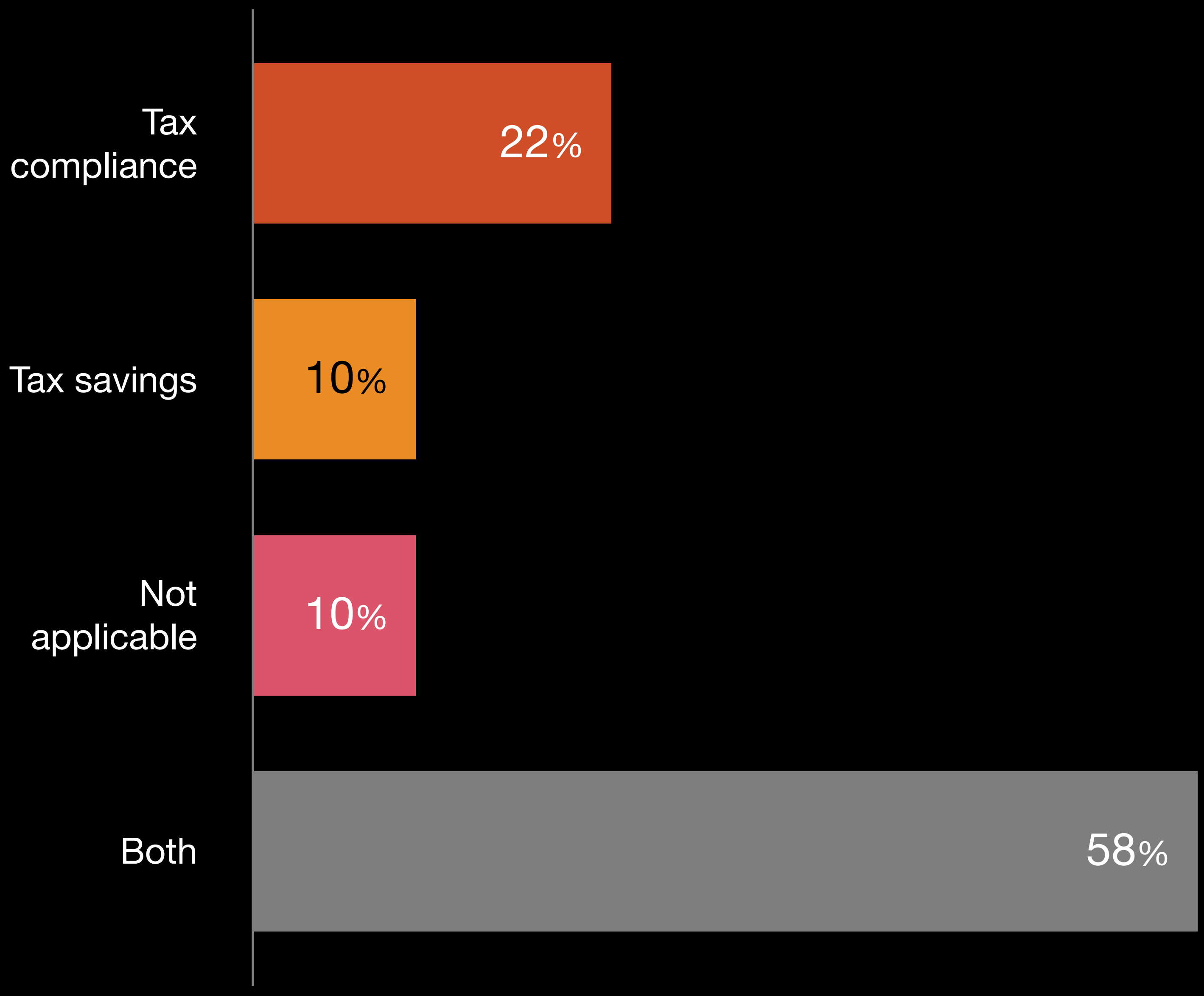
> *"Given the significant public spending incurred to combat the adverse effects of the Covid-19 pandemic, it seems inevitable that organizations will face increased scrutiny of their tax contributions as governments seek fiscal balance. Companies can avoid unnecessary controversy by being transparent with their taxation and implementing sustainable tax practices, rather than waiting for those to become obligations imposed by regulators or legislation."*



More than half of our survey participants reported increasing demand for transparency in their tax practices from investors, customers, employees, and other stakeholders. Most **take reputational issues into account** when deciding whether to adopt procedures that may reduce their tax burden.

Are stakeholders demanding more transparency in tax practices?

Metrics for assessing tax area managers



Companies can and should tout their ethical credentials – for example, banning the use of child labour and investing in initiatives that benefit local communities in areas such as education and healthcare – but must also ensure good tax practices, governance and transparency.

