Consumer products sector: Global tax rate benchmarking report

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About the study

In this study, we report on the findings from our analysis of key tax ratios of 55 large companies in the global consumer products market. The analysis provides insight into the effective tax rate ("ETR") and current tax rate reported by these companies, the trend over the last three years, and drivers of the ETR. The study uses publicly available data for the three years up to June 2013, sourced from data providers and individual company accounts. By using publicly available information, we can include any listed company, which gives us good coverage of the sector from which to identify trends.

The companies in the study are spread across a number of subsectors: beverages (10 companies), household products (11), food products (17), textiles, apparel & luxury goods (13) and tobacco (4). Geographically, the companies span the globe with a bias towards US headquarters (23 companies), but also including the UK (6), France (4), Italy (4), China (4), Switzerland (3), Belgium (2), and 1 each from Brazil, Denmark, Germany, Hong Kong, Japan, Netherlands, New Zealand, Sweden, Taiwan.

Table of contents

Executive summary: With tax at the forefront of debate, companies need to know where they stand

The global tax system has been the subject of much debate in recent years and never more so than in 2013.

Fiscal deficits around the world have led to increased scrutiny of taxes paid by large corporations, and civil society organizations have run high-profile campaigns using new media to put out their messages. While tax planning may comply with the letter of the law, it may be seen by some as not operating within the spirit of the law; overseas tax havens have come under particular criticism.

The debate has been particularly fierce in Europe, where a number of multinationals have tasted the bitterness of public opinion. One UK CEO recently argued that tax is a "moral" issue, and that companies should be evaluated by consumers based on how much they put back into their communities — while others believe that good governance requires protecting shareholder value by not paying more than is legally required, and that once laws are complied with there is no second standard.

Until or unless governments step in with further anti-avoidance laws, multinational companies will make choices as to how to pursue their business goals in light of these issues. What is clear—is that the issues surrounding tax and increasing tax burdens are no longer issues confined to the tax department. Our 16th Annual CEO survey found that 62% of CEOs were worried about the tax burden, which was considered to be the top business threat to growth.[1]

In this new world of debate and scrutiny over tax affairs, it has never been more important for a tax professional to understand how the tax affairs of the business compare to other companies in the sector. Heads of tax and CFOs must be prepared to explain and justify their company's effective tax rate (ETR). As such, they must understand the spread of ETRs in their industry, identify the drivers for the rate and be able to assess their position against the ETR trends of their peer group. What's more, they must also understand how the business footprint impacts the tax profile and tax expense. So while the average effective corporate tax rate in the US is around 35%, companies with more international footprints tend to pay taxes well below that, partly because of their ability to locate manufacturing plants in low-tax countries, or because a large percentage of their volume comes from low-tax countries.

Our study of key tax ratios in the consumer products sector found that the average three-year ETR for the large companies in the sector was 25.1%, remaining constant over the three years. One of the most significant factors influencing the ETR was foreign operations, which had an overall favorable impact on the ETR of 2.8 percentage points, consistent with the finding that the ETRs of domestic companies were on average 6.8 percentage points higher than the

1 http://www.pwc.com/gx/en/tax/publications/ceosurvey-tax.jhtml

ETRs of multinational companies. The most significant factor driving down ETRs overall was tax incentives, with net unrecognized tax losses the most significant factor driving ETRs up.

Focusing on US-based companies, the three-year average ETR was 27.3%, four percentage points higher than the three-year average for non-US-based companies. US companies disclose unrecognized benefits (tax positions that are uncertain but are “more likely than not” to be sustained), and we found that these had decreased by 5% between 2012 and 2013. In addition, unrepatriated earnings (income earned and considered to be permanently reinvested outside the US) have increased, by an amount equal to 7.8% of 2012/2013 income before tax.

This benchmarking study sets the context for your company’s tax profile and, we hope, will inform tax strategy and board-level conversations.

1. Tax rate benchmarking for the consumer products sector

The global consumer products market faced a challenging economic environment in 2012/2013. With the continuing recession in southern Europe, slowing growth in China, unrest in Middle East, and persistently high unemployment in the US, companies invested to generate revenue and control costs.

Investment in the revenue line came in the form of market research, focusing on a small number of key brands and overseas customers. Marketing drives launched new brands to new markets, and customers were more efficiently targeted via digital media. In order to differentiate products in an ever more competitive landscape, companies invested in research and development. The result was sales growth, typically in the emerging markets, with the developed markets showing less growth. Rising and volatile costs in the year were challenging, but inventory and supply chain management helped to control costs.

Megatrends, such as aging populations, climate change and urbanization, will continue to have an effect on corporate taxes. The shift in economic power to emerging markets may mean that governments increasingly use tax breaks as an economic lever. Aging populations in mature economies are putting governments under pressure to raise taxes to fund social programs. Solutions related to climate change and resource scarcity will require regulation and potentially tax incentives or disincentives.

All these factors make tax an increasingly significant business cost to be managed, and ETR benchmarking can be a useful tool to provide insight into this significant cost.

1.1 ETR in the consumer products sector

The ETR is the tax provision as a percentage of income before corporate income tax, as taken from the face of the income statement. It provides a basic indicator of the impact of tax on results.

$$\text{ETR:} \quad \frac{\text{Income tax provision}}{\text{Income before corporate income tax}}$$

We calculated a trimmed average ETR, excluding extreme values from both the top and bottom of the data set. The upper and lower quartiles represent the resulting ratios for which 75% and 25% of companies fall below that point, respectively (see Appendix 2 for further explanation).

