



PRUDENTIAL



# Managing our tax affairs responsibly and sustainably

Prudential plc

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# Introduction

At Prudential, our purpose is to help de-risk the lives of our customers and enable them to face the future with greater confidence. At the same time, we provide sustainable returns for our investors, jobs and development opportunities for our employees and wider social and economic benefits to the communities in which we operate, including financial confidence and investment in infrastructure and the real economy.

Paying the right amount of tax at the right time is a key part of those wider benefits. Around the world in 2017 we made a total tax contribution of more than £2.9 billion, enabling communities to provide vital public services and foster the development of infrastructure that provides a platform for growth and prosperity.

We seek to build constructive relationships with tax authorities and provide transparent disclosure to ensure that our stakeholders are well informed about our tax matters. Tax transparency is important to all our stakeholders – tax authorities, investors, employees and customers – and we ensure that we meet this need by providing within this report a tax contribution analysis of every major market in which we operate. This shows the clear link between our business footprint around the world and our tax footprint, demonstrating how we generate the most revenues and pay the most tax in the places where we have the most presence.

Our accountability and governance on tax matters are clear and strong. Our tax strategy applies to all our local businesses in all jurisdictions in which we operate. We report on our tax affairs on a regular basis to the Group Audit Committee and to the Board, which is accountable for the tax strategy, we have mechanisms in place to ensure awareness of and adherence to the principles outlined in this document, and we have clear procedures in relation to tax risk management.

This report has been prepared to meet the requirements of the UK Finance Act 2016 to publish a tax strategy annually, and also provides insight into our responsible and sustainable tax practices worldwide, alongside additional tax disclosures, which complement the existing disclosures in our 2017 Annual Report. This publication was approved by our Group Audit Committee in May 2018.

Our tax strategy is a key part of our contribution to the communities around the world in which we operate. We take a transparent and sustainable approach to all our tax matters, and we will continue to do so. I hope you find this report useful and informative.



**Mark FitzPatrick**  
Chief Financial Officer  
Prudential plc

**£2,903m**

2017 global total tax contribution

# Our tax strategy

Our clear and consistent business strategy is to meet the long-term savings and protection needs of a growing middle class and ageing population. We focus on three markets – Asia, the US and the UK – where the need for our products is strong and growing and we use our capabilities, footprint and scale to meet that need. In recent years, we have expanded into Africa, taking advantage of the emerging demand for our products in the region.

Our trusted brands and strong distribution channels enable us to understand the growing needs of our customers for long-term savings and financial security, and to design innovative products that meet those needs. By helping to build better lives and stronger communities and to fuel the growth cycle, we create long-term value for both our customers and our shareholders.

## Responsible and sustainable management of our tax affairs

### Tax compliance

We act responsibly in all of our tax matters. We understand the importance to governments and societies of paying the right amount of tax on time, and so we take our tax compliance obligations seriously.

### Approach to tax

We take an objective view of the generally understood interpretation of the tax laws and regulations in each jurisdiction in which we operate.

### Governance

We manage tax (including uncertainties and risks) in line with our Group Governance Framework and risk management procedures.

### Transparency and engagement with stakeholders

We provide transparent disclosure of our tax affairs to better inform our stakeholders of how tax works in our group and our tax governance practices. We respect the tax authorities with which we interact. Where possible and following prevailing practice, we seek to build constructive relationships with tax authorities, discussing and resolving matters in real time.

We manage our tax affairs to provide responsible and sustainable support to our business strategy. In delivering this tax strategy through our day-to-day operations, we follow a set of guiding principles (see boxes).

Customers are at the heart of our business strategy and the business decisions we make. Responsible tax practices – in terms of providing tax-efficient products and investment returns, ensuring accurate reporting of customer information to tax authorities where required and paying the right amount of tax in each jurisdiction in which we operate – are critical in meeting the needs of our customers and providing them with peace of mind. More than ever, responsible tax practices are a key driver in customers' decision-making, and in customers becoming advocates for our business. We have an obligation to act in the best interests of our investors by maximising the returns to the people and organisations that have invested with us, through managing the taxes we pay in a responsible and sustainable manner. We seek to comply fully with all our tax obligations, including paying the right amount of tax in each jurisdiction in which we operate and applying rigorous management over our tax uncertainties and risks.

It is also in our customers' and shareholders' interest for Prudential to be a responsible business which invests in and has a positive and sustainable impact on our local communities, alongside the jobs, growth and tax revenue we provide. More information on Prudential's approach to sustainability can be found in our [Environmental, social and governance report](#).

We place great importance on having an effective relationship with those who supervise us and our markets. Our customers' interests are best served when we work constructively with our regulators. Therefore, positive and transparent engagement with tax authorities, which leads to the timely and accurate payment of taxes, helps the societies in which we operate provide valuable public services and build infrastructure for the benefit of the wider community and the economy.

### What do we mean by 'responsible and sustainable'?

By responsible, we mean that the tax decisions we make balance our responsibility to support our business strategy with our responsibility to the communities in which we operate, which need sustainable tax revenues.

By sustainable, we mean making tax decisions with a long-term rather than short-term perspective.

### What do we mean by paying the 'right' amount of tax?

Tax is inherently complex, particularly when it involves financial services and international dimensions. Where the tax treatment of a particular transaction or activity is unclear, we will follow the generally understood interpretation of tax law.

### What do we mean by 'generally understood interpretation'?

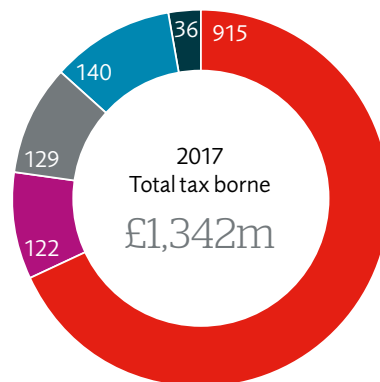
Within each of the jurisdictions in which we operate there arises over time a common view across the informed tax community (comprising taxpayers, tax advisers and the prevailing practice followed by the tax authority) of how the tax laws and regulations are interpreted and applied. This forms a 'generally understood interpretation'.

# What taxes do our businesses pay?

We set out below the taxes that our businesses bore in 2017 – which represents a cost to the Group – and the taxes our businesses collected and remitted to tax authorities in 2017. Together these represent the total tax contribution of the Group (£2,903 million) to the societies and economies in which our businesses operate and invest. In addition, we have provided a comparison between the 2017 and 2016 total tax contribution for the six jurisdictions in which we pay the most tax and the historical total tax contribution for the past five years in the Appendix.

