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Aggressive tax optimisation: what is the best ESG approach?

RESEARCH STRATEGY & ANALYSIS

Document for the exclusive attention of professional clients, investment services providers and any other professional of the financial industry

About Amundi

Amundi is Europe's largest asset manager by assets under management, totaling 1.4 trillion euros[1], and ranks in the top 10[2] worldwide. Amundi offers a wealth of market expertise and a full range of capabilities across the active, passive and real assets investment universes to over 100 million retail, institutional and corporate clients in Europe, Asia-Pacific, the Middle-East and Americas.

Amundi considers that an asset manager's responsibility extends beyond the purely financial aspect, and has built into its investment policies not only financial, but also general interest criteria, namely environmental, social and governance (ESG) criteria.

Amundi's ESG analysis is thus based on the coverage of more than 5,000 issuers worldwide and on an engagement policy designed to support companies in their sustainable development strategy. Amundi has a strong expertise in implementing ESG solutions and actively supports collective initiatives for responsible practices.

Amundi believes no subjects or sectors should be taboo: the most sensitive themes need to be addressed. Thus, our discussion papers aim to shed the light on controversy and accompany companies toward best practices.

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[1] *Amundi figures as of September 30, 2017*

[2] *Source IPE "Top 400 asset managers" published in June 2017 and based on AUM as of December 2016*

Aggressive tax optimisation:
what is the best ESG approach?

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Abstract

Between 100 and 240 billion euro per year. This is what aggressive tax planning costs governments in lost revenue[1].

Such practices, designed to enable companies to avoid tax by using and abusing the legislation in place, have flourished in recent years. They have been supported by globalisation of communications and the growing dematerialisation of the economy. These practices have also become more complex and industrialised, with the help of tax advisory companies that are increasingly professionalised. Companies today are therefore encouraged to create financial flows that enable profits to be transferred to zones with tax advantages, for example by creating companies that hold patents or brands or by using asymmetry between local legislation to benefit from double non-taxation.

Although these practices are usually legal, the size of the amounts in question makes them increasingly unacceptable in a context of austerity. For governments as much as people. Aggressive tax optimisation practices therefore represent a risk for investors if international tax regulation changes. Moreover, this is exactly what is happening at the European level with, for example, the implementation of a package of measures designed to strengthen fiscal transparency, such as the Common

[1] *Policy brief "Taxing Multinational Enterprises BASE EROSION AND PROFIT SHIFTING (BEPS)", OECD, October 2015, https://www.oecd.org/ctp/policy-brief-beps-2015.pdf*

Consolidated Corporate Tax Base (CCCTB) or the fight against abusive tax rulings whereby companies manage, on an exceptional basis, to be subject to a particularly accommodating tax regime. Similarly, implementation of the conclusions of the OECD working group on base erosion and profit shifting (BEPS) should soon affect companies that use aggressive tax optimisation. Asset management companies should factor this risk into their investment decisions, as a fiduciary responsibility.

But taking these practices into account also raises moral questions. As a responsible management company, we should be interested in practices that mean companies benefit from a country's riches without paying their fair share, circumvent legal requirements to contribute to government budgets and thereby question the role of public bodies in setting taxation levels. It is worth noting here that the governments most affected by these practices are emerging countries as they cannot turn to income tax of physical persons to rebalance their income.

We therefore wanted to put in place a specific analysis criterion for this question. As with other criteria used to measure companies' Environmental, Social and Governance (ESG) performance, we used our data suppliers' ratings to create a consensus on aggressive tax optimisation. This criterion covers more than 2,000 stocks in our reference universe. If this criterion meets a best-in-class policy, like all ESG criteria used by Amundi, a best-in-universe calculation shows that the software and pharmaceutical industry sectors have the least good practices.

Finally, to put this criterion into perspective, we have developed an internal model to measure tax risk exposure, based on companies' presence in risky countries. We have also analysed statistically the media controversy on this subject. Although such approaches are limited by the quality of information available, they have enabled us to put in place a list of stocks that seem risky at first glance, to which we could then apply more detailed qualitative analysis.

Key words

Abuse of rights, BEPS, Dutch sandwich, Fiscal asymmetry, Fraud, Irish double, Tax base, Tax evasion, Tax haven, Tax optimization, Tax rulings, Tax treaties, Transfer pricing

Table of contents

I. Introduction p. 7

II. Tax evasion and tax optimisation p. 8

III. Tax optimisation methods p. 9

IV. The regulatory reaction? p. 14

V. What is AMUNDI's position? p. 16

VI. How can this risk be measured? p. 19

Discussion Papers list p. 23

I. Introduction

"For the maintenance of the public force, and for administrative expenses, a general tax is indispensable; it must be equally distributed among all citizens, in proportion to their ability to pay."

art. 13 of the Declaration of Human and Civic Rights of 1789

"Wanting to pay as much tax as possible is perhaps saintliness or heroism for some people; you could see it as a mental illness (which can be treated)".

