Pennon

Pennon Group

Contributing to society through a responsible approach to tax

March 2019





As one of Britain's largest FTSE 250 environmental infrastructure groups in the UK, Pennon has assets of c.£6.2 billion and a workforce of around 5,000 people.

Fair Tax 2017–18

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Our values



Trusted
We do the right thing for our customers and stakeholders



Responsible
We keep our promises to our customers, communities and each other



Collaborative
We forge strong relationships, working together to make a positive impact

Progressive
We are always looking for new ways to improve and make life better

Foreword from **Susan Davy**



As a British company, paying tax is one of the many ways we contribute to our communities.

In March 2018, we published our first tax strategy document discussing how the Pennon Group contributes to society through its responsible approach to tax. This document was designed to not only meet our legal obligation to publish the Group's tax strategy, but also as an opportunity to discuss the Group's tax position and the contribution it makes to society in more depth than the legislation requires.

In preparation for this, our second document, we have once again sought customer feedback on the approach we take. This feedback has re-affirmed and supports our approach.

At Pennon, we know the taxes we pay help fund vital public services, investment in people and investment in infrastructure to support future growth.

In this document you'll find our Tax Strategy and policies, as well as information on our tax profile. Customer feedback continues to be supportive of the stance we have taken. The strategy and policies are applied across the Group and HMRC, as part of their governance processes, will review what we say in this document to ensure that it is reflected in our practices and day-to-day operations across the Group.

This document builds on the one published previously hence why much of it will appear familiar to those who read our first one.

Like any successful business we continue to work hard to be efficient and effective to deliver the best possible result for our customers, communities and shareholders. We adopt the same approach when it comes to tax. In 2017/18 Pennon's taxes borne and collected resulted in a total tax contribution of £265 million being paid over to the Government.



We are all too aware that the attitude of a few companies towards payment of taxes has been a factor in a loss of public confidence in big businesses and we will play our part in winning that trust back. Businesses must do more to prove our positive contribution both to the country and regions in which we operate. Transparency is a critical component of this.

We are the first water and waste group to be awarded the Fair Tax Mark. The Fair Tax Mark is the UK's accreditation scheme for businesses paying their fair share of corporation tax and reporting on their tax practices transparently. Achieving the Mark demonstrates that we are paying the right amount of corporation tax in the right place at the right time and apply the gold standard of transparency.

We know that our tax position can seem complex, so this document is designed to clarify how we arrive at our tax contributions. We want to be open and honest with our customers. We seek to optimise our tax position as this helps to keep customers bills down, but we do not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation. By the latter we mean that we do not make use of any loopholes in tax legislation or take "left-field" interpretations of such rules.

In previous years we have had small ancillary operations based in Guernsey. Whilst these generated little in the way of any tax benefits, we have this year relocated these operations to be UK tax resident. Our sole remaining connection with tax havens is with the Group's captive insurance company, and this arrangement is maintained for regulatory purposes, with the company being UK tax resident.

At Pennon we pay corporation tax, whilst benefiting from Government incentives to invest in critical new infrastructure. Governments across the world encourage companies to invest in such infrastructure, and in the UK this is through the availability of capital allowances. This helps companies to plan major investment and consequentially maintain lower customer bills, as corporation tax relief is given towards the investments made. As a long-term business with a long-term approach to financial management, the Group's overall tax strategy supports our long-term objectives.

We proactively seek views from customers and other stakeholders on our approach, and welcome feedback to further improve our position.

Susan Davy
Chief Financial Officer
Pennon Group plc

Fair Tax 2017–18

The Finance Act 2016 requires the Group's tax strategy in relation to UK taxation to be reviewed and updated annually.

The Group's overall approach to tax planning, risk management and governance is outlined in the following pages and is in line with the Finance Act 2016 requirements. This second published strategy applies for the year to 31 March 2019. The Group does not expect its tax strategy to change significantly year on year but it reviews and updates it annually. Pennon is a long-term business with a long-term approach to financial management.