**Figure 1: 2017 tax borne**

- Corporation tax
- Irrecoverable VAT and sales tax
- Employer payroll taxes
- Other withholding taxes
- Property taxes



## Corporation tax

The Group pays corporation tax on taxable profits as computed under the relevant tax laws of the jurisdictions in which we operate or have a taxable presence. Further details about what drives our taxable profit is set out in the Appendix.

## Irrecoverable VAT and sales tax

The Group incurs VAT and other sales taxes on goods and services that it purchases. In most jurisdictions, life insurance products are exempt from VAT and sales tax and our insurance businesses can usually only recover a small proportion of the VAT and sales tax incurred. The VAT and sales tax incurred that we cannot recover results in a cost to the Group.

## Employer payroll taxes

This represents the payroll tax such as national insurance and social security, that the Group's businesses pay as an employer.

## Other withholding taxes

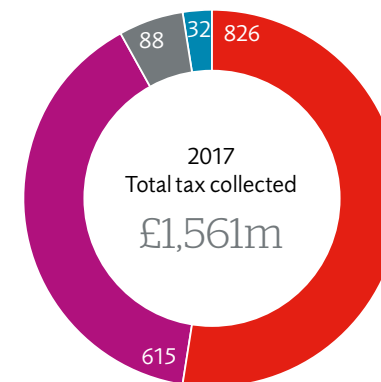
As a large institutional investor, the Group incurs withholding tax on investment income (eg dividends and interest) received in certain jurisdictions. Where the withholding tax cannot be offset against corporation tax or otherwise recovered, it represents a cost to the Group.

## Property taxes

This relates to stamp duty or transfer tax paid on properties we have bought.

**Figure 2: 2017 tax collected**

- Tax collected from policyholders
- Employee payroll taxes
- Sales and premium tax collected
- Other withholding taxes



## Tax collected from policyholders

In jurisdictions such as the UK and US, we are required to deduct tax from annuity payments made to customers and remit this to the relevant tax authority.

## Employee payroll taxes

In many jurisdictions in which we operate, we are required to deduct tax and social security from payments made to our employees, and then remit this tax and social security to the local tax authority.

## Sales and premium tax

The Group collects sales tax (eg VAT/GST) on some services it provides to third parties and its customers, and remits the tax collected to the relevant tax authority.

## Other withholding taxes

The withholding taxes collected represent tax deducted by our businesses on certain payments to third parties.

# How much tax do we pay?

We make significant tax contributions in the jurisdictions in which we operate. In 2017, our global total tax contribution was £2,903 million. Figure 3 breaks down corporation taxes paid, other taxes borne and taxes collected for each jurisdiction in which £5 million or more in total tax was paid to the local tax authority in 2017. Revenue, profit and employee numbers for these jurisdictions are also shown to give context for the tax disclosures. As can be seen from Figure 3, the Group's tax footprint (where we pay taxes) is consistent with the Group's economic footprint (where we earn revenues and profits).

The tax notes in our financial statements provide information on our effective tax rates and why these differ from the corporation tax rates applicable to the Group's businesses. These can be found on pages 196 to 201 of the Group's 2017 Annual Report.

**Figure 3: 2017 total tax contribution by jurisdiction**

| 2017 (£m – other than employee numbers) |                                  |                                       |   |                                     |                                |                              |                      |                          |
|---|----------------------------------|---------------------------------------|---|-------------------------------------|--------------------------------|------------------------------|----------------------|--------------------------|
|   | Total revenue net of reinsurance | Profit (loss) before tax <sup>1</sup> | Total current tax charge <sup>2,3</sup> | Corporation taxes paid <sup>4</sup> | Other taxes borne <sup>5</sup> | Taxes collected <sup>6</sup> | Total taxes remitted | Average employee numbers |
| UK                                      | 28,070                           | 756                                   | 495                                     | 441                                 | 197                            | 912                          | 1,550                | 6,262                    |
| USA                                     | 34,132                           | 603                                   | (55)                                    | 117                                 | 68                             | 507                          | 692                  | 4,567                    |
| Indonesia                               | 2,327                            | 454                                   | 107                                     | 100                                 | 44                             | 20                           | 164                  | 2,060                    |
| Malaysia                                | 1,627                            | 163                                   | 28                                      | 32                                  | 11                             | 31                           | 74                   | 2,255                    |
| Singapore                               | 5,268                            | 441                                   | 49                                      | 65                                  | 5                              | 4                            | 74                   | 1,422                    |
| Hong Kong                               | 11,808                           | 590                                   | 60                                      | 66                                  | 4                              | –                            | 70                   | 1,516                    |
| Vietnam                                 | 1,001                            | 185                                   | (23)                                    | 13                                  | 3                              | 9                            | 25                   | 5,179                    |
| Thailand                                | 625                              | 54                                    | 11                                      | 14                                  | 5                              | 4                            | 23                   | 762                      |
| Philippines                             | 545                              | 33                                    | 5                                       | 5                                   | 6                              | 10                           | 21                   | 656                      |
| Japan                                   | 56                               | 7                                     | 3                                       | 1                                   | 11                             | –                            | 12                   | 56                       |
| Germany                                 | 16                               | 8                                     | 5                                       | 3                                   | 6                              | 2                            | 11                   | 34                       |
| Ireland                                 | 214                              | 13                                    | 1                                       | 2                                   | 6                              | 2                            | 10                   | 69                       |
| Taiwan                                  | 1,004                            | 107                                   | 2                                       | (3)                                 | 5                              | 6                            | 8                    | 843                      |
| France                                  | 10                               | 1                                     | –                                       | –                                   | 7                              | 1                            | 8                    | 24                       |
| India                                   | 16                               | 4                                     | 1                                       | 5                                   | –                              | 1                            | 6                    | 685                      |
| Italy                                   | 20                               | 10                                    | 3                                       | 2                                   | 3                              | 1                            | 6                    | 23                       |
| Switzerland                             | 4                                | –                                     | –                                       | –                                   | 5                              | –                            | 5                    | 9                        |
| Korea                                   | 281                              | (4)                                   | (1)                                     | 1                                   | 3                              | 1                            | 5                    | 70                       |
| Rest of the world                       | 208                              | 15                                    | 5                                       | 5                                   | 15                             | 9                            | 29                   | 659                      |
| <b>Total subsidiaries</b>               | <b>87,232</b>                    | <b>3,440</b>                          | <b>696</b>                              | <b>869</b>                          | <b>404</b>                     | <b>1,520</b>                 | <b>2,793</b>         | <b>27,151</b>            |
| Joint ventures and associates           | –                                | 302                                   | –                                       | 46                                  | 23                             | 41                           | 110                  | –                        |
| Intra-group revenue <sup>7</sup>        | (670)                            | –                                     | –                                       | –                                   | –                              | –                            | –                    | –                        |
| Gain on disposal of businesses          | –                                | 228                                   | –                                       | –                                   | –                              | –                            | –                    | –                        |
| <b>Group total 2017</b>                 | <b>86,562</b>                    | <b>3,970</b>                          | <b>696</b>                              | <b>915</b>                          | <b>427</b>                     | <b>1,561</b>                 | <b>2,903</b>         | <b>27,151</b>            |
| <b>Group total 2016</b>                 | <b>71,842</b>                    | <b>3,212</b>                          | <b>1,377</b>                            | <b>950</b>                          | <b>382</b>                     | <b>1,555</b>                 | <b>2,887</b>         | <b>26,267</b>            |