Figure 1: Effective tax rate for all companies

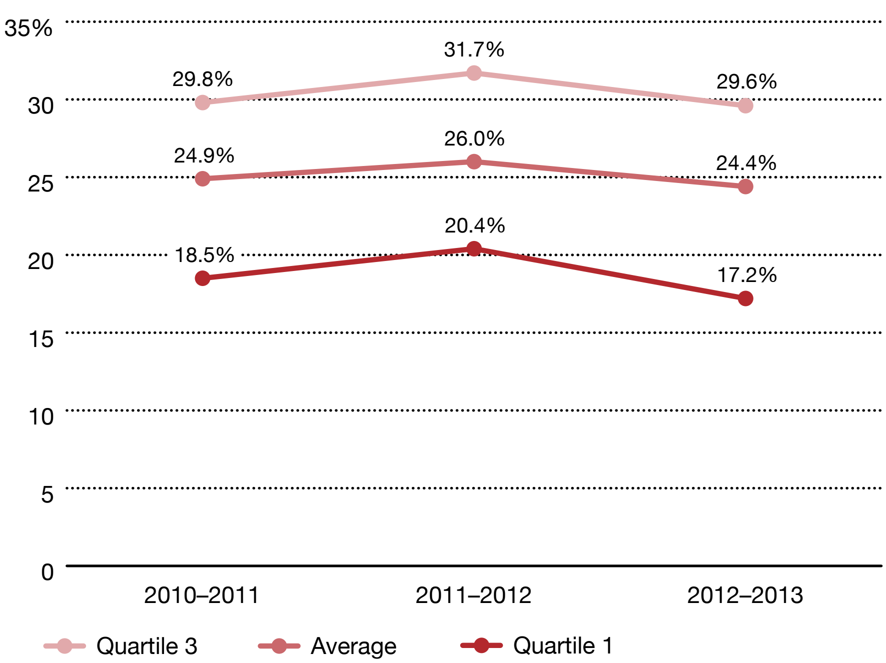


Figure 1 shows that the average three-year ETR of companies in this study was 25.1% and remained broadly constant over the last three years.

Over the period of the study, the number of companies reporting tax losses and tax benefits were similar due to losses in this sector, (two companies in 2010/2011 one in 2012/2013), and there was only minor volatility between quartiles. Four companies had a reduction in the ETR of greater than 10 percentage points, and four companies had an increase in the ETR of greater than 10 percentage points over the three years.

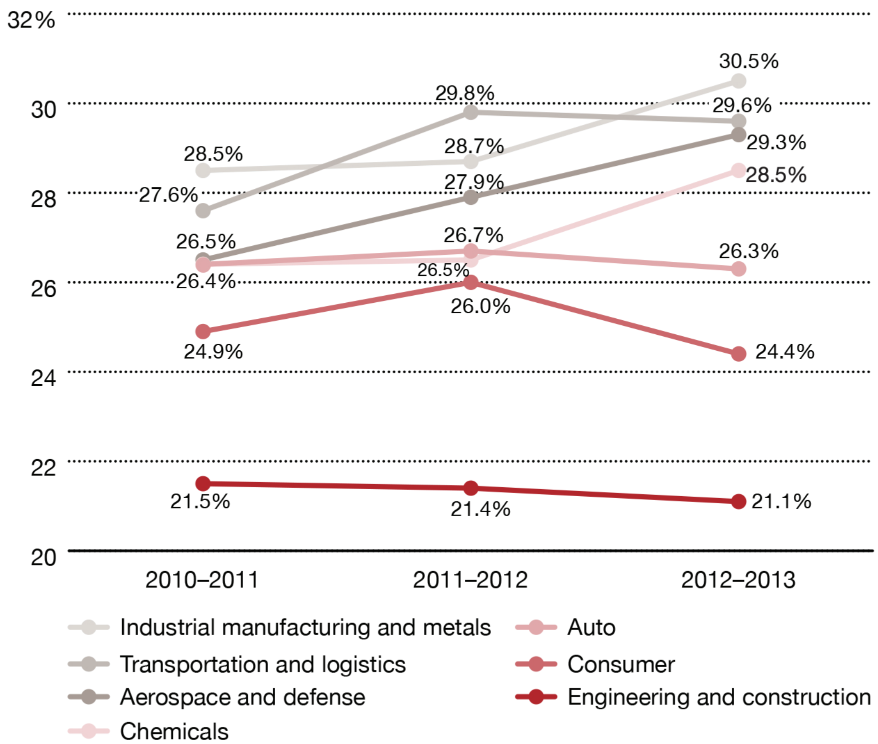
1.2 ETRs of the consumer products sector compared to other sectors

We carried out a tax rate benchmarking study in 2013, *"Assessing tax: 2013 tax rate benchmarking study for industrial products and automotive sectors"*.[2] The report covered six sectors: aerospace and defense, automotive, chemicals, engineering and construction, industrial manufacturing and metals, and transportation and logistics, providing an overview of ETRs for 316 companies in these sectors.

Figure 2 shows that the consumer products sector had the second lowest ETR compared to these six sectors. This is a result of consumer product companies operating in foreign jurisdictions with lower tax rates, tax incentives and losses present in other sectors.

