In the vault with KPMG

ESG: Key reasons a bank tax department should get involved

Banks: Why tax is important to the ESG conversation

Identify opportunities and understand your ability to create long-term value by looking at business performance through an ESG lens.

What is ESG and how does it impact your business?

ESG (Environmental, Social, and Governance) is the new barometer to evaluate corporate behavior and a company's future performance through nonfinancial factors. Significant demand from investors, regulators, employees, and customers is driving financial organizations to change for a sustainable future.

- Looking at business performance through the ESG lens can help your bank identify risks and opportunities as well as understand your ability to create long-term value.
- While companies are adopting proactive approaches to integrate ESG practices into their business decisions, there is an evolving narrative regarding tax and its contribution to the "S" and "G" of ESG.
- Corporate tax has become a leading governance consideration and a powerful indicator of how a bank demonstrates its commitment to sustainability and social responsibility.

Tax as a lever to drive ESG outcomes

Tax has become an integral part of the ESG conversation in two major ways:

- Driver of sustainability: Tax policies can motivate companies to innovate and drive sustainability, such as tax incentives to adopt renewable energy or carbon credits.
  - The Inflation Reduction Act offers incentives to propel financial institutions to adopt ESG initiatives and help them defray these costs.
- Measure of sustainability: A push for tax transparency means companies are being asked to disclose their approach to tax as well as earnings and tax payment data.
  - Banks are developing strong tax governance that would provide tax transparency with accurate data to regain public confidence that they have a sustainable approach to tax.

Countries have continued the trend toward implementing tax policy reforms as part of wider strategies to boost growth, with an increased focus on reducing inequalities and driving behavioral change. In the current political and social spotlight, there is a growing emphasis on governance and internal controls tied to the ESG commitments that companies are making in their public tax strategy documents.

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ESG and tax transparency

- Banks and financial institutions are already subject to many regulations. With ESG, shareholders are demanding increased reporting metrics while seeking accountability and outcomes.
  - Stakeholders are engaging with corporate boards and management to take an active role in shaping the governance frameworks at companies in which they are invested.
  - Active ownership becomes an important way for shareholders to protect the long-term value of their investments.
- Most reporting requirements related to tax strategy are voluntary, particularly in the United States.
  - For countries like Australia, the United Kingdom, and Poland, companies are required to publish tax strategy documents describing their approach to tax.
  - The European Union has passed a directive requiring companies with a presence in Europe and a billion dollars of global revenue to publish a country-by-country report on their revenues, profits, and income taxes paid online.
  - It is no longer enough for businesses to just outline their global tax strategy. To build confidence and ensure compliance with rating agencies and standard setters, stakeholders are also looking at the requisite controls and governance to fulfill those commitments.

Embedding strategy and governance in ESG policy

A few common themes and principles measured by rating agencies are critical in order for banks to achieve their ESG goals:

- Develop and publish a public tax strategy document: In the past few years, constant pressure has been building on companies to become more transparent in their financial reporting.
  - Today, 75 percent of the Fortune 100 have a public tax strategy document compared to 18 months ago.
- Robust governance: Institutional investors and stakeholders are putting a greater emphasis on whether companies have the right control systems and governance mechanisms to ensure commitment to the claims made in their tax strategy documents.
- Gathering the right data for reporting purposes: Companies also need to evaluate whether they have the right data to be able to report tax information according to each country's standards.
  - With the EU mandate going operational in 2025, this is an opportunity for companies to evaluate their approach to tax transparency.
  - The right time for tax directors to evaluate the effort required to gather needed ESG data on an annual basis and tell their ESG story to the public.

Providing transparency on your organization's tax position and approach is increasingly becoming the standard. Tax departments and the C-suite should align their overall ESG strategy, including their approach to sustainable tax practices, to ensure that their messaging activities match company and stakeholder interests.

[1] Euro Tax Flash from KPMG's EU Tax Centre—KPMG Global (home.kpmg). Separately, Australia is expected to adopt its own country-by-country reporting rules in 2023 as well.

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