## Notes

- 1 This measure is the formal profit before tax measure under IFRS. Profit before all taxes is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of the Prudential Assurance Company's with-profits fund, after adjusting for taxes borne by policyholders.
- 2 The total current tax charge is the tax liability we expect to be due when the 2017 corporation tax returns are filed, together with adjustments for prior years. This differs from the corporation tax paid in the year principally due to the timing of when tax is paid, and also because the tax payments in 2017 include adjustments to tax payments made in previous years reflecting tax returns filed or adjusted in 2017. These differences between current tax charge and tax paid are explained further in the following section 'Why does the amount of corporation tax paid differ from the tax charge in the accounts?'
- 3 The £55m tax credit for the US reflects the impact of the tax deductions for derivative losses which, as noted on page 197 of the 2017 Annual Report, was the main cause of a reduction in the Group's current tax expense from 2016 to 2017. The tax credit in Vietnam reflects the exclusion from taxable profit of unrealised gains, which are taxable when realised.
- 4 Corporation tax includes (i) corporation tax paid on taxable profits, and (ii) withholding tax on income in Indonesia and the Philippines where this withholding tax is a form of corporation tax. In addition, for certain jurisdictions such as the UK, the corporation tax paid includes amounts paid on policyholder investment returns on certain life insurance products. In 2017, the corporation tax paid in the UK on policyholder investment returns was £298 million (2016: £226 million). The taxable profit on which corporation tax is calculated, will be based on local tax laws and regulations, typically using local generally accepted accounting principles ('GAAP') profits as a starting point. As noted in the Appendix, there are some jurisdictions where the taxable profit is based on something other than the local GAAP profits.
- 5 Other taxes borne include irrecoverable VAT, sales tax, employer payroll taxes, withholding taxes and property taxes. Withholding taxes are disclosed against the jurisdiction to which the withholding tax has been paid.
- 6 Taxes collected are taxes that Prudential is required to collect from employees, customers and third parties which are paid to tax authorities. See Figure 2 for more information.
- 7 The Group's asset management operations provide services to the Group's insurance operations. These intra-group fees included within revenue of the asset management operations are eliminated on consolidation.

# How much tax do we pay? continued

## Why does the amount of corporation tax paid differ from the tax charge in the accounts?

The amount of corporation tax paid (sometimes referred to as the cash tax paid) will differ each year from the current tax charge shown in the Group's Annual Report. This is due to a number of factors. The principal factor is the timing of when payments are made in respect of a given financial period. Some payments will be due during the year in question and some will be due in the following year. A secondary factor is that adjustments made when the tax return is filed (or when the tax return is agreed with the tax authority) can lead to additional tax payments being made or refunds being received in a later year.

In 2017 our current tax charge was £696 million and our corporation tax payments were £915 million. Figure 4 provides a reconciliation between the expected tax charge and the current tax charge and Figure 5 reconciles the current tax charge to the corporation tax payments made during 2017.

**Figure 4: 2017 reconciliation of expected tax to current tax charge**

|   | £m           | 2017 Annual Report reference |
|---|--------------|------------------------------|
| <b>Profit before tax</b>  | <b>3,970</b> | Page 161                     |
| Less: Tax charge attributable to policyholders' returns (Note 1)        | (674)        | Page 161                     |
| Profit before tax attributable to shareholders                          | 3,296        | Page 161                     |
| Tax at the expected rate of 23.9% (Note 2)                              | <b>789</b>   | Page 198                     |
| Adverse recurring items (Note 3)  | 131          | –                            |
| Favourable recurring items (Note 4)                                     | (483)        | –                            |
| Non-recurring items (Note 5)  | 469          | –                            |
| Less: Deferred tax charge attributable to shareholders                  | (618)        | Page 196                     |
| Total Current tax charge attributable to shareholders                   | 288          | Page 196                     |
| Add: Current tax charge attributable to policyholders' returns (Note 1) | 408          | Page 196                     |
| <b>Current tax charge</b>   | <b>696</b>   | Page 196                     |

