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Dear GRI,

Hermes EOS response to the GRI draft standard: Tax and Payments to Governments

Hermes EOS welcomes the opportunity to provide our comments on this consultation regarding reporting on tax and payments to governments.

Hermes Investment Management is an asset manager with a difference. With £33.5[1] billion in assets under management, we focus on holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world. Our stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on £359 billion on behalf of over 40 international institutional investors.

The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients. Our response to this consultation is explicitly supported by Brunel Pension Partnership Ltd. and First State Super.

We would like to express our strong support for increased transparency on tax and payments to governments and welcome a GRI standard that will facilitate this. In our ongoing engagements with public companies, on behalf of our institutional investor clients, we will encourage disclosure and any related standard.

Tax and government and policy influence is an issue of significant public interest, however, disclosure to date has been disproportionally low in comparison. Given the ongoing incidents of illegal and/or unethical behaviours the GRI standard is a valuable step forward. However, our view is that the GRI standard in its current wording will not achieve sufficient and material change on this important issue. Too many critical disclosures are left optional for the reporting organization. An organization achieving reporting in accordance with a GRI standard on tax and payments to governments should be providing a higher level of transparency.

In responding to this consultation, our perspective is informed by our role as users of such reporting. We see good disclosure as a method of accountability for organizations, a source of information to inform tax authorities and other stakeholders on appropriate tax policy and guidance, and for investors a tool to better appraise risk and an indicator of internal governance. It would be helpful for the GRI guidance sections to explain how investors can use the tax disclosures, especially with regards to the more technical country-by-country data.

Furthermore, we suggest that the GRI guidance should stress that companies' confidentiality arguments relating to tax are not compelling because we do not regard the information to be sufficiently commercially sensitive to override the benefits of disclosure. We would welcome the development of GRI sector-specific reporting over time, prioritising the financial services, technology, extractives, consumer staples and pharmaceuticals sectors.

Below we set out our response to the consultation, specifically question 6. We have not commented on questions 1 to 5 as we are content with the current requirements, subject to the

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[1] Hermes as at 31 December 2018 with the exception of two portfolios totalling US$4.5m / £3.5m / €3.9m valued as at 30 September 2018. See www.hermes-investment.com/uki/about-us/ for latest figures.

specific additions that we raise in our response to question 6. We set out the areas we believe are important reporting items to understand an organization's approach to tax and payments to governments. These are either new items or indications of where we believe existing items should be elevated.

We hope that our comments and suggestions are of assistance. If you would like to discuss our views in further detail, please do not to hesitate to contact myself at (andy.jones@hermes-investment.com).

Yours sincerely,

Andy Jones
Associate Director, Hermes EOS

Question 6:
Are there any critical disclosures missing from GRI XXX: Tax and Payments to Governments that are necessary to understanding an organization's tax practices?
When responding to this question, please provide a rationale for your comments. If you want to comment on a specific word, sentence, or paragraph, provide the line numbers of the text your comment relates to.

<u>XXX-I-a-i</u>
Lines: 223-226 and 247-249
Comment: We recommend moving the current guidance to report the overview of the approach including "the use of tax havens, the types of tax incentives it makes use of, or its approach to transfer pricing" to the reporting requirements section. We would welcome including their approach to beneficial ownership within the disclosure requirements.
Rationale: It is critical to understand key positions taken by the organization as stated within its tax strategy/approach. Without this the following disclosures under XXX-I (a-i, a-iv) and XXX-2 (a-i, a-ii, b) will not be informative.
Alternative wording suggestion:
Reporting requirements for Disclosure XXX-I-a:
ii. An overview of the approach including responsibilities, the use of tax havens, the types of tax incentives it makes use of and its approach to transfer pricing.
[The next requirements would then continue from iii to v]

Lines: 223-226 and 257-259
Comment: We recommend moving the current guidance to report on the scope of application of the tax strategy/approach to the reporting requirements section. This should apply whether or not the strategy is publicly available.
Rationale: It is critical to understand the scope of application of an organization's tax strategy or approach as context for the following disclosures under the GRI framework and to ensure an organization is not limiting its approach to responsible practice to a subsection of the total entity.
Alternative wording suggestion:
Reporting requirements for Disclosure XXX-I-a:
ii. The scope of application of the tax strategy, including coverage of the organization's entities, locations, business lines, subsidiaries and joint ventures.
[The next requirements would then continue from iv to vi]

