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Tax and ESG: From risk to opportunity

A practical guide to enhancing value from tax sustainability and transparency

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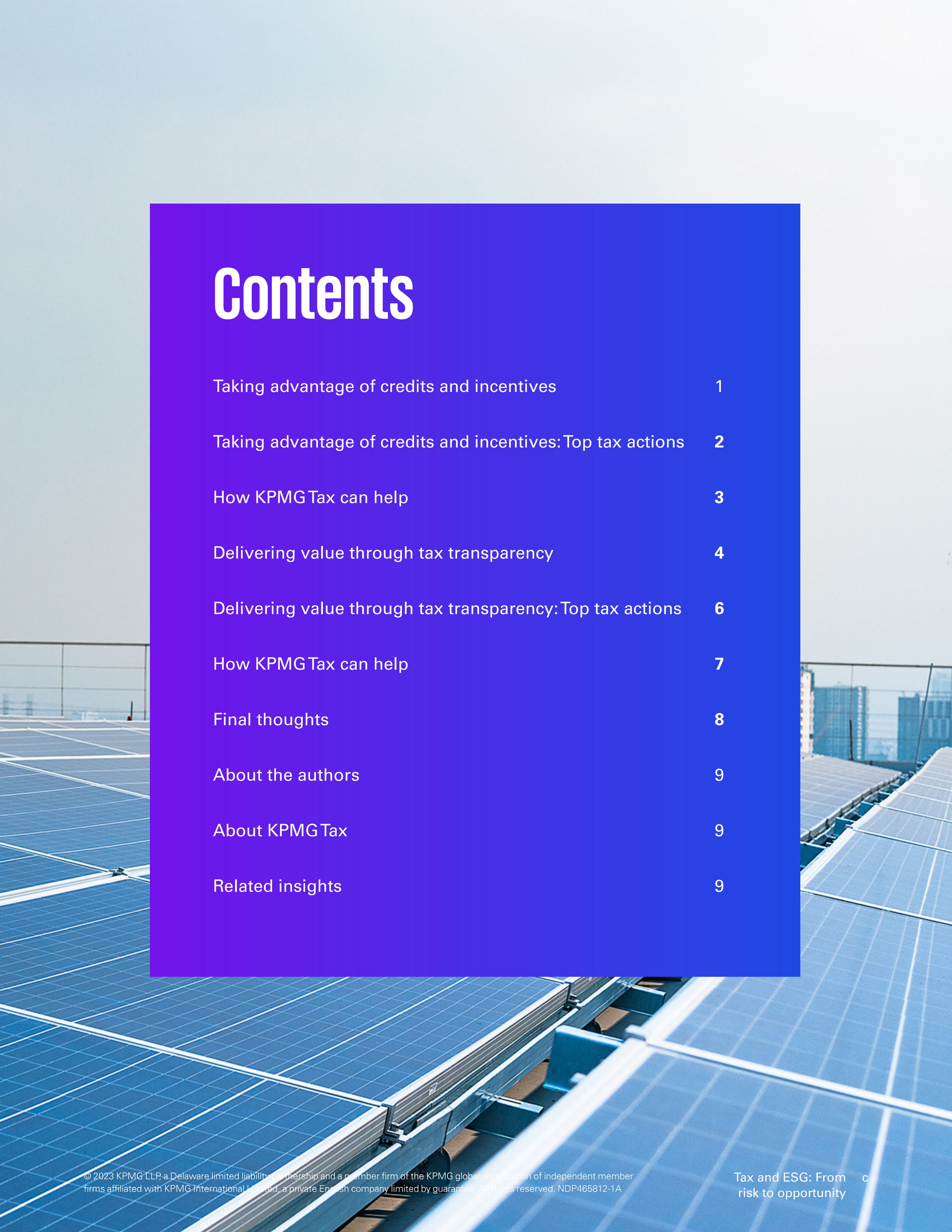

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Preface

As the impact of businesses on society and environments continues to gain stakeholder and regulator attention, the influence of environmental, social and governance (ESG) themes on tax departments can no longer be pushed aside or overlooked.

KPMG research shows that commitment to sustainability and social responsibility is a primary pressure on today's tax functions. ESG-related activities are moving steadily up the corporate tax mandate and agenda, affecting everything from planning to operations and profitability, and even compliance.

The data speaks for itself. In a series of annual outlook surveys, KPMG asked hundreds of Chief Tax Officers (CTOs) to rank the top threats to tax organizations' growth over the next three years. In a single year, ESG-related risks rose all the way from last to first.[1,2] And while tax departments are stepping up their involvement in ESG strategies, much work lies ahead. ESG remains largely outside of the tax function, with only 28 percent of CTOs having a seat at the table supporting ESG initiatives.[3]

While navigating ESG impacts looks to be the next big challenge for tax functions, as experienced business advisers we know that all risks—viewed through a different lens—can be opportunities. This is certainly the case when it comes to tax's role in ESG. It is also the reason for this report.