Maurice Cozian

"I am very proud of the structure that we set up. We did it based on the incentives that the governments offered us to operate."

Eric Schmidt, Google Inc, 2012

"The phenomenon [of competition between countries] has intensified with the crisis. States preferred to keep businesses on their territory and increase taxation on household incomes and consumption"

John Christensen, director of the Tax Justice Network

Companies try to manage their resources optimally and maximise their profits. This involves developing their business but also managing their costs, including tax costs. This desire has led to a greater number and complexity of practices designed to avoid tax, on an unparalleled scale, particularly because of the growth and skill of legal firms specialising in tax planning.

Companies' techniques for shrinking their tax base and transferring profits are equivalent to lost revenue for governments of between 100 and 240 billion dollars, according to the OECD[2]. In the European Union alone, the loss to government budgets would amount to between 50 and 70 billion euro[3]. But the main victims of these practices are, however, developing countries that often cannot rely on household tax receipts and see the contribution of multinational companies to financing their public services fall.

Although tax planning practices are mainly legal, they are generally in a judicial grey area. They therefore represent a risk for companies, given current regulatory developments, which could undermine their organisation and lead to a potential risk for investors.

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[2] *Policy brief "Taxing Multinational Enterprises BASE EROSION AND PROFIT SHIFTING (BEPS)", OECD, October 2015, https://www.oecd.org/ctp/policy-brief-beps-2015.pdf*

[3] *European Commission fact sheet on the anti tax avoidance package, January 2016 http://europa.eu/rapid/press-release_MEMO-16-160_en.htm*

Furthermore, our role as a responsible investor means we cannot avoid the ethical debate on these practices, which could endanger economies and lead to the transfer of companies' public costs to households.

Through this study, we therefore wanted to understand what tax optimisation is (I) and the main methods used (II). Moreover, understanding how the regulatory context evolved to combat, or not, excessive practices in this area seemed interesting (III).

As taking these elements into account enables us to position ourselves in relation to this phenomenon (IV), we have been able to put forward a model to factor these practices into our ESG analysis (V).

II. Tax evasion and tax optimisation

We should distinguish between two distinct practices that still sometimes have a hazy border: tax evasion and tax optimisation.

Tax evasion is by definition illegal. It is a violation of regulatory rules and should incur a legal or administrative penalty. It can be defined as disguising income or elements of property to reduce the tax that would normally be applied. One particular method is to hold assets in countries that do not send the required information to the tax domicile of the ultimate beneficiaries.

A key question in combating fraud is therefore the availability of information and how countries or territories cooperate with information requests. Therefore, tax havens are characterised not by low taxes but by their lack of cooperation with other tax administrations and refusal to send the information needed to track down evaders. Lists of tax havens are not officially blacklists but lists of non-cooperative jurisdictions.

Moreover, the nomenclature used by the Financial Action Task Force (FATF) for countries on the «blacklist» of tax havens is «non-cooperative countries or territories» (NCCTs)». It is on this issue of tax evasion that banks have been called into question in recent years. Institutions have been accused of helping clients to hide their assets, generally using the transnational networks of private banking services. This support has gone from passive complicity, by simply closing their eyes to reprehensible practices, to active solicitation of clients in other countries to enable them to benefit from illegal tax evasion schemes (as the famous Swiss banks managed to do).

It can be noted that the legislation applicable to banks has been strengthened in recent years. We would mention in particular the Foreign Account Tax Compliance Act (FATCA) in the US that inaugurated the principle of automatic exchange of information between banks and tax authorities, which should make concealment operations more difficult.

Finally, insofar as it is an offence, a tax evasion operation now constitutes money laundering. All the monitoring requirements to which banks are subject for money laundering therefore apply to the question of tax evasion.

Whereas tax evasion is defined by its illegal nature, **tax optimisation** is developing in a grey area, full of nuances, which is often at the borderline of legality but tries to stay there. This study will look at these practices specifically.

They mean that companies, particularly multinational ones, can use the possibilities offered by various legislations to reduce their tax due, even if this involves reviewing their organisation, creating subsidiaries, putting in place financial flows, moving their headquarters... For companies, this is not simply about benefiting from tax measures designed to encourage investment or particular practices (the famous tax «niches») but about how best to organise their overall tax situation. The more complex and distanced from the corporate economic reality these operations become, the more aggressive the optimisation or planning is said to be.

We should bear in mind the legal notion of abuse of right whereby a tax administration can remove an arrangement that could only be explained by a desire to circumvent the tax rules that would normally apply. This is what French tax regulations use, for example (article L64 of the livre de procédure fiscale[4]). This simple notion shows the potentially precarious nature of complex arrangements. As their legality is sometimes tenuous, they therefore represent a risk for companies that use them.

