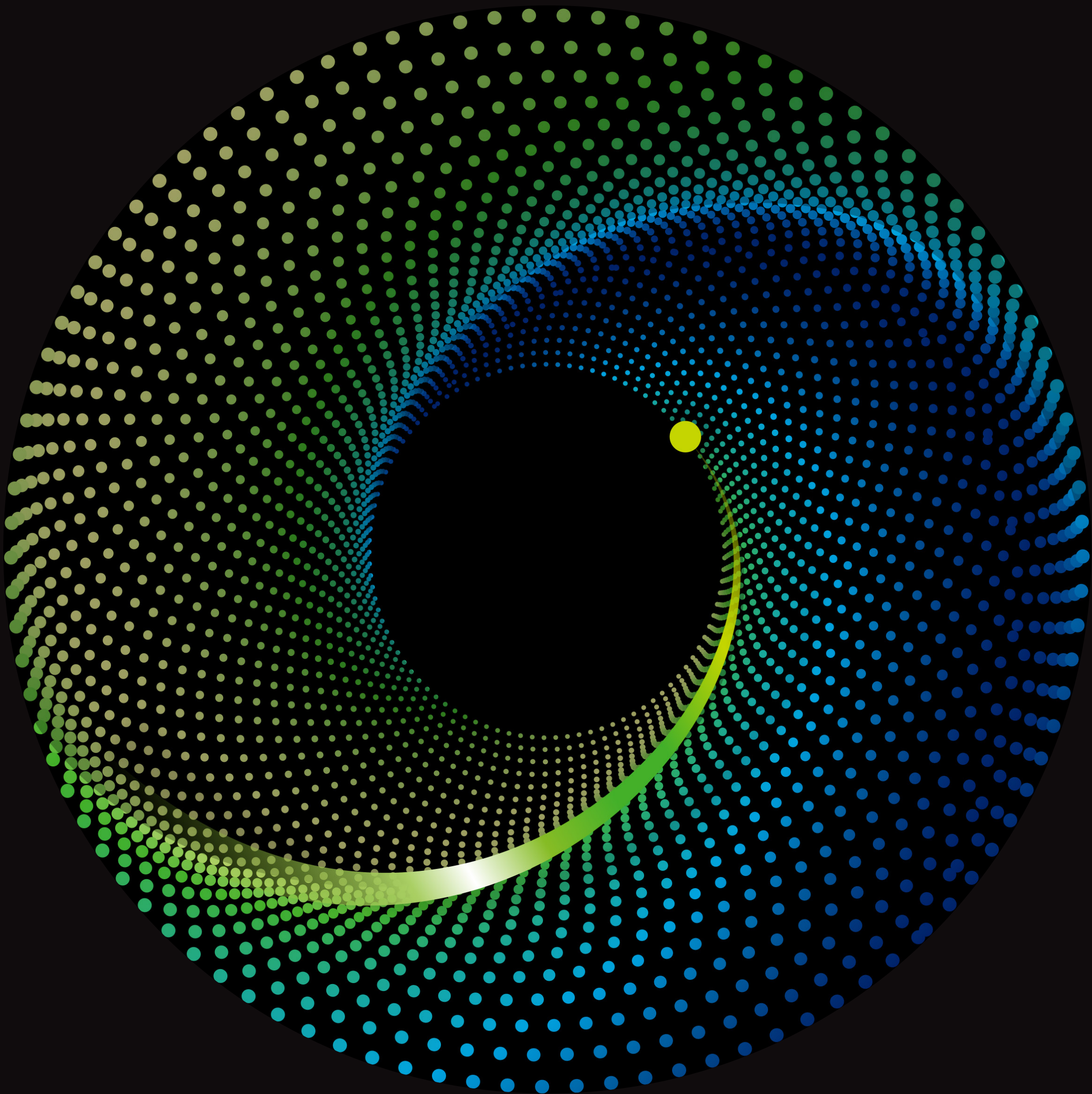
Deloitte.



How ESG developments shape business tax practice in Luxembourg

Tax Governance Survey

MAKING AN IMPACT THAT MATTERS since 1845

Contents

Key Findings

Tax is an essential dimension of the Environmental, Social and Governance (ESG) criteria, proven by the rapid evolution and development of tax governance and transparency. Tax governance and control frameworks are high on the agenda of business executives, C-suites, and Boards seeking to reduce tax risks and demonstrate the responsible tax behavior of their businesses. Sustainability, as well as the development of cooperative tax compliance, has placed an additional emphasis on tax transparency in order to proactively disclose tax information, beyond statutory obligations, to a wider base of stakeholders, including investors, clients, the media, and the general public. However, business executives and C-suites are concerned about media coverage and political and activist group interest in corporate taxation.

Understanding the current environment, ongoing trends, and stakeholders' expectations and how these factors influence businesses and tax-related risks is the first action to take to successfully develop a tax related ESG strategy. The growing complexity of the tax environment is the primary source of tax risk for 59% of respondents to Deloitte Luxembourg's survey, "How ESG developments shape business tax practice in Luxembourg". 63% of them believe that engaging with tax administrations in cooperative tax compliance programs would be a great solution to navigate through said complexity and reduce tax risks.

Despite the interest of such a broad base of stakeholders, tax is still perceived as a matter for experts, mainly discussed internally within the tax or finance function and with little involvement from the risk, internal audit and compliance, public relations, and sustainability teams.

Analyzing the maturity of the elements of tax governance and control frameworks is essential when identifying the existing gaps in expectations and requirements imposed by regulations, the environment, and the various stakeholders, when demonstrating its sustainability, and when communicating confidently on the subject. There is an increasing awareness from respondents on the necessity to develop tax governance and control frameworks to adapt to the growing complexity of taxation and to meet sustainability expectations.

However, the impact of such awareness appears limited, not yet translating into tangible plans and actions to fully integrate tax into the business operations and controls which could transform organizations. Such concerns about the five pillars forming tax governance frameworks include:

- The maturity of the oversight and governance is basic or developing for 73% of respondents. Tax risks affect the ability of organizations to achieve their tax strategy and business objectives. Even though 60% have a tax strategy or policy in place to set the tone from the top, only 17% have at least one of the two publicly available. Effective tax risk management is essential to Boards and management in order to optimize outcomes with the goal of generating value for the organization.
- Almost 81% of respondents have basic or developing processes to identify, manage, and control tax risks, with limited understanding and integration with the wider business.
- The available resources and their organization, including the employment and management of skilled people, was the most developed of the five pillars forming tax governance frameworks in Luxembourg, with 32% of respondents marking this area as mature or even advanced. However, this demonstrates the need for further investment for the remaining 68% of respondents, as the insufficiency of resources to cover tax function activities is perceived as a major source of tax risk.
- The current limited development of tax data and technology heavily limits the ability of respondents to identify, control, and manage tax risks, as well as comply with their growing tax compliance and transparency obligations. Communicating confidently on tax would be a challenge.

Generating value in relation to tax by creating a good tax governance and control framework is a clear topic of today. The current limited maturity of the tax governance and control frameworks of respondents in Luxembourg may be an

"Tax is an essential dimension of the Environmental, Social and Governance (ESG) criteria, proven by the rapid evolution and development of tax governance and transparency."