As the conversation about ESG moves further into the tax department, two significant yet often misunderstood opportunities stand out: 1) taking advantage of green credits and incentives; and 2) delivering value through tax transparency.

From accessing government funding for the company's ESG initiatives to reducing compliance risk and shaping the public narrative through increased tax disclosure, organizations have the potential to increase business value by embedding tax into strategic ESG discussions and transforming tax operations through best-in-class tax governance and data-driven public tax narratives.

This article presents practical guidance for corporate tax departments to make progress toward both key objectives. We recommend key actions across data, technology, operations, strategy and governance for tax teams to focus on today. We also share how KPMG helps tax departments transform for the future to accelerate their organization's long-term ESG goals.

Elements of the information found in this report originated from the **KPMG 2023 Chief Tax Officer Outlook**. The fourth annual CTO survey examines the challenges and opportunities facing tax functions today and tomorrow.

Read more >

[1] 2022 Chief Tax Officer Outlook Study (KPMG LLP, January 2022)

[2] 2023 Chief Tax Officer Outlook Study (KPMG LLP, January 2023)

[3] 2023 Chief Tax Officer Outlook Study (KPMG LLP, January 2023)

Taking advantage of credits and incentives

All efforts around ESG have tax implications. However, operational changes and investments that companies are making to "go greener" touch tax affairs in particularly significant ways.

Companies in many industries are making large operational investments to lower emissions and meet sustainability objectives. Clean energy production, vehicle fleet electrification, and installation of solar panels and energy-saving HVAC systems are just a few examples of what will typically be substantial, multiyear investments.

The good news is that big money is out there for the taking in the form of green credits and incentives. Governments at the federal and state level have a wide variety of tax incentive programs for businesses that green their operations. Most notable are provisions of the federal Inflation Reduction Act (IRA), which offer tax credits to lower the costs of green power investments and incentivize emissions reduction.

There is strong interest within business units and sustainability groups to identify available tax credits and drive ongoing compliance. Yet, many companies simply are not aware of what programs are out there, let alone what it will take to qualify.

For companies to optimize the benefits of ESG-driven operational transformation, they will need tax leadership to help show the way. KPMG research shows that helping companies access tax credits and incentives is a big focus within a substantial share of tax departments. According to the 2023 KPMG CTO Outlook survey, 46 percent of tax functions are seeking to work more closely with business units to identify and access ESG-driven tax credits and grants.[4]

[4] 2023 Chief Tax Officer Outlook Study (KPMG LLP, January 2023)

> "As companies invest in greening their operations, the tax costs and opportunities are significant. In our experience, most companies don't appreciate the full tax implications of sustainability-driven operational transformation. Without tax involvement and insight, many will miss opportunities to tap into green credit and incentive programs that can help offset the costs of their investments."
>
> **Brett Weaver**, *Partner and KPMG Tax ESG Leader in the US*

Taking advantage of credits and incentives (continued)

Top tax actions

Contribute to planning around ESG-driven operational changes

Tax leaders should participate in early strategic business decisions to "go green." COOs, CSCOs, and other top decision makers will make better investments when they fully understand the tax implications—before investments are finalized—giving them time to adjust the strategy where necessary in order to qualify for tax credits and incentives for showing progress in the sustainability space.

Implement tax operational enhancements

Companies need new and different data—in much greater volume—to take advantage of green tax incentives and manage the tax elements of operational sustainability. Adding to the complexity is the fact that the data needed to calculate and apply credits is not always native to tax departments' systems (e.g., reductions/sequestration of carbon, wages paid by employee class, investments in underprivileged areas, types of technologies employed in new processes, etc.). As such, refreshed reporting processes, as well as controls and policies, will be critical to claim tax credits for climate-positive investments that are favored in the tax code and ensure ESG impacts are thoughtfully considered throughout.

Strengthen governance of credit and incentive activities

Driving ongoing compliance with ESG-driven tax credits and terms requires robust yet agile oversight. Some programs have limited access windows, while others may depend on geographic location. All have specific criteria for qualification, which must be met to benefit from the program. Technology-enabled governance processes can help tax stay afloat of available programs, quickly determine if they qualify, submit applications on time, and put checks in place to ensure milestones are hit.

How KPMG Tax can help

Green tax credits and incentives abound. Are you capturing all of them?