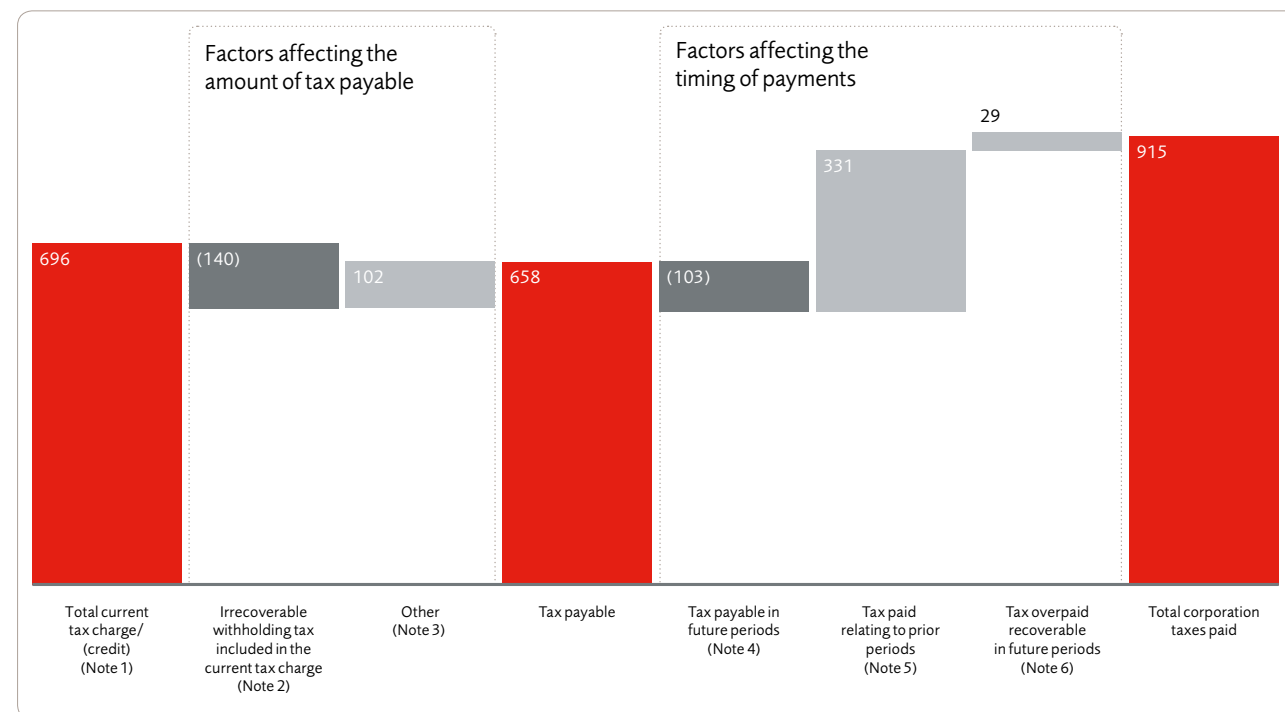
## Notes

The following items affect the 2017 total current tax charge:

- 1 The total tax charge attributable to policy holders of £674 million is split between current tax of £408 million and deferred tax of £266 million and represents corporate tax charged on the investment returns of our insurance funds which are subject to tax at the policyholder rate. This differs from the "tax collected from policyholders" outlined in Figure 2.
- 2 Total expected tax of £789 million reflects the tax on profit before tax attributable to shareholders using the corporate tax rates that are expected to apply to the taxable profit of the relevant businesses.
- 3 Items that increase the current tax charge include: deductions not allowable for tax purposes (£55 million); deferred tax adjustments (£22 million); and irrecoverable withholding taxes (£54 million).
- 4 Items that decrease the current tax charge include: income not taxable or taxable at concessionary rates (£91 million); items relating to taxation of life insurance businesses (£332 million); the effect of the post-tax results of joint ventures and associates being included in pre-tax profits (£55 million); and other (£5 million). More detail on these adjustments can be found on page 199 of the 2017 Annual Report.
- 5 Items that are not expected to recur include: adjustment to current tax charge in relation to prior years (£24 million); movement in provision for open tax matters (£44 million); impact of US tax reform on deferred tax balances (£445 million); and adjustments in relation to business disposals (£4 million). More detail on these adjustments can be found on pages 199 and 200 of the 2017 Annual Report.

# How much tax do we pay? continued

**Figure 5: Reconciliation of current tax charge to corporation tax paid 2017 (£m)**



The following items affect the total amount of tax payable and not the timing of payments:

- 1 Total current tax charge of £696 million is per Note B4 on pages 196 to 201 in the 2017 Annual Report and comprises the current tax charge in respect of 2017 together with adjustments for prior years. It does not include any deferred tax.
- 2 Reducing tax payable, this relates to irrecoverable withholding tax on dividends payable to the UK from certain non-UK subsidiaries, and dividends on overseas portfolio investments of insurance funds. The withholding tax is included in the accounts current tax charge but as it is not corporation tax as such, it is not included in the corporation tax paid. The withholding tax is included in 2017 total taxes borne as per Figure 1 of this report.
- 3 Increasing tax payable, 'Other' includes a combination of £54 million in respect of Prudential's share of tax paid from joint ventures and associates, prior year adjustments of £50 million and £42 million of other adjustments, including foreign exchange, offset by a £(44) million reduction relating to movement of provisions for open tax matters.

The following items affect the timing of tax payments and not the total amount payable:

- 4 In most jurisdictions, corporation tax is payable in regular instalments, some of which fall into the current period, and some which fall into the following year.
- 5 This is a combination of £342 million in respect of instalment tax payments falling due in 2017 relating to 2016, partly offset by £(11) million repayments from tax authorities following routine true-ups of prior period tax returns. The tax paid in 2017 relating to prior periods is lower than what might have been expected (£447m per Figure 5 in the 2016 published tax strategy) principally due to overpayments of tax paid in 2015 by our US business being used to settle 2016 tax liabilities falling due for payment in 2017.
- 6 Instalment tax payments are typically based on estimated taxable profits. The £29 million above reflects overpaid tax following a downward revision of estimated taxable profits.

# How we manage our tax affairs

## Questions we consider when making tax decisions

- What is the overall business objective underpinning our approach?
- Is the tax position sustainable in the long term, or is it based on an area of tax law that is likely to change?
- What is the legal and regulatory framework that we need to respect?
- Does the idea reflect the business and economic reality?
- What is the potential reputational impact?

## Our approach to tax planning

The management of our tax affairs reflects the regulatory, legal and commercial environment in which our businesses operate. All decisions are taken after careful consideration of all the issues and potential impacts. Where we have a choice on how to structure a particular business, transaction or investment, we will structure it in a tax-efficient manner, where we have concluded that it is a responsible and sustainable choice, consistent with our business strategy. We do not base our decisions on aggressive interpretations of the tax law.

