20 January 2016

FORTUM'S COMMENTS CONCERNING COMPETITIVENESS, CORPORATE TAX TRANSPARENCY AND TAX REPORTING

Fortum as a tax payer

Fortum is an international energy company operating in more than 20 countries. We have subsidiaries in 15 countries, including in the Nordic and Baltic countries, Poland, Russia and India. Our share is listed on the Nasdaq Helsinki, and our biggest shareholder is the State of Finland with around 50.6% ownership. In addition to income tax, we pay taxes related to production, employment and property. In fact, the corporate income taxes comprise only 20-30% of our total taxes borne. Focusing exclusively on them does not provide a true picture of the real tax payment or tax burden.

As a company operating in several countries, we are well familiar with the challenges related to the application of differing national tax policies and interpretations in an international business environment. In our experience, a clear, stable and predictable tax environment is a major driver for competitiveness and growth – both for companies and countries. This means, for example, transparency in decision making and smooth processes by law makers as well as tax authorities, which both reduce the need for lengthy disputes.

Reasonable taxation enables and attracts investments and creates societal wellbeing as a whole. It can and it should also support the achievement of energy, climate and environmental targets. On the other hand, constantly – and sometimes even retroactively –changing legislation and tax authorities' interpretations can seriously undermine the competitiveness of companies, consequently hindering their ability to invest and create jobs. Moreover, double- or even triple-taxation impedes the competitiveness of any country or company.

As taxation is always a consequence of business operations, our principle is to pay taxes in the country where the revenue has been generated, according to local legislation and regulations. Similarly, the tax management at Fortum always strives to seek solutions to business needs. We agree that aggressive tax planning and tax avoidance are negative issues; they should be addressed with well-designed policy tools to ensure that there is the right balance between tax-related objectives and the objective to create a sustainable investment environment.

We firmly believe that companies must become more active in explaining their taxation and tax management to a broad group of stakeholders. As a forerunner in corporate tax reporting in Finland, we have published our tax footprint on a voluntary basis since 2012 (including data since 2011) as part of our annual report. Since 2014 we have also applied the guidelines of the Ownership Steering Department of the Prime Minister's Office for the state-majority-owned companies, including country-by-country reporting on the most significant operating countries.

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Remarks on tax solutions that improve competitiveness and drive growth

The current public tax discussion in the EU has focused on the non-taxation, aggressive tax planning or even tax avoidance of some multinational companies. We stress the importance of balancing this discussion with a similar one on how taxation could be improved to drive competitiveness and growth of EU companies and the internal market.

Solution needed to multiple taxation

Multiple taxation is a significant challenge to the competitiveness of EU companies and EU countries alike. As a result of the varying interpretations or contradictory rulings of national tax authorities, companies operating in the EU may have to pay taxes on the same income in two or more countries. Appeals and legal processes can only be started after the taxes have been paid, and the processes are usually long and expensive.

We strongly support the initiative for an EU-wide plan of action to improve the predictability of taxation and to avoid double taxation. This applies both to tax-related legislation and interpretations and decisions of tax authorities. We also insist that national tax authorities should be required to mutually agree on the right taxation country before the company pays the taxes. Transparency and ex-ante interpretations of tax authorities in general together with well-established practises to deliver advance rulings in specific cases would be instrumental building blocks of a competitive tax environment, which benefits both companies and societies as a whole.

Internationally common rules

Re-launching the EU internal market project is a positive initiative to increase the EU’s competitiveness. One of the critical issues will be how to properly balance the protection of economic growth and competitiveness with the fight against aggressive tax planning.

On the EU level, it is essential that all legislation is prepared carefully and with sufficient impact assessment, taking also into account sector specific aspects. However, it is even more important to strive for international rules on taxation to maintain a level playing field for EU companies in comparison to other countries.

More active role for the EU Commission

In some EU countries taxes borne have become disproportionately high, even confiscatory. For example, in Sweden the real estate tax on hydropower plants and the nuclear capacity tax have made an otherwise competitive business unprofitable.

In line with EU's fundamental principles, the EU Commission can take an active role in cases where taxes borne become disproportionately high or when they have clear elements of state aid.

No discriminatory tax policies

In recent years, the implementation of more discriminatory tax policies has impacted the markets in some countries. In the energy sector, for example, some taxes target specific CO_2-free energy generation technologies, while other CO_2-free technologies both receive state aid or other subsidies and carry a much lighter tax burden. In Sweden, for example, the real estate tax on hydropower plants is much higher than that on solar or wind power, or any other power production technology, such as coal or gas.

