Part 1: The impact of ESG on private enterprises

Featuring Mike Linter, our Global Head of Private Enterprise Tax, KPMG International, Loek Helderman, Global Tax Lead, KPMG ESG, KPMG International, and Partner, KPMG in the Netherlands, and Shay Menuchin, Policy Lead for KPMG's Private Enterprise Tax Network, KPMG in Canada

Musical intro

Announcer:

Hello and welcome to another episode of ESG voices! This podcast series addresses the opportunities and challenges within ESG, through interviews with ESG specialists from KPMG and beyond. Throughout this series, we will discuss a broad range of environmental, social and governance issues, aiming to support governments, businesses, and communities in creating an equitable and prosperous future. With ESG topping leadership agendas around the world, and with much to discuss on the topic as it relates to private enterprises, this podcast will be part one in a two-part episode on ESG in the Private Enterprise Tax space. In both episodes, we will be joined by Mike Linter, our Global Head of Private Enterprise Tax, KPMG International, based in the UK. Loek Helderman, Global Tax Lead, KPMG ESG, KPMG International, and Partner based out of the Netherlands, and Shay Menuchin, Policy Lead for KPMG's Private Enterprise Tax Network based at KPMG in Canada. Thank you all for being here today. As ESG increasingly becoming integrated into business strategies. Private enterprises are presented with a big role to play. Mike, to start us off, can you tell us a bit about why tax is important in relation to ESG?

Mike Linter:

Absolutely. Tax cuts across all elements of ESG and particularly in the private enterprise space. We've talked previously on a podcast about how important reputation is to a private enterprise businesses. I think with a world of full transparency now and an expectation that the businesses will comply, I think taxes and actually every single part of ESG, we're in a world of actually increasing complexity. We've talked about the agility of private enterprise businesses as well, and obviously how their supply chains have changed over the last 12 months, over the two years of the pandemic. And I think what you're seeing is the fact that obviously tax being across every part of ESG for private businesses. You combine that with reputational focus. The fact that it's very, very important for them to be fully transparent, but also the added complexity I think we've seen from not only regulation and compliance, but also changing supply chains means that tax is actually relevant in all aspects of ESG for private businesses.

Announcer:

Thanks, Mike and Loek — can I get your thoughts on the same question?

Loek Helderman:

Yes, of course. And happy to give you my views and in particular sharing some of my experience when, when speaking and working with, with clients on this topic. As you will know, he stands for environmental, social and governance. And within each of these areas, tax issues have emerged and are relevant. And Mike already alluded to that. There are basically three areas of great interest today in terms of ESG, and there's probably more.

But these are, the, the three I would like to mention to highlight today's let's see importance, for large, multinationals, usually with a sizable in-house tax function, certain topics would be at the heart of these tax professionals already for several years, for instance, tax, governance, tax policy setting, country by country reporting and tax transparency in general. That is basically the first area I would like to cover, and we will probably talk a bit more about that in, in the rest of this podcast.

And this sits, in, in my view, in the S&Gs, so social and governance. For many companies, however, and even for many tax professionals, this is still new territory. Or they have just embarked on the journey recently where lots of challenges would still arise. In my view, this is maybe also true for private enterprise. This topic largely sits in the area of S&G.

As I mentioned, and I'm sure that also for private enterprise, this topic is getting more and more relevance when considering the E of environmental, which involves the environmental taxes, grants and incentives. This is probably the second area I wanted to highlight, and there is a lot of very relevant development in this area also for private enterprise for that matter, the EU Green Deal as a major example of such developments, with many new regulations being introduced in the coming period, we could probably touch on a few of these in a few moments later on in the podcast. It is important for companies in my view, to get in control of that responsibility and making sure that the companies position is being optimized and that risks are being mitigated. So this is about compliance as well as policy setting and maybe even planning a maybe the third area to cover. And I think Mike also alluded to this is the impact ESG will have on a company's supply chain. This is about the impact of a company's decarbonization duty on its supply chain in general and the associated tax and legal implications of any changes in the supply chain. In fact, this could involve a deep rethink of long established business models, which could include manufacturing processes, the technology being utilized, R&D investments, and the way materials and inputs in the supply chain are being sourced. An early adopter or for instance, no way circular manufacturing process and that's what we see with some companies will likely gain a strong competitive advantage and maybe shorten the path to to a net zero goal. And this will have many, many tax implications that must be addressed. For instance, direct indirect tax, people issues, international tax issues and transfer pricing and associated with the supply chain issues, and this decarbonization journey are the sustainable finance issues, the impact of this sustainability on the ESG, on, on, on the group's financing structure as well as M&A policies. There's, there's much, much to be discussed in my view.

Announcer:

Mike and Loek, thank you. That gives us some really good background as we head into the rest of the episode. So in what ways are you seeing private enterprises implement ESG into their business profiles? Mike, can we start with you?