Engineering and construction companies had the lowest ETR – only 46% of companies were profitable and tax paying in all three years. By contrast, the aerospace and defense and chemical sectors, with fewer than 20% loss making companies, have higher ETRs. Consumer product companies take the greatest benefit from tax incentives out of all the sectors studied, impacting the ETR favorably. Only the industrial manufacturing and metals and automotive sectors take a greater benefit from foreign operations, although the industrial manufacturing and metals sector has specific sector taxes which raise the ETR.

Figure 2: ETR for industrial products, automotive and the consumer products sectors



2 http://www.pwc.com/us/en/industrial-products/publications/tax-rate-benchmarking-study.jhtml

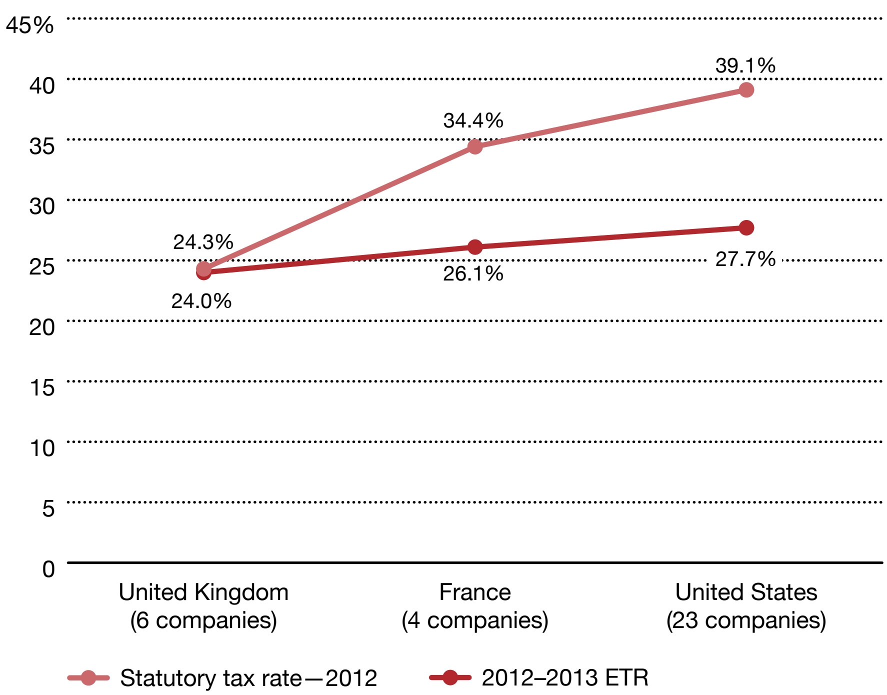
1.3 Statutory corporate income tax rate and ETR by country

For the US, UK and France, we compared the statutory corporate income tax rates with ETRs by country (averaged over all companies in the country). ***Figure 3*** shows a comparison of statutory[3] and average effective tax rate by country for 2012/2013.

We found a wide range between statutory rate and ETR, with a differential of 0.3 percentage points in the UK and 11.4 percentage points in the US. This differential was 8.3 percentage points in France.

Although these consumer products companies are headquartered in countries with very different statutory rates (a range of 15.1 percentage points), the effective tax rates are much closer (a range of 3.4 percentage points). The ETR for the French companies was reduced due to foreign operations, and further analysis on the favorable ETR drivers for US-headquartered companies is explained in the following section (Section 2).

Figure 3: Statutory corporate income tax rate and ETRs for the study



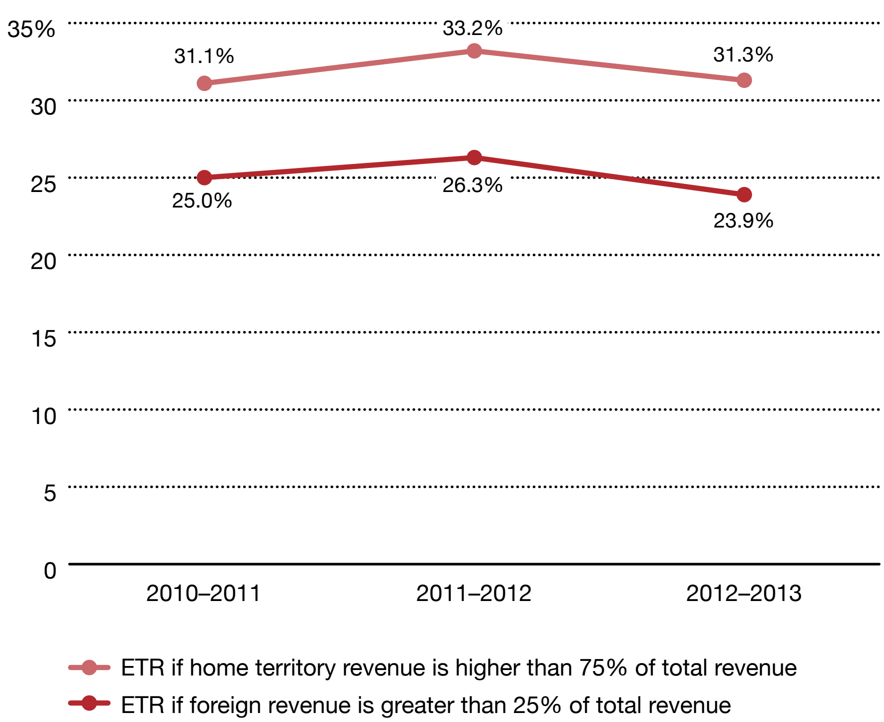
3 Source: OECD

1.4 ETR comparison for domestic vs. multinational companies

The ETRs were analyzed based on the location of revenue in 2012/2013 for the 50 companies where data were available. In order to identify a company as either domestic or multinational, we used the criteria that if revenue outside the home territory constitutes more than 25% of total revenue, these companies are treated as multinational companies, and if home territory revenue constitutes more than 75% of total revenue, these companies are deemed to be domestic. In the study, there were 42 multinational and 8 domestic companies.