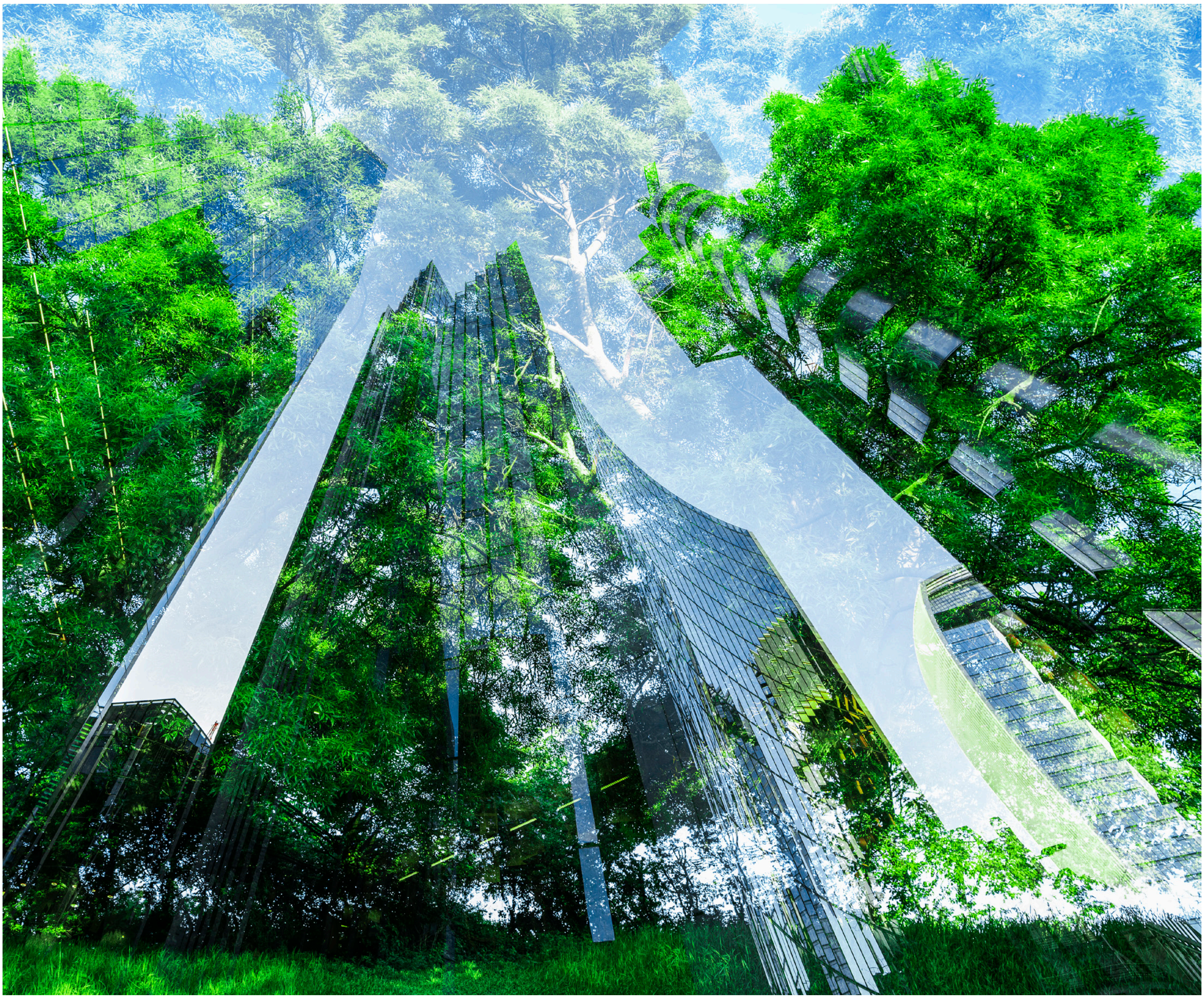
Bernard David, Deloitte

important source of tax risk, requiring further development in order to become sustainable. The time is ripe for value creation from good tax governance and control framework.

A proper tax communication is able to provide various benefits and added business value. The overall ESG rating and reputation of both businesses and investors would notably be improved.

Therefore, it will be key in building a narrative to clearly explain tax data and to educate stakeholders in light of the high reputational risk involved. While 95% of respondents expect to communicate publicly complex and highly technical tax data, only 46% expect to go beyond requirements to provide explanations. From a "nice to have", such communication is quickly becoming an obligation in 2021 and beyond.

Tax governance and transparency are the common denominator to the challenges posed by sustainable development. It is now time to act on this opportunity offered to Luxembourg businesses to generate value in relation to tax by creating a good tax governance and control framework.



Introduction

Tax became a focal point for European public opinion in the aftermath of the 2008 financial crisis. Fiscal needs, economic and political pressures, and new rules and regulations are contributing to a rapidly changing international tax landscape. This Global Tax Reset has brought in a new era of international tax, with an emphasis on transparency, consistency, and sharing of information between authorities. At the same time, some governments may be seeking to increase their country's base of revenue by using taxation as a protectionism tool, while political pressure on businesses has been increasing to change their tax behavior to align with the public interest.

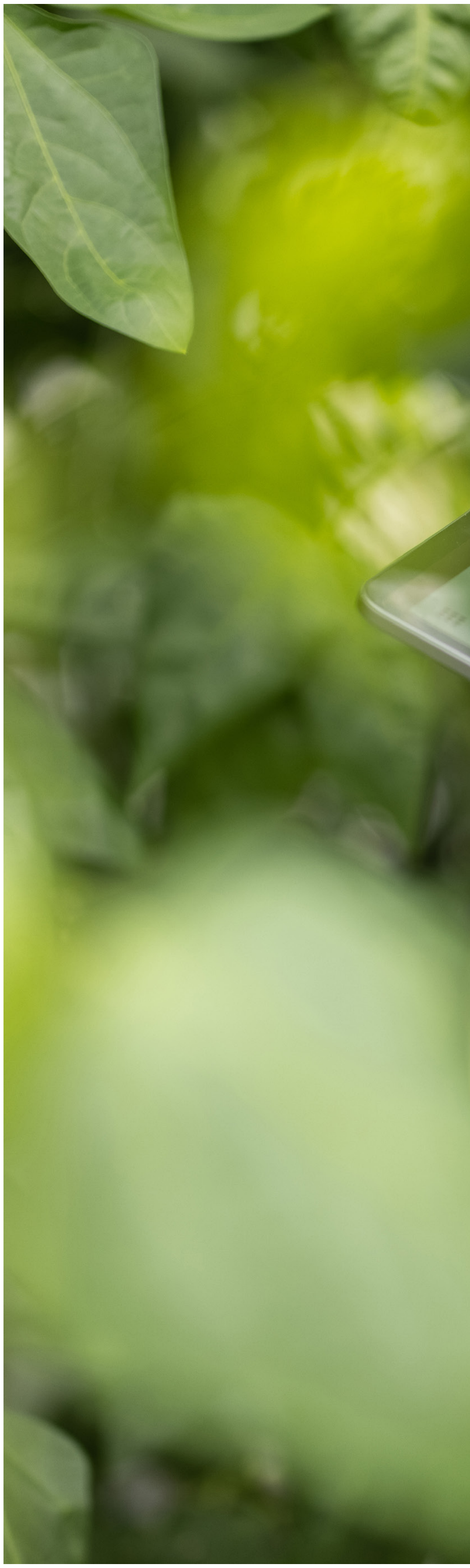
Tax is now a key criteria to achieve outlined Environment, Social, and Governance (ESG) objectives, forming part of corporate sustainability strategies of businesses beyond their corporate governance framework. A wider base of stakeholders, including investors, clients, the media and the general public, are increasingly taking an interest in the tax behavior of businesses and how this aligns with corporate social responsibility, its strategy and the road to net zero. Having good tax governance practices gives stakeholders confidence that corporate taxpayers have responsible tax behaviors, meeting their obligations and paying the right amount of tax. A poor tax governance may be detrimental from a reputational standpoint as the expectation nowadays is not only about doing things right, but also about being perceived as doing things rightly and fairly.

Tax governance means, in essence, having a Board-approved strategy with clear controls and processes within the corporate governance framework to support tax decision-making and the management of tax risks. It is effective when these arrangements consistently result in correct tax outcomes and ensure businesses meet their obligations.