## Managing and structuring investments

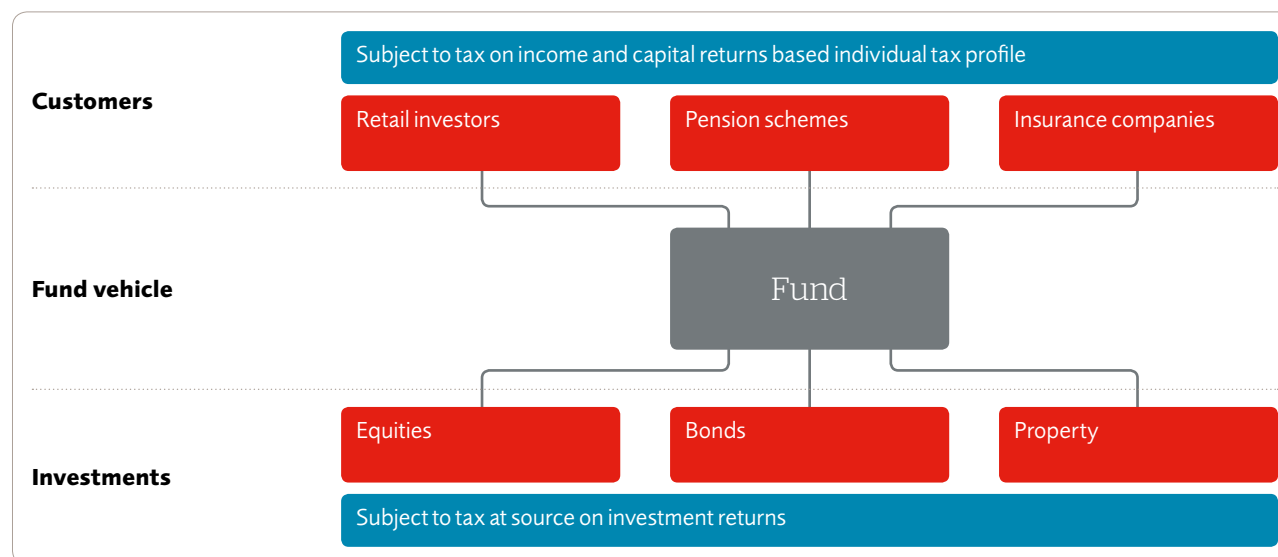
An important part of our business is managing investments from our insurance companies and third parties through investment vehicles. Collective investment vehicles, such as funds, are designed to provide a cost-efficient, diversified pooling vehicle to facilitate investment and savings. Funds are widely accepted and used by a variety of investors for a number of reasons:

- Professional management – investing directly requires considerable time and research. Our asset managers have the expertise to keep on top of any market changes and make the decisions about when to buy or sell assets.
- Spread the risk – our funds help mitigate the risk associated with investing into individual stocks and bonds. If one of the fund's investments underperforms, its impact may be mitigated for the investor by the overall investment performance.

- Convenience – our asset management companies handle the buying and selling of the assets and the collection of dividends and income on behalf of the investors.
- Reduced cost – by pooling investors' money the cost of investing is reduced and shared.

It is common for funds to be established in jurisdictions that do not impose an additional layer of taxes on the fund itself. Instead the investment return is taxed in the hands of the investor (commonly referred to as the 'look through tax treatment'). This ensures that as much as possible of the investment return from the underlying investments flows through to the investors. Most widely held fund vehicles seek to ensure the investors' tax position would be the same if they had the capacity to invest directly. Regardless of where the fund is established, investors will be subject to tax on investment returns in accordance with the tax rules of those jurisdictions where the investors are resident.

Illustrative example of simplified fund structure:



# How we manage our tax affairs continued

## Our investments

Our insurance companies hold a broad investment portfolio on behalf of our customers that will include investments in real estate and infrastructure. Such investments are typically made through a layered fund structure with special purpose vehicles that will hold the underlying physical assets. These may be supported by debt funds that provide a vital source of capital for companies that own real estate and infrastructure investments to enable future economic growth. These funds will often be managed by one of our investment managers and widely held by both external investors and Prudential's insurance companies.

Funds are often structured with various legal entities in different jurisdictions. There are a number of reasons for this including commercial and regulatory factors, eg to facilitate the segregation and limited liability of investments, to provide flexibility on the future disposal of investments or, as is often the case with real estate, to address legal impediments of non-residents holding property.

In common with other investors, our insurance companies invest in funds as part of a diversified investment strategy and as part of managing liquidity. Real estate and infrastructure funds in particular also provide a vital source of capital for investment to drive future economic growth. In many instances our insurance companies will provide the start-up capital for such funds.

Fund look through tax treatment is recognised in many tax regimes throughout the world and we do not invest in funds with the intention to reduce the tax that we pay. Our investing companies will be subject to tax on income and capital returns from the fund based on their individual tax profile. The consequence of our companies investing in these funds is that in most instances the tax paid is similar to what the tax would have been if our companies had invested directly in the underlying assets.

## Low tax rate jurisdictions

At the end of 2017, the Group had 32 entities<sup>1</sup> tax resident in jurisdictions with a headline corporate tax rate of 10 per cent or lower. The 32 entities accounted for 0.01 per cent (£7 million) of total Group revenues (2016: 0.01 per cent, £10 million) and 0.13 per cent (£5 million) of total Group profit (2016: 0.06 per cent, £2 million). Figure 6 provides an analysis of these entities by location and activity.

**Figure 6: 2017 analysis of entities tax resident in low tax rate jurisdictions**

|                      | Total     | Insurance | Investment activity | Investment management | In liquidation |
|----------------------|-----------|-----------|---------------------|-----------------------|----------------|
| Bermuda              | 1         | 1         | –                   | –                     | –              |
| Cayman Islands       | 6         | 1         | 4                   | 1                     | –              |
| Guernsey             | 14        | 1         | 9                   | 4                     | –              |
| Jersey               | 10        | –         | 10                  | –                     | –              |
| United Arab Emirates | 1         | –         | –                   | –                     | 1              |
| <b>Total</b>         | <b>32</b> | <b>3</b>  | <b>23</b>           | <b>5</b>              | <b>1</b>       |

We also have a number of business operations in jurisdictions that often feature on lists of low tax rate jurisdictions. For example, as evidenced in Figure 3, we have a significant presence in Hong Kong and Singapore where we are one of the leading providers of life insurance and asset management services offering savings and protection opportunities to local customers. In Ireland, we have been offering investment bonds to predominantly UK customers for nearly 20 years.

In common with the asset management industry, our asset management businesses have fund-related entities in jurisdictions such as Luxembourg, Mauritius, Ireland and the Cayman Islands. These jurisdictions are established centres for asset management businesses, and because they typically have either low or zero corporate tax rates or special rules for asset management vehicles, basing funds in these jurisdictions will in most situations ensure that our customers are only taxed once, where the customer is resident. We comply with all customer tax disclosure requirements for the funds that we manage.