Pennon is committed to having a robust and transparent tax strategy

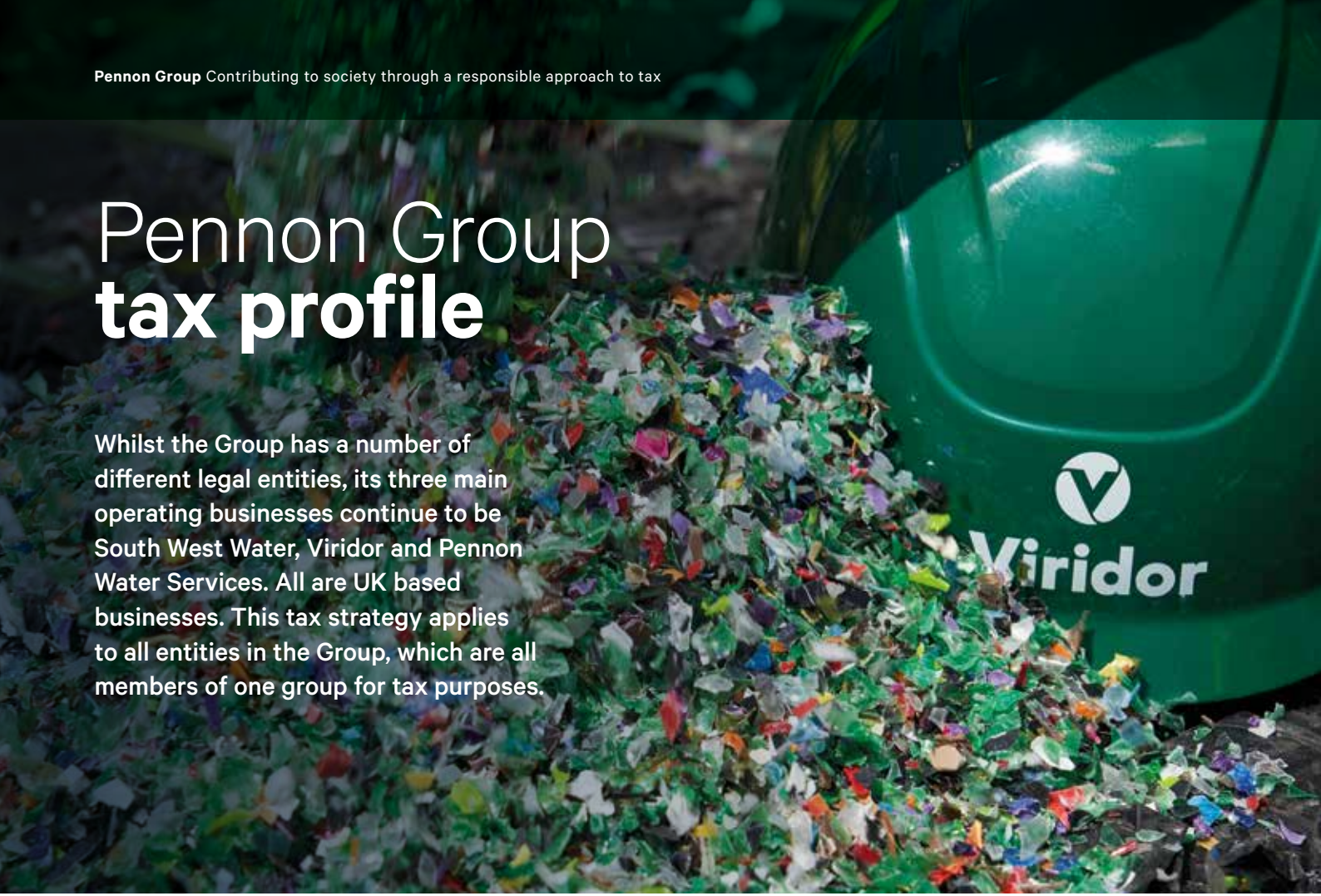
Pennon Group plc and its subsidiaries are collectively referred to as "the Group".



