12TH ANNUAL NABE

TRANSFER PRICING SYMPOSIUM

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NABE

National Association for Business Economics

Potential Impacts on MNC Transfer Prices from Developments Related to Climate Change

July 20, 2022. 10.30AM – 12.00PM

Introduction
Overview

Environmental, Social & Governance (ESG) Developments

- Developments regarding carbon markets and taxes
- The rise of ESG Investing
- Increased disclosure requirements
  - SEC Disclosures
  - Tax Transparency

Transfer Pricing (TP) Implications

- ESG impact of required future TP disclosures
- Potential changes to TP economic analyses and pricing policies

Government and International Organization Perspectives

Introduction
Panel agenda

1. **Carbon Pricing: European Union (EU) and Global Landscape**
   - Carbon tax
   - Cap and trade
   - Border adjustments
2. **SEC Disclosures**
   - Internal carbon pricing and risk
3. **Tax Transparency**
   - Where tax and ESG meet
   - Tax transparency and reporting
4. **TP Planning Considerations and Opportunities**
   - Impact on TP models
   - Pricing questions regarding sustainability contributions
5. **Developments in International Organization and Government related to ESG and TP Matters**

Carbon Pricing:
European Union (EU) and Global Landscape

Pat Breslin – Breslin Consulting LLC

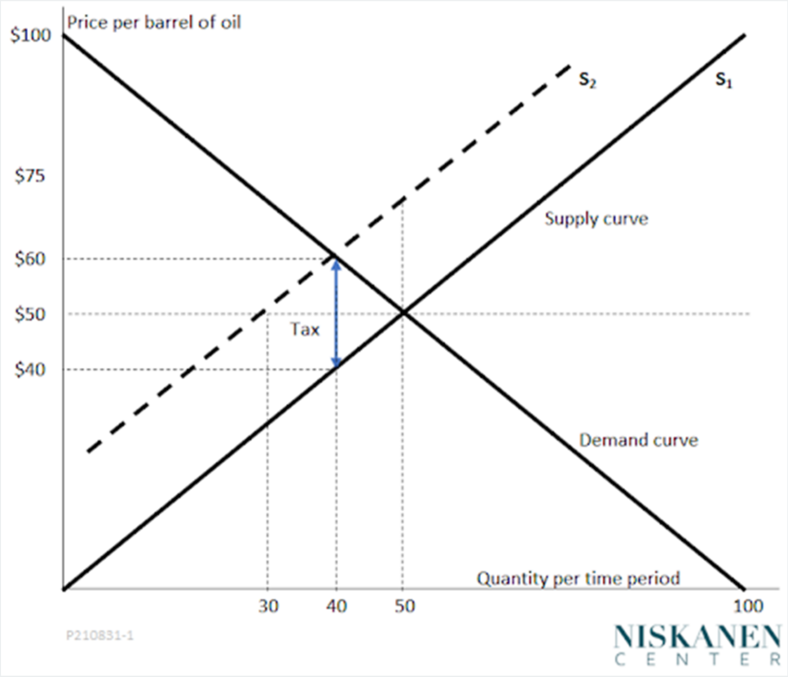
Carbon Pricing
Overview

Carbon pricing designed to measure and internalize the hidden costs of a negative externality

- Putting a price on carbon - purpose and measurement
- Carbon taxes (price approach)
- Cap and trade (quantity approach)
- EU and other jurisdiction examples
- Carbon border adjustment taxes (EU example)

Carbon Pricing

Carbon tax: "price certainty" approach



Hypothetical: "Effects of a Carbon Tax on the Market for Oil"*

1. Example assumes a tax of $50 per ton of CO_2 which converts to **$20** per barrel of oil
2. Before the tax, equilibrium price of a barrel of oil is $50, output produced is 50 million per day
3. Tax increases cost per barrel from $40 to $60, and supply is reduced (*See* S_2 *e.g.*, high-cost producers leave the market)
4. Tax lowers output (from 50 to 40 mil. barrels/day), increases price pressure, less dependent buyers choose substitutes
5. Allocative effects of the price (tax)? Who pays? (here 50/50 buyer and seller)

Authors: CO_2 price has demand- and supply-side effects on oil prices. But indirect effects quickly spread to other markets

*Chart and example source: https://www.niskanencenter.org/

EU and Global Landscape
Cap and trade: “quantity certainty” approach

- Quantity of CO_2 emitted capped to achieve < 2^oC rises in temperature
- “Cap” targets key sectors—incl. energy, transportation, industrial
- Firms allotted allowances (“free” or auctioned—varies)
- “Trade” results to yield an effective carbon price
  - Low-emitting firms with allowance surpluses sell credits to high-emitting firms
  - Low emitters become more competitive, lower-cost producers
  - High emitters’ costs increase; and they bid up carbon prices they must pay for
- Shift in supply curve mandated, but effect is similar to carbon tax (see example), given the resulting carbon price from trading