KPMG Tax helps companies get the tax credits they qualify for, including those in the ESG space. The KPMG Tax Credit & Incentive Services practice includes local and national tax, accounting, engineering, and technology professionals who specialize in helping companies benefit from such tax credit and incentives that may be used to help fund other ESG investments.

KPMG uses a tested methodology that is technology enabled to design a customized approach—based on your company and industry, potential audit exam issues and risk profile—to efficiently collect, analyze, and document your qualified activities, expenses, and credits. This results in knowing you captured the tax benefits you are eligible for within the definition of this complex and quickly expanding area.

Delivering value through tax transparency

The momentum behind ESG is closely linked to another trend impacting tax departments: The global push for greater tax transparency.

Businesses around the world—especially large multinationals—are facing formal requirements to publicly report more tax data within the next few years. The most notable impending changes, with the most sweeping future impacts, are public country-by-country reporting rules in the European Union (EU) and the proposed FASB country-level tax disclosure rules.[5] At the same time, governments across the globe are adopting global minimum tax rules[6] that also require country-by-country reporting data. Further, tax authorities in many jurisdictions, including the United Kingdom,[7] Singapore,[8] Malaysia,[9] and Australia,[10] are increasingly reviewing organizations' tax control and governance frameworks to assess audit risk and focus resources on the most material potential tax shortfalls.

Taken together, these measures increase the importance of both quantitative and qualitative transparency by global taxpayers. They are also creating significant demands for new data capabilities within the tax function. Marking a significant shift in reporting requirements, these rules and regulations are spurring many tax departments to rethink their end-to-end data-related processes. New and significant data and reporting processes are needed to meet data-intensive compliance mandates that will rely on information that frequently either does not exist or is not easily accessible by the tax department. For example, just one in five CTOs believe their tax functions are well positioned to comply with EU public country-by-country reporting rules though the 2025 deadline is not far off.[11]

Being ready for mandated tax transparency compliance often goes beyond the basic required disclosures. Many companies will consider the new disclosure requirements to present an incomplete portrait of their global tax footprint, present information in a way that is likely to be misconstrued, and risk putting the company in a bad light. These companies will want to consider both enhanced qualitative tax disclosures as well as voluntary tax payment disclosures that illustrate why the company's approach to tax is both responsible and sustainable. According to KPMG research, more than half of CTOs (56 percent) are more interested in being perceived as a good corporate citizen than in reducing their company's tax burden. In addition, nearly half (49 percent) say their approach to tax transparency is to be fully transparent, e.g., sharing significantly more detail than is otherwise required for compliance.[12]

As expectations about the impact of businesses on environments and communities evolve, standard setters, investors, and other stakeholders are scrutinizing how companies manage their tax affairs, including the downstream impacts of tax outflows on the communities in which companies operate. Across sectors and geographies, information about tax payments, strategies, policies, and tax governance are increasingly being used as a measure of fair and responsible corporate citizenship. While there is little appetite to increase tax transparency for the sake of it, disclosing additional strategically selected tax information can help shape public perceptions and protect brand value.

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[5] FASB Exposure Draft – Improvements to Income Tax Disclosures, March 15, 2023

[6] Organization for Economic Co-operation and Development (OECD) Base Erosion Profit Shifting (BEPS) Pillar Two rules

[7] UK's Business Risk Review

[8] Singapore's Tax Control Framework

[9] Malaysia's Tax Governance Framework

[10] Australia's Justified Trust Program

[11] 2023 Chief Tax Officer Outlook Study (KPMG LLP, January 2023)

[12] 2023 Chief Tax Officer Outlook Study (KPMG LLP, January 2023)

> An organization's approach to tax is increasingly seen as a measure of the sustainability of their business. As mandatory public disclosure regimes take effect, tax leaders are facing more urgent pressure to control the narrative about their organizations' overall tax impacts. Developing a comprehensive approach to both quantitative and qualitative transparency is essential to maintaining control and preserving brand value.

Matt McNeill, U.S. Tax Transparency Leader, KPMG in the U.S.

Delivering value through tax transparency (continued)

Top tax actions

Ramp up tax reporting processes to address transparency mandates

To get ready to comply with impending public country-by-country tax disclosure requirements, as well as impending Pillar Two rules, tax functions will need to transform data gathering, management, analytics, and reporting capabilities. While new or upgraded systems and processes don't come easily, they will be necessary to mitigate compliance risk—which may be far costlier from a financial and brand standpoint. Manual data pulls and reconciliations no longer suffice. Various groups within the tax department and many of the tasks they perform will rely on common data sets. To make sure numbers are both calculated and reported properly, users will need quick and reliable access to the data, in a manner that is both repeatable and auditable. Trust in the data is paramount to success.