This means that we will:

1. At all times consider the Group's corporate and social responsibilities in relation to its tax affairs
2. Operate appropriate tax risk governance processes to ensure that the policies are applied throughout the Group
3. Comply with our legal requirements; file all appropriate returns on time and make all tax payments by the due date
4. Consider all taxes as part of ongoing business decisions
5. Not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation
6. Not undertake transactions which are outside the Group's low risk appetite for tax or not in line with the Group's Code of Conduct
7. Engage with HMRC in a proactive and transparent way and discuss our interpretation of tax laws in real-time, such interpretations following both the letter and spirit of the laws

Pennon Group **tax profile**



Whilst the Group has a number of different legal entities, its three main operating businesses continue to be South West Water, Viridor and Pennon Water Services. All are UK based businesses. This tax strategy applies to all entities in the Group, which are all members of one group for tax purposes.

South West Water provides water and wastewater services to a population of c1.7 million in Cornwall, Devon and parts of Dorset and Somerset and water only services to c.0.5 million in parts of Dorset, Hampshire and Wiltshire. South West Water is regulated by such agencies as The Water Services Regulation Authority (Ofwat), the Environment Agency and Department for Environment, Food and Rural Affairs (Defra) and the Drinking Water Inspectorate. The tax strategy and processes for the Group are mirrored for South West Water, which is considered separately for regulatory purposes.

Viridor is a leading UK recycling, energy recovery and waste management company, providing services to more than 150 local authorities and major corporate clients as well as over 32,000 customers across the UK.

Pennon Water Services is our growing water retailer for businesses, currently serving c.160,000 customers nationwide.

The Group's taxes borne and collected are made up across a number of different types of tax and tax regimes. The Group calculates its total tax contribution by combining its taxes borne together with those it collects and remits on behalf of the Government. These taxes can be grouped into the following categories in order to improve clarity where these taxes are borne and collected:

Environmental taxes (borne and collected) – These encourage businesses and their customers to act in more environmentally friendly ways. For the Group, the most significant is landfill tax which is borne and collected on waste material deposited at our landfill sites. The Group also makes payments to the Environment Agency and other regulatory bodies which reduce profit before tax.

Employment taxes (borne and collected) – Taxes on employees' salaries and benefits are collected by employers through the Pay As You Earn system and National Insurance Contributions and paid over to HMRC. Employers also bear National Insurance Contributions on employees' salaries and benefits. The Apprenticeship Levy is also included within employment taxes.

Business rates (borne) – This is a levy paid by businesses on non-domestic property. It is a cost borne by the business and reduces the Group's profit before tax.

Profit taxes (borne) – These are the taxes a business bears on its profits. The Group is subject to corporation tax on its taxable profits. The corporation tax rate is 19% for the year to 31 March 2019, and this will reduce further to 17% for the year ending 31 March 2021.

Value Added Tax (VAT) (borne and collected) – This is a tax charged on goods and services, which are either bought from suppliers or sold to customers. VAT is both borne and collected.

Further details of the Group's tax contributions for 2017/18 are included in the Annual Report and Accounts 2018.



Our contribution to society through a responsible approach to tax – **Key points**

£1,396m
Revenue

Profit before tax **£236m**

£116m **Taxes borne**

£149m **Taxes collected**

£265m **Total tax contribution**

Taxes borne includes all taxes which are a cost to the group, such as business rates, corporation tax and employer's National Insurance Contributions on employees' salaries and benefits.

Taxes collected are those where the business is acting as a tax collector and includes landfill tax, employees' National Insurance Contributions and income tax withheld at source together with net VAT. All figures relate to the year ended 31 March 2018 and come from the Annual Report and Accounts 2018.