EU and Global Landscape

Carbon taxes and cap and trade: advantages, challenges

- **Carbon prices *equalize* marginal cost of abatement across firms and sectors**
- **Increase adoption of *lower cost abatement* solutions and technologies**
  - All firms face the same cost (advantage) for emitting (avoiding) a unit of CO_2
  - Low-emitting firms more competitive, high-emitters must recover their CO_2 costs
  - Low-emitting substitutes more viable (e.g., solar power, electric vehicles, new tech)
- **Challenges and how addressed**
  - Whether to tax or cap?
  - Point of regulation (for tax or cap)?: upstream , midstream, or downstream?
  - Sector-specific approaches reduce administrative burden of carbon taxes
  - Modeling the price (tax) or quantity (cap) needed for < 2^oC avg. temp. rise
  - Divergent pricing (e.g., government-set versus voluntary offsets).
  - Leakage?

EU and Global Landscape

International carbon market developments (EU, etc.)

- EU Emissions Trading Scheme (EU ETS)—largest carbon market since 2005; followed by California cap and trade system
- Carbon taxes also more common in EU countries, at national level
- *“Leakage”*: Each unit of CO_2 in the atmosphere affects all countries equally. CO_2 pollution is inherently global. Solutions (lack of?) often local, national, regional. Leakage impedes carbon markets’ success.
- EU plans to implement a “carbon border adjustment mechanism” (CBAM) to address leakage
  - Will tax imports produced below EU carbon standards
  - Tax will be consistent with avg. prices for tradeable credits for EU allowances
  - Will tax domestic (EU-based) firms that offshore production to plants operating below EU standards for CO_2 emissions, when reimporting into EU

SEC Disclosures

Jessie Coleman - KPMG

SEC Disclosures
Overview

The SEC's proposed climate rules are extensive, resulting in companies rapidly needing to address climate related risk leading to value creation

Low SEC Readiness

17%

of companies feel very prepared for SEC ESG reporting[1]

Increased Effort

78%

of companies believe SEC reporting will require more effort than current ESG reporting[1]

Strong Support for Climate Reporting

75%

of almost 600 respondents in the public consultation period supported some form of SEC-mandated climate disclosures[2]

Sources: (1) KPMG ESG Survey 2022; (2) Goldman Sachs

SEC Disclosures
Timeline

Illustration assuming an effective date of December 2022 for the final rule and a registrant with a December 31 year-end

DISCLOSURES

	FY 2023 Filed 2024	FY 2024 Filed 2025	FY 2025 Filed 2026	FY 2026 Filed 2027	FY 2027 Filed 2028
Smaller reporting company	None		Excluding Scope 3		
Non-accelerated filer	None	Excluding Scope 3	Including Scope 3		
Accelerated filer	None	Excluding Scope 3	Including Scope 3		
Large Accelerated filer	Excluding Scope 3	Including Scope 3			

ASSURANCE on Scopes 1 & 2

	FY 2023 Filed 2024	FY 2024 Filed 2025	FY 2025 Filed 2026	FY 2026 Filed 2027	FY 2027 Filed 2028
Large Accelerated filer	None	Limited assurance		Reasonable assurance	
Accelerated filer	None		Limited assurance		Reasonable assurance
Other filers	None				

SEC Disclosures
Disclosure requirements

SEC Proposed Climate Rule Disclosure Topics

Organizational Impacts	Climate-Related Risks & Opps	Proposed Time Horizon	Materiality Determination	Material Climate-Related Impacts	Carbon Offsets & RECs	Internal Carbon Price	Scenario Analysis	Board Oversight	Manage-ment Oversight	Process to identify, assess, manage, climate-related risks	Transition Plan	Financial Impact Metrics	Expenditure Metrics	Financial Estimates and Assumptions	GHG Emissions (Scope 1+2)	GHG Emissions (Scope 3)	Targets & Goals
Processes & Controls	Disclosure	Disclosure	Audit + Disclosure	Disclosure	Sometimes Required	Sometimes Required	Sometimes Required			Disclosure	Sometimes Required	Audit + Disclosure	Audit + Disclosure	Audit + Disclosure	Assurance + Disclosure	Disclosure	Disclosure
Methodology & Policy	Disclosure	Disclosure	Audit + Disclosure	Disclosure		Sometimes Required					Sometimes Required						Disclosure
Sustainability Strategy/ Business Resiliency	Disclosure			Disclosure											Assurance + Disclosure	Disclosure	Disclosure
Data & Technology	Disclosure			Disclosure		Sometimes Required	Sometimes Required					Audit + Disclosure	Audit + Disclosure	Audit + Disclosure	Assurance + Disclosure	Disclosure	Disclosure
Corporate Governance			Audit + Disclosure			Sometimes Required		Disclosure	Disclosure	Disclosure							Disclosure