III. Tax optimisation methods

By definition, there are multiple tax optimisation methods. As we have just seen, they usually involve setting up financial flows to make use of differences in treatment allowed by the tax agreements signed between countries. Whereas these conventions were originally designed to avoid double taxation, they will now be used to allow double non-taxation.

These mechanisms are generally therefore based around the following factors:

- Using transfer prices that have no economic reality or choosing to domicile intellectual property in low-tax countries,
- Setting up intragroup loans at high interest rates to transfer income,

[4] *"In order to establish their real nature, the administration has the right to remove, as unenforceable, acts constituting an abuse of right, either because these acts are fictitious in nature or because, seeking to profit from a literal interpretation of texts or decisions that goes against the authors' objectives, they could not have any other motive than to elude or lessen the taxes that the interested party, in the absence of such acts happening or being carried out, would normally have been liable to pay given their situation or actual activity."*

- Using tax asymmetry that allows double non-taxation,
- Using hybrid operations (operations that have different qualifications according to the country's legislation),
- Abuse of tax rulings.

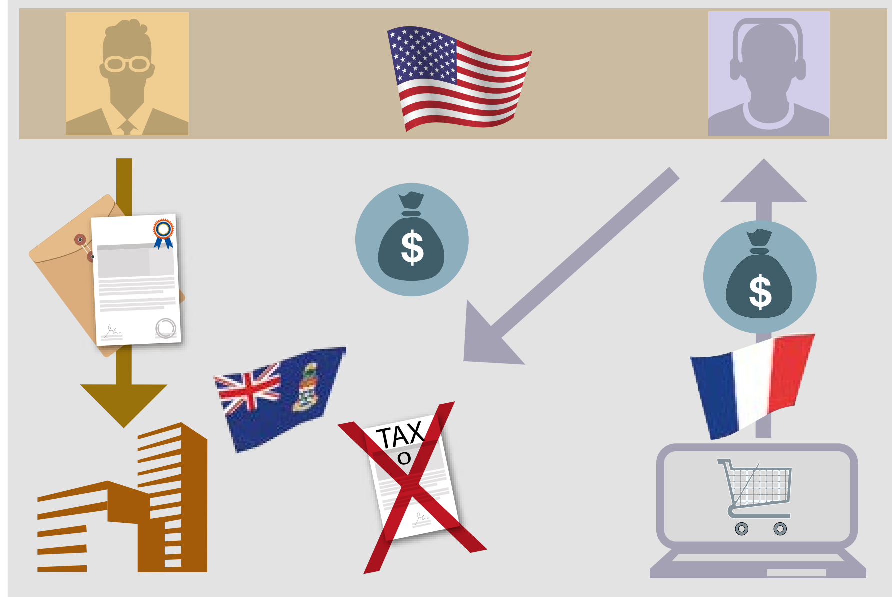
We will try to illustrate these complex arrangements through real examples that have been used by multinationals.

Transfer prices and patent boxes

The economy, as we know it today, is characterised by intensified dematerialisation. The price of goods and services is often less linked to manufacturing costs or the material used than to the research and development that enabled their creation and to their brand value. A tax optimisation strategy then involves domiciling these elements of intellectual property in low-tax countries. Group subsidiaries with significant commercial activities will therefore have to pay high fees to the holder of the patent or brand, so will not make a profit and pay low or no taxes in the countries where the goods are produced or the business activity takes place.

Use of «patent boxes

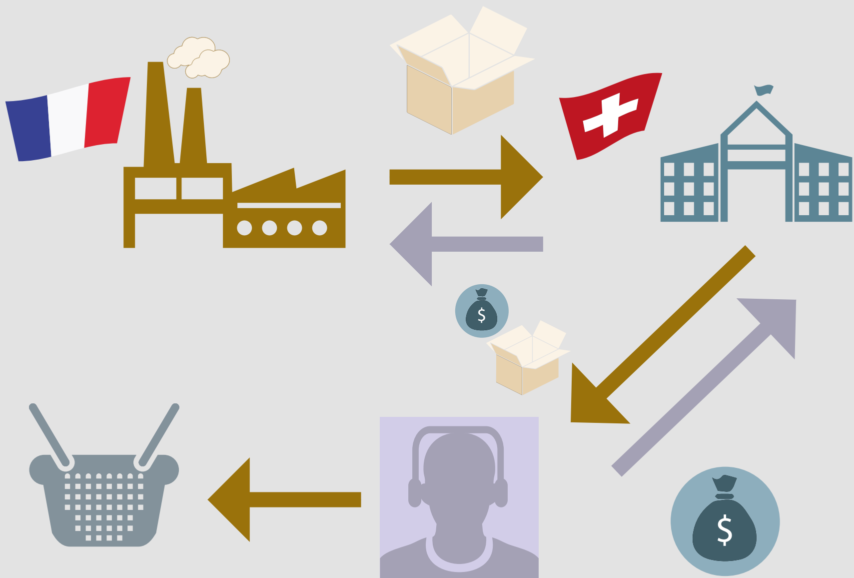
In this example, the US company has ceded ownership of its patents to one of its subsidiaries, domiciled in Bermuda. The company must then repay a significant part of its business income to this subsidiary in the form of royalties. Its income is therefore moved to a low-tax country.



