PIRC comments on exposure draft Income Taxes (Topic 740) Improvements to Income Tax Disclosures

The voice of responsible shareowners

FINANCIAL ACCOUNTING STANDARDS BOARD

PROPOSED ACCOUNTING STANDARDS UPDATE: INCOME TAXES (TOPIC 740), IMPROVEMENTS TO INCOME TAX DISCLOSURES

About PIRC

Pensions & Investment Research Consultants Ltd (PIRC) is Europe's largest independent corporate governance and shareholder advisory consultancy with over 25 years' experience in providing proxy research services to institutional investors on governance and other ESG issues. Our clients encompass major institutional shareholders, faith-based investors, trade unions and other responsible investors.

PIRC obtained Fair Tax Mark Certification in 2017, demonstrating our belief that taxation is an important contribution to wider society, rather than a cost to be minimised.

In December 2021, PIRC launched a new collaborative investor initiative on Responsible Corporate Tax, in collaboration with the Centre for Corporate Tax Advocacy and Research (CICTAR). The initiative facilitates active engagements with multinationals on tax transparency and responsible tax – including the filing of shareholder proposals. Company adoption of the GRI Tax Standard, and specifically, public country-by-country reporting (CbCR), is a key focus of this initiative.

PIRC coordinated the filing of shareholder proposals at Amazon, Microsoft and Cisco in 2022 requesting that the companies produce a tax transparency report in line with the GRI Tax Standard. These proposals received 21%, 23% and 27% respectively. Alongside the Amazon proposal, PIRC coordinated an investor sign-on letter to the US Securities and Exchange Commission (SEC). Investors with $3.6 trillion in assets under management signed onto this letter, expressing support for the GRI Tax Standard and public CbCr.[1] PIRC, again, coordinated the submission of the proposal to Amazon which will be voted on at the company's AGM in May.

In May 2022, PIRC published a tax brief outlining our expectations for companies on tax transparency and responsible taxation and how we intend to vote on tax issues.[2]

As stated in this brief, PIRC expects companies to publish CbCR. Following this, PIRC intends to vote FOR shareholder proposals calling for public CbCR and vote AGAINST financial statements where companies to not publish CbCR. PIRC is a member of the UNPRI and we endorse their submission to this inquiry. We supported the submissions by the FACT Coalition and CICTAR.

Comments – Re: File Reference No. 2023- ED100

PRI appreciates the opportunity to comment on proposed changes to Topic 740 of the FASB Accounting Standards Codification®. Specifically, the PRI provides comments on questions 4 and 10.

PIRC supports the proposed amendments to Topic 740 and recommends that the FASB implement these proposals in full. We recommend FASB consider additional future amendments to meet the needs of investors concerning multinational enterprise income tax disclosures.

PIRC firmly believes it is in investors' best interest to better identify tax related factors that could present a downside risk and integrate those risks in evaluating companies' financial reporting and assessing the efficacy of companies' corporate governance. PIRC's clients are among the many investors globally who are increasingly interested in assessing the sustainability of entities' effective tax rates over time and the reasons for differences between effective tax rates and statutory income tax rates. We believe FASB's proposed changes will provide additional information to investors that will allow them to make more informed assessments and ultimately more prudent investment decisions.

The current disclosure regimes by the vast majority of multinational enterprises on income tax rate reconciliations and income taxes paid for foreign jurisdictions do not provide investors and other key stakeholders with too limited levels of data to allow them to effectively assess the enterprises' management of their taxes. FASB's proposed amendments would improve investors' ability to assess tax related risks and opportunities.