Figure 4 shows that the three-year ETR of domestic companies is on average 6.8 percentage points higher than ETRs of multinational companies. Multinational companies have more ability to arrange their tax affairs, as a result of cross-border transactions, taking advantage of lower tax rates in some jurisdictions. By contrast, domestic companies do not have such an opportunity and their ETRs are higher.

Figure 4: ETR for domestic and multinational companies



1.5 ETR by subsector

The ETR data for the consumer products sector were categorized by subsectors. ***Figure 5*** shows that beverage companies had the lowest three-year average ETR with an average rate of 20.7%. Tobacco companies had the highest ETR (31.0%) compared to other consumer products subsectors.

The lower ETR for beverages companies was driven by the favorable impact of foreign operations. As to the higher ETR for tobacco, all of the companies were subject to high statutory rates in their home territory (e.g., US, Japan).

Figure 5: Average ETR by subsectors

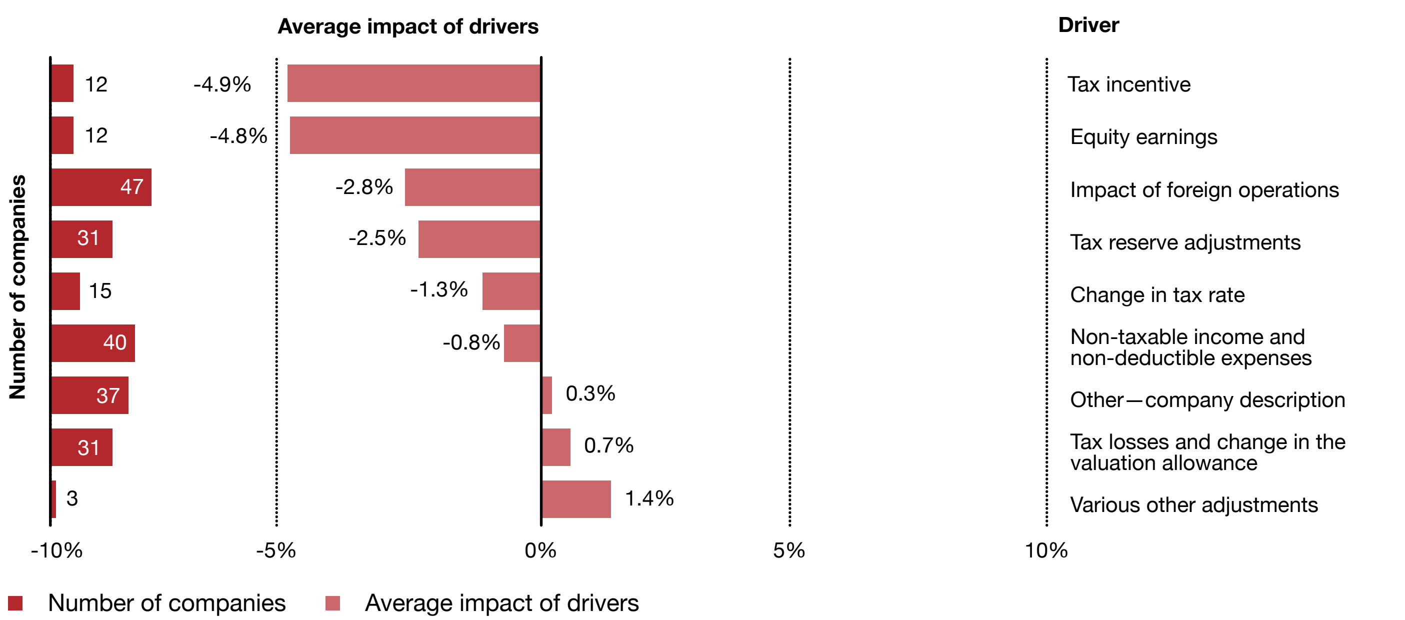
1.6 ETR Drivers

The difference between ETR and statutory rate can be understood by analyzing the statutory/effective rate reconciliation notes disclosed in each company's annual report. We categorized differences into either favorable or unfavorable items. A favorable driver brings the tax provision and ETR down lower than the statutory rate: Such drivers might include tax incentives or non-taxable income. An unfavorable driver, such as non-deductible expenses, raises the tax provisions and ETR higher than the statutory rate. Drivers can be both structural and recurring, such as lower tax rates resulting from overseas operations, tax incentives, or that may not necessarily recur.

We have analyzed and summarized common drivers and their impact on the ETR. The reconciling items, as disclosed in the statutory/ effective rate reconciliation, were analyzed, collated, and averaged over the study companies. Fifty-two companies in the study disclosed reconciliation between their statutory and effective rates in their company accounts, and it was possible to gain some insight into the drivers of the effective rate in the consumer products sector by reviewing this analysis. Single outlying ratios in excess of 50% have been excluded.

Figure 6 illustrates some drivers of the effective rate and shows how frequently they appear in companies' statutory reconciliations for 2012/2013. The bars on the left of the chart show the number of companies reporting the driver. The 0% line represents the statutory rate and the bars on this line show the impact of the driver, both favorable and unfavorable.