<u>XXX-I-a-iv</u>
Lines: 265-273
Comment: We would welcome additional reporting by organizations providing advisory services involving tax.
Rationale: Responsibility for responsible tax practice also sits with advisors as well as organizations themselves. Stakeholders would benefit from additional reporting by those

organizations providing advisory services that can impact another organization's tax practice, in particular transaction structuring teams within banks.
Alternative wording suggestion:
Recommendation for Disclosure XXX-I-a-iv
For advisory services, including banks, asset managers, consultants and professional services firms, the organization should describe its code of conduct in relation to advisory services and whether this includes not turning a blind eye to unethical or illegal tax practice. The organization should also describe how its advice/advisory services are linked to its own approach to tax, sustainable development strategy and to the broader economic needs of the countries in which the recipient organisation operates.

Lines: 265-273
Comment: We would welcome reporting by organizations on whether, and how, tax is part of its sustainable development policies and reporting.
Rationale: A common indication of whether an organization seeks to follow responsible practices is whether tax and payments to governments are seen as a sustainability issue and societal responsibility rather than just a compliance or annual reporting requirement.
Alternative wording suggestion:
Guidance for Disclosure XXX-I-a-iv
The organization can describe where tax sits within the organization's sustainability/corporate responsibility materiality assessment, whether tax is included in any sustainability/corporate responsibility policy and a reference to where tax is reported in the organization's sustainability/corporate responsibility or integrated reporting.

<u>XXX-I-a ii and 2-a-i</u>
Lines: 227-229 and 279-280
Comment: We would welcome clarification by the organization on the role of the highest governance body in relation to both setting the tax strategy and compliance to it.
Rationale: Stakeholders would benefit from understanding what role the highest governance body in an organization, usually the board of directors or a sub-committee of it, has in overseeing the tax strategy and compliance to it if not named as the formal responsible body in either case.
Alternative wording suggestion:
Reporting requirements for XXX-1-a
ii. The governance body or executive-level position within the organization that formally reviews and approves the tax strategy, and the frequency of this review. Where this is not the board of directors, or a subcommittee of the board, or equivalents, the oversight by this board/committee of the tax strategy should be described.
Reporting requirements for XXX-2-a
i. The governance body or executive-level position within the organization accountable for compliance with tax strategy. Where this is not the board of directors, or a subcommittee of the board, or equivalents, the oversight by this board/committee of compliance with the tax strategy should be described.

<u>XXX-2</u>
Lines: 277
Comment: We would welcome clarification that the reporting on tax governance, control and risk management should relate to the latest reporting year, in particular points 2-a-ii, 2-a-iii and 2-a-iv.
Rationale: It is important that reporting on embedding the tax approach, approach to tax risks and evaluation of compliance is in relation to the most recent reporting year.
Alternative wording suggestion:
Disclosure XXX-2
The reporting organization shall report the following information *in relation to the most recent reporting year.*

<u>XXX-2-a-ii</u>
Lines: 312-320
Comment: We would welcome reporting on the alignment of remuneration with the tax approach as part of the disclosure on how the approach is embedded within the organisation.

Rationale: Tax professionals within organizations should not have variable pay linked to the effective tax rate or taxes paid but instead linked to any breach of the relevant tax approach and code of conduct. Executives and senior management should be assessed based on pre-tax metrics (e.g. pre-tax earnings) to avoid any incentive to reduce the tax bill. Remuneration structures are an indicator and driver of culture within an organisation and stakeholders would benefit from an understanding of these in relation to tax and payments to governments.
Alternative wording suggestion:
Guidance for Disclosure XXX-2-a-ii
These initiatives can include…

- Aligning, and avoiding any misalignment of, remuneration with the stated approach to tax and payments to governments, in particular for tax professionals and executive officers.