However, we believe investors would benefit greatly if these proposed changes were to be accompanied by disclosures on key jurisdiction-level information such as revenues and operating results on a similar level of disaggregation. PIRC believes more detailed disclosure requirements on income taxes combined with additional jurisdictional information related to a company's revenue, taxable income, and income tax expense (or benefit), enables investors to properly assess tax risks and opportunities in their portfolios through:

- understanding exposure to potential changes in jurisdictional tax legislation and the subsequent g risks and opportunities;
- assessing income tax information that affects cash flow forecasts and capital allocation decisions;
- evaluating the scale of operations in different jurisdictions, to identify the companies best prepared for upcoming regulatory changes and able to meet the challenge of increased scrutiny at the jurisdictional level;
- questioning companies where tax structures and strategies might not align with economic value generated and may lead to increasing risk exposure from challenges by tax authorities; and
- fostering more informed dialogue between corporates and investors.

Beyond FASB's proposal, PIRC supports country-by-country reporting (CBCR). Tax related risks and opportunities are present at the jurisdiction level. Investors' ability to properly examine risks and estimate future tax rates will be improved but will remain limited due to the lack of corresponding disclosures on other jurisdictional information.

PIRC disagrees with FASB's statement that CBCR *"is beyond the objective of general purpose financial reporting, which is to provide financial information about the reporting entity that is useful to existing and potential investors in making decisions about providing resources to the entity".* Increasingly investors, elected officials, tax authorities and some multinational corporations believe CBCR is relevant and useful data for investors that want to understand the tax implications of businesses operating in multiple jurisdictions.

FASB concludes that the costs of incorporating OECD-aligned country-by-country reporting in financial statements is significantly high because OECD-aligned CBCR data is not necessarily based on GAAP amounts. We understand the significance of these costs for preparers must be weighed with the needs of investors. Legislators have introduced mandatory public CBCR requirements in the European Union and Australia.

Question 4: For investors, would the proposed amendments to the rate reconciliation disclosure result in more transparent and decision-useful information? If so, how would that information help assess income tax risks and opportunities and how would it influence investment and capital allocation decisions? If not, what additional information about rate reconciliation should the Board require?

PIRC supports:

- the improved disclosures to the rate reconciliation; this will help investors gain a more transparent and meaningful look into a companies' income tax positions. Currently, most company reconciliations lack important detail making it hard for investors to understand the implications of different foreign tax rates and factors such as various tax credits and other tax advantages impacting the tax rate;
- the proposed specific reconciliation categories to enhance investors' ability to analyse and compare companies' tax reconciliations;
- the amendments to require separate disclosure of reconciling items by nature and by jurisdiction, based on a quantitative threshold of 5 percent, within the foreign tax effect category. Companies report an aggregate amount to account for the impact of differing foreign tax rates on their income tax reconciliation, but this only provides investors with extremely limited insights on the effects of foreign tax rates; and,
- amendments for business entities to provide an explanation of reconciling items impacting the rate reconciliation. The footnotes companies include with tax disclosures usually do not contain useful information and contain vague and incomplete information. In turn, investors are hampered in trying to make an informed analysis on entities' tax rates.

Question 10: For investors, would the proposed amendments to the income taxes paid disclosure result in more transparent and decision-useful information? If so, how would that information help assess income tax risks and opportunities and how would it influence investment and capital allocation decisions? If not, what additional information about income taxes paid should the Board require?

PIRC supports the proposed amendments on income taxes paid on a jurisdictional basis. These changes will result in more transparency and provide more decision-useful information for investors. The current aggregate information from companies regarding foreign income taxes provides far too limited explanations of their foreign tax rates and related adjustments. This is especially true for companies who make the bulk of their revenues and income before taxes. We firmly believe the proposed amendments will mean more substantive information for investors. We also support disclosures of additional jurisdictional information related to an entity's revenue, taxable income and income tax expense (or benefit) with the same level of jurisdictional specificity would increase the benefits of FASB's proposed changes for investors.

Conclusion
PIRC views FASB's initiative to require more tax related disclosures of U.S. filers as a welcome improvement. We believe it will better inform investors and other users of income tax data of the potential risks and opportunities stemming from the tax policies and practices of multinational companies. It is our hope FASB deems these improvements as an important step that must be followed upon to provide investors with the complete, comparable, and decision-useful information for which they have increasingly seek from multinationals. We urge FASB to consider requirements of publicly disclosed CbCR data for multinational filers.