An **organization's approach to tax transparency** should be a core tenet of its broader business strategy and sustainability commitments, including via more in-depth disclosures to stakeholders. Examples of voluntary tax transparency initiatives include disclosing the company's tax strategy, relationships with tax authorities and total effective tax contribution, as well as information on its tax governance and risk management practices and total amounts paid in each jurisdiction in which they operate.

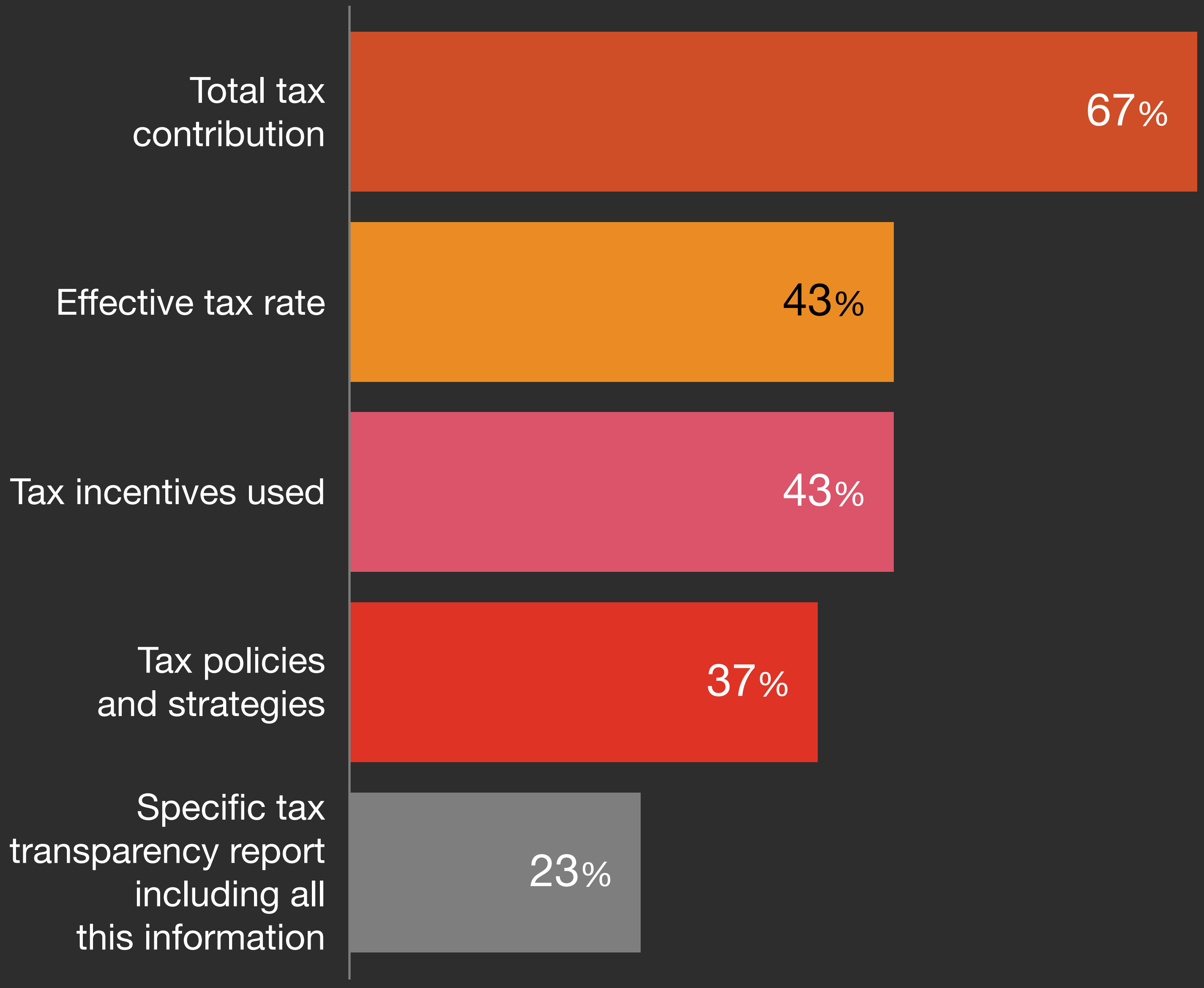
Only

25%

of companies surveyed publish international standards-based tax information in their sustainability or other reports.

Types of tax information companies disclose

In 2020, the World Economic Forum published a set of Stakeholder Capitalism metrics, including recommendations to disclose information on tax contributions adapted from the standards established by the Global Reporting Initiative (GRI).



