Why is Tax an important element of TCFD?

The Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD is applicable to all organisations and premium listed companies must report on a 'comply-or-explain' basis in the UK from 1 January 2021 – but what relevance does TCFD have in relation to Tax?

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Tax is an important element of the TCFD framework. Often off the radar for tax professionals, recognising the importance of Tax in the discussions around this new regulatory framework is key to creating a sustainable business model, improving market stability, and to ensure a fair transition into a greener future. We cover the connections between Tax and TCFD in this document.

What is the TCFD framework and why should it be adopted?

Although it includes narrative disclosures, the TCFD framework[1] is above all about disclosing and accounting for the financial impacts of climate change on businesses. As the understanding regarding the role of business evolves, attention grows on the policy of organisations from an environmental, social and governance (ESG) perspective.

Climate change is not only a long-term issue affecting companies in the future, it is one that needs consideration today. It is a challenge which brings uncertainty for investors, lenders and insurers around the world in understanding how companies will be able to adapt and thrive in the new world.

In that context, the TCFD was created by the Financial Stability Board to improve and increase reporting of climate-related financial information, improve transparency, and help inform better investment, credit and insurance writing decisions.

TCFD supporters now span 89 countries and nearly all sectors of the economy, with a combined market capitalisation of over $25.1 trillion – a 99% increase since last year.

In the UK, through Policy Statement 20/17, the Financial Conduct Authority (FCA) amended the Listing Rules so that premium listed companies (other than investment trusts) must report on a 'comply-or-explain' basis against the TCFD framework for periods beginning on or after 1 January 2021.

From a business perspective, climate-related disclosures and the TCFD recommendations help companies consider the impact of climate change and associated mitigation efforts on their strategies and operations. A company that communicates its climate resiliency to its investors will have a competitive advantage over those that don't – and Tax has an important role to play within this context.

The benefits of TCFD are reflected in the rapid growth, with disclosures increasing by 9% between 2019 and 2020 in comparison to 4% between 2018 and 2019, and 83 of the world's largest 100 companies now support or report in line with the recommendations.[2]

TCFD and Tax: why is it an important element?

One of the outputs from the TCFD work is a climate impact toolkit, containing a high-level scenario analysis, informing material climate-related and transitional risks and opportunities. Under the risk assessment, companies need to consider physical and transition risks. As part of the transition risks, policy and regulatory risks need to be considered and it is in this context that tax policy issues would be appraised.

Companies are undertaking rapid transformations and strategic shifts to adapt to the transition to a greener economy and Tax is likely to be one of the levers that governments will use to change behaviours. The tax function, therefore, needs to be involved in the implementation of the TCFD.

In order to accurately make TCFD disclosures and provide stakeholders with adequate information on their commitments, companies need to consider how tax will impact their model and forecast for future changes in tax policy.

[1] More information available in our 'TCDF: Where do I start?' guide, available at **https://www.pwc.co.uk/services/audit/insights/tcfd-guide.html.**

[2] Source: TCFD, 'Fourth TCFD Status Report Highlights Greatest Progress to Date on TCFD Adoption', available at **https://www.fsb-tcfd.org/press/fourth-tcfd-status-report-highlights-greatest-progress-to-date-on-tcfd-adoption/**.

We highlight three key areas which links the TCFD framework to Tax below:

The future tax landscape

1

The Tax landscape is rapidly changing to combat the challenges from climate change. Understanding the scope of the existing and new environmental taxes, as well as global fiscal policy, incentives and grants, is key to minimising climate-related risks, but also maximising climate-related opportunities.

At PwC, our team of specialists have created the Global Green Tracker to help businesses navigate through the increasingly complex taxation and incentives legislation, identifying global trends and keep track of enacted and substantively enacted changes in tax legislation and incentives on the horizon, to inform the assessment of the risks arising from changes in the environmental tax legislation to be modelled and reported under the TCFD.

The impact on supply chains

2

As new policies emerge to shift business behaviour to less carbon intensive activities, transfer pricing departments will need to consider:

a) How to identify and attribute value to ESG activities in an organisation;

b) the right pricing mechanism for those ESG activities; and

c) examine how changes on their supply chain will impact overall profitability and geographical split.

Building on c) above, understanding your value chain and the changes expected due to planet taxes, incentives and social responsibility will be important to setting the right strategy. Value Chain Transformation (VCT), in the future will need to incorporate these ESG elements to optimise product flow, processes and systems. Understanding factors, from carbon border taxation, technology to labour mobility, increases complexity.

Impairment of assets

3

Finally, we have the potential impact on tax attributes which are currently sitting on the balance sheet of companies. As climate change brings challenges and opportunities for businesses and they are forced to adapt to this new reality, an assessment should be made as to what happens to the realisation of those assets.

From an IAS 12 tax accounting perspective, deferred tax assets should be assessed based on financial forecasts in line with the remainder of the financial statements (e.g. impairment testing). As company TCFD scenario forecasts are adjusted for climate change, where territory profitability is reduced there may be tax attributes that can no longer be recognised.

In conclusion: what should businesses do next?

Firstly establish who within your organisation is going to take responsibility for identifying, collecting and forecasting carbon taxes/planet taxes/incentives and setting the strategic direction of the operating model for the organisation.

Any ESG tax strategy will need to be aligned with the overall tax and sustainability strategy of the organisation. Tax functions will need to dedicate time to connecting with the wider business and sustainability team.

Finally, embedding the above within the TCFD financial statements reporting as it is evident that organisations need to address not only the risks, but also the opportunities of climate change to tell their story.

Now is the time to act as it becomes more incumbent on companies to report their own sustainability performance. Our specialist teams at PwC can support organisations on the implementation of TCFD recommendations and disclosures, working together across different areas (including with our colleagues in assurance and sustainability) to achieve a successful transition to a sustainable future, helping firms with all aspects of TCFD.

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