Lines: 312-320
Comment: We would welcome reporting on how the organization embeds its approach to tax in the organization's conduct and culture.
Rationale: Training and guidance can only go so far to ensure an organization complies with the intention and letter of its approach to tax and payments to governments. It is actual conduct and culture within an organization that will ultimately determine tax compliance and risk, including not turning a blind eye to unethical tax conduct.
Alternative wording suggestion:
Guidance for Disclosure XXX-2-a-ii
These initiatives can include…

- Embedding the approach into the conduct and culture of the organization, for example by including the approach in the organization's code of conduct and performance assessment scorecard for relevant responsible persons.

<u>XXX-2-a-iii</u>
Lines: 332-338
Comment: We recommend including the decision making process as part of the reporting on the approach to tax risks.
Rationale: Companies will face key decisions with differing potential outcomes for tax risk, such as on corporate structuring. To provide stakeholders with an understanding of the organization's approach to tax risk it is important to understand approaches in these challenging but critical situations.
Alternative wording suggestion:
Guidance for Disclosure XXX-2-a-iii
• When reporting on how tax risks are identified, managed, and monitored, the organization can describe:…

  o The decision making process for significant decisions related to tax risk, including due diligence undertaken, who is involved, when they are involved and the internal reporting and escalation channels. The organization can include specific examples of such a situation and the process followed.

Lines: 332-338
Comment: We would welcome reporting on the organization's professional tax capability.
Rationale: Tax risk can also be elevated by an absence of appropriately qualified, resourced and up-to-date professionals within the organisation.
Alternative wording suggestion:
Guidance for Disclosure XXX-2-a-iii
• When reporting on how tax risks are identified, managed, and monitored, the organization can describe:…

  * How the organization ensures it has appropriately qualified, resourced and up-to-date tax professionals to adequately control for tax risk. The reporting should include the extent to which the organization uses external service providers for routine tax management.

Lines: 286-287 and 346-347
Comment: We would welcome reporting on how organizations manage relationships with their tax advisors and service providers. There should also be guidance for companies to disclose the names of their tax advisors or an explanation as to why this is not possible.

Rationale: Organizations should report on whether, and how, they require advisors and service providers to comply with the organization's approach to tax and payments to governments, and code of conduct. Emerging good practice is also to exclude, where possible given capacity in the local market, the organization's financial auditor from tenders related to tax advisory work. This helps maintain the independence of the financial auditor and limited any conflict of interest and threat of self-review of tax related reporting. Finally, organizations should also describe how they reward tax advisors, including whether this is on a fixed or contingency fee basis.
Alternative wording suggestion:
Reporting requirements for Disclosure XXX-2-a.
v. how the relationship with tax advisors and service providers is managed
Recommendation for Disclosure XXX-2-a-v
In relation to the management of relationships with tax advisors and service providers the organization should report on whether, and how, they are required to comply with the organization's approach to tax and payments to governments and code of conduct, how they are rewarded, how conflicts of interest are avoided and any incidences reported, and how the independence of the financial auditor is protected. Companies should disclose the names of their tax advisors or otherwise disclose the reason why they cannot do so.

<u>XXX-2-c</u>
Lines: 355-359
Comment: We would welcome reporting on whether the assurance process is the same across the reporting organization's entities and locations.
Rationale: The same standard of assurance on disclosures on tax and payments to governments should be applied in jurisdictions known as tax havens, and jurisdictions likely to have lower capacity to enforce tax law, as it is for the central organization/location.
Alternative wording suggestion:
Guidance for Disclosure XXX-2-c
The organization should list any corporate entities and locations where the assurance provider for disclosures on tax and payments to governments in jurisdictions is different to that of the head organization/location.

<u>XXX-3</u>
Lines: 382-385
Comment: We would welcome further detail from organizations on their approach to tax authorities beyond that currently requested.
Rationale: The approach of organization's to tax authorities is especially important in developing markets or where the organization has disproportionate economic influence in the local market. Stakeholders would benefit from additional reporting on how the organization takes a responsible approach to engagement with tax authorities.
Alternative wording suggestion:
Recommendation for Disclosure XXX-3-a-i
The organisation should describe its approach to use of tax incentives and reliefs, for example whether use of incentives is beyond those generally available and published.
Guidance for Disclosure XXX-3-a-i
[Additional wording:] The organization can describe how it avoids undermining the policy, capacity or independence of local tax authorities, in particular in developing markets or where it has the high economic influence.