A journey of transparency

A considered approach to tax transparency and tax governance has a vital role to play as businesses look to engage with ESG issues and build trust with their stakeholders. It requires the company to articulate its tax strategy in the clearest possible way.

There is no one-size-fits-all approach. Depending on geography, sector, and other factors, different businesses will come to different conclusions at different times about how much and what information should be disclosed to build trust. The idea is not just to tell your own story but also to be helpful, providing information that can help the public monitor how the taxes collected are used.

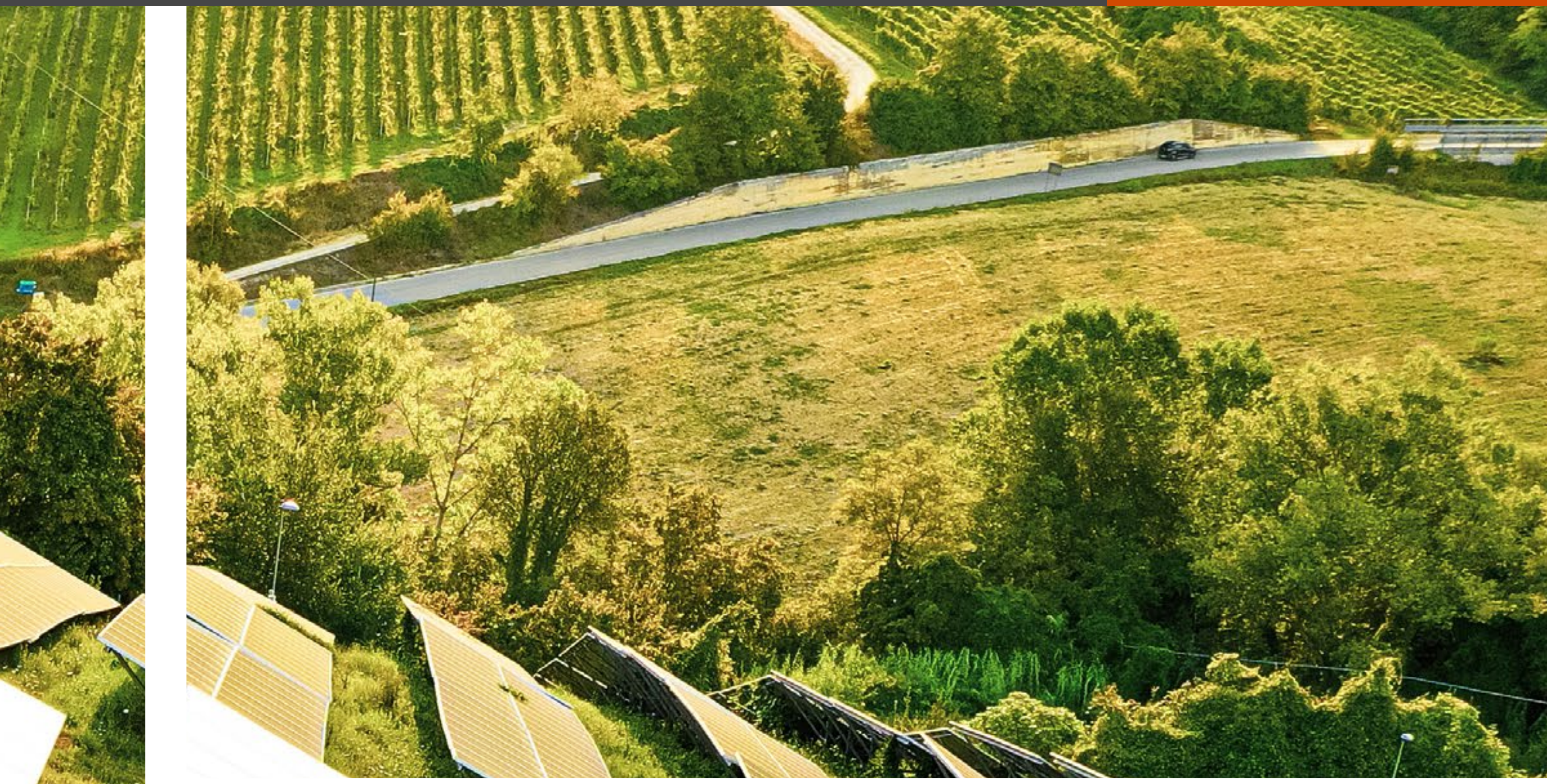
Taxes are a complex and sometimes overwhelming topic.

In Brazil

Companies need to comply with around 4,600 rules, according to a study by the Brazilian Institute of Planning and Taxation (IBPT in the local acronym). Brazil is estimated to issue 53 new tax rules per day, at least two per hour.