Figure 6: Drivers of the ETR in 2012/2013



Many factors drive ETR. The most favorable of these is tax incentives, reported by 12 companies, with an average impact of 4.9 percentage points. Favorable foreign earnings were the most commonly reported driver, reported by 47 companies, with a benefit of 2.8 percentage points. The most unfavorable driver was various other adjustments. It was reported by only three companies, reporting an average unfavorable impact of 1.4 percentage points.

The drivers of ETR are many and varied

-4.9

Tax incentives

Tax credits and incentives gave an average benefit to companies in the study of 4.9 percentage points. In the US, where several tax incentives temporarily expired in 2012, this picture is similar to the study for industrial products (-3.3 percentage points in 2012). Descriptions included domestic manufacturing deduction and tax benefit.

-4.8

Equity earnings

Equity earnings was reported by 12 companies, which reflected increased "joint venture and associate" activities. Under IFRS, a company presents its share of the associate's post-tax profits and losses in the income statement, but there is no associated tax charge, therefore this is a favorable reconciling in the statutory/effective rate reconciliation. For the companies reporting this item, the favorable average impact on the ETR was 4.8 percentage points.

-2.8

Impact of foreign operations

This is usually a structural, recurring driver that was reported by the majority of companies in the study (47 companies). This reconciling item reduced the ETR by 2.8 percentage points on average for the consumer products sector, compared with a reduction of 2.0 percentage points for the industrial products sectors in 2012.

-2.5

Tax reserve adjustments

This reconciling item includes net adjustment of prior year federal and state tax accruals, changes in prior year estimates and audit settlements. The ETR for 31 companies was lowered on average by 2.5 percentage points.

-1.3

Change in tax rates

The net impact of the change in tax rate was -1.3 percentage points. Statutory rate reduction results in a revaluation of deferred tax assets and deferred tax liabilities. In the study, eight companies reported that change in tax rate decreased the benefit of the deferred tax assets and consequently increased income tax expense. By contrast, seven companies recognized a decrease in the deferred tax liabilities, which reduced the income tax expense.

-0.8

Non-taxable income and non-deductible expenses

A favorable driver with an average impact of 0.8 percentage points, this reconciling item frequently had broad descriptions such as 'permanent differences,' and 'non taxable income.' Individual reconciling items were both favorable and unfavorable, netting off to give a favorable driver for the consumer products companies.

+0.7

Tax losses and change in valuation allowance

Tax losses and change in valuation allowance represented an unfavorable driver overall to companies during the study. Descriptions included losses not available to carry forward, effect of non-recognition of deferred tax assets, change in valuation allowance, recognition of previously unrecognized deferred tax assets, and tax losses utilized. Although there were reconciling items going in both directions, the net of these items overall is an increase of 0.7 percentage points in the year.

+1.4

Various other adjustments

This category included descriptions such as tax effect of distributions to shareholders, which were consolidated under one heading to avoid excessive detail.

+0.3

"Other" in company descriptions

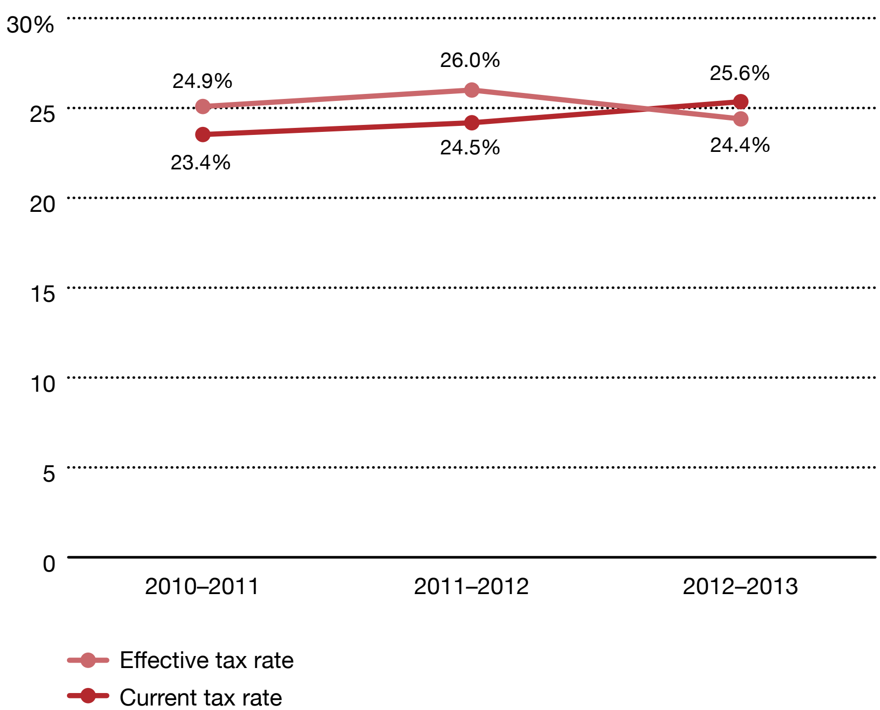
This category is for the line described as "other" in company reconciliation. No further detail was available.

1.7 Current Tax Rate

The current tax rate is defined as the current tax provision as a percentage of income before corporate income tax, where current tax is the portion of the total tax provision that is not deferred. Comparing this ratio to the ETR gives an indication of the impact of deferred tax.

