



Our tax strategy



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Purpose

This publication sets out our tax strategy. It complies with the UK legislative requirements under Paragraph 16(2) of Schedule 19 of Finance Act 2016 and was approved by the Kemble Water Holdings Limited Board on 27 March 2024 for publication on the Thames Water website.

Scope

Our tax strategy covers our approach to the following:

- Tax governance arrangements
- Tax planning
- Tax risk management
- Working with tax authorities

This strategy applies to all our Group entities. The Group comprises of the ultimate holding company, Kemble Water Holdings Limited (“Kemble”), and its subsidiaries.

Introduction

As you might expect from a company that takes a long-term approach to its activities, our tax strategy was designed to be sustainable over the course of time. As a result, it is largely unchanged from last year. We have also included examples and a compliance statement, to show our policies in action and enhance the understanding of our approach to tax.

Thames Water does not currently pay corporation tax because of the Government’s capital allowances regime, and the impact of our interest costs. The capital allowances rules encourage capital investment in infrastructure and effectively defers the time at which corporation tax is paid. Interest costs are deductible for tax purposes and are substantial at the moment. Importantly, our customers benefit from our current corporation tax payment position as the reduced cost is fully passed on to customers through lower bills, reflecting the current regulatory model for the water sector.

It’s also useful to consider some additional context. We paid £258 million in other taxes like business rates, payroll taxes and environmental taxes in the financial year ended 31 March 2023. This is at a time when we are investing over £1.5 billion a year in our network and incurring a further £1 billion a year on operating costs. Our external shareholders have not received any dividends since 2017 as they have prioritised reinvestment in the network. More information is published within Our Finances Explained.

Key principles – describing our approach

Our tax strategy is straightforward and is underpinned by five key principles to ensure we are a tax responsible business. It applies to all our Group entities. Our principles are:

1. We comply with tax legislation, both within the letter and spirit of the law
2. We do not use tax avoidance schemes or aggressive tax planning
3. We engage fully and transparently with HMRC and other Government bodies, and seek to resolve any disputes in a co-operative manner
4. We adopt a conservative approach to tax risk management and apply a strong tax governance framework
5. We accept only a low level of tax risk in relation to taxation.

These key principles underpin our strong tax administration process that includes accurate and timely tax return filings and payments of taxes.

Our key performance and management indicators

1. **We comply with tax legislation, both within the letter and spirit of the law**
 - We submit all tax returns on time with accurate information and full disclosure
 - We make accurate and timely tax payments
 - We do not apply an aggressive interpretation of tax legislation.

How is this achieved?

Our Tax team of experienced professionals ensures all tax returns and payments are accurate and made on time. The Corporation Tax computations submitted to HMRC also include explanatory notes to ensure full disclosure.

The team uses their experience and judgement to identify situations where the tax treatment of transactions may be uncertain. In such circumstances, we ensure that our position is fully supportable, and tax legislation is applied in its intended manner; i.e., it is not an aggressive interpretation and in line with our key principles set out above. To better understand the intention of the legislation, we consider published HMRC guidance, leading tax commentary and, where necessary, obtain external tax advice.

Compliance statement

As in previous years, all of our Corporation Tax, VAT and employment tax returns have been submitted, and tax payments made, on time and no aggressive interpretations of tax law have been applied.

2. **We do not use tax avoidance schemes or aggressive tax planning**

What is our attitude to tax avoidance and tax planning?

- We do not engage in tax avoidance schemes
- We do not engage in aggressive tax planning, i.e., planning that is not underpinned by commercial and economic substance, or applies an aggressive interpretation of tax legislation
- We plan our tax affairs to be efficient.

What does 'tax avoidance' mean?

There is no universal definition of "tax avoidance" but HMRC says¹ that the following might indicate that tax avoidance is taking place:

"Tax avoidance involves bending the rules of the tax system to try to gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage. It involves operating within the letter, but not the spirit, of the law...The scheme involves money going around in a circle back to where it started, or some similar artificial arrangement where transactions are entered into which have no apparent commercial purpose."

Taxpayers will generally know when they are engaging in a tax avoidance scheme; it is not entered into by mistake.

What does 'aggressive tax planning' mean?

Tax planning can mean anything from tax avoidance to a simple plan to utilise government tax reliefs in the manner in which they are intended. HMRC acknowledges² that a taxpayer is "...entitled, if he can to order his affairs so as that the tax attaching under the appropriate acts is less than it otherwise would be". In our view, tax planning becomes "aggressive" when it is not underpinned by commercial and economic substance, or applies an aggressive interpretation of tax legislation in order to achieve a favourable tax position.

Tax planning in the context of one-off business transactions

Generally speaking, one-off business transactions such as disposals and debt refinancing or shareholder funding can provide opportunities for tax planning and therefore it is important for our tax strategy to be clear on this. The Tax team is involved from the early stages of all significant business transactions in order to understand the potential options and the associated regulatory, accounting, commercial, and reputational implications.