In this continuously evolving and complex environment, where the costs of cross-border business are rising due to increasing tax risks and double taxation, businesses are facing growing pressure for tax transparency. Society requires them to explain and demonstrate the sustainability of their governance and control framework for fulfilling their tax obligations. Businesses are also expected to explain the outcome of this "sustainable" governance (the taxes paid and collected) based on data. Communication regarding taxation is an important and constituent part of good governance that enables business to demonstrate their responsible tax behaviors, but it is a highly technical subject that may be difficult for stakeholders to understand. In addition, businesses operating in Luxembourg are influenced by a plethora of factors beyond the country's borders with globalization, international business, multi-lateral relations, and cross-border flows that are essential to the continuous economic growth of Luxembourg. This survey pursues three main objectives:

- Understanding the environment, trends, and stakeholder expectations that influence the organization of businesses operating in Luxembourg and the tax-related risks they are facing;
- Measuring the maturity and effectiveness of their tax governance to result in correct tax outcomes and to ensure they meet their obligations; and
- Understanding the integration of tax within the sustainability strategy and communication of respondents.

These observations are key to taking pre-emptive actions required to meet stakeholders' expectations, as well as to navigate the challenges and risks related to the alignment of business strategies and objectives with the public interest in ESG.




27 May, 2021
82%
18°

How ESG is shaping business tax practice in Luxembourg

Tax is a highly technical and complex subject. This is the result of lawmakers' increasing eagerness to address topics as they emerge from government priorities, public opinion, media attention on certain matters, or evolution of tools available to tax authorities. Businesses have to understand, digest, and integrate fast-changing EU and international tax legislation that has, and will continue to, significantly change tax practices – see Figure 1 for an overview of the main current and upcoming EU and international reforms on business taxation. Adapting to this environment requires appropriate resources and governance structures.

Figure 1: Overview of the main current and upcoming EU and international reforms on business taxation

2010

- US Foreign Account Tax Compliance Act (FATCA)

2011

- Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC1)

2014

- DAC2 – Directive 2014/107/EU

2015

- DAC3 – Directive 2015/2376/EU
- OECD base erosion and profit shifting (BEPS) reports
- 4th Anti-Money Laundering (AML) Directive (EU) 2015/849 fighting against tax crimes

2016

- Anti-Tax Avoidance Directive I (ATAD I) – Directive (EU) 2016/1164
- DAC4 – Directive 2016/881/EU
- DAC5 – Directive 2016/2258/EU

2017

- ATAD II – Directive (EU) 2017/952
- Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the EU

2018

- DAC6 (Council Directive (EU) 2018/822 of 25 May 2018)
- 5th AML Directive (EU) 2018/843 on beneficial ownership

2021

- DAC7 – Directive (EU) 2021/514
- Public Country-by-Country Directive
- European Commission Proposal for ATAD 3 (fighting the use of shell entities and arrangements for tax purposes)
- OECD Agreement on Pillar 1 and Pillar 2
- European Commission proposal on OECD Pillar 2 (minimum taxation)
- European Commission Proposal for the publication of effective tax rates paid by large companies based on the OECD Pillar 2 methodology

2022

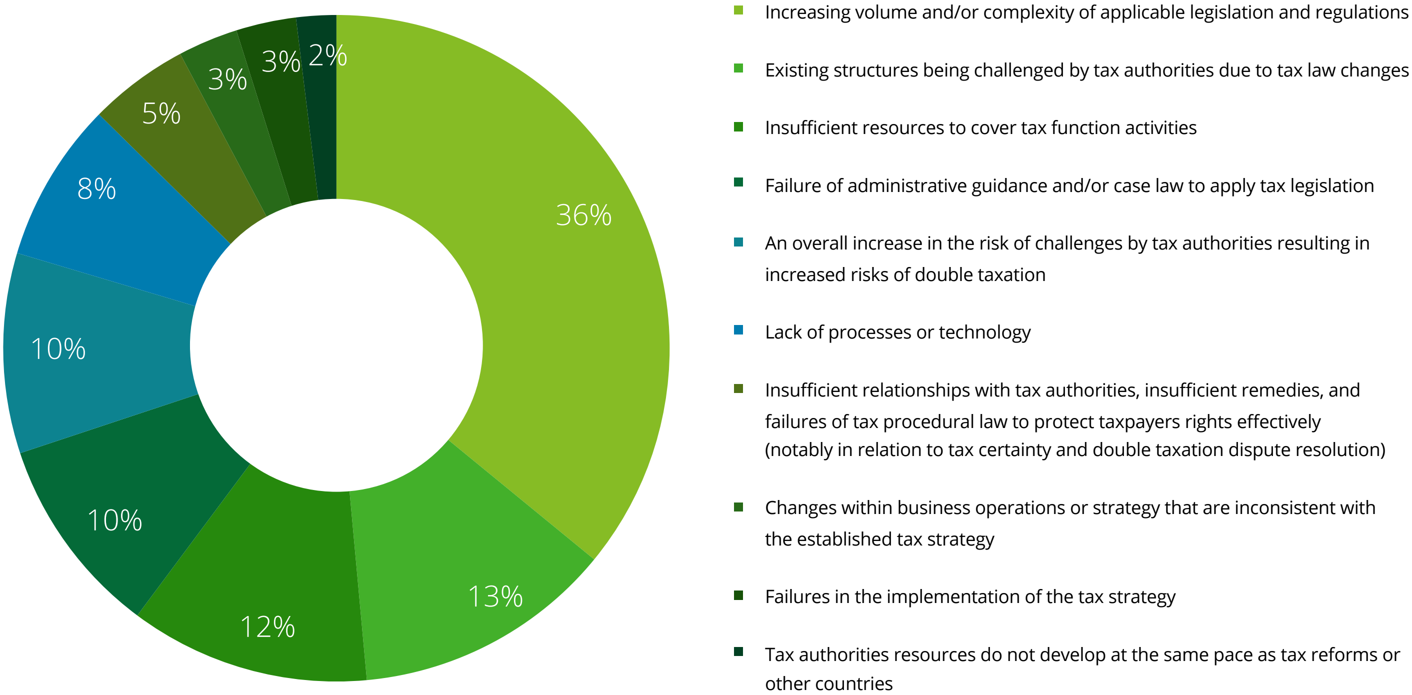
- DAC8 - European Commission proposal on cryptocurrencies and cryptoassets
- European Commission proposal creating a Debt Equity Bias Reduction Allowance (DEBRA)
- European Commission proposal on the EU transposition of the OECD Pillar 1
- Broader reflection on the future of EU taxation – "EU tax mix on the road to 2050" Symposium in 2022
- New European Union withholding taxes system proposal

2023

- European Commission proposal for business in Europe: Framework for Income Taxation (BEFIT) replacing the proposal for a Common Consolidated Corporate Tax Base (CCCTB)

Complexity is the primary source of risk for respondents, posing compliance challenges and creating higher tax risks for 59% of them (Figure 2). It is the result of a combination of an increasing volume and/or complexity of applicable legislation and regulations; existing structures being challenged by tax authorities due to tax law changes; and the failure of administrative guidance and/or case law to apply tax legislation.

Figure 2: Top 10 factors most likely to increase tax risks and/or tax controversy in Luxembourg-based organizations



Despite the existence of a single market and a single currency in the European Union, harmonization of the tax system is limited due to the absence of a single European taxation system, given some Member States consider taxation as being intrinsic to their sovereignty, sometimes even using taxation as a protectionism tool. Usually, European Directives are transposed with differences in each of the 27 Member States, causing an additional source of complexity and risk for cross-border businesses.

It also means a significant increase in the cost of doing business internationally within or outside the EU because of double taxation, which is evidenced by the OECD mutual agreement procedure (MAP) statistics[1].

These statistics show that double taxation is primarily happening among EU Member States at the European level, and, in the case of Luxembourg, mainly with Belgium, France, Germany, Italy, and Switzerland[2].

54% of the respondents to Deloitte's 2021 Global Tax Survey: Beyond BEPS[3] agree or strongly agree that their group has experienced instances of double taxation as a result of unilateral tax law changes, confirming the OECD MAP statistics which concluded on the continued increase of MAPs.

"Tax governance remains high on the Board's agenda to navigate increasing complexity."