The question of transfer prices has been illustrated in particular by the case of a large multinational company in the personal care goods sector that moved its headquarters to Switzerland. Its products were manufactured in France and sold back to the Swiss parent company without achieving the normal margins for the sector. It was the parent company that sold the products and made the profit. Similarly, the French sales teams made a limited profit of 2.5% although margins in the sector are usually 20 times greater. As the whole of the production and sales chain remained in France, virtual flows were put in place to return all the profits to the parent company in Switzerland, where taxation of corporate profits is lower than in France. Although the lost revenue for the French state totalled tens of millions of euro, it was impossible for the tax authorities to question the arrangement as such. However, the margins achieved by the factories and sales teams could be investigated, enabling tax to be recouped and the share to which French employees were entitled to be recalculated.

Use of transfer prices

After its transfer to Switzerland, the headquarters of the company buys the goods at cost price to its factory in France. A French structure dedicated to the commercialisation buys them in turn, at a much more expensive price and sells them with a small margin. This margin is then transferred to Switzerland.



This case shows the tax planning put in place by a company in the «old economy», but there are multiple possibilities if the product sold is an internet service. Companies can locate their patents in low-tax jurisdictions, even though no research and development activity has been performed there. The choice of location therefore depends solely on tax criteria and the status of tax agreements made by these jurisdictions. This is known as «treaty shopping». It should be noted, as this concerns US companies, that the US normally taxes financial flows to their subsidiaries at 35%. These companies, particularly by creating subsidiaries whose sole purpose is to hold patents, in low-tax countries, will therefore accumulate astronomical sums without being able to return them to the US and distribute them to shareholders. They will actually wait for politicians to decide on a «tax holiday», offering the temporary possibility of repatriating dormant amounts abroad without the usual taxes being applied.

Using tax asymmetry that allows double non-taxation

"True this side of the Pyrenees, a mistake beyond them". As tax is mainly a national matter, countries sign agreements with other countries to avoid double taxation. Countries are also free to interpret the legal nature of operations and the tax treatment applicable to a financial instrument.

Companies can therefore use asymmetry to benefit in each jurisdiction: tax paid by a subsidiary reduces its income but its Dutch parent company will not be taxed if this sum goes to a different country. This is the «Dutch sandwich» technique used by internet giants in particular. Similarly, securities can be subject to different tax regimes according to the country: debt securities in one country being transformed into equity securities in another, interest becoming dividends... Companies can therefore plan their organisation, debt etc. to benefit from such asymmetry. In France, they can organise themselves so that their set-up is not considered a permanent establishment that would involve taxation. The treaties which would normally avoid double taxation will then lead to double non-taxation that is just as questionable.

The notion of "permanent establishment"

The expression **permanent establishment**» generally refers to a fixed business installation with its own operations in France or a dependent agent in France with the power to commit the company.

This notion of permanent establishment is key to understanding whether industrial or commercial activities in a state or territory other than the residence of the moral person concerned are taxable in the place of residence or, conversely, in the place where the business is carried out.

For **corporation tax**, domestic law uses the notion of a «business operated in France». Three separate criteria characterise the habitual exercise of an activity:

- Running an establishment in France;
- Operating in France through a dependent representative;
- Conducting operations that form a complete commercial cycle.

