ESG factors:

Tax is also in the spotlight

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The ESG landscape includes a complex and evolving set of standards, but what are these standards exactly and why are they important?

There is considerable discussion around the impacts of **environmental, social and governance (ESG)** factors on private and public companies with the introduction of mandatory and voluntary measures involving disclosures. This can impact companies of all sizes and across a variety of industries.

The ESG framework aims to integrate environmental, social and governance risks and opportunities into an organization's strategy to help develop a future based on sustainability, growth, and profitability. These factors can then be used by investors and consumers to assess a business based on its approach to these risks and opportunities.

Environmental

Examines performance as an environmental leader

Social

Examines how the business treats its employees, suppliers, and the community as a whole

Governance

Examines how the business regulates itself and is managed

Tax is an important consideration when building a comprehensive ESG strategy. The following outline breaks down each component of ESG and outlines how tax services can support the overall ESG plan.

Environmental factors

Tax legislation includes provisions and/or proposals to address environmental issues. Many ecofiscal measures and credits include significant compliance, reporting and certification components. These measures and credits may provide the business with the necessary financing (or cost reductions) to implement its ESG objectives.

The following are a few examples where tax departments can play an important role:

Environmental programs or measures	What tax departments will/may do
Tax rate reduction for zero-emission technology manufacturers	• Determine whether the business is manufacturing zero-emission technology. • If so, determine revenues relating to these activities.
Investment Tax Credit for Carbon Capture, Utilization, and Storage (CCUS)	• Determine if the business has eligible expenditures. • Complete a climate risks disclosure report. • Complete a knowledge sharing report. • Report the amount of eligible/ineligible CO_2.
Critical Mineral Exploration Tax Credit (CMETC)	• Identify eligible expenditures. • Obtain certification for eligible expenditures.
Air Quality Improvement Tax Credit	• Determine whether the corporation has eligible expenditures. • Complete Schedule 65 of the T2 return.
Refundable tax credit for the production of biofuel in Québec	• Determine whether the business has eligible expenditures. • Obtain certification from the Minister of Energy and Natural Resources.
Addition of capital cost allowance (CCA) classes for carbon capture, utilization and storage equipment, including eligibility for the Accelerated Investment Incentive	• Determine whether the business has acquired assets that qualify for these classes.
Addition of CCA classes for intangible exploration expenses and development expenses for storing carbon dioxide	• Determine whether the business has acquired assets that qualify for these classes.
Expand access to the accelerated CCA for certain clean energy equipment (Classes 43.1 and 43.2)	• Determine whether the business has acquired clean energy equipment.
Accelerated amortization for certain zero-emission vehicles	• Determine whether the business has acquired eligible zero-emission vehicles.
Fuel charge (carbon tax) and cap-and-trade regime (carbon market in Québec only)	• Determine whether the business is subject to either of these regimes. • Develop an internal carbon tax policy. • Register with the CRA. • Obtain an exemption certificate, if possible. • Calculate the charge, then prepare and file the return. • Make a joint election. • Keep records.
Canadian border carbon adjustments	• Public consultations are in progress. • These new rules could introduce other customs, reporting and audit requirements.

Social factors

Corporate social responsibility is increasingly important, including the way the public and investors view their operations and behaviour as corporate citizens. For example, a business could be more willing to “pay its fair share” of income taxes and apportion its global revenue base more equitably. There could also be greater board accountability regarding tax and transparency obligations.

The following are a few examples where tax departments could play an important role:

Social programs or measures	What tax departments will/may do
Provide equal pay for equal work to women and men (more inclusive, diverse, and equitable workforce)	• Understand the principles of deductible retroactive lump-sum payments. • Understand measures providing employee tax relief.
Tax on sugary beverages (since September 1, 2022, in Newfoundland and Labrador)	• Ensure application of and compliance with the new tax. • Update systems.
Implement the new tax on luxury goods	• **Purchasers of subject items:** take the additional cost upon the purchase of such items into account. • **Sellers of subject items:** register for luxury tax purposes and ensure that obligations are met.
New 1% tax on underused housing	• Be familiar with the tax and remain abreast of possible exceptions.
Prohibition on the purchase of residential property by non-Canadians	• Remain informed of possible exceptions to this new rule.