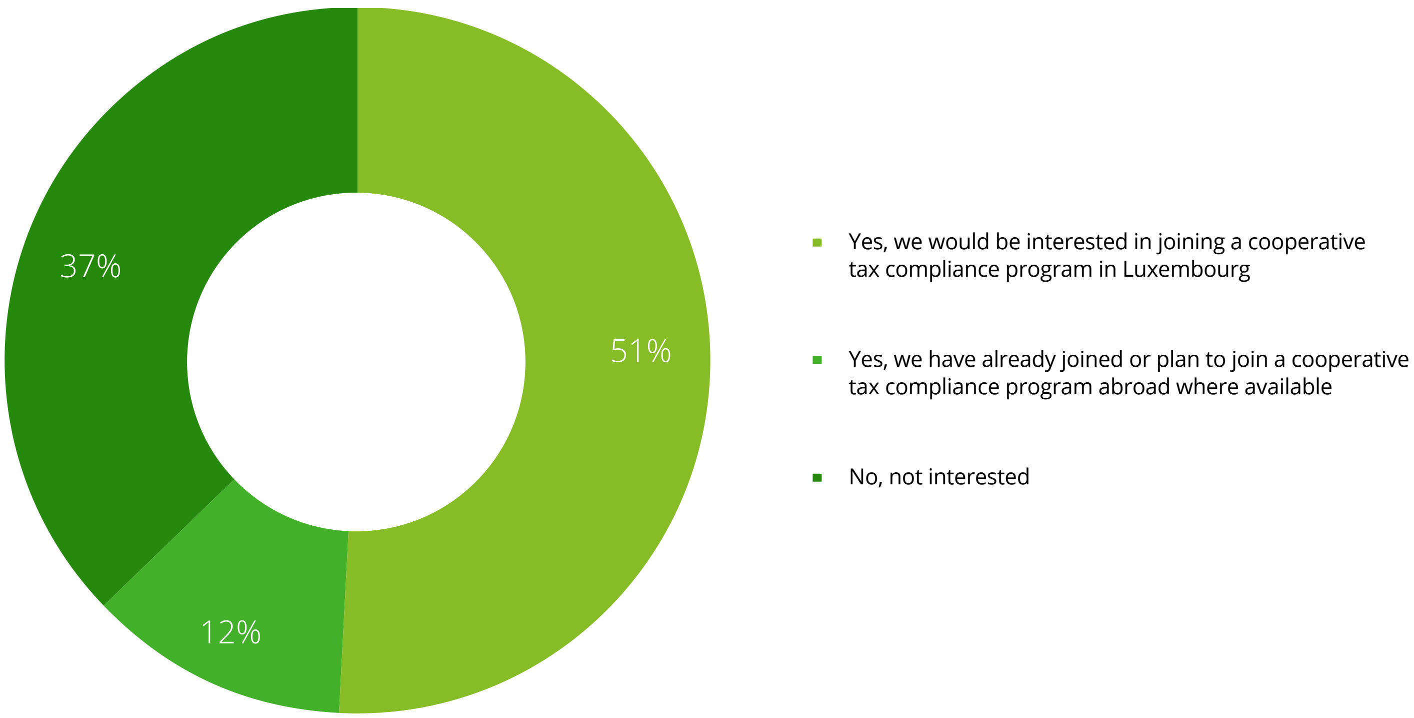
Eric Centi, Deloitte

The COVID-19 pandemic, which left large deficits for many governments, is expected to accelerate these trends, leading to tax raises (required to finance various support measures), and increased tax risks and disputes. Deloitte's 2021 Global Tax Survey: Beyond BEPS highlights that *"There is a clear expectation of higher tax costs as a result of COVID-19 more than half (58%) of the respondents expect tax increases or new taxes in their ultimate parent company's jurisdiction and just over a half of the respondents expect corporate tax liability of their group to increase over the medium term."*[4]

Part of this complexity and the associated risk factors may be resolved by tax administrations who take concrete actions to improve relationships with taxpayers and ease tax compliance obligations. 40% of respondents call for further improvements of tax administration services provided to taxpayers by developing capabilities and resources, which is the second major source of tax risk for respondents. Close to 75% of tax administrations in the OECD continue to accelerate their digital transformation[5], as well as provide sufficient and meaningful administrative guidance to raise clarity in applying tax legislation in Luxembourg. As governments seek new ways to increase their tax revenues following the pandemic, it is expected that tax audits will become more rigorous; 45% expect this to occur in their parent company's jurisdiction[6]. Indeed, the need for tax revenues is likely to intensify leading to more tax disputes with 90% of respondents expecting this to occur, while 38% expect global tax cooperation to decrease as a result of COVID-19[7].

63% of respondents (Figure 3) are willing to proactively engage with tax administrations and consider relationships with tax administrations as key in managing the complexity of taxation and related risk, looking to engage by joining cooperative tax compliance programs to facilitate taxpayers' compliance based on greater cooperation, trust, and transparency between taxpayers and tax administrations as well as amongst the administrations themselves. This has indeed been acknowledged by the European Commission in July 2020 in the Action Plan for fair and simple taxation supporting the recovery strategy[8] as being key to secure tax revenues for governments, promoting the adoption of cooperative compliance programs across the European Union. Promoting such voluntary trust behavior from taxpayers is beneficial for all stakeholders.

Figure 3: Interest of Luxembourg-based businesses in joining a cooperative tax compliance program to facilitate compliance with tax obligations and improve relationships with tax authorities



Establishing an appropriate tax governance and control structure is a prerequisite to enter into cooperative tax compliance programs. However, respondents have difficulties in doing so. 26% noted the insufficiency of their resources to cover the tax function activities or the lack of processes or technology, hinders their ability to manage and control tax risks.

These challenges are testing the tax function and tax governance. The tax governance structure of businesses located in Luxembourg is thus pressured to adapt to changes to manage increasing tax risks and controversy. Tax governance remains high on the Board's agenda as 74% of respondents to Deloitte's 2021 Global Tax Survey: Beyond BEPS are concerned about the media coverage, and political and activist group interest in corporate taxation, and 79% expect such interest to increase following the COVID-19 pandemic. In response to such increased scrutiny related to corporate taxation, 60% of organizations have implemented additional corporate policies and procedures according to Deloitte's 2021 Global Tax Survey: Beyond BEPS. Such a trend will continue in the years ahead with the development of public tax transparency obligations such as the recently adopted EU public country-by-country reporting obligation or the proposals for future publication of effective tax rates paid by large multinationals operating in Europe. The small steps strategy adopted by the European Commission aims to encourage businesses to go beyond legal requirements in order to strengthen their responsibility for their impact on society. It aims to enhance corporate transparency and the transparency and public scrutiny of corporate income tax information by imposing obligations to publish certain tax information for the protection of the interests of stakeholders broader than investors and creditors, extending to other interested third parties, including competitors and the general public.

The only way for businesses based in Luxembourg to answer these complex challenges and meet internal and external stakeholder expectations is to develop an appropriate and good tax governance. This observation raises the question of the readiness and maturity of their existing governance.