Top taxes

Landfill tax



£132m

Employment taxes



£59m

Business rates



£41m

Corporation tax

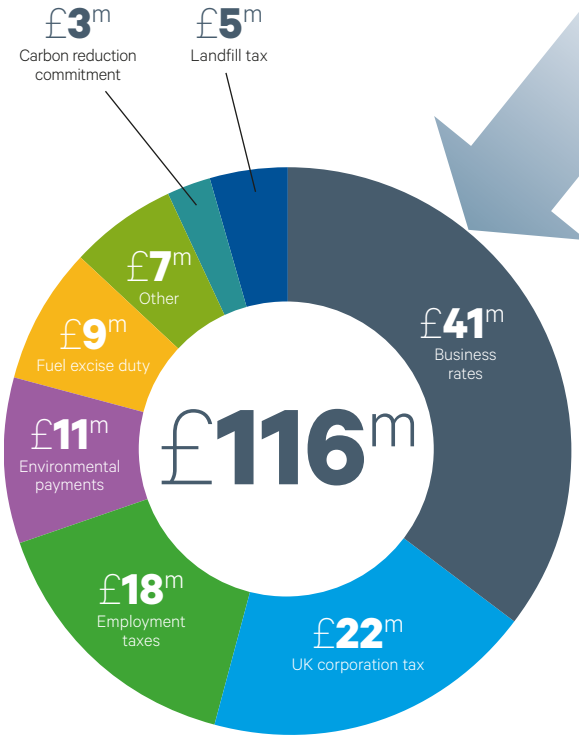


£22m

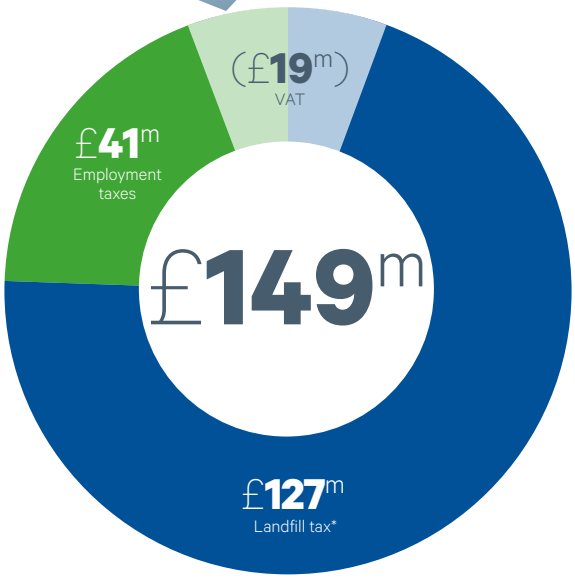


£265m

Total tax contribution for the year ended 31 March 2018



Taxes borne



Taxes collected and remitted to HMRC

*As the operator of landfill sites, Viridor is subject to Landfill tax on waste disposed of at its sites. This tax is paid over to HMRC. This amount forms a significant part of the waste disposal cost that Viridor charges its customers.

Tax compliance **and planning**

Capital allowances are given by Government to encourage investment in infrastructure. The Group incurred capital expenditure during 2017/18 of £395m on assets, including new Energy Recovery Facilities ("ERFs"). Tax relief on capital allowances of £48m was claimed during the year on these assets.

The Group also continued to offer a variety of tax efficient salary sacrifice arrangements*, all of which are supported by the UK Government. These aid and support employee engagement and retention.

*Described in more detail on page 14

The Group...

...filed in excess of

750

different tax returns
during the year

...made over

150

different tax payments to HMRC
during the year



In the normal course of business the Group manages its tax planning efficiently for the benefit of its shareholders and customers.

£6.2bn
Asset base

The Group does not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation. By the latter we mean we will not make use of any loopholes or take "left-field" interpretations of tax legislation.

The Group ensures that its commercial business and economic activities are carried out in a tax efficient manner. This is in line with the principles published in HMRC's 2016 Framework for Co-operative Compliance. The Group seeks to ensure that all its tax obligations are fulfilled and that tax is paid where and when it is due.

The Group will apply relevant tax laws in a reasonable way and in the spirit they were intended to apply.

Pennon's Code of Conduct sets out the principles we believe should guide our actions. We play a crucial role in the lives of our customers and partners, who rely on us to make the right decisions. The Code of Conduct requires decisions to be legal, ethical and to stand up to external scrutiny. All staff are required to follow the Code including decisions which relate to tax.