Some options may have a more favourable tax outcome than others and, whilst we have a duty to shareholders and customers to keep tax costs low, only options that comply with our Tax Code of Conduct (see Appendix) are implemented.

Statutory tax reliefs

Tax reliefs and incentives are often introduced by the Government to encourage investment and employment. We claim statutory tax reliefs including capital allowances on our significant investment on infrastructure, group relief which enables tax losses generated by a group entity to be offset by taxable profits in another group entity, and Research & Development tax credits.

Where the tax treatment is uncertain, we use external tax advisors to ensure we comply with the rules, do not over (or under) claim tax reliefs, and understand what might be considered aggressive.

Use of tax havens

We do not use tax havens to avoid tax. Although no tax benefit was derived from our Cayman financing entities, these were dissolved in 2019 to address any negative perceptions. Our Guernsey insurance company was also sold in 2019.

Compliance statement

As in previous years, we have sought advance clearance from HMRC where considered appropriate, and disclosed transactions to HMRC on a real-time basis.

3. We engage fully and transparently with HMRC and other Government bodies, and seek to resolve any disputes in a co-operative manner

What do we mean by this?

HMRC's role is to administer the taxation system by ensuring that taxpayers comply with tax legislation and pay the right amount of tax at the right time. We acknowledge the importance of this role and are committed to full and transparent engagement with HMRC.

Tax legislation is complex and there are areas of uncertainty which can, from time to time, give rise to disagreements with HMRC. Where such situations arise, we are committed to full and open dialogue with HMRC and seek resolution based on practical and technical arguments. Where the Government issues public consultation documents on tax legislation which could materially affect us, we proactively engage and submit representations with our views.

How do we achieve this?

In the spirit of collaborative and open relationships with HMRC, we have regular discussions with HMRC to explain business transactions and provide updates to HMRC on a real-time basis, and to listen to their views. We respond to any HMRC questions promptly and maintain dialogue with them even where we may disagree with HMRC's position. We acknowledge that errors can occasionally arise and we are committed to communicating any issues to HMRC on proactive and prompt basis with suggested ways forward.

Compliance statement

As in previous years, we have met or spoken with HMRC on a number of occasions to discuss business developments on a real-time basis.

4. We adopt a conservative approach to tax risk management and apply a strong tax governance framework

What does tax risk management mean?

Tax risk management means identifying the tax risks in our business, implementing suitable processes and controls, and ensuring these are in line with our conservative low risk approach to taxation. Tax risks can arise in a number of situations:

- Business transaction risks

For example, reorganisations, financing transactions and disposals can all give rise to tax risk. Under our low risk approach, the business would not undertake reorganisations for tax avoidance purposes, or undertake material refinancing transactions without consulting the Tax team.

¹ <https://www.gov.uk/guidance/tax-avoidance-an-introduction>

² Inland Revenue Commissioners v Duke of Westminster (1936)

- **Operational risks**

For example, new operating models, new billing systems and IT platforms can all give rise to tax risk. Under our low risk approach, the business would not implement a new billing system without consulting the Tax team; instead sign off procedures are in place.

- **Compliance and risks**

For example, insufficient resources, system changes, tax legislative changes, lack of appropriate management oversight, etc. can all give rise to tax risk. Our low risk approach addresses these aspects.

- **Tax accounting, statutory and regulatory reporting risks**

For example, the risk of material tax misstatements in our statutory financial statements and regulatory reporting to Ofwat. Our tax governance processes address this risk.

What does tax governance mean?

Tax governance refers to the responsibility and oversight of the Group's tax affairs; for example, the reporting framework for tax matters, and the seniority level at which tax is considered.

Our tax governance

The day-to-day management of the Group's tax affairs is the responsibility of the Tax team. The structure, roles and responsibilities of the Tax team are clearly defined. The Tax team is managed by the Head of Tax who reports to the Director of Corporate Finance, who in turn reports to the Chief Financial Officer ("CFO"). The CFO is the Senior Accounting Officer ("SAO") and has ultimate responsibility for the tax affairs of the Group.

The Thames Water Utilities Limited ("TWUL") Board has ultimate responsibility for risk management and internal control. The Executive Team is responsible for ensuring effective risk management and internal controls, including maintaining the corporate risk register and ensuring risks are mitigated within the risk appetite agreed by TWUL's Board. The Audit, Risk and Reporting Committee ("ARRC") is responsible for providing risk management and internal control assurance to the Board and overseeing the risk management process.

Significant tax developments potentially impacting the Group are communicated to the TWUL and Kemble Boards through the monthly Board report and Board meetings. Significant decisions concerning tax are escalated to the ARRC and the Boards where deemed appropriate by the Head of Tax, Director of Corporate Finance, and the CFO.

Our tax risk management

The Group's enterprise risk management policy states that "Our aim is to ensure we manage the risks associated with delivering...our strategic objectives appropriately by maximising potential opportunities and managing risks to an acceptable level, rather than eliminating risk from our business completely". Our approach to tax risk management is consistent with this overall policy - we adopt a conservative approach in order to mitigate any potential adverse implications.

