

# Proxy Perspectives

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## Shareholders target board oversight of company tax strategy

Tax related issues are among the top reasons for financial restatements. Shareholders are focusing more on risks arising from a company's tax policy, requiring the board to become more familiar with a company's overall tax strategy.

### Boards prepare to deal with new shareholder proposal

A new shareholder proposal for 2011 requests disclosure of board oversight of risks arising from a company's tax strategy. To date, the non-binding proposal, sponsored by a labor pension fund, has been submitted to six companies.

The targeted companies are challenging inclusion of the proposal in proxy statements primarily on the grounds that corporate tax matters fall within the scope of a company's ordinary business operations; the SEC has allowed for omission in one case and is likely to take a similar stand on the other challenges.

Shareholder proposals provide insight into coming trends, and as such, boards should consider tax strategy and related risks on their growing list of operational risk areas that require board oversight.

### Overview

- ▶ The American Federation of State, County and Municipal Employees (AFSCME) pension fund has submitted for inclusion in target companies' proxy statements, a proposal requesting disclosure of the board's assessment of the risks created by a company's actions to minimize or avoid corporate income tax.
- ▶ While it is too early to predict the future of the "tax oversight" proposal, directors should become more familiar with the risks associated with a company's tax strategy, and be aware that disclosure of board oversight in this area could well become a shareholder-driven governance issue in coming years.

## The proposal asks

" Resolved, that the shareholders of [Company] request that [Company's] board of directors annually assess the risks created by the actions [Company] takes to avoid or minimize US federal, state and local corporate income taxes and provide a report to shareholders on the assessment, at reasonable cost and omitting proprietary information."

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## Background to the proposal

- ▶ AFSCME believes that a company's approach to taxation can create several distinct risks for share value, from the overall impact on financial results to an increased likelihood of financial restatements. It believes that companies that rely on tax avoidance practices could be exposed to greater risk and decreasing earnings and that such practice may be indicative of other "harmful" conduct.
- ▶ AFSCME argues that greater disclosure of board oversight of a company's tax strategy may dissuade companies from pursuing aggressive tax strategies that exacerbate shareholder risk.
- ▶ AFSCME is also concerned that aggressive tax planning will worsen the fiscal deficits facing state and federal governments, an argument that some say demonstrates the fund's conflicting agenda.
- ▶ To gain better insight into risks arising from a company's tax strategy, AFSCME has targeted six companies so far in 2011 – Amazon.com, The Home Depot, Lazard Ltd., Pfizer, TJX Companies and Wal-Mart Stores, Inc. with its non-binding proposal.
- ▶ All six companies have filed with the SEC their intention to omit inclusion of the proposal from the proxy statement, arguing that:
  - ▶ Tax matters are a day-to-day operational issue
  - ▶ The proposal is an attempt to engage the company in a political or legislative process
- ▶ The SEC's response to Lazard's challenge, in which it states it will not take enforcement action if the company omits the proposal from its proxy materials, indicates its belief that the proposal, in current form, falls under ordinary business operations, noting it relates to "decisions concerning the company's tax expenses and sources of financing."
- ▶ AFSCME was an early promoter of "say-on-pay" and is associated with advancing the current form of proxy access.
- ▶ While we expect that the "tax-oversight" shareholder proposals will not be a significant issue in the 2011 proxy season, it is important to make note of the development as shareholder proposals shape trends, create market practice and often guide future legislation on governance matters.