Our tax strategy.

September 2018

Introduction

Last year we published 'Our Taxes Explained' for the first time, which was designed to fulfil our commitment to be open and honest with our customers and explain our taxes in a simple way. This year, we've built on this commitment and separated our tax strategy and our tax payment information which will further enhance transparency and accessibility. Our tax payment information will be incorporated into 'Our Finances Explained', where it can be viewed alongside other financial information relating to our business. It will be published at the end of October.

In Our finances explained, you'll find more information about our corporation tax position. Importantly, although Thames Water is not paying corporation tax at the moment, the only people to benefit from this are our customers. This is because the reduced cost is fully passed to customers through lower bills. That is how the regulation of the water sector works. Currently, Thames Water does not pay corporation tax because of the Government's capital allowances scheme, and the impact of our interest costs. The Government's capital allowance scheme incentivises capital investment and effectively defers the time at which tax is paid. Interest costs are deductible for tax purposes and are substantial at the moment. Again, neither the Company nor its shareholders benefit from this – only our customers see the benefit in the form of lower bills. It's also useful to consider the context. While Thames is not paying corporation tax right now, we are paying over £192 million in other taxes like business rates, payroll taxes and environmental taxes – and this is at a time when we're investing over £1 billion a year, spending a further £1 billion a year on operating costs, and our shareholders are not taking any dividend.

Our tax strategy is contained in this publication. 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 virtually unchanged from last year. We have, this year, included examples and a compliance statement, to show our policies in action and enhance the understanding of our approach to tax.

Brandon Rennet
Chief Financial Officer

Our tax strategy

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

1. We comply with all tax legislation requirements at all times, 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 Her Majesty's Revenue & Customs (HMRC) and other Government bodies, and seek to resolve 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 risk in relation to taxation

In 2016, HMRC categorised us as 'low risk' for the first time in our history. We have worked hard to achieve this coveted status, and the tax policies that we publish here will ensure that our behaviour is consistent with, and contributes towards us maintaining, this status.

Tax policy 1

We comply with all tax legislation requirements at all times, both within the letter and spirit of the law

Our principles:

- submitting all tax returns on time with accurate information and full disclosure;
- making tax payments on time, and;
- not applying an aggressive interpretation of the tax legislation.

How is this achieved?

Our Tax Department of five experienced professionals ensures all tax returns and payments are made on time. The Corporation Tax computations we submit 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 the legislation is being applied in the manner in which it is intended, i.e. it is not an aggressive interpretation. In order to understand the intention of the legislation, we consider published HMRC guidance, leading tax commentary and, if necessary, obtain external tax advice.

Compliance statement

Since the publication of our last tax strategy in June 2017, all of our Corporation Tax, VAT and employment tax returns have been submitted, and tax payments made, on time and no aggressive interpretations have been applied.

Tax policy

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We do not use tax avoidance schemes or aggressive tax planning

What is our attitude to tax avoidance and tax planning?

Our principles:

- 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 the tax legislation, and;
- we plan our tax affairs to be efficient;

What does 'tax avoidance' mean?

There is no universal definition of "tax avoidance" but HMRC says the following might indicate tax avoidance is taking place: "…the scheme is artificial or contrived; a tax haven is involved; the scheme involves money going around in a circle; the scheme involves arrangements which seem complex given what you want to do; offshore companies are involved with no commercial reason…". 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 acknowledges that a taxpayer is "entitled to plan [their] tax affairs in a way that makes sure [they] do not have to pay more tax than [they] have to". In our view, tax planning becomes "aggressive" when it is not underpinned by commercial and economic substance, or applies an aggressive interpretation of the 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 can provide opportunities for tax planning and therefore it is important for our tax policy to be clear on this. The Tax Department 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 solutions that comply with our Tax Code of Conduct are implemented.

Our Tax Code of Conduct

- Ensures that non-tax considerations are taken into account when determining the most appropriate approach;
- Prevents us from undertaking transactions with no commercial or economic substance, or from taking an aggressive interpretation of the tax legislation;
- Requires external tax advice to be sought 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;
- Outlines the circumstances in which we will seek formal advance clearance from HMRC on a potential transaction;
- Outlines the circumstances in which we will disclose a transaction to HMRC on a real time basis and seek less formal confirmation on the tax treatment;

A paper is prepared for all 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 Chief Financial Officer (CFO). The Tax Department works with the business throughout the life of a transaction to ensure that its implementation is in accordance with its original scope.

Tax reliefs

Tax reliefs and incentives are sometimes introduced by the Government to encourage investment and employment. We claim Government tax reliefs including Research & Development tax credits and capital allowances on fixed assets.