Mike Linter:

Well, I think firstly, it's amazing how quickly that this has become a boardroom issue, I think for private enterprise businesses. Obviously, we've talked in previous podcasts how agile private businesses have been. Certainly historically, but also that's been accentuated through the, I think, pandemic. So obviously the businesses want to actually not only make sure they're complying as Loek actually describes is a very complex environment out there.

But I also think they actually want to actually demonstrate this as a competitive advantage in the fact that they're actually being agile, they're actually looking at their supply chains, they're looking at their governance. And I think they also want to actually be able to project this to the outside world, not only, I guess to their employees, and also that customers and further down in the supply chain. But I think also in the work in the wider world as well, that reputation is very important to them and I think we're seeing boards grapple with this and the fact that of course they want to do the right thing. But obviously the myriad of legislation we've seen and vastly changing supply chains is absolutely key to this. And obviously, I think we've got a really important role in actually helping them articulate that.

I also want to pick up on something that Loek also mentioned as well around capital and as well about how the banks and are responding. It's absolutely fundamental really in the fact that obviously access to capital and the rate that you actually have to pay for that capital are absolutely key. What's evolved I think now is obviously making sure as well that not only to the external marketplace, their customers, but also the that the bank is actually it's actually really important that ESG is actually being projected back actually when business is looking at to grow through acquisition and also through their day to day funding. So I think what we're seeing here is an environment that private enterprise businesses want to embrace for a variety of reasons. But I also think as well is that I think it's fast moving, it's mercurial at the moment. And I think what we're seeing is that those businesses reaching out for help and support in terms of not only to make sure that their compliant, but also to make sure that they maximize all the work they've actually done in this space and actually projected properly through not only their tax profile, but their relationships through their supply chain and also their bankers.

Announcer:

And Loek, do you have anything to add?

Loek Helderman:

Well, maybe not, not too much, because I think we will be covering a couple of other topics later on. And we already covered quite, quite a few, but maybe private enterprise, at least that is my experience, will be less vocal about the tax force here. Maybe the pressure for private enterprises is, is less than, for instance, listed public enterprises.

I'm focusing on said public interest companies in the Netherlands, and of course they have to comply with certain regulations around tax transparency. Still, in my view, companies have to be prepared and make sure that that you will be prepared for the questions, which might arise by the various stakeholders, NGOs, customers, even employees. And this may also be relevant for tax policy and behavior of private individuals as shareholders, as this will also impact the company's reputation and the brand's positioning. We've seen various newspaper articles on this subject during the last couple of years. So being prepared is, I think, very important also for private enterprise.

Announcer:

And Shay I'd love to hear your thoughts as well, from a tax policy perspective.

Shay Menuchin:

I think that, you know, Mike and Loek already mentioned that. We talked about it in a previous podcast. The key word is reputation. In general terms, the history is in line with BEPS initiative by increasing disclosure, transparency among businesses with the goal of leading to a greater accountability of businesses to their stakeholders. Customer, employees, and, of course, the public at large. This is connected with the need for businesses nowadays to ensure that they manage their reputational risk, both financial metrics, as we see in the case of country by country reporting, other tax disclosures and non-financial metrics, like in the case of ESG. Overall, it's a good start, I think, towards a more transparent and accountable business environment. BEPS and ESG are both highlight the need for businesses, public and private alike to develop and maintain their global reputational and ethical profile. That is the way that they would like to be perceived by shareholders, by customers, by employees. And as I said earlier, public at large and public at large is a very important group because this can affect many, many things, including their bottom line, as we saw in previous cases. And we're likely to see more a greater push for more disclosure, for more transparency from businesses and for demand for higher level of accountability in this respect, private businesses are usually not accustomed to have this level of disclosure, and they'll need to quickly adapt and work around their reporting mechanism, their identity, to be more transparent, to be more open to the public, to their employees, to customers and vendors. As Loek previously mentioned about the supply chain, it's not only customers. You also need to look at your vendors and the overall environment. And this is not necessarily a bad news for business, private businesses, because my view is that if they embrace the challenge, they can probably leverage on their connection to the local communities, their tradition, their history with the local communities, the fact they are private with more, let's say, loyalty to communities as opposed to large, multinational and try to basically shed some light on their good profile, to enhance their reputation, to enhance why they should be chosen as opposed to others, you know, competing in the same field when it comes to customers to, to employees, to vendors and like. So overall, I think that if private businesses take this as a as a challenge, as something that can take them to the next level, it can be very good for them in the long term.

Announcer:

From a tax perspective, the current environment gives private businesses the unique opportunity to review their tax affairs, from a social responsibility standpoint. What considerations should private enterprise leaders keep in mind to ensure ESG initiatives not only enhance their brand and underpins its reputation?