Specific tax allowances, incentives and exemptions from UK tax legislation are used by the UK Government typically to support economic investment and employment. Where these allowances are applicable to the Group's activities, the Group applies them in the manner intended.

Salary sacrifice

The Group offers salary sacrifice arrangements, which are fully supported by the UK Government, to its employees in the following areas:

- Payments into pension schemes
- Childcare vouchers
- Cycle to work

Each of these arrangements is administered by specialist third party providers. The Group does not offer any non-Government supported salary sacrifice schemes.

Capital allowances

The Group also claims capital allowances on its qualifying capital expenditure. With a significant asset base these allowances are important to the Group.

Capital allowances are available when a business incurs qualifying expenditure on capital items such as infrastructure assets. Capital allowances provide tax relief on these items in place of accounting depreciation which is not tax deductible.

Over the period of ownership of an asset, cumulative depreciation and capital allowances will equalise. Capital allowance rates are set by the UK Government and every business receives the same rate of allowance. Capital allowance rates vary from 8% up to 100% in certain instances, with the majority of items qualifying for relief at either 8% or 18% per annum.

For the year ended 31 March 2018, the Group had capital expenditure of £395m. The Group claimed capital allowances of £48m on eligible expenditure of £354m, giving a blended capital allowance rate of c.14%.





Construction of an Energy Recovery Facility in Dunbar, Scotland. Tax relief is available through capital allowances on projects such as this, but requires us to maintain a very detailed and thorough analysis of what is being spent because the amount of relief given depends on the type of expenditure.

Relationship with **tax authorities**

The Group engages with HMRC in a proactive and transparent way to identify potential areas of uncertainty in real time.

Where differences of opinion arise, the Group seeks to resolve these in a co-operative and timely manner.

The Group works with HMRC to enable them to understand the tax risks the Group faces and how these are managed. The same approach is taken for both routine and non-routine matters.

As an example of routine engagement, the Group tax team provided HMRC with a tour of one of Viridor's Energy Recovery Facilities ("ERF") and explained how the ERF process works. The aim of the tour was to explain ERF operations and demonstrate how the capital expenditure on building an ERF flows through to the capital allowance position for the Group as set out in its tax returns.

Due to the complexity of tax legislation, which sometimes can be interpreted in different ways, the Group and HMRC may occasionally have conflicting opinions on the treatment of certain tax items. Regular calls and meetings between the Group and HMRC covering all of the Group's tax affairs enable potential tax issues and areas of uncertain tax treatment to be highlighted at the earliest opportunity. This enables the Group and HMRC to reach resolution as promptly as possible.

Tax risk management **and governance**

The Board of Pennon Group plc ("the Board") has ultimate responsibility for the Group's approach to tax and receives regular updates on tax matters and risks.

The Board is responsible for the Group's strategy, risk management and policies, including those in relation to tax.