The tax governance and control framework must be improved in Luxembourg in order to meet sustainability challenges

Stakeholders focusing on ESG are expecting businesses to carry out their tax affairs in a responsible manner, which is measured in terms of good tax governance and its outcome, i.e. the taxes paid and collected usually referred to as a "fair share". Sustainability, as well as the development of cooperative tax compliance, places an additional emphasis on tax transparency to disclose proactively tax information to a wider base of stakeholders beyond statutory obligations by sharing information about tax governance and control framework. Such information would typically provide explanations on the design, implementation, and effectiveness of the tax governance and control framework to prove the responsible tax behavior of the business, as well as prove the effectiveness of the oversight of the Board and to demonstrate the appropriateness of the broader risk management systems on tax. In light of this growing pressure, businesses operating in Luxembourg and beyond are thus required to develop mature and sustainable tax governance and control frameworks. The OECD provides the six essential principles for the design of a tax control framework that are consistent with the existing enterprise-wide models of internal controls such as COSO[9]:

1. Tax strategy established (clearly documented and owned by the Board)
2. Applied comprehensively with a tax governance and control framework embedded in the day-to-day management of the business operations that is able to govern the full range of the enterprise's activities, given all transactions are capable of affecting the tax position and creating risks.
3. Responsibility assigned: The Board is accountable for the design, implementation, and effectiveness of the tax control framework. The role of the tax department and its responsibility for the implementation of this tax control framework should be clearly recognized and properly resourced.
4. Governance documented with the existence of rules and reporting that ensures transactions and events are compared with the expected norms and potential risks of non-compliance, are identified and managed. This governance process should be explicitly documented and sufficient resources should be deployed to implement the tax control framework and review its effectiveness periodically.
5. Testing performed: Compliance with the policies and processes of the tax control framework should be subject to regular monitoring, testing, and maintenance.
6. Assurance provided: The tax control framework should be capable of providing stakeholders, including external ones such as tax administrations, investors, etc., that tax risks are subject to proper controls and that outputs such as tax returns can be relied upon. This is accomplished by establishing the business' 'risk appetite' and then ensuring that the risk management framework is capable of identifying departures from that with mechanisms for mitigating and eliminating the additional risk.

There is no one-size-fits-all tax governance and control framework. It is different for each business, but the underlying elements of good tax governance are the same: oversight and governance; processes; people; data; and technology (Figure 4).

Figure 4: The five building blocks of tax governance and control frameworks

Oversight and governance

- Tax strategy / policy
- Tax objectives
- Executive reporting
- Stakeholders
- Incident management
- Decision escalation
- Tax transparency
- KPI setting and monitoring
- Business continuity

Processes

- Process design / documentation
- Risk management
- Transaction / risk register
- Control activities and testing
- Assurance framework
- Document retention
- Significant transactions
- Regulatory changes
- Authority relationships

People

- Role descriptions
- Performance management
- Capability and training
- RACI
- Headcount capture
- Capacity
- Stakeholder relationships
- Tax awareness
- External advisers

Data

- Data integrity
- Data analytics
- Spreadsheet controls
- Data flow and controls
- Data access rights
- Tax information management
- Tax and business data integration
- Tax forecasting model

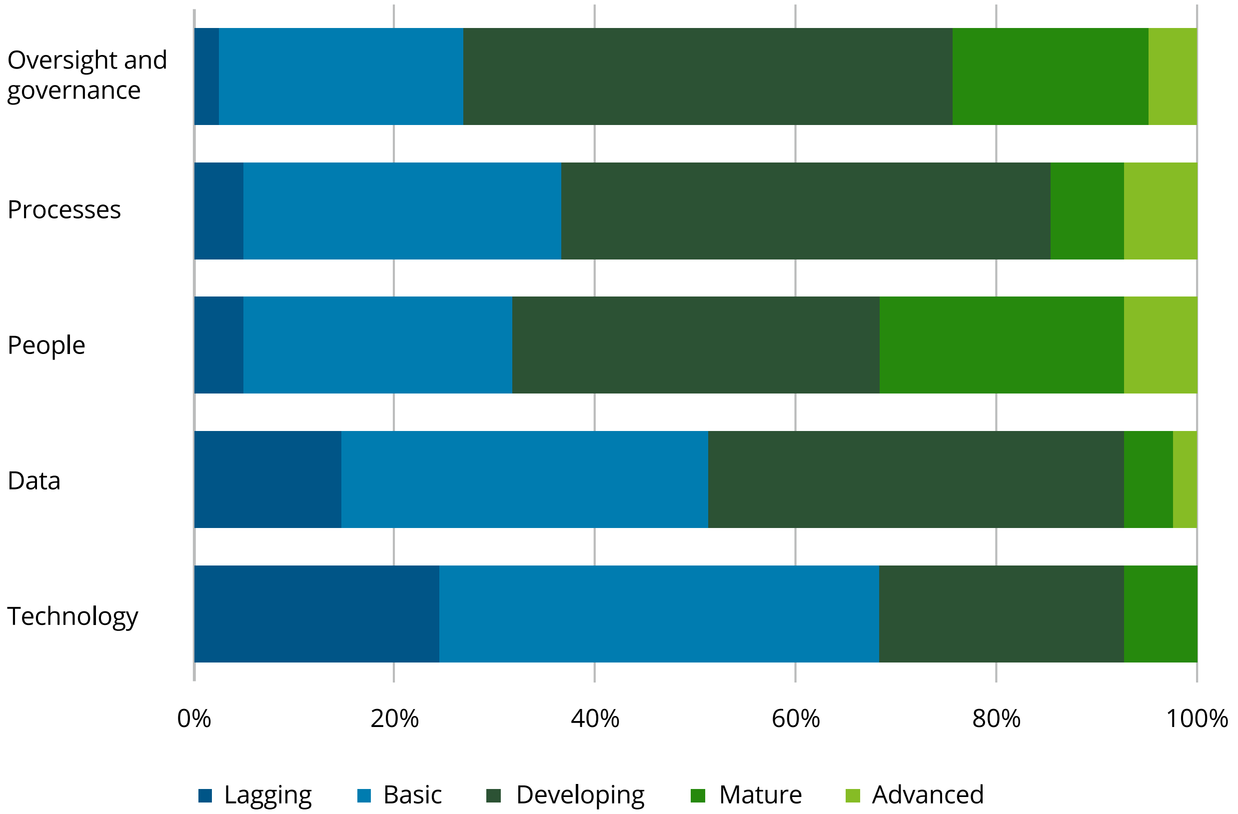
Technology

- Tax technology / transformation strategy
- Tax and IT integration
- ERP systems
- Tax software deployment
- Workflow management
- Document storage
- Robotic process automation
- Automated controls
- Information gathering and processing

The OECD provides the six essential principles for the design of a tax control framework that are consistent with the existing enterprise-wide models of internal controls such as COSO.

The maturity of tax governance and control frameworks of Luxembourg businesses (Figure 5) proves that tax remains a very technical and complex matter, usually perceived as a matter being reserved to specialists, while it forms integral part of the corporate governance strategy and structure, now extending to the sustainability strategy. Hence, C-Suite and Boards do not seem to focus enough on tax as a strategic dimension of ESG.

Figure 5: Maturity of tax governance and control frameworks in Luxembourg



Technology and data
Technology and data are becoming key in the management of tax and related risks, however, according to our respondents, they are the least mature of the elements within tax governance and control frameworks. Over 68% of respondents have lagging or basic technology with limited use, and no plan to deploy it for tax risk management and reporting. Although technology adoption has been noted as slow, deployment of those utilizing solutions has increased. Only 24% of respondents are developing this area of tax with tools to address localized areas of risk and complexity. Data follows the same trend, with 51% of respondents having lagging or basic data. They consider tax as an unknown and unimportant consumer of business data with limited access for risk management. Otherwise tax has some say in the data architecture and access but the organization uses data inconsistently for tax risk management. It must be noted that 41% of respondents are developing data to expand the access and use of data in cooperation with the business with basic analytical application to mitigate risks. The current state of technology and data heavily limits the ability of respondents to identify, control, and manage tax risks, as well as comply with their growing tax compliance and transparency obligations and even communicate confidently on the subject. Indeed, 8% of the respondents identify the lack of processes or technology as one of the top 10 factors most likely to increase tax risks and tax controversy in their organizations (Figure 2).

Processes
Almost 81% of respondents have basic or developing processes, with some formalization, but limited understanding and integration with the wider business or, at best, a periodical update of the processes with some training of the staff on leading practices. Less than 15% have mature or advanced processes that are formalized, standardized, fully integrated with the business, continuously monitored, tested and improved.