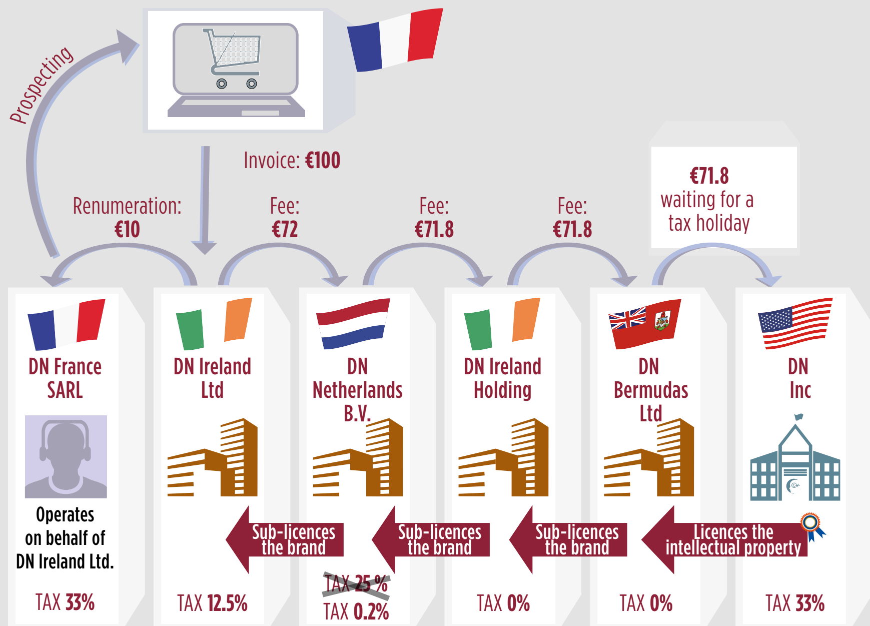
In **terms of VAT**, the notion of «permanent establishment» only applies to services and has the following characteristics:

- A sufficient degree of permanence;
- Structural human resources and technical capacity to enable services to be provided or used, as applicable

Source https://www.impots.gouv.fr/portail/etablissement-stable-en-france

Dutch sandwich and double Irish: tax structure

The tax structure described here uses the "Dutch sandwich" technique that permits to avoid taxes on repatriated profits if they go back to a country with which there is a bilateral agreement. This structure also uses the "Irish double" technique: incomes collected by an Irish company but intended to be transferred to a subsidiary domiciled outside Ireland, are not taxed. In this structure, the main part of the revenues derived from the sale of services to a French client are accumulated in a subsidiary located in Bermuda, without taxation, until a "tax holiday" law permits a repatriation to the United States."



Abuse of tax rulings

As tax matters can be particularly complex, it is sometimes helpful or beneficial to have the tax authorities confirm the interpretation of a rule or the propriety of applying provisions to a tax arrangement. This is the whole point of tax rulings, which therefore give some legal security through confirmation, which is then enforceable, of the tax treatment of a given situation.

This tool has, however, been twisted into a real tax exemption machine, whereby companies negotiate bilaterally with administrations the tax due if they set up in the country. The various jurisdictions therefore start commercial warfare using low taxes to try to attract multinational companies, with this tax leniency only applicable to them and not to other companies established in the country. Such abuse was part of the LuxLeaks affair: according to the revelations, Luxembourg's tax authorities signed dispensatory agreements with more than 340 multinationals to encourage them to set up in the Grand Duchy.

IV. The regulatory reaction?

Limitations on government reactions

As the sums in question are large, countries usually indebted and economic growth limited, governments are clearly tempted to react to this abuse by limiting undesirable use of the applicable regulation. Because tax is by default a national matter, governments might seem best placed to fight this.

In reality, their reactions are limited for two reasons. The first involves asymmetry between the regulatory framework and actual economic activity. National regulations and the competencies of the tax authorities and courts are by definition national whereas the parties with which these administrations must deal are increasingly multinational and these companies' attachment to one or several countries seems increasingly tenuous. Administrations are therefore incapable of taking suitable measures to limit the distorted effects of regulation, as optimisation often involves using several sets of national rules. There is also the question of the speed of execution: companies of whatever size show great reactive agility in their tax planning, as opposed to public bodies that must respect a sometimes long democratic process. Finally, in this cat and mouse game, the means at the disposal of the different players seem unequal, to the benefit of companies.

The second factor limiting states' activity in fighting aggressive tax optimisation is not technical but political or tactical. As mentioned above, there is strong competition between countries to attract companies. Although they do not pay much in tax, these companies will generate economic

activity, direct and indirect employment and, in short, tax receipts. States are their own worst enemy in the fight against tax optimisation, because they «preferred to keep businesses on their territory and increase taxation on household incomes and consumption», in the words of John Christensen, director of the Tax Justice Network.

Nonetheless, governments have managed with varying degrees of success to take measures to fight aggressive tax optimisation. An example is the reporting by country set out by the loi Sapin 2 in France, which required French companies to publish a breakdown of their activity and tax paid by country. However, the Constitutional Council sanctioned this requirement as a disproportionate constraint on business freedom.

European authorities prioritise free competition

Although tax regulations are usually a national matter, the European Union also has a say on aggressive corporate tax optimisation.

The role of the European Commission is to strengthen the single market, which can involve work to standardise treatment of crossborder operations within the Union. The European Commission therefore decided in 2015 to restart its work on creating a Common Consolidated Corporate Tax Base (CCCTB), first launched in 2011. This move aims to establish a single tax base for groups operating in various member states. An allocation system would enable revenue to be distributed by country, according to the company's business, so that a fixed tax rate can then be applied and paid back to each country. The distribution by country would therefore be based on three factors: capital, work and actual sales.