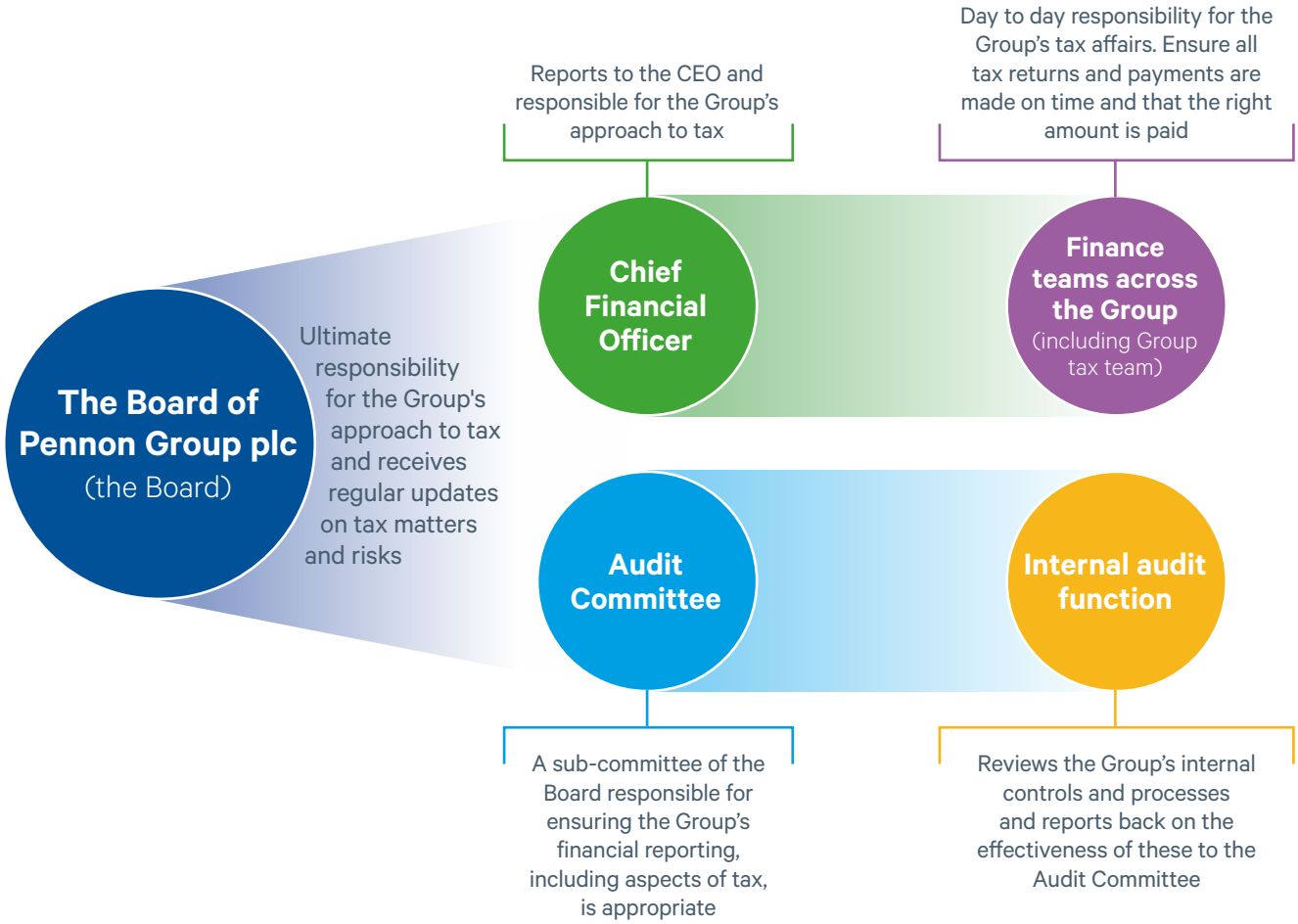


The Audit Committee is a sub-committee of the Board and is responsible for ensuring the appropriateness of financial reporting, reviewing and challenging the ongoing effectiveness of the internal control environment and reviewing and considering the scope of risk management processes across the Group.

The Board aims to adopt a low risk approach to tax risk management.

Tax risk management and governance

The diagram below set outs how the Group's governance in relation to its tax affairs works:



Further assurance is provided by the Group's external auditors that the taxes borne and collected by the Group are reported correctly.

The Board is responsible for identifying principal risks and ensuring appropriate risk mitigation is in place to manage those risks effectively. The Board is supported in this by the Audit Committee and a Group Risk Forum which provides a 'top down' assessment of the Group's risks. This is supplemented by 'bottom up' risk assessments undertaken by each operating subsidiary. The Group's risk report within its annual report and accounts contains more information on the risk management framework. South West Water has its own board and audit committee which operate in the same way as those of the Group and adopt the same tax policies and procedures.

The Audit Committee receives detailed "deep dive" presentations from senior management on individual principal risks which during 2017/18 included a review of the Group's provisions for uncertain tax positions.