Figure 7 shows that the current tax rate and the ETR remained relatively constant during the first two years, with ETRs higher than current tax rates indicating deferred tax liabilities. However, in 2012/2013, the current tax rate increased and the ETR decreased, falling below the current tax rate. This decline in the deferred tax provision could be a result of restatement of deferred tax liabilities related to changes in the statutory tax rates around the world.

Figure 7: Current tax rate as a percentage of income before tax



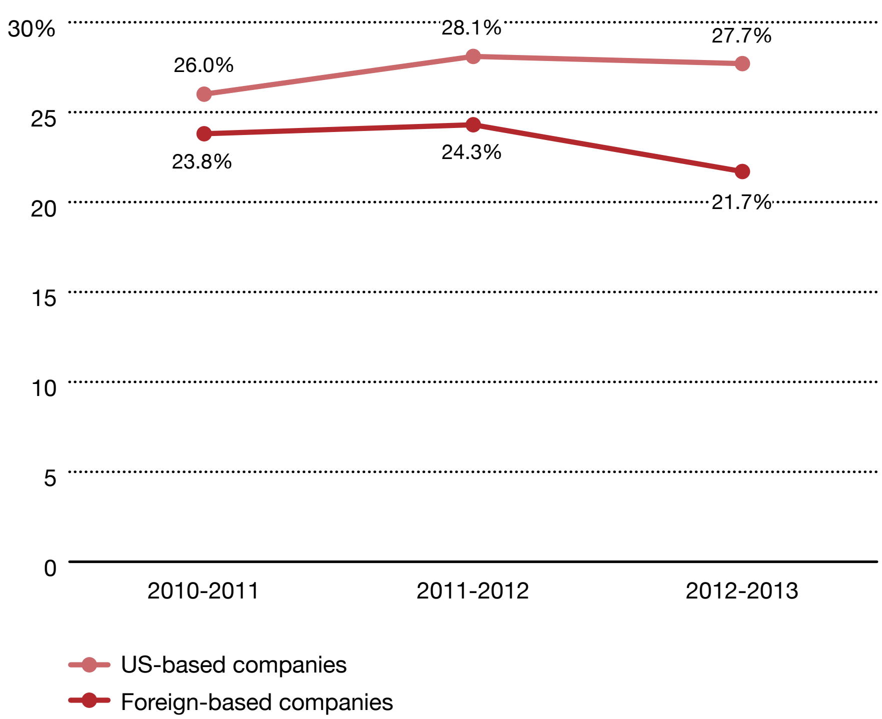
2. US-headquartered consumer products companies

As a large proportion of the companies in the study are headquartered in the US (23 companies out of 55), we are able to prepare a country-specific tax rate benchmarking analysis for the US consumer products sector. In addition, we are able to analyze the specific US reporting requirements relating to unrecognized tax benefits and unrepatriated foreign earnings.

2.1 ETR for US-based companies compared to non-US-based companies

Figure 8 shows that the three-year average ETR for US-based companies is 27.3%, which is 4.0 percentage points higher than the three-year average ETR for non-US-based companies of 23.3%. In the tax rate benchmarking study for the US-based industrial products companies (149 companies) cited earlier in this report, the average ETR was 30.9%.

Figure 8: US based and vs. foreign based

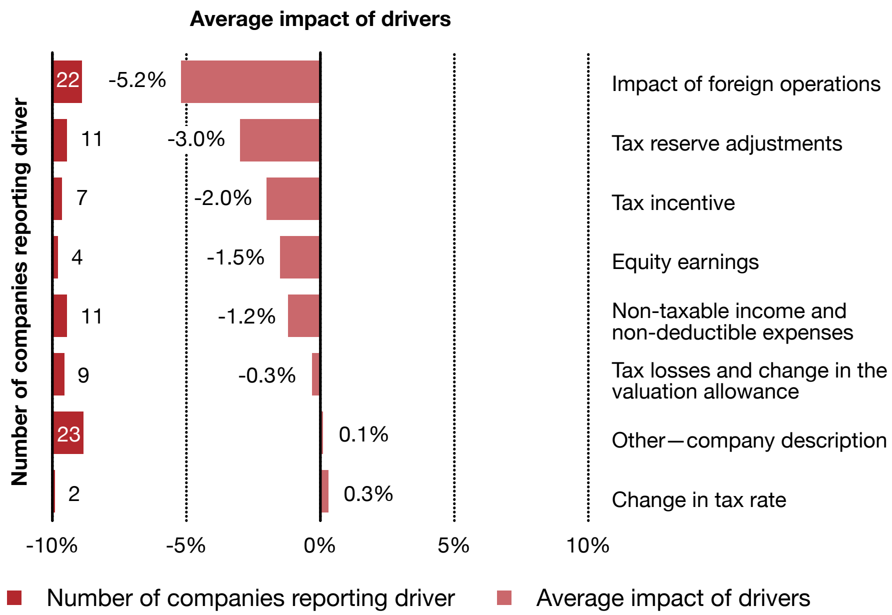


2.2 ETR drivers for US-based companies

Figure 9 shows ETR drivers for the US-based companies in the study. The most common driver is foreign operations, reported by 22 US companies, and the average impact on the statutory rate is to reduce it by 5.2 percentage points. This reconciling item reduced the ETR for non-US-based companies on average by 0.6 percentage points.