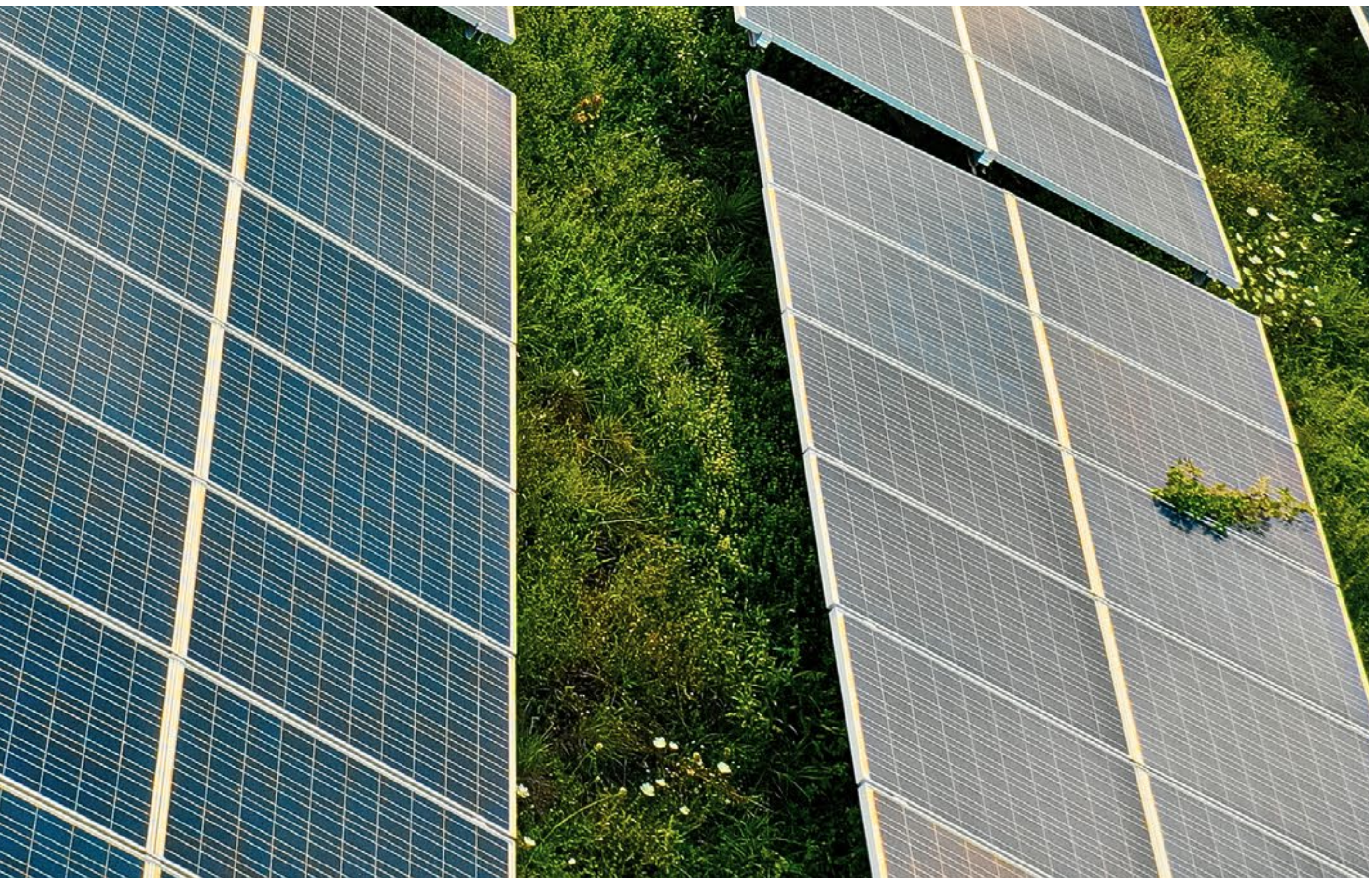
Worldwide

There are already more than 1,000 environmental taxes across the OECD member countries alone, according to a PwC analysis of the OECD's Policy Instruments for the Environment database, and the list is changing all the time.



It is essential to explain the concepts behind a company's tax strategy, especially in a scenario of new tax incentives for sustainable growth.

One example would be to justify the need for a company to use a tax incentive to reduce its tax contribution when investing in new technology or adopting measures to reduce its environmental impact.