Governance factors

Responsible fiscal behaviour is now recognized as a key component of sustainable business. There are also many more disclosure and fiscal transparency obligations due to growing stakeholder demand (including tax authorities). How can tax departments manage these demands, and do they have the tools they need to meet these obligations?

The following are a few examples where tax specialists could play an important role:

Governance programs or measures	What tax departments will/may do
Calculating and publishing the business's effective tax rate (internally and externally)	• Develop an income tax strategy and a communication plan. • Identify individuals responsible for tax transparency in the business. • Maintain and produce appropriate, reliable, and specific financial data.
OECD BEPS 2.0: Pillar One - New profit allocation mechanism	• Closely monitor developments regarding OECD Pillar One implementation. • Model repercussions and assess the potential impacts of these new rules.
OECD BEPS 2.0: Pillar Two (minimum global tax)	• Closely monitor developments regarding implementation of OECD Pillar Two, which is to come into effect in 2023. • Under the proposed rules, model the repercussions and assess the potential impacts of this new tax.
Country-by-country reporting	• Determine whether the entity is subject to country-by-country reporting requirements. If so, file the appropriate returns within 12 months after the last day of the reporting fiscal year.
Reportable and notifiable transactions	• Determine whether the business is required to report certain transactions under the new federal rules governing reportable and/or notifiable transactions. • Document these transactions.
Specified transactions	• Establish whether the business is required to report some of its transactions under the Québec rules governing specified transactions. • Document these transactions.
Transparency of trusts	• Ensure trust complies with the new, stricter trust reporting requirements. • Gather information and maintain records.
Uncertain tax treatments	• Determine whether the corporation is required to comply with the mandatory disclosure of uncertain tax treatments reflected in the financial statements for taxation years starting after 2022. • Document uncertain tax treatments.
2022 Federal budget proposals for banks, insurance companies and pension plans	• Prepare for the new disclosure requirements regarding environmental, social and governance factors as well as climate change risks, starting in 2024.
New reporting requirements for RRSP issuers and RRIF carriers (2022 federal budget)	• Monitor the total fair market values of RRSP and RRIF accounts being administered.

Risk management

In establishing an effective ESG strategy, it will be important for a business to develop and incorporate internal policies and procedures regarding these new obligations as well as a stringent framework for managing tax risks. It is critical to adopt risk management policies that clearly identify the various risk owners. Who is held accountable for tax risks? Is a board-approved tax strategy or policy in place? If so, is it available and does it clearly outline the business's organizational tax approach? Is the strategy being implemented across all jurisdictions and are there mechanisms in place to ensure awareness and buy-in?

Automation

Given the growing demand for reports and data, it may also be a good idea to automate some compliance services/tasks. In an environment where more and more data is processed, this automation could help better meet demand while ensuring the quality of the information transmitted. Tax automation can streamline specific everyday tasks that can otherwise be time-consuming and repetitive. To name a few, automation could be used in such functions such as gathering data from several sources, generating jurisdiction-specific adjustments and reports, performing reconciliations, etc.

Tax technology

In today's fast-paced and complex business landscape, global tax transparency, real-time information sharing, and compliance management have become increasingly common and continue to be time-consuming. In the current and future tax department, transforming or modernizing the tax function through technology is fundamental. Through this transformation, the technologic tax strategy should include tax automation technologies and should aim to maximize the tax functionality of existing platforms. Altogether, this will bring new value to the business. Simply put, **constantly doing more with less is the name of the game.**

Several tax technologies, innovative software and improved data analytics are now available to help tax departments deal with regulatory changes, turn data into value and enable effective collaborations between functions in the business – a more holistic approach is key. Thus, tax technology tools can bring efficiencies, increase data accuracy, enhance transparency, and contribute to timely delivery. In addition, innovative technology can help support tax data management and contribute to minimize risks and manage exposure.

Conclusion

Tax management clearly forms an integral dimension of a solid ESG strategy. A business's action plan must therefore include tax transparency, a strategic approach to tax incentives and compliance with tax rules.

Should you have questions regarding your business's ESG strategy, contact us for more information.

Contact us

Pascal Martel

Partner in charge,
Tax, Quebec Region

514 840-2681
pascalmartel@kpmg.ca

kpmg.ca\tax

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