People
Progress was most pronounced in available resources and the set-up of the organization, including the employment and management of skilled people with 32% of respondents marking this pillar within the framework as mature or even advanced. These respondents noted their organization's workforce had established capacity, capability, and organized necessary roles with limited inefficiencies and risks mitigated and even an effective reduction of risk cost thanks to a forward-looking agile resource plan and complete role and RACI formalization. 37% of respondents are developing the 'people dimension' by putting resource planning in place with scope for harmonizing low- and high-value activities to the highest areas of risk (Figure 2).

The ability to manage and control tax risks with sufficient resources to cover the tax function activities is identified by respondents as the third source of tax risk in the top 10 factors most likely to increase tax risks and tax controversy in their organizations.

Oversight and governance

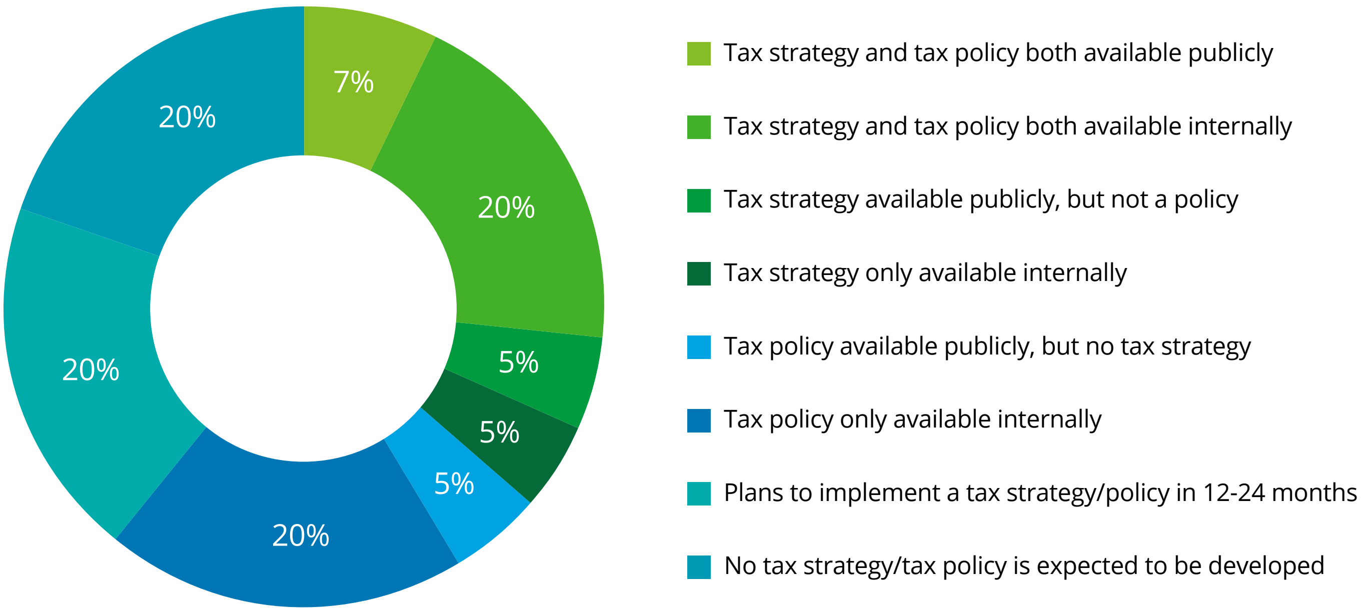
Tax risks affect the ability of organizations to achieve their tax strategy and business objectives. Therefore, one challenge for management is determining the amount of tax risk the organization is prepared for and able to accept. Effective tax risk management helps Boards and management to optimize outcomes with the goal of enhancing capabilities to create, preserve, and ultimately realize value.

Oversight and governance is basic or developing for 73% of respondents who consider that tax issues are reactively identified and escalated to the management and, to a certain extent, the business is engaged in tax matters with some, but not formalized, management reporting. 19% estimate their oversight and governance to be mature with the business being engaged in tax matters with a visibility on the key performance indicators and the tax risks being proactively reported to the management.

A tax strategy and a tax policy that are approved by the Board are fundamental and constituent documents for an effective oversight and governance. A tax strategy is defined as the plan to achieve the business mission and vision, and to apply its core values, based firmly on data and business realities, that sets out the tax decisions made with a view to supporting the organization's goals. The tax strategy sets the tone from the top. A tax policy is different as it is defined as the governance framework that establishes standards for the way tax decisions are made and implemented. It formally sets out the organization's key tax management procedures and accountabilities.
Even though an established and Board-approved tax strategy and tax policy are key elements of oversight and governance, they are absent for 40% of respondents[9], with only 20% planning to implement such a tax strategy or policy in the next 12 to 24 months (Figure 6). 60% of respondents have a tax strategy or policy, with 17% having at least one of the two publicly available and overall a great heterogeneity among respondents.

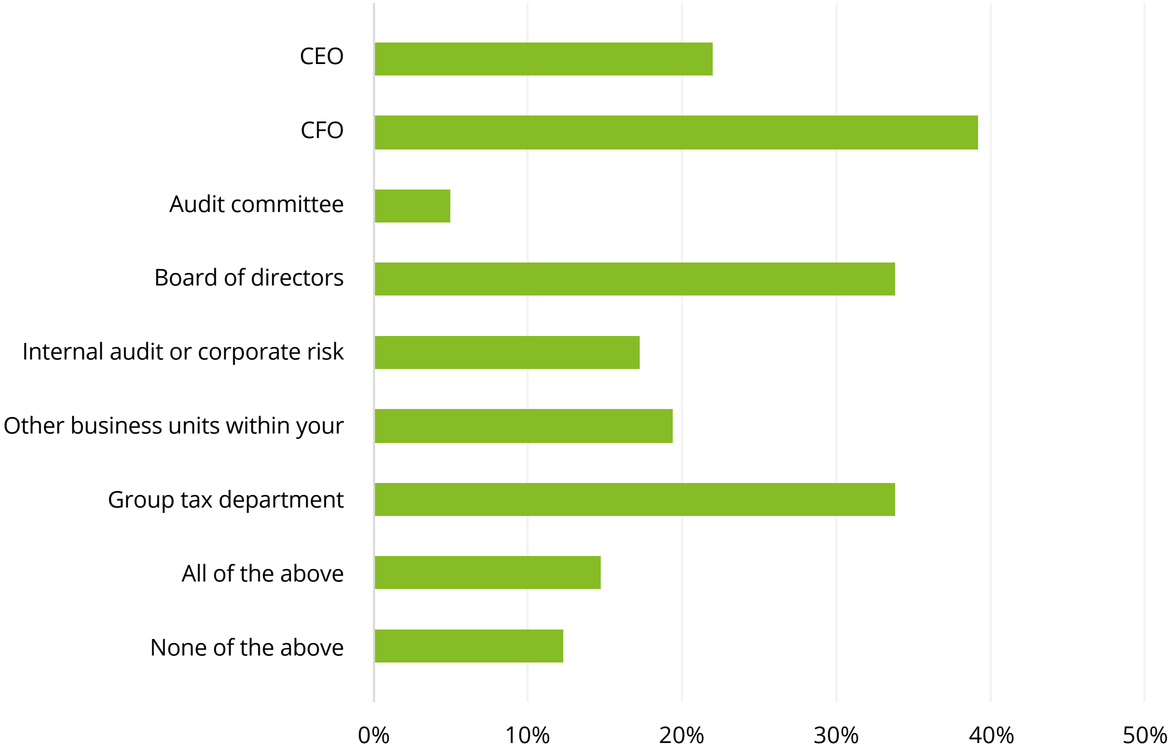
A well-defined tax strategy drives the efficient allocation of resources and effective decision-making. It also provides a road map for establishing business tax objectives throughout the entity. Tax risk management does not create the entity's tax strategy, but it influences its development. An organization that integrates tax risk management practices into setting its strategy, provides management with the risk information it needs to consider alternative strategies and, ultimately, to adopt a chosen strategy.

Figure 6: Has the organization developed a written and Board-approved tax strategy and tax policy?