M&G Prudential has established an authorised presence in Luxembourg and launched a new range of Luxembourg domiciled SICAV funds. As one of the most popular investment vehicles within Europe, the ability to offer SICAV funds will enable M&G Prudential to expand and deepen its highly successful international business further over the coming years. The new platform will also ensure that M&G Prudential can continue to serve its European-based customers regardless of the outcome of Brexit negotiations between the UK and the EU.

## Note

1 Note D6(c) of the Group's 2017 Annual Report provides a full list of entities disclosed in accordance with Section 409 of the Companies Act 2006.

# How we manage our tax affairs continued

## Interaction with tax authorities

Our tax affairs are complex, reflecting a combination of specific or additional corporation tax rules for life insurance companies, the range of taxes that apply to our businesses and the cross-border dimensions that come from being an international group. We deal with tax authorities in an open and constructive manner aimed at bringing matters to a timely conclusion. In the UK, we are committed to discussing all significant matters in real time with HMRC.

The complexity of the tax laws and regulations that relate to our businesses means that from time to time we may disagree with tax authorities on the technical interpretation of a particular area of tax law. Generally this is due to:

- Ambiguity in the law and its intent;
- Changes that occur over time in tax authority interpretation;
- Case law developments; and
- Tax law not keeping pace with product or wider commercial/regulatory developments.

Most of the time, these disagreements can be resolved through discussion. Sometimes, however, it is necessary for the matter to proceed to litigation to clarify the interpretation of the law.

## Tax policy work

We believe that more informed and sustainable outcomes are achieved where governments openly consult with industry and other affected stakeholders. We work with governments, both directly and through industry trade bodies, to explain the wider impact that tax proposals will have on the industry, the regulatory environment and our customers. We seek to provide pragmatic, proportionate and constructive comments to help meet the objectives of new initiatives in the interests of all of our stakeholders. We have engaged with US, UK and other tax authorities on the scope and implementation of a variety of matters including the recent US tax reform and the implications of Brexit on the financial services industry. Similarly, we have proactively engaged with civil society forums that are focused on building a sustainable and transparent global tax system.

## Use of tax advisers

Our tax teams at group, regional and jurisdiction level are comprised of individuals with a mix of industry and business knowledge and subject matter expertise. From time to time we will engage tax advisers to provide specialist expertise, to provide second opinions on significant transactions, to help us understand new legislation or to provide us with insight on industry practice. In addition, we engage tax advisers (and others) to undertake tax compliance work on our behalf in various jurisdictions where it is more cost-efficient or operationally sensible to do so.

# Governance and management of tax risk

## Governance over tax

Ownership of our tax strategy, as with the wider business strategy, rests with the Group's Board. The day-to-day responsibility for tax rests within the business units, as taxes by their nature are levied on legal entities, and sometimes groups of entities, rather than on the Group as a whole. Business unit audit and risk committees receive regular reports and updates on material tax risks, tax disputes and tax policy developments. Business units submit regular tax risk reports to Group Tax, which are reviewed by the Group's Head of Tax, and are discussed in regular meetings between the Group Tax function and the business units. At Group level, the Group Audit Committee receives regular updates from the Group's Head of Tax on material tax issues, tax disputes and tax policy developments. The Chief Financial Officer provides updates on material tax matters as part of the regular updates to the Board.

## Managing tax risk

Tax risk is managed in a manner consistent with the management of all other risks. We recognise that we are implicitly committing to customers that we will maintain a healthy company, and are there to meet our long-term commitments to them. We define 'risk' as the uncertainty that we face in implementing our strategies and objectives successfully. As outlined in our report on the risks facing our business and how these are managed in our 2017 Annual Report, we have well defined risk governance structures in place made effective through individuals, Group-wide functions and committees involved in the management of risk. Our Group Risk Framework requires all of our business units and functions to establish processes for identifying, evaluating, managing and reporting the key risks faced by the Group. Our Group Tax Risk Policy comprises processes to identify, measure, control and report on our tax risks within this framework.

## We define tax risk as:

Any uncertainty from either the interpretation of tax law to a particular situation or the practical implementation of tax law in an operational or tax compliance sense, which has the potential to have an adverse financial or reputational outcome.

Risk identification covers Group-wide:

- Top down risk identification
- Bottom up risk identification
- Emerging risk identification

Risk reports provide monthly updates to the Group Executive Risk Committee, Group Risk Committee and Board on exposure against Board-approved risk appetite statements and limits.

Risk reports also provide updates on the Group top risks.



Risks are assessed in terms of materiality.

Material risks which are modelled are included in capital models, including ECap.

Risks which cannot be quantified are assessed qualitatively.

Risk processes that support the management and controlling of risk exposures include:

