SHAREHOLDERS for CHANGE

BAD CONNECTION

ENGAGEMENT RESULTS June 2020

Our engagement with European telecommunication companies on tax related issues

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INTRODUCTION

SfC - Shareholders for Change is a European investor network for shareholder engagement on ESG (Environmental, Social and Governance) issues. It currently has eleven members from seven countries and represents a total of over €25bn AUM.

One of the network's engagement priorities is "addressing inequality through the promotion and implementation of tax justice" (Point 12. of SfC's Charter of Values).

On 5 December 2018 SfC - Shareholders for Change published the report "Bad Connection". The report revealed a general lack of tax transparency at four major European telecommunication companies: Vodafone, Deutsche Telekom, Telecom Italia and Orange.

Except for Vodafone, none of the analysed companies published country-by-country data[1], as it would be recommended in order to address base erosion and profit shift-

[1] Country-by-country reporting (CbCR) aims to provide tax authorities with additional information on cross-border corporate structures.
Generating country-based reports for multinational enterprises and automatic exchange of their information is meant to allow the tax authorities to better review them.
Civil society organisations have long called for a disclosure of such information to the public, to have a public insight into basic information about where corporations do business and what they pay in taxes in the countries where they operate. This stance, backed by SfC, would help dissuade multinational corporations from shifting their profits to tax havens or low tax jurisdictions (conduits).

Telecommunication companies were cooperative but tax transparency remains an exception

ing by multinational enterprises. 18 months after the publication of the report this has not changed.

While Vodafone was certainly recognised as a leader in tax transparency, a large share of its 2017 profits (38%) were generated in two conduit jurisdictions (low tax jurisdictions), Luxembourg and Malta, where the group has just about 300 employees, out of a total 99,000 employees. This has not changed either.

For Vodafone's peers Telecom Italia, Deutsche Telekom and Orange, a similar analysis was not possible because country-by-country data were missing. However, the report identified intra-group transactions, involving conduit jurisdictions such as Luxembourg or Netherlands, that could result in profit shifting and tax avoidance.

As a result of the report, a number of questions on tax related issues was drafted and sent to all four companies and an engagement process was started. The engagement with each of the companies was done on behalf of the whole SfC network and led by individual SfC members:

- Friends Provident Foundation for Vodafone;
- Bank für Kirche und Caritas for Deutsche Telekom;
- Ecofi Investissements for Telecom Italia;
- Meeschaert Asset Management for Orange.

The current report presents the main results of the engagement process, that was terminated on the 22nd of June 2020, as planned. By that date, we were still awaiting a feedback from some of the analysed companies. If any company will answer and send more information after the publication of the report, we will publish any further information on SfC's website in due time.

MAIN RESULTS OF THE ENGAGEMENT

Vodafone, Deutsche Telekom and Telecom Italia were generally cooperative and engaged in a dialogue with SfC, while Orange was the "worst in class" and never replied to any question.

Neither Deutsche Telekom nor Telecom Italia committed to publishing country-by-country data (CbCR). Telecom Italia will take a decision on this issue but not in the short-term.

Although Vodafone is the "best-in-class" in terms of tax transparency, its disclosure of CbCR data evidenced an apparently more aggressive tax strategy compared to Deutsche Telekom and Telecom Italia (on the basis of the data provided by the two companies, following specific requests).

Vodafone is currently not exposed to relevant regulatory risk but would be indeed exposed to potential reputational risks, since its strategy results in significant tax revenue losses for UK and other countries, with an impact on their welfare systems. This doesn't seem to be the case for Deutsche Telekom and Telecom Italia, at least not to the same extent as Vodafone.

SfC engagement based on the "Bad Connection" report has been terminated on the 22nd of June 2020. However, two of the analysed companies (Vodafone and Telecom Italia) may still send further information after the publication of this report, while the unsuccessful engagement with Orange could possibly be taken to a new level with the submission of the questions at the company's Annual General Meeting in 2021.