Demonstrating the "sustainability" of the tax governance and control frameworks of Luxembourg-based businesses to their stakeholders requires businesses to build bridges between tax, public relations, and sustainability teams within the business and enhance dialogue. However, tax is mainly discussed internally within the tax or finance function, while the risk, internal audit, and compliance teams are less involved. The Board and CEO compose the second tier of internal stakeholders for tax matters (Figure 7). 12% of respondents do not communicate at all on tax internally.

Figure 7: Does the organization provide periodic briefings on tax risk/tax controversy management and tax policy trends to any of the following?



Although tax governance and control framework is a broad subject there may be many areas that would be quick and simple wins to improve maturity. It is important to approach it from a business perspective, as well as a regulatory angle to ensure the alignment of the tax governance and control framework with the broader corporate governance, risk and control framework.

Tax governance and control framework is frequently controlled during due diligence exercises or on a regular basis by investors (e.g. institutional investors, pension funds) as tax would impact the brand value and investment return, hence having a direct influence on the investment price at the time of the negotiation. With the rise of topics in between tax and compliance (e.g. last one being DAC 6), this may also be a topic for internal audit and also for regulators when launching audits on regulated entities.

Analyzing the maturity of the tax governance and control framework is essential to identify existing gaps in requirements imposed by regulations, the environment, and various stakeholders to demonstrate its sustainability and to be able to communicate confidently. There is an increasing awareness of respondents on the necessity to develop tax governance and control frameworks to adapt to the growing complexity of taxation and meet sustainability expectations. However, this does not yet translate into tangible plans and actions to transform the organization, by fully integrating tax in the business operations and controls to demonstrate publicly the long-term vision of the tax behavior.

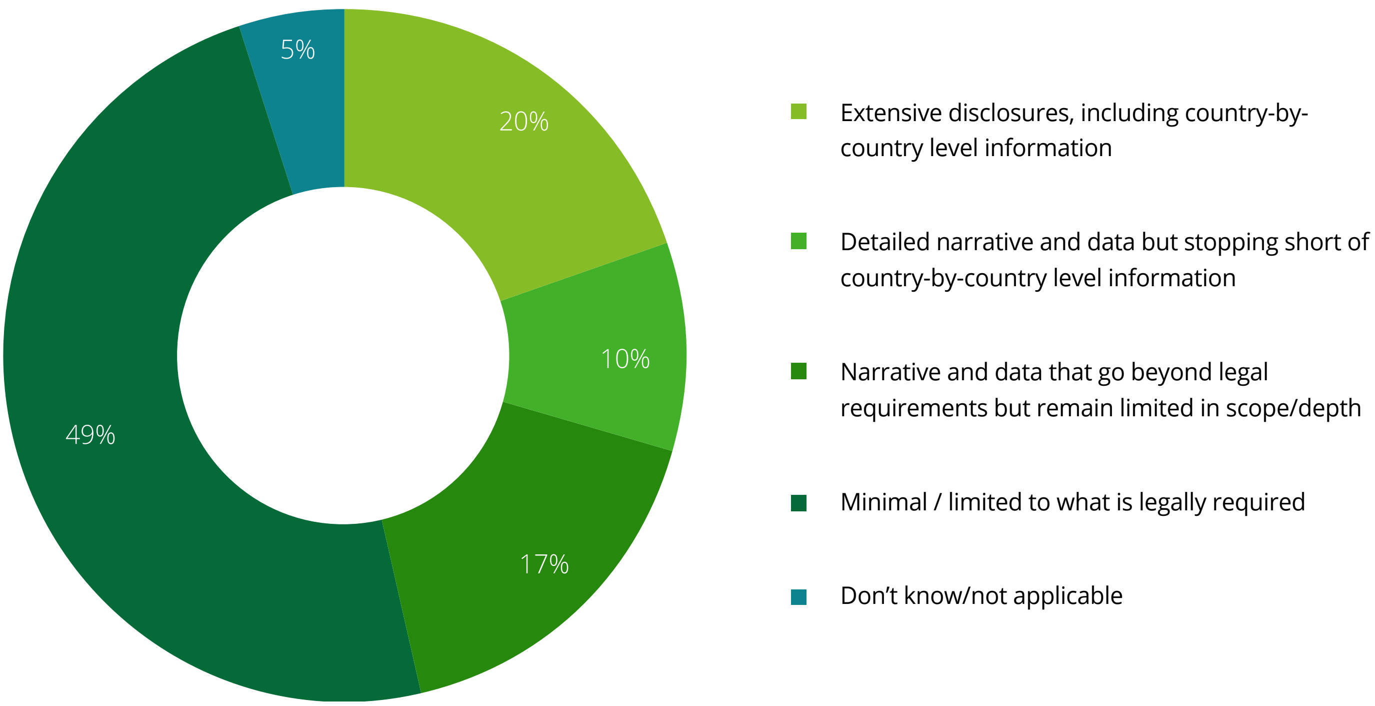
Going beyond requirements with tax transparency

There are currently few legal requirements for businesses to be publicly transparent regarding taxes (such as in Australia, Poland, Spain, and the UK, or in the extractive and banking sectors) beyond pure financial reporting obligations (e.g., international financial reporting standard (IFRS), Sarbanes-Oxley (SOX) in the US, etc.). However, a significant number of voluntary best practices exist (B Team, Global Reporting Initiative (GRI), etc.). From 2021, the EU has started to enhance sustainability reporting connected to financial reporting and will create new tax transparency obligations, with taxation embedded in sustainability reporting aimed at measuring business performance based on ESG criteria. Businesses will have to report about tax twice, once for financial reporting purposes to their shareholders, and a second time for sustainability reporting purposes to a much wider base of stakeholders, including tax administrations, governments, regulators, investors, clients, and the general public. For example, under the EU Sustainable Finance Disclosure Regulation, financial market participants and advisers must disclose sustainability risks in all investments, notably with respect to companies' good governance practices and in particular tax compliance. The challenge posed by sustainability in relation to tax requires businesses to anticipate, adapt, and act proactively by developing and mastering tax policy, tax governance, and tax communication, which are interdependent.

The upcoming European public tax transparency obligations follow this trend, such as the public country-by-country reporting on tax information and the future proposal for the publication of effective tax rates paid by European large companies. Those reports focus on the publication of highly technical and complex data, which would be challenging to produce in light of the current level of maturity of the respondents. These new tax transparency obligations leave little room for explanation, taking into account that stakeholders focusing on ESG would measure tax behavior against the set of information available in terms of good tax governance and amounts of taxes paid. The heterogeneity within the market demonstrates a need for companies to understand the different asks from their different stakeholders and to develop good governance practices encompassing such different asks within the ESG spectrum.

Therefore, organizations must build a narrative to clearly explain tax data and educate stakeholders in light of the high reputational risk involved—and this is being actioned. 95% of respondents expect to communicate tax data with 46% of them likely going beyond requirements. However, 49% will limit their tax communication to what is legally required. The development of tax legislation, the investment in digitalization by tax administrations to secure tax revenue require to accelerate the development of governance and represents a threat for 54% of the market players in Luxembourg who would, at best, continue to apply the minimum legal requirements to their businesses (Figure 8).

Figure 8: How would you expect your organizsation's tax transparency strategy to look in two years' time?



"By developing good governance and tax communication, businesses can take part in the debate on tax instead of being the subject of it."

Grégory Jullien, Deloitte

Figure 9: To what extent is tax part of your organization's business and sustainable development strategies?

The expectations of respondents on their organization's tax transparency strategy in two years' is consistent with the fact that 57% of respondents have not integrated tax into their business and sustainable development strategies, with 37% of respondents claiming they would not integrate tax as a component of their sustainability strategy (Figure 9). This trend is in contradiction with the evolutions of society and the economy, especially taking into account the will of the market to integrate cooperative tax compliance programs.