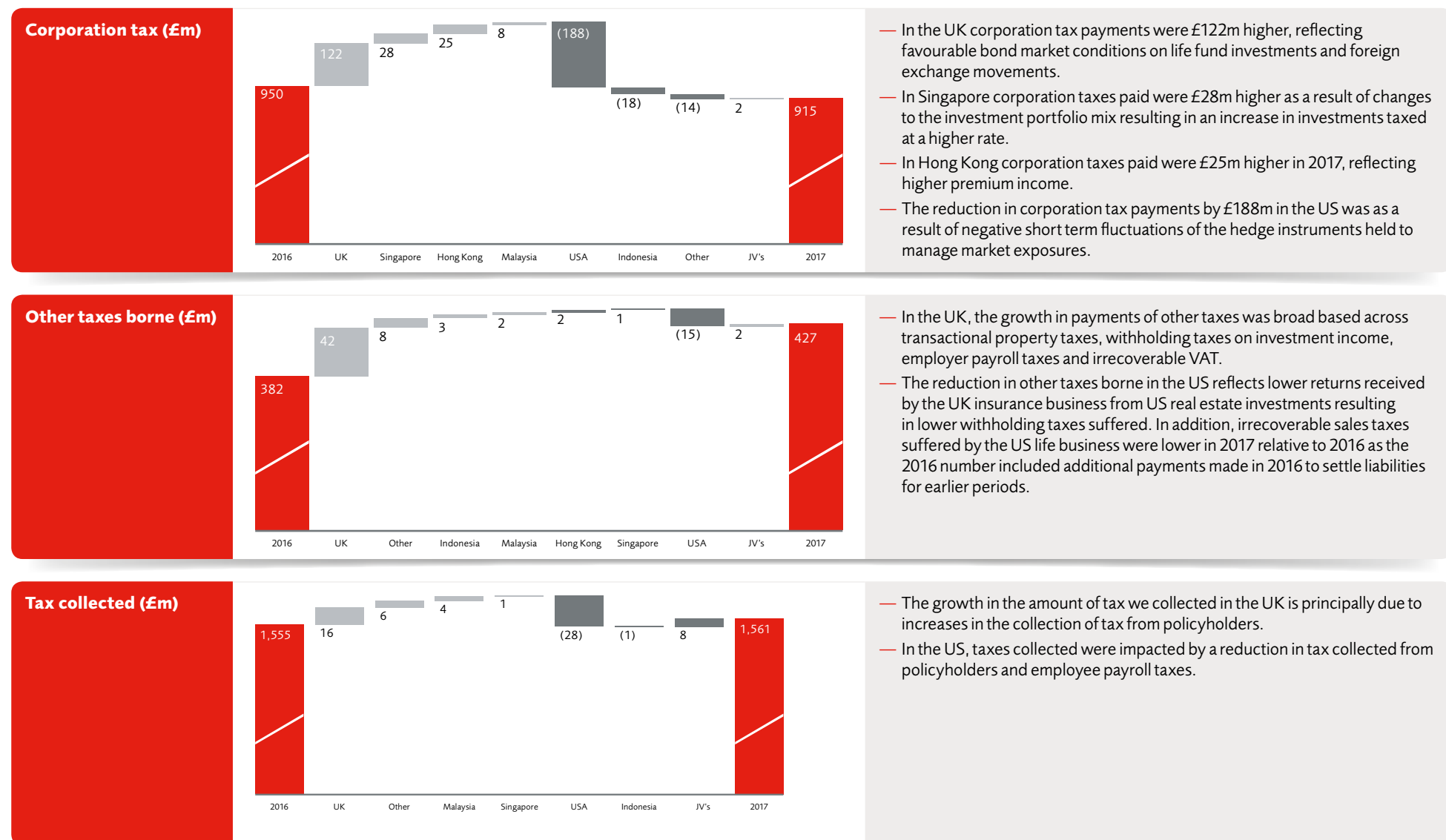
- Risk appetite and limits
- Financial incidents procedures
- Large risk approval process
- Global counterparty limit framework
- Own risk and solvency assessment
- Reverse stress testing

Tax risk can broadly be grouped into four categories as set out in the table below.

|                    | Technical judgment tax risk   | Operational tax risk  | Regulatory tax risk  | Reputational tax risk  |
|--------------------|---|---|--|--|
| Definition         | This is the uncertainty arising where a transaction or investment is structured, or a tax return is filed based on an interpretation of the tax law where it is (1) possible that the tax authority may take a differing interpretation, or (2) where the tax authority does dispute the interpretation, or (3) where it is possible that the tax law may change in a manner that affects the tax treatment of the transaction or investment. | Risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel and systems, or from external events, which result in the filing of inaccurate or late tax returns or incorrect tax payments. | This is risk that relates to compliance with changing tax and regulatory requirements. The high rate of global tax change, in an already complex tax and wider regulatory landscape, increases the risk of non-compliance due to a failure to identify, correctly interpret, implement and/or monitor regulations. | Risk that, as a result of actions or decisions we take or as a result of an external event, the perception of our Group, from the perspective of key stakeholders, is damaged, leading to financial and non-financial impacts.   |
| Risk appetite      | We have no appetite for adopting a technical judgment which is based on an aggressive interpretation of the relevant tax law, nor do we have any appetite for adopting a technical judgment where external advice has been obtained and has indicated a 'less likely than not' chance of success.   | We have no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement and monitor appropriate controls to manage operational tax risks.  | We have no appetite for material losses (direct or indirect) suffered as a result of failing to monitor and respond to tax changes.  | We have no appetite for suffering reputational damage, which destroys shareholder value, adversely impacts revenues or results in significant costs to rectify, as a result of failing to develop, implement and monitor appropriate controls to manage reputational risk. |
| Management of risk | We take an objective view of the generally understood interpretation of the tax laws that exist. Where alternative rules or positions are available, we will only look for responsible and sustainable tax outcomes in the context of seeking to deliver long-term value for our customers and our shareholders.  | We look to manage these risks by the way we operate on a day-to-day basis when meeting all our tax filing and financial reporting disclosure requirements and our interactions with tax authorities.                                      | We actively monitor emerging tax changes and input, where appropriate, into the tax policy process.  | We expect our employees to exercise reasonable care and operate in a way that preserves the Group's reputation and to consider reputational consequences in their decision-making processes.   |

## Appendix - Prudential's total tax contribution in 2017 compared to 2016

We set out below a comparison between the 2017 and 2016 taxes that our businesses bore and collected with reference to the year-on-year differences for the six jurisdictions in which we pay the most tax.