The European Commission is also working to ensure that a fair contribution is paid by the various economic players. Countries are still free to set corporate tax rates but abuse of tax rulings may mean there is not a level playing field for companies in terms of tax and therefore be viewed by the European authorities as a barrier to free competition. Based on this analysis, the Commission asked Ireland about the collection of several billion euro in tax from a computer giant, as the effective tax rate was seen as a subsidy in disguise. EU member states have also reached agreement on automatic exchange of information in relation to tax rulings, to avoid abuse of these.

The BEPS project, a real weapon against tax optimisation?

As aggressive tax optimisation practices are fuelled by asymmetry and competition between states, the most relevant level at which to fight the phenomenon is through international cooperation.

This is what the OECD and G20 tried with the Base Erosion and Profit Shifting (BEPS) project. Launched in 2013, 60 countries have actively participated in

technical groups set up as part of the project. Various regional tax bodies have also been involved.

This joint work led to a series of reports approved by all participating countries. In fine, 15 actions were agreed and should enable the potential for aggressive tax optimisation (or «aggressive tax planning» as it is described in the statement on BEPS actions) to be massively curtailed. These actions, which are both technical and pragmatic, therefore involve neutralising hybrid measures, limiting intragroup interests and stopping patents from being domiciled in structures with no real research and development centres. The goal is to give governments a real toolbox to combat aggressive tax planning and develop a tax collaboration platform: the BEPS inclusive framework that currently involves about one hundred states.

Updating bilateral tax accords to include these new elements can take some time. As a result, one of the actions was to create a multilateral tool enabling a large number of agreements to be changed by activating this tool. The first signature of this multilateral instrument was made as part of a ceremony on 7 June 2017.

V. What is AMUNDI's position?

To factor in the financial risks linked to such practices, in all their forms

Aggressive tax optimisation practices are not without consequences and involve various reactions that could represent a financial risk for companies. Our fiduciary responsibility as an investor requires us to include these risks.

One initial result of these practices concerns the **reaction of consumers**: as we have emphasised, taxes that are not paid by companies are in some way transferred to households. Consumers may feel betrayed by companies that seem to shirk their civic responsibility. This image risk can even result in product boycotts. This is actually what happened in the UK with the boycott of the Starbucks café chain in 2012, which forced the brand to review its tax practices. However, the importance of these boycotts should not be exaggerated as their success remains exceptional. Most large internet companies, for whom brand strength is vital, use aggressive tax optimisation schemes in an often unbridled way without really tarnishing their image.

The real reputational risk is therefore perhaps worse for the **financial community and tax authorities**. The growing number of investigations, reports, tax adjustments or disputes may therefore worry potential investors and affect the value of companies. The approach of tax departments is also hardening. The Indian tax authorities therefore seized assets of an international business in the hardware sector as part of a tax dispute, even

though the company had ceased operating. The buyer therefore could not access the factories and other buildings belonging to the company that it had recently acquired. These practices therefore harm companies' reputations and can undermine takeovers.

Companies' reputations ultimately alter the tax authorities' approach to monitoring operations. Disputes arising in one jurisdiction will alert the tax authorities in another jurisdiction, who will be stricter in their checks, and there may be a snowball effect.

The main short-term financial risk for companies is nonetheless the **risk of adjustment**. We have seen that optimisation practices are borderline in terms of legality and that tax authorities and European bodies have tools for calling into question companies' tax planning. The most striking example is the European Commission's decision to ask Ireland in 2016 to tax Apple at a rate it considered reasonable given the country's tax regime. The company was liable to pay a sum of 13 billion euro.

Over the medium term, risks linked to **radical changes to tax regulation** may be of concern. The case of the abandoned merger between Pfizer and Allergan, during 2016, was spectacular from this point of view. Although the transaction was set to create a pharma giant with Pfizer buying Allergan for 150 billion euro, the US administration's questioning of the tax treatment if the entity was entirely domiciled in Ireland (the target's country) changed the project's economics and led to its abandonment. But the change which should have greater repercussions for companies who use tax optimisation aggressively was born from international cooperation through the BEPS project. As we saw earlier, this project should fundamentally change the potential for tax optimisation. We can therefore question the real profitability of companies that currently use a set of optimisation techniques and will no longer be able in future to transfer their income to the country of their choice (according to its tax regime) and independently of the economic reality of their business.

However, the potential impact of these changes should be kept in perspective. Because on the one hand, the measures resulting from the BEPS project have not yet taken effect (and we know how tortuous and full of pitfalls the process of adopting regulations can be). And on the other hand, we can always rely on the tax ingenuity of companies and the legal tax specialists that help them. The effectiveness of measures taken in the wake of the BEPS project can only therefore be measured when they confront companies' actual practices... and their reactions.