The impact of tax reserve adjustments on the ETR for US-based companies was -3.0 percentage points and this item reduced the ETR for non-US-based companies on average by -2.2 percentage points, indicating that this measure is less dependent on territory.

Figure 9: ETR drivers for US-based companies in 2012/2013



2.3 Unrecognized tax benefits

Accounting for uncertainty in income taxes can be complex, and criteria exist in the US for recognizing and measuring unrecognized tax benefits. There is a two-step approach for evaluating tax positions and determining if they should be recognized in the financial statements. Tax positions that are 'more likely than not' to be sustained upon examination must be measured using specified criteria.

Figure 10 shows that the total unrecognized tax benefit balances in the 23 US-based companies was $8.1 billion in 2012/2013, a decrease of 4.9% from the prior year. On an individual company basis, the unrecognized tax benefit was $352 million on average in 2012/2013.

We reviewed the frequency of the named drivers of unrecognized tax benefits that were disclosed by the companies. The largest movement was in the "settlements," which drove the overall decrease ***(Figure 11).***

Figure 10: Opening and closing unrecognized tax benefits

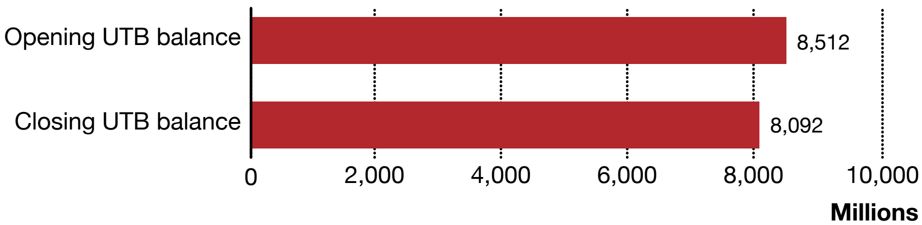
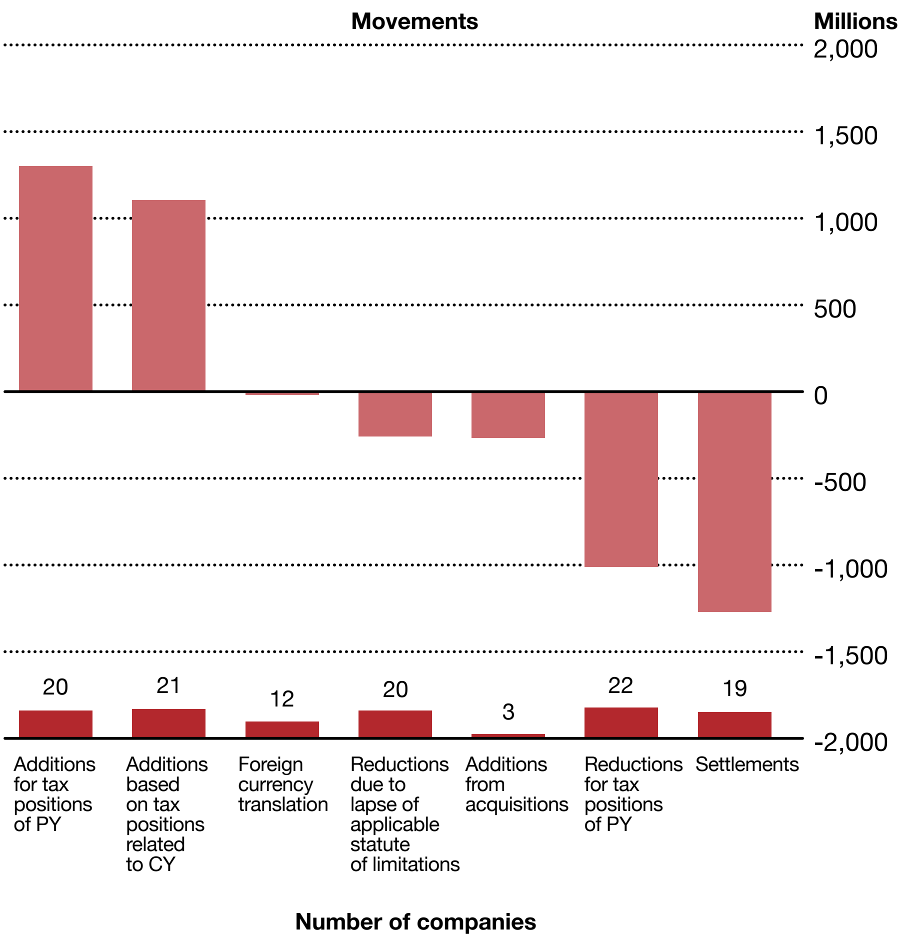