Audit + Disclosure   Assurance + Disclosure   Disclosure   Sometimes Required

Tax Transparency

Amparo Mercader - PwC

Where Tax and ESG Meet

Tax has been largely absent from the ESG conversation. However, this is changing fast

1	The perception of tax has changed over the last few years. Huge public spending and rising budget deficits due to the Covid-19 pandemic have strengthened this process
2	ESG metrics are expanding to include taxes paid. Governments are increasingly using taxes, credits or incentives to change corporate behavior towards climate change goals (e.g., “Net Zero” pledges)
3	The public scrutiny on tax reporting is only increasing, with numerous proposals worldwide to not only broaden the data that must be provided, but also to a wider scope of stakeholders (e.g, Public Country by Country Reporting)

Deals:

Stakeholders are using ESG considerations including tax information to assess a company’s risks profile and strategy. These considerations are now integrated into a due diligence process for acquisitions and IPOs

Transparency reporting:

Being responsive to stakeholders and transparent about one’s tax strategy and tax contribution can help companies improve their reputation

Strategy and controls:

Companies should design and maintain processes and controls for tax reporting as they become an increased focus area for external auditors and tax administrations

Tax Transparency and Reporting

There are increasing calls on companies to be transparent about their tax affairs and to highlight how the taxes they pay relate to their business footprint

Common challenges for PLS companies:

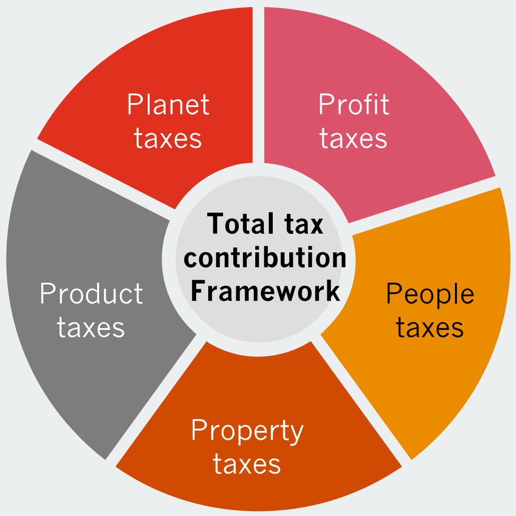
- Finding the best communication strategy to substantiate being “a good corporate tax citizen”
- Publicly available information that may be contradictory to their reporting

Total Tax Contribution (TTC)

TTC is a universal framework that allows companies to highlight their economic contribution to public finances and treasuries that:

- Reflects the total of all cash taxes and levies paid to government
- Makes a clear distinction between taxes borne, which are a cost to the company, and taxes which the company collects from others
- Categorizes taxes into five tax bases “the five Ps”

TTC framework - the five Ps



TP Planning Considerations and Opportunities

Perry Urken – Economic Partners LLC

TP Planning Considerations and Opportunities
Overview

Opportunities

- “ESG Hubs”

Potential considerations and challenges

- Challenges of quantifying income attributable to ESG contributions
  - Can ESG indices be reliably used as a tool for this purpose?
  - Quantification of forward-looking sustainability investments
- Viability of limited risk profiles for entities that make material sustainability contributions
- Potential impact of ESG disclosures on measurement of costs and liabilities used in TP policies

Developments in International Organization and Government related to ESG and TP Matters

Jose Andres Romero - IMF

Developments in International Organization and Government related to ESG and TP Matters

Let's begin with ESG TP matters….

- Should corporate income tax be considered as part of ESG investment?
- New perspective: Will the global taxation process continue in an ESG environment? and what is the future of TP?
- Future of business restructuring and aggressive tax planning in an ESG world

… Policy developments and public sector

- ESG assessment and investing practices are integrated within the risk analysis of the financial sector and the economy (i.e., Colombian Central Bank)
- Policy considerations to strengthen global ESG practices: 5 key areas
- Policy comments around carbon taxes, border carbon adjustments, carbon credits, and carbon caps
- Colombia as an example of a non-return journey

Appendix

Carbon Pricing: EU and Global Landscape

CO_2 Emissions by energy source and sector (US example)