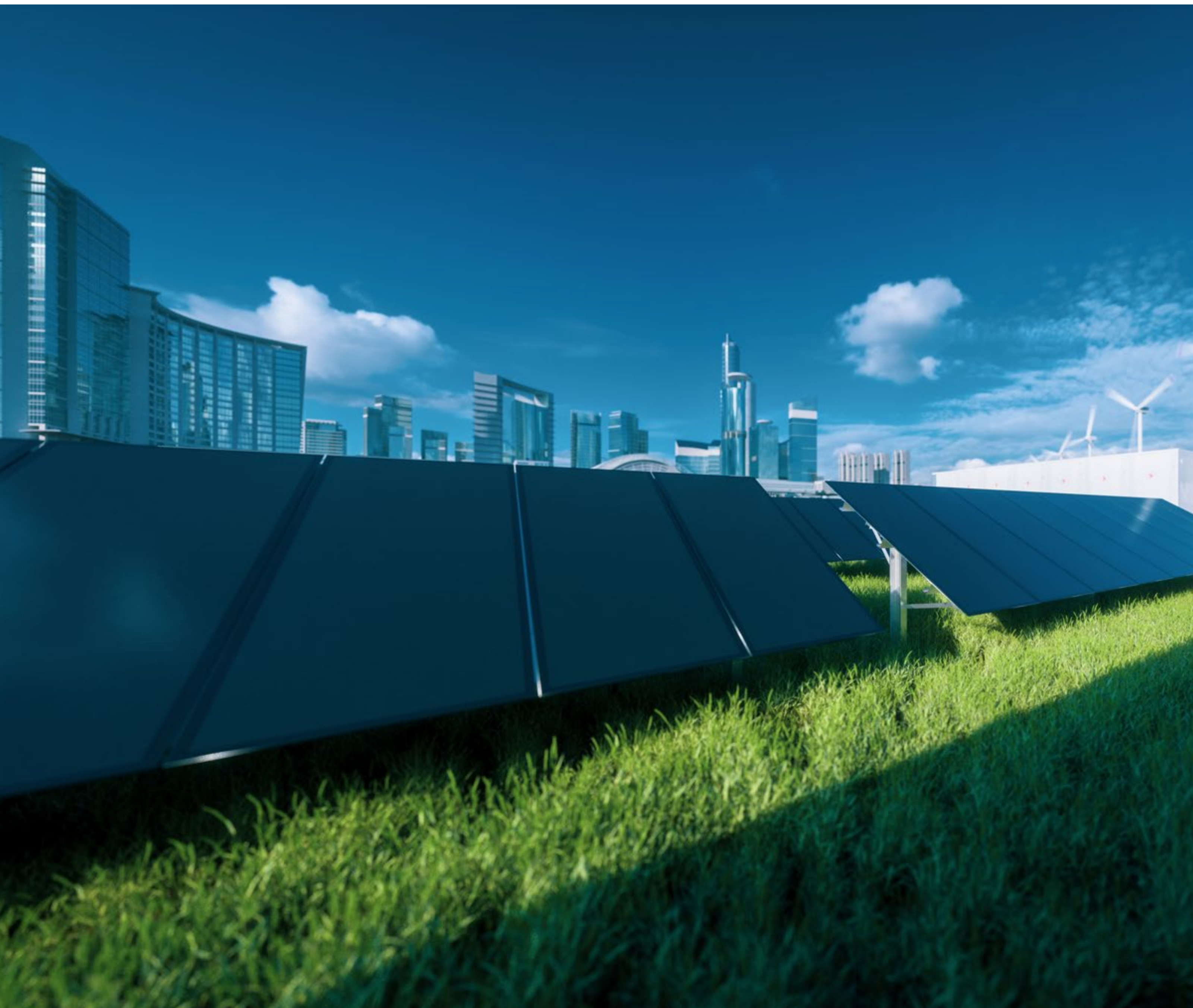


What does tax transparency mean for me?

A small number of companies worldwide are leading the tax transparency journey with voluntary disclosures, often motivated by specific legal, regional or industry requirements, but most organizations make disclosures of limited scope.

PwC UK's annual tax transparency report, published in June 2021, found that 47 companies in the FTSE 100 made total-tax contribution disclosures in 2020, up from 34 in 2018. This increase reflects a growing desire to move the conversation beyond corporate income tax.

To find out which model is suitable for your company, it is important to encourage a debate within the company to canvass views and plan how the business will respond to this challenge.



What is the roadmap for this journey?

Businesses seeking to build a narrative connecting tax practices to values and strategies while also demonstrating to stakeholders a commitment to ESG imperatives should consider the following:

1 Understand your own facts

Boards, management leadership teams, and heads of tax need to understand their company's tax position not just from a shareholder's point of view, which focuses on consolidated financial statements, but also from the investors' perspective with a focus on ESG, as well as that of employees, civil society and tax authorities. This requires a commitment of time and resources because, as noted before, taxes are complicated and constantly changing.