The Group maintains a register of tax risks for taxes borne and collected with material risks being discussed with the Audit Committee and Group Risk Forum to ensure adequate controls and processes are in place to monitor and report against such risks. Risk reviews and "deep dives" are undertaken periodically across the different tax areas. The Board is regularly updated on tax matters and any tax implications arising from commercial activities are highlighted to the Board via a risk matrix to help assess the appropriateness of a proposal. The risk matrix considers the strategic fit of any commercial activity against any risk factors, benefits and costs.

The Group manages its tax risks carefully and accounts for areas of tax uncertainty in line with accounting standards requirements, where appropriate.

The Group's tax team is expected to:

- Maintain a tax risk framework
- Provide tax training and guidance to non-tax specialists so that they have appropriate tax knowledge relevant to their role
- Apply professional care and judgement when considering direct and indirect tax risks in line with the Group's risk management framework
- Thoroughly document and explain conclusions reached where tax risks are identified, ensuring there is a strong technical position for such conclusions
- Where appropriate, seek specialist external advice to ensure tax risks can be managed effectively

The three key tax risks and details of how the Group manages them are:

I Complexity and changes in legislation

The Group is subject to a range of different taxes in the UK, each of which is governed by complex tax legislation. Such legislation is typically updated on an annual basis. To keep up to date with these changes the Group ensures that its tax team is appropriately qualified and has access to daily tax updates and specialist tax resources as well as the opportunity to attend technical briefings. The Group also uses the services of external tax advisers as and when required.

II Compliance and reporting risk

The Group is required to meet many different statutory filing and payment obligations. If these are not complied with, the Group could incur interest and penalties as well as an increased risk rating being applied by HMRC. The Group uses a combination of tools to ensure that all compliance and reporting obligations are met in accordance with statutory deadlines.

The Group tax team works across the business to obtain the necessary commercial understanding of the Group's operations and to obtain the financial information to ensure that the tax computations and returns are complete and accurate. Explanations are provided in the tax computations to assist HMRC in understanding the transactions and their financial implications. In addition, the Group aims to meet with HMRC ahead of filing the Group's corporate tax computations so that it can explain the main areas and highlight transactions where HMRC may seek to gain a greater understanding. This enables the Group and HMRC to reach agreement on the facts as quickly as possible, thus enabling the tax treatment to be agreed proactively.

Where there are points to be highlighted to HMRC with regard to indirect taxes and associated returns, these are typically raised ahead of the return being submitted.

III Uncertainty arising from open computations where liabilities remain to be agreed

Censure for non-compliance with HMRC requirements could lead to financial penalties, significant legal costs, damage to reputation and loss of shareholder value. The Group has a professionally qualified and experienced in-house tax team which is supported when necessary by external specialists. Significant progress has been made in recent years to agree outstanding items with HMRC, reducing this risk going forward.

Additionally, the UK's annual Senior Accounting Officer (SAO) regime requires the SAO to be able to certify that each entity within the Group had appropriate tax accounting arrangements in place throughout the year, thus focusing attention on the processes and systems used as part of these arrangements. Clearly defined and documented processes are followed for the filing of tax returns. These are completed prior to the returns being submitted to HMRC.

Internal certification is also provided by the preparer and reviewer of the different tax returns so that the SAO is satisfied that the Group meets its obligations under the regime.

The Group's Chief Financial Officer is responsible for the implementation of the Group's approach to tax and reports on this to the Pennon and subsidiary Boards and Audit Committees on a regular basis.

The senior management teams of the Group's subsidiaries are responsible for ensuring that their businesses follow this tax strategy and that processes and procedures are adopted and followed.

Examples of the day-to-day responsibilities for tax operations of the Group are as follows:

a) Landfill tax – Finance Director, Viridor

b) All Corporate Income Taxes – Group Tax Team

c) Value Added Tax – Finance Directors of South West Water, Viridor and Pennon Water Services

d) Employment taxes (Pay As You Earn/National Insurance Contributions) – Group Human Resources and Group Tax Team

e) Stamp Duty Land Tax – Group General Counsel

f) Other applicable tax matters (e.g. CIS returns) – Finance Directors of South West Water, Viridor and Pennon Water Services

Customer **engagement**

I think everyone should pay their fair share of taxes

18-45, C2DE







I know there's a lot of publicity about companies that don't pay tax

18-45, C2DE

Ultimately that tax will benefit us, because that's the point of the tax, it's going to the government so that they can provide services we all need.