TABLE 1 Summary of SfC's engagement with four major European telecommunication companies

Company	Issues	Dialogue	Results
Vodafone	Alleged aggressive tax planning and profit shifting to Luxembourg and Malta.	The company was cooperative and answered to SfC's letter and mails providing the requested information.	The company does already publish CbCR data but does not envisage to relocate some of its Luxembourg activities to the UK, as suggested by SfC. Its tax strategy appears to be more aggressive than that of Deutsche Telekom and Telecom Italia.
Deutsche Telekom	Request to publish country by country reporting data in the group's financial statements and clarify the role of its subsidiaries in Luxembourg, Netherlands and Cyprus.	The company was very open to dialogue and provided SfC with detailed answers. A conference call was organised with DT's tax managers.	The company does not envisage to publish CbCR data. Based on the provided information, all intragroup transactions are taxed in Germany and DT's tax strategy does not appear to be particularly controversial.

Company	Issues	Dialogue	Results
Telecom Italia	Request to publish country by country reporting data in the group's financial statements and clarify the role of its subsidiaries in Luxembourg, Netherlands, Ireland and Panama	The company was open to dialogue and provided SfC with detailed answers.	The company does not envisage to publish CbCR data, at least not in the short term. Based on the provided information, Telecom Italia's tax strategy does not appear to be particularly controversial.
Orange	Request to publish country by country reporting data in the group's financial statements and clarify the role of its subsidiaries in Luxembourg, Netherlands, Ireland, Singapore, Panama and UK.	The company wasn't cooperative and never replied to SfC's questions.	SfC will evaluate the opportunity to submit the "Bad Connection" questions at the company's Annual General Meeting in 2021.

THE "BAD CONNECTION" ENGAGEMENT WITH EACH OF THE FOUR ANALYSED COMPANIES

1. VODAFONE

A first letter to Vodafone was sent by SfC - Shareholders for Change, led by its UK member Friends Provident Foundation, on the 20th of February 2019. SfC asked Vodafone, among others:

- *to quantify the corporation tax savings which have resulted from Vodafone operating centralised funding and global services functions in Luxembourg, in the period 2001-2018, vis à vis the same functions being provided by UK affiliates subject to UK corporation tax.*

By choosing to structure centralised funding and global services functions out of Luxembourg, Vodafone has indeed taken away significant corporate tax revenues from the UK (and other countries) tax authorities.

Moreover, SfC asked:

- *to quantify what would be the business impact of transferring the functions currently performed in Luxembourg to Vodafone's UK affiliates, so that the profits associated with their activities are subject to UK taxation.*

The company replied on the 1st of March 2019, but did not answer to any question. Instead, it referred to its CbCR (Country-by-Country-Reporting), which was already known to SfC and had actually been the base for the network's analysis.

Vodafone is a pioneer on CbCR but its tax strategy may be more aggressive than its peers'

Asked again to answer SfC questions, the company replied on the 14th of March 2019, Vodafone specified that:

- *its Luxembourg subsidiaries have been reviewed in details as part of the settlement the company reached with the UK tax authorities in 2010 (where Vodafone paid £1.2bn to end a long-running dispute related to the level of tax it paid on its acquisition of Mannesmann in Germany, in 2000, our note[2]);*

- *the profits of the company's Luxembourg activities are fully taxable and are offset by historic losses of its Luxembourg subsidiaries (which are a consequence of the acquisition of Mannesmann, our note[3]);*

- *the corporate tax liabilities of the company's subsidiaries are not impacted by the location of its specialist group functions; the costs they incur for these activities would be the same regardless of where these activities are located.*

Following a review of Vodafone's answers and a debate within the network, SfC wrote to Vodafone again on the 3rd of June, recognising that the company is currently not exposed to relevant regulatory risk but would be indeed exposed to potential reputational risks, since its strategy results in significant tax revenue losses for UK and other countries, with an impact on their welfare systems.

Therefore, SfC asked Vodafone:

- *to consider a relocation of at least some of its companies in Luxembourg and Malta to the countries in which profits are actually generated (in particular the UK), in case this can be done easily and without significant costs for the shareholders in the short term;*

[2] See: *Financial Times*, Vodafone's UK tax bill falls 20% to £257m, 16 February 2017.

[3] Vodafone benefits from significant historic losses in Luxembourg due to impairment of investments (as a consequence of the Mannesmann operation), which offset profits allocated to Luxembourg's entities, so that limited corporate taxation is paid in Luxembourg.
These losses are significant (€19,6bn) and will ensure that, for the next few years, Vodafone will continue to pay very little tax in Luxembourg (See: SfC, "Bad Connection", December 2018, pag. 19).