Develop a comprehensive approach to tax transparency

Intention. Action. Evidence. These three hallmarks form the basis of a comprehensive approach to tax transparency. A public tax strategy or policy document that clearly demonstrates the organization's approach to tax can help guide and govern decisions, behaviors, and actions by organizational leaders. Transparency around the processes and mechanisms that ensure adherence to the organization's approach to tax are necessary to demonstrate that its intentions are serious. The evidence that the company is true to its commitments is greatly aided by public country-by-country tax data. As mandated qualitative and quantitative disclosures become "the new normal," many companies will see the need to go beyond the required minimum to make disclosures about all material taxes they pay, e.g., a Total Tax Impact report, not just corporate income taxes.

Communicate the tax strategy to the C-suite

Transparency regarding a company's approach to tax matters is a central component of the ESG agenda, requiring greater buy-in from the C-suite on the public story about tax strategies, risks, and payments. Sustainable business practices are increasingly defined as inclusive of both quantitatively and qualitatively transparent tax strategies. Beyond compliance with forthcoming quantitative disclosure requirements, companies will be well served to integrate tax into their overall sustainability narrative and initiatives. Most companies are responsible taxpayers willing to partner with governments, through tax incentives, to build a more sustainable future for everyone. That is a great story, but one that should be told with the proper nuance and precision guided by the tax department.

How KPMG Tax can help

We've "been there, done that." We have helped many companies assess these new data requirements and understand how difficult it can be to extract, load, and analyze these new data elements.

That's why we built the **KPMG Tax Transparency Services – Impact Analyzer (Impact Analyzer)**—a technology and process solution that can automate and simplify how you implement your tax transparency strategy. The Impact Analyzer is a cloud-based solution that uses artificial intelligence and machine learning to simplify how you pull the data you need and the analytics necessary to give you the comfort you require.

We've also built a database of company tax transparency disclosures (both qualitative and quantitative), as well as templates and guidance to implement your tax strategy through the policies and procedures, to assist you in building a comprehensive tax governance framework. Additionally, the Impact Analyzer allows you to quickly assess how well you adhere to public tax ESG standards compared to your selected peers. These can be valuable data points as you assess your current tax ESG maturity and where you want to go.

Access KPMG insights on more tax transparency initiatives.

Final thoughts

It's true that tax is just one piece of the whole ESG pie.

Making progress around ESG issues is a long-term challenge that touches every part of the enterprise, not tax alone. Although coming up with a strategy to deal with this new environment can feel daunting, taking a data-informed approach will provide clarity as to what to do and when to implement.

Tax leaders can't afford to wait. The opportunities for tax to help the broader business capitalize on ESG trends is very real, very attractive, and very imminent. The landscape surrounding these trends is budding and taking shape right now, and it will continue to evolve in the future.

In the coming months, there is much tax work to be done on ESG-related initiatives. We hope this guide helps set your tax function on the right path to deliver value today and tomorrow.

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Brett is a KPMG partner, U.S. Tax ESG leader, and Global Value Chain Management leader. His clients are Fortune 50 companies across multiple industries focused on adding value through the tax function. Brett has led KPMG's development of data transformation technology tools to provide tax insights to business leaders. He has extensive tax policy experience and has assisted companies in partnering with governments around the world to build a sustainable future for everyone.

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Matt is a principal in the national KPMG Value Chain Management practice and national leader for Tax Transparency Services. With more than 15 years of international tax experience, he has held positions at Big Four accounting firms and a Fortune 100 company. Matt's practice helps clients align global tax planning with business operations and corporate strategy, focusing on major disruptive global trends including digital transformation, supply chain disruption, the OECD BEPS project, and ESG. As national leader for Tax Transparency Services, Matt also helps businesses navigate calls for greater transparency on corporate tax matters.

About KPMG Tax

When tax performance is put under a microscope, you need precise knowledge and the latest facts.

When you are called on for a bigger role, you need insightful, forward-thinking perspectives. In times with greater demands for transparency, you need a steady, trusted hand.

Passionate, collaborative, and committed to your business success, the KPMG Tax practice works with you to learn all we can about your organization, understand your goals, and uncover unexpected opportunities. We deliver a broad range of tax services, reimagined now and for the future.

Learn more at tax.kpmg.us, KPMG Tax ESG insights, and KPMG Tax ESG services

Related insights

2023 Chief Tax Officer Outlook Study: Read forward-looking perspectives on key CTO agenda items, drawing on data from the fall 2022 survey of 300 CTOs of companies across all major industries; one-on-one interviews with five CTOs representing a diverse set of businesses; input from KPMG Tax partners who advise CTOs on the topics explored in the survey.

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