Mike Linter:

Yeah, absolutely. Building on what Shat and Loek have been saying, is that we are in a world of full transparency now. I think sort of interesting actually to see the lens that some people are looking at private businesses. We saw some of this during the pandemic with those businesses that have actually taken government support. For example, and that the scrutiny that they've been placed under. I think ESG will be the same. I think progression, I think of transparency and people wanting to actually see that these businesses have actually demonstrated to their local communities, their local, local businesses, environment as well. So I think the transparency piece is absolutely key. I also think is a real positive in that there is the fact that obviously the promotion and I guess projection in terms of how these businesses actually manage those affairs, how they've actually not only been compliant, but actually they've actually also had left a firm imprint in their local communities from things such as job creation, investment in new businesses, investment in energy transition. All of these things I think can be made actually embraced by private enterprise businesses to actually make sure that obviously they're actually not only the forefront of ESG and also the S of ESG, but also as well is the fact that they can actually make this a real differentiator for themselves. There is something as well that I do want speak about Loek.

The point that Loek and Shay both made and that's around developing a tax strategy, I think. Often we've always thought of tax strategies just being really those of big listed businesses, those with an under kind of more regular public scrutiny. But I think the thing about the celebration and creation of a robust tax strategy can really help private enterprise businesses as well. So I think actually demonstrating how it's investing in its employees, how it's investing in research and development, how it's actually investing actually in its supply chain to make sure that's compliance and ethical as well. So I think obviously putting all of that together, I think it's a great opportunity for private enterprise businesses to actually embrace the S in ESG and actually use that as a promotion tool for itself and its employees in the business community.

Announcer:

Thanks Mike and Loek with social responsibility top of mind for private enterprise, globally. it's important that private enterprise leaders review their tax affairs in light of the regulatory changes, requirements for tax transparency and the transformation of their businesses over the years. Can you tell us a bit more about how tax transparency, ESG governance and tax impact reporting can help to strengthen trust and build growth for private enterprises in today's environment?

Loek Helderman:

Sure. Also maybe touching on a few comments made by Shay and Mike for that. For that matter, to share this point about ESG being in line or has some similarities with the BEPS initiatives, I fully agreed. In fact, BEPS to a very large extent is all about ESG. It is ESG and it's all about a company's behavior in terms of its tax policy being a responsible taxpayer is, of course, important and a used terminology for that matter.

Of course, tax, governance and transparency is all about social awareness of tax and probably also about paying your fair share. Also a term that has been used very often in the last decade, so I would say. It is about an open and transparent dialog with all relevant stakeholders within the business, with your external stakeholder as your shareholders and in fact the society at large and is all about building trust, as Shay also mentioned. it is also a governance issue, tax being discussed at board level and again already for, for decades in the meantime and making sure that the tax is at the heart of a company's governance structure. How is tax being managed and who is responsible and accountable for having a tax control framework. This will also involve complying with mandatory and voluntary disclosure regulations. Set public CBCR which is coming at the World Economic Forum, metrics that are being used, the B-team approach and also GRI, the Global Reporting Initiative which has been used by many multinationals and will be used by private enterprise in the future, I'm sure as well. And these are very relevant examples in terms of, let's say, the transparency approach companies take. A relevant and related topic, for that matter, is the challenge to access relevant data to meet these compliance requirements. And that's really a challenge not only for ESG but also for the BEPS project that Shay was referring to. A subject of discussion with the finance function and the tax departments as well. And of course, it depends a bit on how the governance for tax has been organized within your company and this is usually involving disclosure of the total tax contribution of a company, and then extracting all that data from your company is quite a challenge for a large groups. And for many, M&Es even the larger groups, this is still a manual or semi manual process and ships data may be sitting in different systems with different business owners. And of course, you want to make sure that your disclosures will be comprehensive, exhaustive, and that you don't miss any item.

So a real challenge for companies. And as I mentioned, also for BEPS and Pillar two, that the global minimum tax standard that is going to be introduced, this also requires the extraction of data from your ERP system. So many of these, let's say, compliance issues will arise for companies in terms of that tax impact reporting approach or tax transparency approach.

Tax transparency, again, is all about responsible tax. As I already alluded to earlier, the policy for tax transparency reporting will have to be embedded into, in my view, the purpose of a company and being in line with the company's overall policy with regards to sustainability. Tax will, will not deal with it, with this on its own as part of the overall business. And for that matter, one has to be able to have the right narrative, as I would call it, in terms of, for instance, your country by country report the effective tax rate that you want to disclose, and as well the overall country by country total tax contribution of the company. So many issues in terms of tax transparency reporting for that better.

Announcer:

Great. Thanks, Loek. And that brings us to the end of part one in this two part podcast episode on private enterprise as it relates to ESG which originally aired on KPMG's own Future of Tax podcast series. Join us next week for part two, where we'll dive deeper into tax policy, strategy and growth and the challenges faced by private enterprises all through an ESG lens. Thanks for listening.

Musical outro

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