Must we take a moral stance?

The ESG analysis that we are undertaking is based on the idea that the environmental, social and governance stakes ultimately have a material

financial nature and therefore affect the performance of companies in which we could invest for our client accounts. So it would be only our fiduciary responsibility that forces us to include these factors.

At first glance, a purely moral stance could seem difficult, as aggressive corporate tax planning is designed overall to stay within legal limits. Therefore, even if excesses sometimes breach legal limits, we could consider not condemning aggressive tax optimisation as such, and not including it in a negative way in our analysis.

But on further consideration, we see that we cannot do without such an approach.

On the one hand, it's a legitimate question for some of our clients. Just as several of them want to exclude from their portfolios the tobacco, alcohol, defence or fur industries (which are all completely legal), other clients including large pension funds want to factor the issue of aggressive tax optimisation into the ESG rating. We therefore need to offer them an approach that enables companies' performance on this question to be measured. Similarly, when we look at the serious issues that companies may face, we cannot overlook the full extent of the consequences and believe that if a fine (sometimes symbolic) is paid or an oil slick cleared up the controversy stops there. Our approach should go beyond simple financial measurement of the extra-financial risk. Some external factors (economic, geopolitical, climatic) are not yet captured today in financial indicators, but it would still be wrong to ignore them.

On the other hand, we should ask ourselves about our role as an investor and our wish to be a responsible investor. If taxes are usually compulsory, they are also necessary, above all. This is the sense in France of article 13 of the Declaration of Human and Civic Rights of 1789[5]. It is not up to individuals or companies to decide the amount, base or place where they should pay taxes. This is a legislative question. Undermining these principles (via practices that amount to an abuse of right or systematic use of asymmetry in rules leading to quasi-cancellation of taxes paid) therefore calls into question the role of the public sector. Finally, we can argue that companies benefit indirectly from the authorities' spending: it is easier for them to sell superfluous things to clients if the basics (security, education, health etc.) are provided. Without public spending, companies would not benefit from the social and economic framework that allows their development. Systematically avoiding taxes and refusing to pay their fair share therefore means companies do not participate in the emergence or maintenance of the conditions needed for their own development. A contradiction that is all the more intolerable for multinationals' aggressive optimisation practices in developing countries.

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[5] *"For the maintenance of the public force, and for administrative expenses, a general tax is indispensable; it must be equally distributed among all citizens, in proportion to their ability to pay"*

In this sense, companies with systematically aggressive practices from a tax perspective cannot be described as responsible and we should not only take into account the financial risk but also the moral stakes of this issue in our ESG analysis.

VI. How can this risk be measured?

Model based on our providers

To measure companies' performance on the issue of aggressive tax optimisation, we decided to create a dedicated ESG criterion to complement the existing criteria. For the record, Amundi's ESG analysis is based on a set of 36 criteria that are weighted differently according to their importance in the various sectors. The scores given on each one of these criteria are based in particular on the expertise of external extra-financial data suppliers in order to obtain several analysis points on the same company and same criterion.

On the question of aggressive tax optimisation, these suppliers offer data measuring in particular companies' transparency on these questions, the estimated difference between the effective tax paid and the amount that should be paid given their presence and controversy linked to tax practices.

Therefore, this new criterion means more than 2,000 companies can be rated using a best-in-class sectoral approach. It can therefore form part of the calculation of companies' ESG performance according to the sensitivity of these stakes in each sector.

We also thought it would be helpful to calculate this criterion without taking into account companies' business sector, to show differences in performance between the various sectors. This *best-in-universe* calculation shows that the worst practices are in the software and services, IT machinery and equipment and pharmaceutical industry sectors. This result can be explained in particular by the fact that these sectors are based on significant intellectual property (patents, intangible assets) that is easy to transfer between jurisdictions, which facilitates tax optimisation.

Internal model

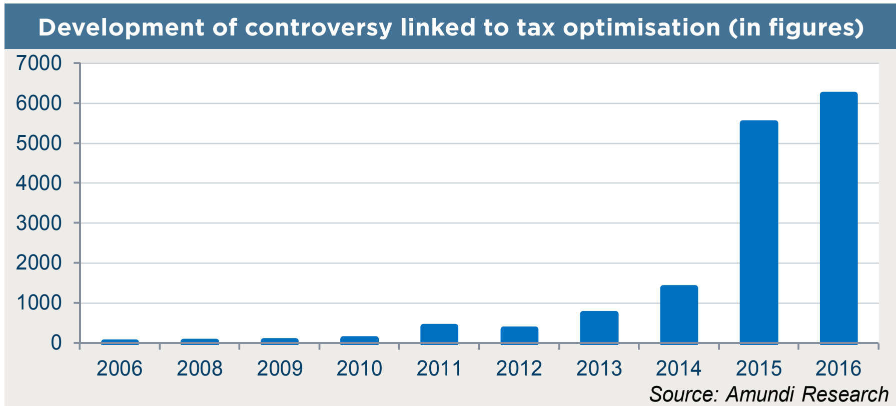
We then wanted to refine this criterion using an internal model that takes into account companies' exposure to aggressive tax optimisation and not elements of good or bad management as proposed in our new calculation criterion.