Market players are aware of sustainability requirements and expectations, but it does not translate in practice with concrete actions because tax is still seen as an expert topic and cost center. This is also reflected by the fact that tax information is mainly shared within the tax or finance function only.

Anticipation is key on tax matters, especially to adapt and align communications about tax with sustainability expectations regarding appropriate oversight and control of tax risk. Businesses must adopt a forward-looking attitude to understand future regulatory and tax policy trends. Mastering tax policy is a pre-requisite for creating good tax governance. This implies developing the resources to monitor the tax policy agenda of national, EU, and international institutions in order to be part of the tax policy discussion, rather than being its subject.

Whatever the form and extent of tax transparency obligations, and regardless of any link to sustainability, there is an incentive for businesses to voluntarily exceed requirements (especially with the EU public country-by-country reporting) so that they can deliver their vision of the management of taxation and provide meaningful explanations of highly technical and complex tax information to their stakeholders. Businesses can draw on the growing body of voluntary tax transparency measures (GRI, B Team, etc.) to achieve this goal.

Businesses will only be able to successfully address the challenges of sustainability in relation to tax by creating good tax governance.

The GRI 207 tax standard and the WEF IBC Core Tax Metric are the most comprehensive voluntary frameworks available for organizations to communicate on tax.

The GRI 207 tax standard
Part of the GRI Sustainability Reporting Standards for organizations to report on their economic, environmental, and social impacts, the GRI 207 tax standard is the most comprehensive framework available for voluntary tax transparency and communication. It sets out reporting requirements for tax and can be used by organizations of any size, type, sector, or location to report on their tax impacts. The standard was effective for reporting and communication purposes as from 1 January 2021.

GRI states in its 207 tax standard that:
"Organizations have an obligation to comply with tax legislation, and a responsibility to their stakeholders to meet expectations of good tax practices. If organizations seek to minimize their tax obligation in a jurisdiction, they might deprive the government of revenue. This could lead to reduced investment in public infrastructure and services, increase in government debt, or shifting of the tax obligation onto other tax payers. Perceptions of tax avoidance by an organization could also undermine tax compliance more broadly, by driving other organizations to engage in aggressive tax planning based on the view that they might otherwise be at a competitive disadvantage. This can lead to increasing costs associated with tax regulation and enforcement. Public reporting on tax increases transparency and promotes trust and credibility in the tax practices of organizations and in the tax systems. It enables stakeholders to make informed judgments about an organization's tax positions. Tax transparency also informs public debate and supports the development of socially desirable tax policy."[10]

The GRI 207 tax standard focuses on how companies manage tax and exercise good tax governance, especially by providing information on:

- Their approach to tax governance (commonly set out in a tax strategy and a tax policy);
- Their tax governance, control, and risk management structures; and
- How they manage stakeholder engagement (including public policy advocacy on tax) and other tax-related matters.

The GRI 207 tax standard also includes guidance on Country-by-Country reporting to publicly disclose certain financial information on a per-country basis, including revenue, profit/loss, number of employees, assets, and corporate income tax paid.

The World Economic Forum Core Tax Metric
At the 2020 World Economic Forum Annual Meeting in Davos, 120 of the world's largest companies supported the development of a core set of common metrics and disclosures on non-financial factors for investors and other stakeholders.

Companies can use the core and expanded set of "Stakeholder Capitalism Metrics"[11] and disclosures to align their mainstream reporting on performance against ESG indicators and consistently track their contributions towards the SDGs. These metrics are based on existing standards, with the short-term goals of accelerating convergence between the leading private standards and making the reporting of ESG disclosures more comparable and consistent.
One of the core metrics proposed by the World Economic Forum is related to the total tax paid, i.e., "The total global tax borne by the company, including corporate income taxes, property taxes, non-creditable VAT and other sales taxes, employer-paid payroll taxes, and other taxes that constitute costs to the company, by category of taxes". This core metric is adapted from GRI 201-1.[12]

There are two additional "expanded" metrics. The first is the additional tax remitted: "The total additional global tax collected by the company on behalf of other taxpayers, including VAT and employee-related taxes that are remitted by the company on behalf of customers or employees, by category of taxes". The second is: "Total tax paid by country for significant locations".[13]

The guidelines provided by these voluntary frameworks do not only allow the fund industry and businesses to communicate confidently on tax—they also allow market players to transform constraints into opportunities.

An opportunity offered to Luxembourg-based businesses
As already mentioned, communication regarding taxation is an important and constituent part of good governance and responsible tax behaviors, but it is a highly technical subject that may be challenging for all stakeholders to fully grasp. From a "nice to have", such communication is quickly becoming an obligation in 2021 and beyond.

The setting-up of the tax governance and control framework function will take time and will require resources in respect to notably people, processes, data, tools, and technology. A good tax governance and control framework can no longer be considered in isolation from a broader business strategy. Anticipating and understanding the tax landscape and setting up a tailored tax governance and control framework will also allow Luxembourg businesses to participate in tax policy discussions and share their experience and point of view to lawmakers.

The ability to produce data and to communicate effectively about tax strategy and tax governance to the public and policymakers may positively impact businesses (e.g. strengthened brand attracting more investors, opportunities to qualify for tax incentives, environmental taxes, etc.). Other immediate benefits from a robust tax governance are the reduced tax risks and associated costs, including decreased insurance premiums. Hence, the value and return on investment for investors and shareholders in companies with a mature tax governance and control framework would increase and be maximized. The overall ESG rating and reputation of both businesses and their investors would be improved, strengthening their brand.

It is now time to act on this opportunity offered to Luxembourg businesses to generate value in relation to tax by creating a sustainable tax governance and control framework.

About this survey

We have contacted a selected number of clients based in Luxembourg which collectively represent the diversity of economic actors present on the Luxembourg market, covering the below economic sectors:

- Banking and capital markets
- Insurance
- Investment management
- Private equity/real estate/hedge funds
- Consumer (e.g. automotive, consumer products, retail, wholesale and distribution, transportation, hospitality, etc.)
- Energy, resources, and industrials (e.g. industrial products and construction, mining and metals, oil, gas and chemicals, power and utilities, etc.)
- Government and public services
- Life sciences and health care
- Technology, media, and telecommunications.

Respondents were 41 in total.

We have corroborated the results of our survey with the outcome of Deloitte's 2021 Global Tax Survey: Beyond BEPS[14].

Endnotes

1. https://www.oecd.org/ctp/dispute/mutual-agreement-procedure-statistics.htm
2. https://www.oecd.org/tax/dispute/2019-map-statistics-luxembourg.pdf
3. https://www2.deloitte.com/content/dam/Deloitte/global/Documents/dttl-tax-beps-survey-2021-report.pdf
4. https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-survey-2021-pager.pdf
5. https://www.oecd.org/ctp/administration/tax-administrations-continue-to-accelerate-their-digital-transformation.htm
6. Deloitte's 2021 Global Tax Survey: Beyond BEPS
7. Deloitte's 2021 Global Tax Survey: Beyond BEPS
8. https://ec.europa.eu/taxation_customs/system/files/2020-07/2020_tax_package_tax_action_plan_en.pdf and https://ec.europa.eu/taxation_customs/system/files/2020-07/2020_tax_package_tax_action_plan_annex_en.pdf
9. OECD (2016), Co-operative Tax Compliance: Building Better Tax Control Frameworks, OECD Publishing, Paris
10. Global Reporting Initiative, Sustainability Reporting Standard 207: TAX 2019, Section D. Background context, page 4
11. http://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf
12. Ibid
13. Ibid
14. https://www2.deloitte.com/content/dam/Deloitte/global/Documents/dttl-tax-beps-survey-2021-report.pdf

Contacts Luxembourg

Bernard David
Partner– Tax Business Leader
bdavid@deloitte.lu
+352 45145 2799

Eric Centi
Partner – Financial Services Tax
ecenti@deloitte.lu
+352 45145 2162

Gregory Jullien
Senior Manager – EU Public Policy | Tax
gjullien@deloitte.lu
+352 45145 2924