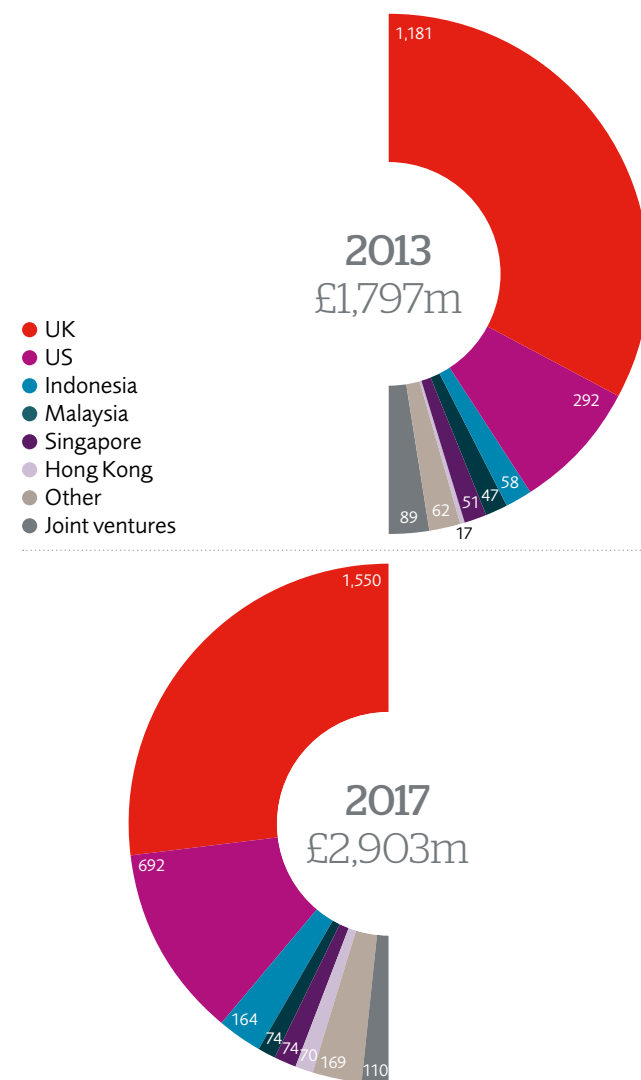
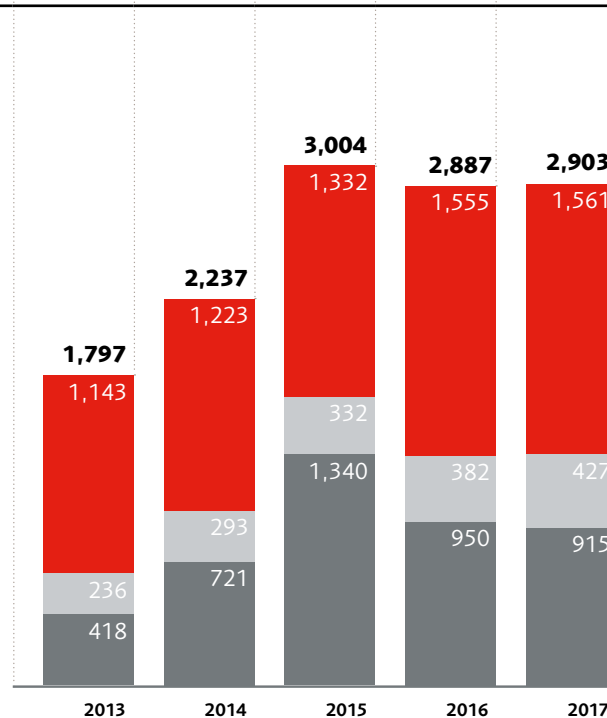


## Appendix - Prudential's total tax contribution for the past five years

Prudential has been publishing our total tax contribution since 2012. Outlined below is the Group's total tax contribution for the past five years.

|                    | Total taxes remitted (£m) |              |              |              |              | Total         |
|--------------------|---------------------------|--------------|--------------|--------------|--------------|---------------|
|                    | 2013                      | 2014         | 2015         | 2016         | 2017         |               |
| UK                 | 1,181                     | 1,275        | 1,491        | 1,370        | 1,550        | 6,867         |
| US                 | 292                       | 615          | 1,040        | 923          | 692          | 3,562         |
| Indonesia          | 58                        | 128          | 135          | 180          | 164          | 665           |
| Malaysia           | 47                        | 42           | 54           | 60           | 74           | 277           |
| Singapore          | 51                        | 31           | 48           | 44           | 74           | 248           |
| Hong Kong          | 17                        | 20           | 57           | 43           | 70           | 207           |
| Other              | 62                        | 69           | 107          | 169          | 169          | 576           |
| Total subsidiaries | 1,708                     | 2,180        | 2,932        | 2,789        | 2,793        | 12,402        |
| Joint ventures     | 89                        | 57           | 72           | 98           | 110          | 426           |
| <b>Total</b>       | <b>1,797</b>              | <b>2,237</b> | <b>3,004</b> | <b>2,887</b> | <b>2,903</b> | <b>12,828</b> |

- Taxes collected (£m)
- Other taxes borne (£m)
- Corporation taxes paid (£m)



## Appendix – Calculating our taxable profit

### What is the taxable profit based on?

For most of our businesses, the taxable profit is based on the accounting profit before tax in the financial statements. However, there are some exceptions to this for some of our insurance businesses. For example:

- In the US, the taxable profit is based on the surplus for the period from the regulatory return.
- In Hong Kong, the taxable profit for most of the business is assessed as 5 per cent of the premium income (net of reinsurance).
- In the UK, Singapore and Malaysia, the taxable profit comprises both the shareholder profit and the investment return earned for policyholders within the insurance funds (policyholder profit). In such jurisdictions, differential corporation tax rates can apply to the shareholder and policyholder profits.

### How do we approach cross-border transactions?

The international tax environment can be complex. In addition to applying the local tax laws of the jurisdiction in which we operate, we follow the OECD's principles on transfer pricing and other international tax matters to ensure we pay tax in the jurisdiction in which economic value is created.

### How are investment income and capital gains taxed?

Most jurisdictions in which our insurance businesses operate have specific tax rules relating to investment income and capital gains, and these rules apply to all businesses and not just insurance companies. However, the rules can have a more noticeable effect on the tax position of insurance companies, given that investment income and capital gains are a major part of the revenues of an insurance company.

In many jurisdictions it is common for dividend income from portfolio investments to be exempt from tax. However, in the US, dividends received from portfolio investments are included in policyholders' taxable income, but a deduction (known as the dividend received deduction) removes 70 per cent (reducing to 35 per cent effective from 1 January 2018) of the dividends from the taxable profit of the company.

In most jurisdictions, capital gains are only taxed when they are realised and so unrealised gains recognised in the accounts will not be taxed (and equally unrealised losses will not be tax deductible).

Some jurisdictions have specific tax rules that only apply to insurance companies or that apply to certain financial companies, including insurers. In the UK, unrealised gains and losses on debt securities and derivatives recognised in the accounts of insurance companies are included in the taxable profit. This can lead to significant volatility in the taxable profits of insurance companies that have investments in debt securities. In addition, in the UK, unrealised gains and losses relating to investments of life insurers in certain collective investment vehicles are amortised into the taxable profit over a seven-year period. In the US, unrealised gains and losses on certain derivatives of life insurers are amortised into the taxable profit over a number of years.

### Are policyholder liabilities and expenses tax-deductible?

Technical reserves set up for policyholder liabilities are generally tax-deductible. There are some jurisdictions (eg the US, Indonesia and Thailand) where there are either restrictions on the quantum of technical reserves that can be deducted in any one year, or where specific types of technical reserve are not tax-deductible.

Whether or not expenses incurred by an insurance company are tax-deductible will generally follow the same rules as for other companies. Many jurisdictions have specific tax rules that require acquisition (or new business) expenses to be deducted for tax purposes over a number of years and not in the year in which they are incurred.

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