Framework for managing tax risk

We are a large enterprise and continually evolving. Evolution in the business arises from regulatory changes and change projects. Examples of change in the Group's past include closing down our Cayman financing entities, selling our Guernsey insurance company, and rationalising our corporate structure. As a consequence, there is potential for tax risk:

- Transaction tax risks arising from one-off business transactions is mitigated to an

acceptably low level through the application of our Tax Code of Conduct, as previously explained.

- Potential operational and compliance tax risks are identified by the Tax team through regular dialogue with senior members of the business units and central functions.
- Potential tax risks are assessed by likelihood and impact, and processes and controls are implemented to mitigate the risks to an acceptably low level. The controls are reviewed regularly for effective operation and improvements.
- The above framework allows the Group to comply with its SAO obligations and maintain appropriate tax accounting arrangements.

A corporate risk register is maintained by the Risk, Audit and Assurance Department which documents risks, their potential impact and mitigating controls. The tax risk profile is monitored and managed in line with our corporate risk management framework and enterprise risk management policy. Risks, potential impacts and mitigating controls are regularly discussed with the CFO and where necessary risks are escalated to the corporate risk register. The Head of Tax regularly reviews Thames Water's tax risks and discusses with the CFO where appropriate. The top corporate risks are communicated to and discussed at the ARRC and Board. As the Group's principal activity is the delivery of water and sewerage services, the risks of the Group are largely the same as for TWUL.

Compliance statement

As in previous years, the Tax team has updated its processes and controls documentation. The following tax topics have been presented and discussed at the TWUL and Kemble Boards in June 2023: tax profile and tax compliance status; impact of forecast FY23 TWUL tax loss and corporate interest restriction; impact of new capital allowances rules on super-deduction and full expensing; correspondence with Ofwat on tax gross-ups of outcome delivery incentives; £500m of shareholder funding implemented in March 2023 on a tax neutral basis; liaison with Trinzic team re set up of new sub-group of companies in Kemble Group.

5. We accept only a low level of tax risk in relation to taxation

What does "level of risk" mean?

The "level of risk" refers to the likelihood and impact of adverse tax consequences materialising. "Adverse tax consequences" has a wide meaning and includes any potential reputational damage, downgrading of our HMRC risk rating, unexpected tax liabilities and penalties. A "high risk" approach (e.g. using tax avoidance schemes) has the potential to create value and reduce costs, but has the significant associated risk of reputational damage, unexpected tax liabilities, and exposure to penalties. Conversely, a "low risk" approach may create little value and be costly to maintain but has reputational benefits.

Level of acceptable tax risk

We adopt a conservative low risk approach to taxation. We believe that this is consistent with our approach to tax risk management and governance, and our attitude to tax planning, as explained previously.

Our approach to the level of acceptable tax risk has been agreed by the Board and provides a clear and sustainable framework for the future. It is influenced by our perception of what our customers, employees, the wider public and other stakeholders expect of us, and the potential adverse reputational implications that might arise if we were to adopt a higher risk approach.

Like any large group, there can be occasions where we may disagree with HMRC. However, our tax policies reduce the likelihood and impact of such instances. Where disagreements do arise, we will be robust in our defence where we believe we are applying tax legislation in the manner in which Parliament intended.

Compliance statement

As in previous years, the Group has continued to ensure that a low level of risk is maintained.

Responsibilities

All employees in our Tax team operate in accordance with this strategy and tax code of conduct

The financial leadership is responsible for setting the strategy

The Board is responsible for approving the tax strategy

Contacting us

For questions, comments or feedback relating to this strategy, you can contact us through <https://www.thameswater.co.uk/contact-us>.

If you have any concerns about any issues relating to our tax strategy you can contact the Executive Sponsor.

For concerns regarding dishonest or unethical behaviour, please contact us on any of the following:

Speak to us in confidence
07747 640 072
investigations@thameswater.co.uk

Report anonymously
0800 917 6936
thameswaterspeakup.co.uk

Write to the CEO
Thames Water Utilities Ltd
Clearwater Court
Reading RG1 8DB

If you are an employee of Thames Water, you can also speak with your Line Manager.

Useful references

- [Our Finances Explained publication](#)

Executive Sponsor: Alastair Cochran, Chief Financial Officer (CFO)

Approval Date: 27 March 2024

Appendix

Our Tax Code of Conduct

- We take non-tax considerations into account when determining the most appropriate approach.
- We will not undertake transactions that do not have commercial or economic substance, and we will not take an aggressive interpretation of tax legislation.
- We will seek external tax advice where the tax treatment is uncertain. This ensures that we understand the technical position, risks and benefits, and what might be regarded as an aggressive interpretation of tax legislation.
- Where possible we will seek formal advance clearance from HMRC on potential transactions where material uncertainty remains even after taking external tax advice.

A paper is prepared for significant business transactions outlining how it complies with our Tax Code of Conduct, and the associated risks and benefits. This paper is reviewed and approved by the CFO. The Tax team works with the business throughout the life of a transaction to ensure that its implementation is in accordance with its original scope.