- *to report about the costs for shareholders of this operation. How much would it cost to Vodafone to transfer the companies to the UK: a) from an operational point of view; b) in terms of lost tax advantages?*

- *to what extent the group has profited from any kind of public subsidies in the UK during the current Covid-19 emergency (furlough schemes, tax breaks and other measures), while paying taxes in Luxembourg for activities that, according to SfC, should be based at the company's headquarters in UK.*

On the 22nd of June, when this report was sent to press, Vodafone hadn't answered to SfC questions yet. SfC will publish any update on its website in due time in case the company will answer after the publication of the report.

2. DEUTSCHE TELEKOM

On the 15th of March 2019, Deutsche Telekom (DT) replied in detail to SfC's questions (sent on the 18th of February), offering the possibility of a conference call with "tax experts of the group". SfC had asked Deutsche Telekom to publish country by country reporting data in the group's financial statements and clarify the role of its subsidiaries in Luxembourg, Netherlands and Cyprus.

Bank für Kirche und Caritas, that led the engagement process on behalf of SfC, reviewed the answers and prepared the call with the company, which took place on the 24th of May 2019 and involved, among others, A-Level and B-Level Senior Tax Experts of Deutsche Telekom. SfC was represented by Bank für Kirche und Caritas, Etica Sgr and Fondazione Finanza Etica, supported by the taxation expert Tommaso Faccio (University of Nottingham, co-founder of Tax Justice Italia).

Deutsche Telekom gave answers to all of SfC's questions, explaining that all intragroup transactions are taxed in Germany except for some low value services. The company mentioned three main reasons for not committing to publishing country by country reporting data:

- high administrative costs;
- DT is already delivering CbCR data to the tax authorities. Making the data publicly available could lead to misinterpretation and false judgements;

- it doesn't want to put pressure on other German multinationals to publicly disclose CbCR data.

Deutsche Telekom explained that it has a tax policy, which is published in its Sustainability Report and tax issues are discussed at Board level once a year, during a reporting session. There are more regular meetings with the CFO: these would the most relevant meetings on tax issues at company level.

During the call, DT committed to sending more information on the subsidiaries T-Systems Nederland B.V. and GTS Ukraine, which it did on 19 July 2019. Following a discussion within SfC, the engagement with Deutsche Telekom was terminated at the end of July 2019.

3. TELECOM ITALIA

A first letter to Telecom Italia (TI) was sent on the 20th of February 2019, asking the company to publish country by country reporting data in the group's financial statements and clarify the role of its subsidiaries in Luxembourg, Netherlands, Ireland and Panama.

The company replied on the 15th of April 2019, explaining that it does not publish country by country reporting data since "it is not legally bound to do so". Telecom Italia would be willing to evaluate to publish some items referring to this information "in the next group financial statements". In any case, a decision (in whatever direction) on this topic "will be taken at a later stage".

The company clarified the role of its subsidiaries in the four conduits mentioned above, explaining that "the presence in the mentioned jurisdictions was, and is still driven by sound business, and/or financial reasons". Profits reported by the companies based there would be "subject to a fair level of taxation".

In a further e-mail to the company, sent on the 30th of March 2020, Ecofi Investissements, that lead the engagement on behalf of SfC, asked more information on what the company meant with "fair level of taxation", asking to specify the percentage of revenue from related parties generated by three TI's subsidiaries respectively based in Panama, Luxembourg and the Netherlands.

The company replied on the 9th of April 2020, providing Ecofi Investissements with the requested information.

A further mail was sent by Ecofi Investissements on the 7th of May 2020, asking for more details on the subsidiary Telecom Italia Finance SA Luxembourg that would not be paying any corporation tax "because of previous tax losses". Ecofi asked how those losses were generated and when and how much losses would be still available in the subsidiary for the future.

On the 22nd of June, when this report was sent to press, Telecom Italia hadn't answered to SfC questions yet. SfC will publish any update on its website in due time in case the company will answer after the publication of the report.

4. ORANGE

In a letter sent to Orange on the 20th of February 2019, Meeschaert Asset Management, that lead the engagement on behalf of SfC, asked the company to publish country by country reporting data in the group's financial statements and clarify the role of its subsidiaries in Luxembourg, Netherlands, Ireland, Singapore, Panama and UK.

Despite several reminders by Meeschaert Asset Management, Orange has never replied to SfC's questions.

Meeschaert AM will evaluate the opportunity to submit the same questions at the company's Annual General Meeting in 2021.

Orange never replied to our questions. The engagement could be submitted to the next AGM

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