2 Collaborate and consult

Tax departments need to engage across the entire business to align tax strategy with broader corporate strategy. The ESG revolution will change how companies operate in all sectors. Almost every business decision has a tax impact, and those impacts will take on increased visibility in the more extensive tax disclosures that are likely to figure more prominently in ESG reporting. Considering tax impacts early will help companies understand and develop the tax narrative accompanying such longer-term transformations.

3 Communicate clearly

Tax disclosures are often read by people who are not steeped in the complexities of tax and compliance. So take the time to develop and communicate a tax narrative that can prevent misunderstandings and build trust. It's essential to consider how your company looks when its tax decisions are viewed through ESG and stakeholder lenses.

4 Set benchmarks and look ahead

Business leaders should think about how they compare over time to their peers and factor that into how they develop their tax reporting. Companies that are leaders in tax reporting must pay attention to the changing views of stakeholders and to new metrics and reporting requirements – for example, the inclusion of tax issues in rating agencies' ESG scores and regulations on corporate social responsibility, such as the EU's Corporate Social Responsibility Directive.

What elements should a tax transparency report contain?

The document should describe all the company's tax strategies and policies, including the tax incentives received, the effective rate of corporate income tax, and total tax contribution, with detailed country-by-country information, in the case of multinational companies.

PwC Tax Transparency Framework

To help guide companies through the thought process needed to develop an approach that maximizes the benefit of greater transparency, we developed a framework that consists of a series of questions to help manage the risks and benefits of making more extensive voluntary tax disclosures.

Our framework is structured into four broad categories:

Approach to tax

- Discussion of tax objectives and strategy.
- Relationship with tax authorities.
- Disclosure of policies in key areas for the business, for example, legitimate tax planning, transfer pricing, and tax-favored jurisdictions or privileged tax regimes, going beyond legal requirements and taking reputation risks into account.

Governance and risk management

- How the tax strategy and function are managed.
- Who has responsibility for governance and oversight.
- Discussion of material tax risks.
- Policies for obtaining third-party reviews and opinions.

Tax numbers and performance

- Clear reconciliation of the tax charge to the statutory rate.
- Forward-looking measures for tax, such as an indication of the future direction of the tax rate.

Total tax contribution and the wider impact of tax

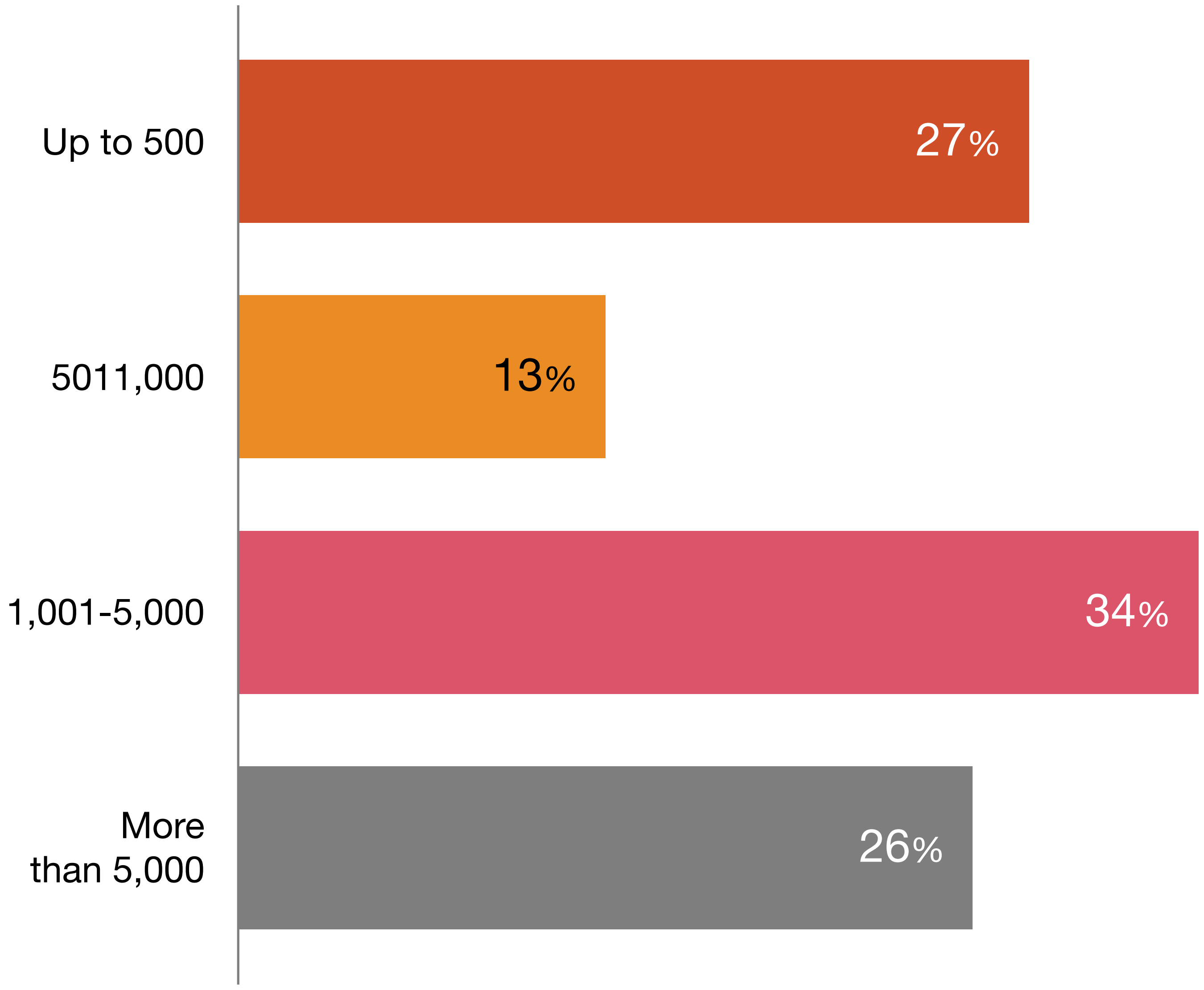
- How tax impacts the wider business strategy and company results.
- Discussion of advocacy activities on tax.
- The impact of tax on shareholder value.
- Communication of the economic contribution of all taxes paid.
- Breakdown of the taxes around the world, either by region or by country.