Such exposure analysis immediately raises the question of the quality and availability of data. We therefore used two approaches. The first was to analyse the media noise around issues of aggressive tax optimisation. The second used a company's exposure to tax havens as a risk indicator.

For media noise, using data from our supplier RepRisk, we put together a database of 800 newspaper articles published between 2012 and 2017 about controversy related to tax optimisation.

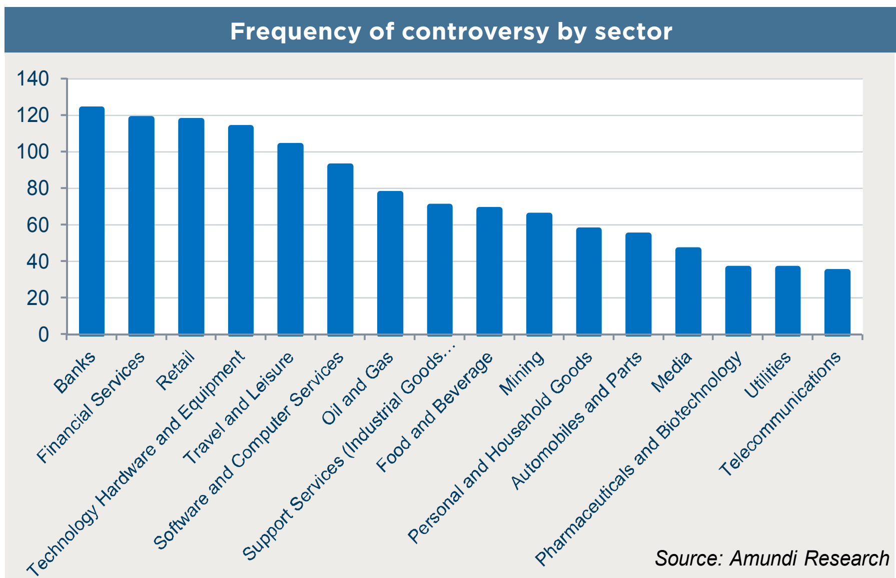
Statistical analysis of metadata associated with these articles enabled us to draw up a list of the most controversial companies on this topic.

We immediately see that the «media noise» around this question has significantly grown in recent years, supporting the idea that the issue is increasingly topical.



Source: Amundi Research

Moreover, our supplier's data enable us to measure the following exposure by sector:



Source: Amundi Research

Beyond media noise, we also wanted to evaluate companies' exposure in terms of their presence in tax havens. In the absence of consensus on a list of tax havens, we decided to use 3 lists with different sources from the existing ones:

- The «Moscovici» list: a blacklist drawn up in 2015 by the European Commission. 18 European lists of non-cooperative countries and territories were compiled and then reduced to 30 countries[6].
- The list used by Oekom, one of our suppliers of extra-financial data: this list includes 60 countries and territories.
- The list put together by the Tax Justice Network in 2009 that comprises around sixty countries and territories. This list was used in particular as part of the report titled «Sur la piste des banques françaises dans les paradis fiscaux» [7].

Although a large number (27) of countries and territories are systematically listed as tax havens, even more (30) only feature on a single list, which shows the absence of consensus on the question of tax havens.

We cross-referenced these lists against the geographic distribution of companies' revenue to estimate the share of activity produced in tax havens (in the absence of more precise data). We eliminated a certain number of false positives (companies that «really» had their headquarters in Switzerland or Singapore) by introducing an indicator of the concentration of the geographical mix, to produce a list of companies that are overrepresented in tax havens.

This list did not aim to automatically exclude issuers, but to suggest to ESG analysts a list of stocks to be verified qualitatively. In most cases, a logical explanation for this overexposure can quickly be found. Sometimes, it helps reveal local controversies that are not necessarily on our radar.

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[6] *http://www.lemonde.fr/economie/article/2015/06/18/la-liste-moscovici-des-paradis-fiscaux-fait-grincer-des-dents_4657400_3234.html*

[7] *CCFD-Terre Solidaire, OXFAM France, Secours Catholique –Caritas France, in partnership with the Plateforme Paradis Fiscaux et Judiciaires*

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