Figure 11: Disclosure of the drivers for unrecognized tax benefits

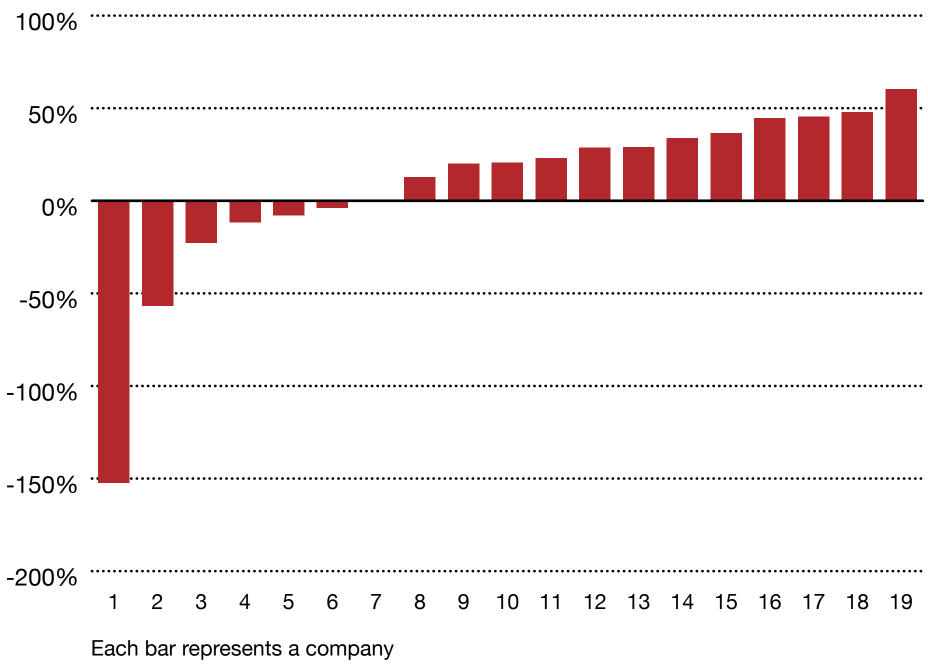


2.4 Unrepatriated foreign earnings

US-based multinationals doing business outside the US are required to account for the tax effects (deferred tax liability) associated with remitting such earnings to the US, unless those unremitted earnings are permanently reinvested outside the US. The amount of undistributed non-US earnings has grown in recent years. We analyzed the level of unrepatriated earnings reported by the US study companies and the movement compared with last year.

Figure 12 shows the 19 US-based multinationals that disclosed the average movement of undistributed earnings as a percentage of income before tax. For the companies reporting this item, unrepatriated earnings increased between 2011/2012 and 2012/2013 by an amount equal to 7.8% of 2012/2013 income before tax.

Figure 12: The average increase in unrepatriated earnings between 2011/2012 and 2012/2013 as a percentage of income before tax



3. Conclusion

Public interest in how much tax is paid by large companies and whether this is the "right" amount of tax is growing. In the current environment, where tax is sometimes becoming a reputational issue, it is more important than ever to know the ETR of your peer group and to assess whether your ETR is higher or lower than that group.

It is possible to prepare a tailored, individual study for any company on request, comparing the key tax ratios examined in this study with those of the company. This can help management understand the company's tax affairs in the context of relevant peers and would be useful in informing tax strategy.

Appendix 1: List of companies

1 Altria Group Inc.
2 Anheuser Busch Inbev SA
3 Archer-Daniels-Midland Company
4 Avon Products Inc.
5 B.S.A. SA
6 Beam Inc.
7 BRF SA
8 British American Tobacco Plc
9 Burberry Group Plc
10 Campbell Soup Company
11 Central European Distribution Corporation
12 Colgate-Palmolive Company
13 Compagnie Financiere Richemont SA
14 Danone SA
15 Diageo Plc
16 Edizione SRL
17 Energizer Holdings Inc.
18 Etablissements Delhaize Freres Et Cie Le Lion SA
19 Fonterra Co-operative Group Ltd.
20 Li & Fung Ltd.
21 General Mills Inc.
22 Guangdong Midea Electric Appliances Company Ltd.
23 Barilla Holding Società per Azioni
24 H. J. Heinz Company
25 Heineken N.V.
26 Henkel AG & Co. KGaA
27 Hisense Electric Company Ltd.
28 Hisense Kelon Electrical Holdings Company Ltd.
29 Japan Tobacco Inc.
30 Kellogg Company
31 Kimberly Clark Corporation
32 Kirkbi A/S
33 Levi Strauss & Company
34 L'Oreal SA
35 Luxottica Group SPA
36 LVMH Moet Hennessy Louis Vuitton SA
37 Masco Corporation
38 Mondelez International Inc.
39 Nestle SA
40 Nike Inc.
41 Pepsico Inc.
42 Pernod Ricard SA
43 Philip Morris International Inc.
44 Reckitt Benckiser Group Plc
45 SABMiller Plc
46 Svenska Cellulosa AB
47 The Coca-Cola Company
48 The Hillshire Brands Company
49 The Procter & Gamble Company
50 The Swatch Group SA
51 Tsingtao Brewery Company Ltd.
52 Tyson Foods Inc.
53 Unilever Plc
54 Uni-President Enterprises Corporation
55 VF Corporation

Appendix 2: Source of information and analysis

Source of information

Our financial analysis was based on a number of ratios derived from publicly available information. This allowed for a large sample size of 55 companies without the need to contact each company, giving us a dependable overview from which to draw our conclusions.

Statistical analysis

Trimmed average

Our conclusions are based on a statistical analysis of the ratios. In a tax benchmarking exercise of this nature, particular ratios may be distorted because of one-off, nonrecurring items. Exceptional items, for example, often attract associated tax at rates far from the statutory rate.

It was necessary to exclude these extreme values, and this was done consistently by taking a trimmed average of a particular sample. The trimmed average is the average result of the data, derived by excluding 15% of the data points from both the top and bottom of the data set. It is a robust estimate of the location of a sample, excluding outlying data points.

Quartiles

These record the ratio where 75% (upper quartile) and 25% (lower quartile) of the sample companies lie below these points. By displaying results in this manner, it is possible to identify the range in which the results of the majority of companies fall.

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