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

Use of tax havens

We have a company incorporated in Guernsey, however we do not use it for tax avoidance purposes – it manages legacy insurance claims against the Group for historic policies. As part of our commitment to simplify our structure and support transparency we will dispose of this subsidiary in 2019.

Although no tax benefit was derived from our Cayman entities, we have taken the decision to close them down to address any negative perceptions. The process to close them is nearly complete and will be outlined in detail in Our Finances Explained 2018.

Compliance statement

Since the publication of our last Tax Strategy in June 2017 we have sought advance clearance from HMRC on a number of occasions. HMRC also reviewed a number of our tax relief claims.

Tax policy

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

What do we mean?

HMRC's role is to ensure that taxpayers comply with the tax legislation. We acknowledge the importance of this role, and are committed to full and transparent discussion with HMRC on all tax matters.

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

How do we achieve this?

We have regular discussions with HMRC to explain business transactions and issues to HMRC on a real time basis, and to listen to their views. We respond to any HMRC questions promptly and maintain dialogue even where we disagree with HMRC's position. We acknowledge that errors do occasionally arise and we are committed to communicating any issues to HMRC, with proposed solutions, as soon as the facts become available.

Compliance statement

Since the publication of our last Tax Strategy in June 2017, we have met or spoken with HMRC on a number of occasions to discuss business developments on a real time basis, resulting in the agreement of a number of potential issues.

Tax policy

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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 controls and determining what level of risk is acceptable. Tax risks can arise in a number of situations:

- **Business transaction risk**
  For example, reorganisations, financing transactions and disposals can all give rise to tax risk. Under a low risk approach the business would not undertake reorganisations purely for tax avoidance purposes, or undertake refinancing transactions without consulting the tax department;
- **Operational risk**
  For example, new operating models, new billing systems and IT platforms can all give rise to tax risk. Under a low risk approach the business would not implement a new billing system without consulting the tax department. Instead sign off procedures would be in place;
- **Compliance risk**
  For example, insufficient resources, system changes, legislative changes, lack of management, etc. can all give rise to tax risk. A low risk approach would address these aspects.

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 Department. The structure, roles and responsibilities of the Tax Department are clearly defined in a centrally held manual. The Tax Department is managed by the Head of Tax who reports to the Head of Corporate Finance, who in turn reports to the CFO. The CFO is the Senior Accounting Officer (SAO) and has ultimate responsibility for the tax affairs of the Group.

The 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 risk register and ensuring risks are mitigated within the risk appetite agreed by the Company'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 Company and Group Boards through the monthly management performance pack and Board meetings. Significant decisions concerning tax are escalated to the ARRC, Group Audit Committee and their respective Boards where deemed necessary by the CFO and Head of Tax.

Our tax risk management

Overall policy

The Group's overall risk management policy is "... to ensure that every effort is made to manage risk appropriately to maximise potential opportunities and minimise the adverse effects of risk". 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 large and continually evolving. Evolution in the business arises from regulatory changes and change projects. Examples of change include closing down our Cayman entities, the Thames Tideway Tunnel arrangements, and the introduction of new billing systems. As a consequence, there is potential for tax risk:

- Transaction tax risk 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 Department through regular dialogue with senior members of the business units and central functions;
- All potential tax risks have been assessed by likelihood and impact, and processes and controls have been 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 Senior Accounting Officer obligations;

A corporate risk register is maintained by the Audit and Assurance Department which documents risks, their potential impact and mitigating controls. 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 Company's Audit, Risk and Reporting Committee (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 the Company.

Compliance statement

Since the publication of our last Tax Strategy in June 2017, the Tax Department has updated its processes and controls documentation, as it does every year. The following tax topics have been presented and discussed at the ARRC: capital allowance strategy; the publication of "Our Taxes Explained"; Corporate Criminal Offence for the Failure to Prevent Criminal Facilitation of Tax Evasion.

Tax policy

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

What does “level of risk” mean?

The “level of risk” means 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 “no risk” approach may create little value and be costly to maintain, but has reputational benefits.

Level of risk acceptable

We are willing to accept only a low level of risk in relation 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 policy on 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 media expect of us, and the potential adverse reputational implications that might arise if we were to adopt a higher risk policy.

Like any large group, there will be occasions where we 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 the legislation in the manner in which Parliament intended.

Compliance statement

Since the publication of our last Tax Strategy in June 2017, the Group has continued to ensure that a low level of risk is maintained.

Glossary

CFO	Chief Financial Officer
Company	TWUL
Group	the ultimate holding company, Kemble Water Holdings Ltd, and its subsidiaries
HMRC	Her Majesty's Revenue & Customs
TWUL	Thames Water Utilities Limited

Get in touch.

ourfinances@thameswater.co.uk

By post
Thames Water
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

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