Survey participants

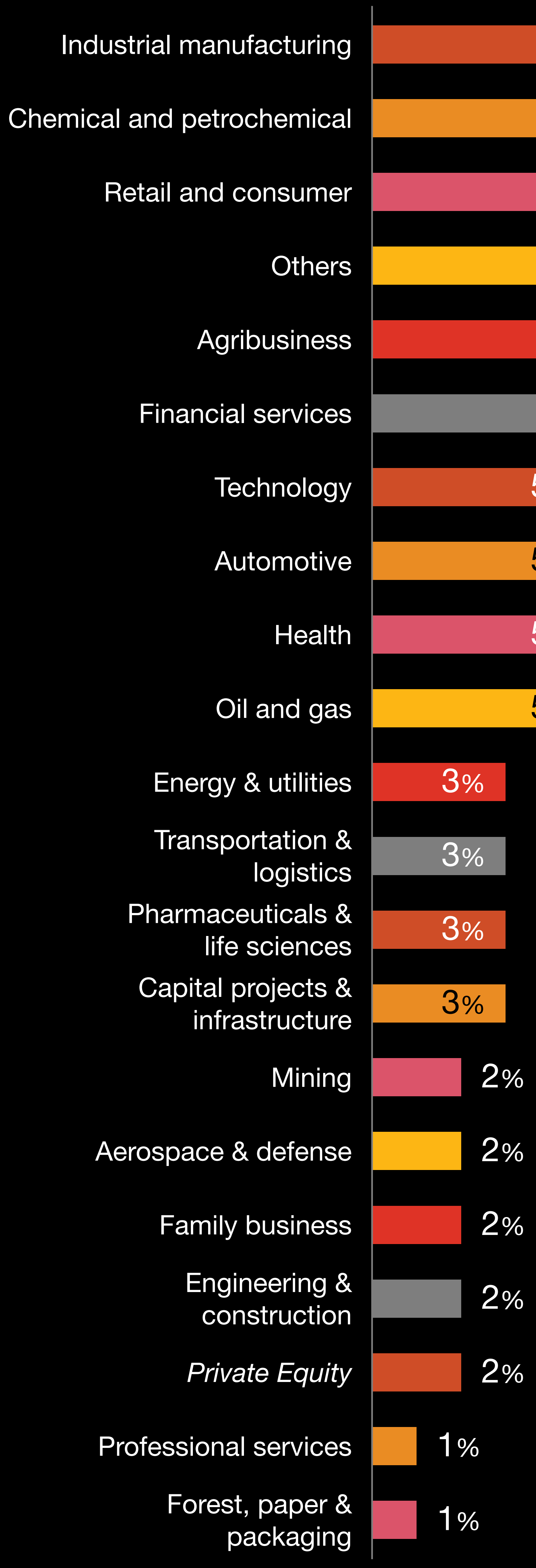
120

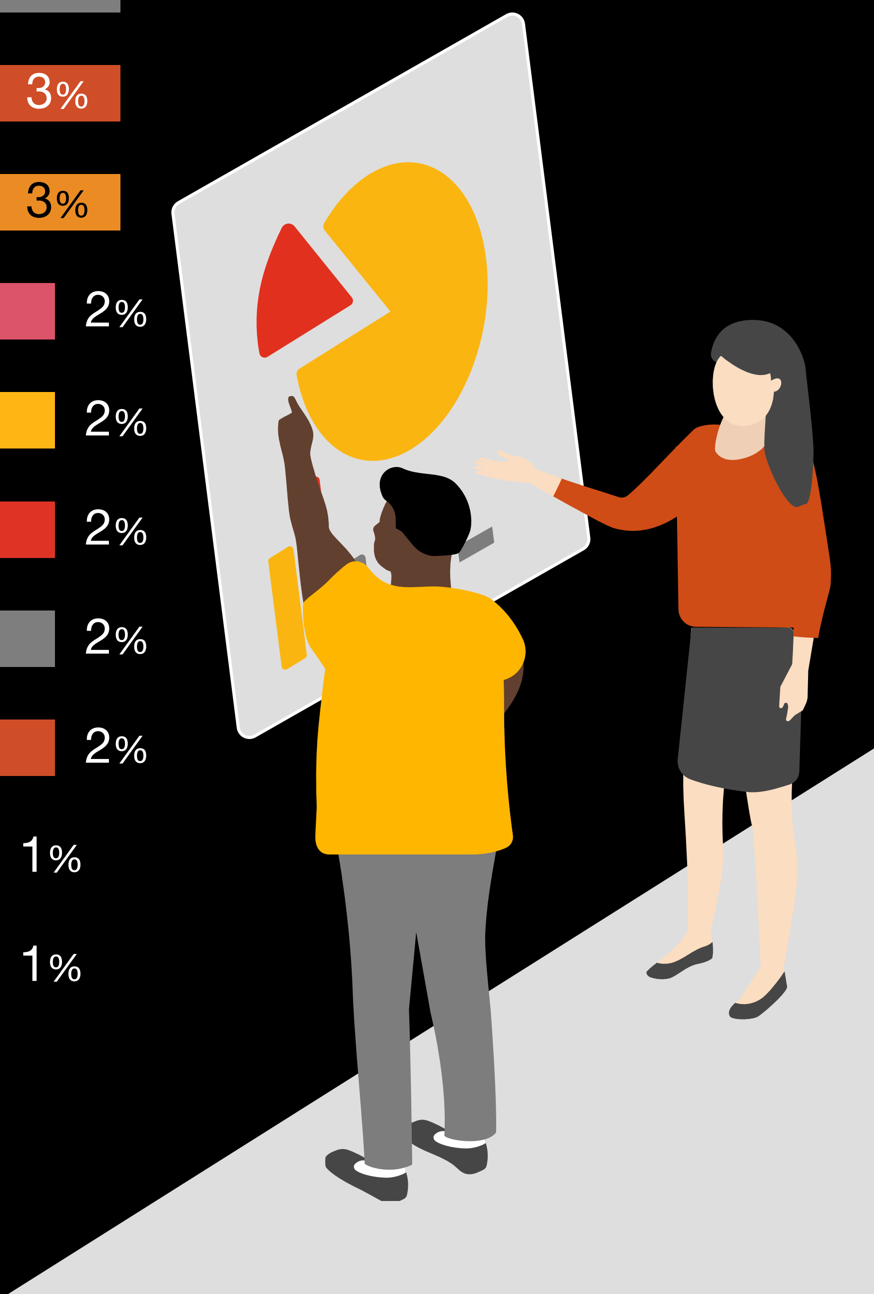
executives from Brazilian companies answered our online questionnaire between December 2021 and January 2022.

Companies by number of employees



Industries


Industrial manufacturing 13%
Chemical and petrochemical 10%
Retail and consumer 10%
Others 9%
Agribusiness 8%
Financial services 6%
Technology 5%
Automotive 5%
Health 5%
Oil and gas 5%
Energy & utilities 3%
Transportation & logistics 3%
Pharmaceuticals & life sciences 3%
Capital projects & infrastructure 3%
Mining 2%
Aerospace & defense 2%
Family business 2%
Engineering & construction 2%
Private Equity 2%
Professional services 1%
Forest, paper & packaging 1%



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