18-45, C2DE



95%
of customers surveyed **are broadly supportive of the tax strategy**

To assist the development of Pennon's tax strategy, customer and stakeholder research was undertaken via focus groups and through qualitative surveys. Key themes included:

- Tax is a key aspect of corporate responsibility.
- The view that a company that gets its tax right is highly likely to get other aspects of corporate social responsibility right.

Key priorities for customers are:

- Companies should pay their fair share of tax.
- Tax policies should be clear for everyone to understand, not just tax experts.
- There should be stronger legislation in place to ensure that companies who provide services in the UK pay the right level of corporation tax.

As a result of this research, Pennon has:

- Been clear in the tax strategy document about Pennon's approach to tax.
- Sought to make the tax strategy accessible to all.
- Included real-life examples to demonstrate how the tax approach works in practice.

The **majority of customers surveyed** thought that **the Group's attitude to tax planning was acceptable**

Glossary

Aggregates Levy	A tax on the extraction of rock, gravel and sand.
Apprenticeship Levy	A tax on employers which can be used to fund apprenticeship training.
Artificial tax arrangements	Involve carrying out or entering into an arrangement which is not a reasonable course of action in relation to the tax provision(s) in question or lacks economic or commercial substance.
Business rates	A tax on non-domestic property.
B2B	Business to Business.
Capital allowances	Tax relief given when a business incurs qualifying expenditure on capital items such as plant and machinery which are used by the business. As such the business is allowed to deduct some or all of the cost of the item from its taxable profits over a number of years, which reflects the fall in value of the asset from its use.
Carbon Reduction Commitment	A tax on electricity and gas consumption, calculated by reference to the amount of associated carbon dioxide emission.
Climate Change Levy	A tax on energy delivered to non-domestic users.
Construction Industry Scheme (CIS)	A scheme whereby contractors are required to deduct money from subcontractors' payments and pass it to HMRC.
Corporation tax	A tax on the profits of the business.
Fuel Excise Duty	A tax on fuel used in the business.
HMRC	Her Majesty's Revenue and Customs, the UK tax authority.
Insurance Premium Tax (IPT)	A tax charged on insurance premiums.
Landfill tax	A tax payable on waste which is disposed of at a landfill site.
National Insurance Contributions (NICs)	Paid by both employers and employees primarily to fund state benefits. Employee NICs are deducted at source from an employee's pay. Employer's NICs are a cost to the business and charged based on an employees pay and benefits. All NICs are paid over to HMRC.
Pay As You Earn (PAYE)	Income tax which is deducted at source from an employee's pay. This tax is paid over to HMRC.
Salary sacrifice	An agreement to reduce an employee's entitlement to cash pay, usually in return for a non-cash benefit. Tax and NICs exemptions are available on the following non-cash benefits: 1. Payments into pension schemes 2. Employer provided pension advice 3. Childcare vouchers, workplace nurseries and directly contracted employer provided childcare 4. Bicycles and cycling safety equipment (including cycle to work). Where an employee sacrifices salary in return for one of these government supported exemptions, they save the tax and NICs on the sacrificed salary up to certain limits set by the Government. The employer also saves employer's NICs on the salary sacrificed.
Stamp Duty Land Tax	A tax on the acquisition of land and property.
Tax advantage	A tax benefit which runs contrary to the overall underlying commercial and economic transaction.
Tax allowances, incentives and exemptions	Tax reliefs offered by the Government to encourage certain behaviours and actions by business to drive them to do specific things. For example to encourage investment in capital expenditure, the UK Government offers capital allowances.
Value Added Tax (VAT)	A tax levied on the sale of goods and services.



Fair Tax 2017–18

This document complies with the Group's duty under Paragraph 16(2) of Schedule 19 of the Finance Act 2016 to publish a group tax strategy for the year ended 31 March 2019.

Pennon

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