The EU Commission should take a more active role against discriminatory tax policies. The recent cases concerning Fiat and Starbucks are two positive examples of the Commission overseeing that tax policies do not violate state aid rules.

However, it is important to distinguish the difference between comfort letters and advance rulings by national tax authorities. We believe that advance rulings are a useful tool for companies planning an investment, be it at home or in another country: Through such rulings, national tax authorities can provide guidance on the investment's applicable national taxes.

Remarks concerning corporate tax transparency and tax reporting (including country-by-country reporting)

- Increased transparency on corporate taxation is needed, with clarity and predictability as the guiding principles when planning new tax rules. A successful outcome will require thorough preparation and technical understanding of the tax system as well as analyses of all potential business impacts, bearing in mind the differences between industries.
- The goal should be to improve the understanding of taxes and tax contributions, and tax-related information published by a company should clarify the operating principles related to the company's taxation and tax management. Highly detailed reporting does not automatically lead to increased transparency and understanding of the total picture can get fragmented.
- Public tax reporting should concentrate on principles and policies that can be audited. This could be supported with relevant numerical data. This will create improved understanding on tax issues.
- All companies could be invited to report their tax policies and principles. Geographic reporting, if possible, could focus on the materially significant countries, to create clarity and to keep the work load at a reasonable level – especially for smaller companies.
- The main purpose for financial reporting is to tell about a company's business operations and its profitability within a certain reporting structure. Tax information should follow the same reporting structure – even though this could sometimes restrict or limit country-by-country reporting. However, tax reporting should never compromise business-sensitive or confidential information.
- International transparency principles on taxation are crucial in order to secure the competitiveness of EU companies against non-EU companies.

- Transparency should be reciprocal. Tax authorities also should be obligated to operate more transparently and to publish their operating principles and the tax policy guidelines driving their decisions in general, and provide rulings on specific cases based on pre-set procedures

Examples of concrete challenges in tax reporting – case Fortum

- We began to voluntarily report our tax footprint to improve both the internal and external understanding of Fortum as a taxpayer. Furthermore, we wanted to openly disclose and discuss the various aspects related to the taxation of multinational companies in general. Our tax reporting is based on the guidelines of the Ownership Steering Department of the Finnish Prime Minister's Office, which requires all companies that are majority-owned by the Finnish state to report their tax footprint. The goal of the guidelines is to enhance transparency. Each company can still decide on the materiality threshold.

- We report income tax information for our Finnish and Swedish companies and for the other companies as a block. Finland and Sweden are Fortum's main operative countries covering approximately 85% of Fortum's income and taxes borne. Furthermore, we report taxes borne and taxes collected by country and by type for the seven most materially significant countries, representing 97% of taxes.

- Our key tax indicators are: weighted average applicable income tax rate, effective income tax rate based on the IFRS accounting rules, including both paid taxes and IFRS taxes with timing differences, and a total tax rate, including total taxes and taxes for continuing businesses.

- To illustrate the allocation of income, we use two indicators: "Total taxes borne in relation to segment assets by location" and "Total taxes borne in relation to sales volumes." These indicators are reported for Finland, Sweden, and Other countries. In our opinion, these indicators illustrate the value creation in a capital-intensive energy business better than traditional indicators, which focus on net sales and number of personnel.

- It is challenging to develop indicators that are comparable between companies and industries, and there are no benchmarks for them. For example, there is seldom a connection between taxes borne and number of personnel.

- In large corporations, data concerning taxes, even income taxes, is split between different systems. Harmonisation, development and automation of accounting systems and routines are needed for tax transparency. Even the identification of taxes can be difficult due to national differences. The preparatory work for our first tax footprint report took us more than two years.

- In addition to income tax, we pay taxes related to production, employment and property. In fact, the corporate income taxes comprise only 20-30% of our total taxes borne. Focusing exclusively on them does not provide a true picture of the real tax payment or tax burden.

- Equally, the use of only numerical data and key indicators can be confusing and does not give a true and fair picture of our tax footprint, nor is purely quantitative data easy to compare to other companies.
- The effective tax rate is volatile due to mixed profits and losses. A change from a small profit to a small loss at the Group-level may move the effective tax rate from negative to highly positive, even if the taxes paid do not change materially.
- Zero tax or negative income tax most often illustrates a loss position rather than aggressive tax planning.