



Pearson

# Playing our part

Pearson  
Tax report 2016

# *Contents*

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# Introduction

*Pearson's mission is to help people make progress in their lives through learning. That mission informs how we invest, develop our products and services, and measure our success.*

Our strategy to deliver growth is to:



1. Be a trusted partner

We also believe that in order to create long-term sustainable value for our shareholders, we must deliver a benefit for the communities, economies, and countries in which we work.

A key principle that underpins us in being a trusted partner is to operate ethically, responsibly, and transparently. This commitment covers a range of issues, such as treating our suppliers as partners in stimulating economic growth, paying our employees fairly, and also paying tax due.

As part of our commitment to greater transparency in how we run our business, Pearson is publishing detailed information on our tax on business profits around the world.



2. Reach more learners

Tax contributions—from individuals and businesses—are fundamental building blocks of well-functioning societies. They provide funds for governments to invest in public services including education, to create and maintain vital infrastructure, and to address inequalities.



3. Build a sustainable business

Yet tax systems and rules, both domestic and international, are often complex and difficult to understand for non-specialists. Trust in large institutions, both in government and in the private sector, has fallen, in part

because companies can do more to be transparent around tax contributions.

Strengthening and maintaining public trust in the way businesses are taxed is vital. Addressing the public concern that some multinationals are not paying their fair share of tax requires both international tax reforms and better efforts to improve public understanding and awareness.

This report sets out, for the first time, Pearson's approach to tax on business profits and the contributions we make to public finances in the countries in which we operate. We have attempted to publish relevant information about our largest markets in an accessible way and to explain complex issues of accounting or tax law wherever possible. Where this report differs from Pearson's annual report and accounts, we have sought to explain why this is.

We intend this public report to provide greater insight into the way Pearson operates and we will make it a regular feature of our corporate reporting.



**Coram Williams**  
Chief Financial Officer



**Q. What types of tax does Pearson pay?**

A. We pay and collect a wide range of taxes. These include employee, property, and sales taxes. This report focuses on tax on business profits.

**Q. How much corporation tax does Pearson pay?**

A. In 2016, we paid £45 million in tax on business profits. Pearson is going through a period of transition with trading challenges, transformation costs, and payments to fund employee pensions. This impacts our profits and thus in 2016 our payments are lower than they have been in previous years.

**Q. Why has Pearson chosen to release a tax report?**

A. We believe that there is a need to strengthen public trust in the taxation system and that one way companies can do this is by being open about their tax practices.

**Q. How do we balance the interests of different stakeholders?**

A. We recognize that different stakeholders potentially have conflicting interests. We consider what we do to be in the interests of all our stakeholders, but recognize that not everyone will agree with the decisions or positions we take.

**Q. Does Pearson have a presence in Luxembourg?**

A. No. Historically, like many other UK multinationals, Pearson did have a presence in Luxembourg. We closed our last subsidiary in Luxembourg during 2016.

# Our global tax strategy

*Our global tax strategy applies to all our businesses, including the UK, and this document therefore covers our obligation to publish our UK tax strategy, including governance, risk management, attitude to tax planning, and working with the UK and other tax authorities.*

*Our approach to tax is guided by our corporate values and by our Code of Conduct. Our tax principles have been published on our corporate website since 2014. These were reviewed and refreshed this year and they guide tax strategy at Pearson.*



## Taxation principles

This report concentrates on tax on business profits; however, our tax principles apply to all taxes, including indirect taxes or sales taxes and payroll taxes. The principles that guide us at Pearson are:

1. To comply with all relevant tax laws, regulations, and tax reporting requirements in all jurisdictions in which we operate, including claiming available tax incentives and exemptions that are available to all market participants and in accordance with generally recognized interpretation of the law.
2. To run our tax affairs in accordance with Pearson's values, code of conduct, risk management, and governance procedures, which include regular reporting to the board, the chief financial officer, and to the audit committee on tax strategy and risks. In addition, any material changes in tax legislation, business environment, or operations will be assessed, and any resultant changes to strategy or risk will be reported as appropriate.
3. To pay tax on profits according to where value is created within the normal course of commercial activity, with transactions

priced within an appropriate arm's-length range, i.e. cross-border transactions take place as if the parties were unconnected. Any exceptions to this are compliant with local laws and fully disclosed to the tax authorities concerned.

4. To align tax planning with business activities, for example, acquisitions, disposals, and changes in business objectives. We do not seek to avoid tax by the use of "tax havens" or by establishing arrangements that we consider to be artificial in nature or transactions that we would not fully disclose to a tax authority.
5. To achieve a more favorable tax outcome where a clear and legitimate choice exists between different options that each comply with our principles. In considering and deciding between different options, the factors we consider include commercial and reputational impact.
6. To have an open, proactive, and constructive working relationship with tax authorities. Where possible and in line with local country practice, to discuss and consult on our interpretation of the law with tax authorities as issues arise. To engage directly or indirectly with governments on proposed changes to tax legislation where appropriate.
7. To ensure our tax professionals are appropriately qualified and trained and to use external advice where appropriate.



### Q. Do you engage in transfer pricing?

A. Yes. Governments generally require companies to apply transfer pricing rules to intercompany activities to ensure profits are reported in the countries where the relevant economic activity takes place. As noted in our principles, intercompany transactions are priced as if the parties are unconnected.

### Q. Why do you still have operations in low-tax countries that are not trading businesses?

A. This is largely a result of Pearson's history of growing through the acquisition of smaller companies over many years. In some cases, those new parts of our business did have low-tax arrangements. In the past few years, we have been winding up such arrangements wherever possible. However, this can be costly, and we have an obligation to our shareholders to act prudently. Our section on tax havens gives details.

### Q. Does that mean you rule out acquiring any future businesses with tax structures in low-tax countries?

A. No, we don't rule that out completely. It would certainly be a factor to consider in any potential acquisition, and it would always be our policy to look at winding up any such arrangement wherever possible, but we judge each case against its own merits and our tax principles.

### Q. What is "generally recognized interpretation of the law"?

A: In each country where we operate, a common view on practice evolves over time within the relevant tax community on the interpretation and application of these rules. An important factor for us is the prevailing practice and attitude of the relevant tax authority with whom we openly consult.

## Tax incentives and arrangements

We do not seek to avoid tax by establishing arrangements that we consider to be artificial in nature. We do claim available tax incentives and exemptions that are available and widely accepted as mainstream tax practice among the tax community (taxpayers, tax advisers, policymakers, and tax authorities). Tax law and regulation is complex and in each country where we operate, a common view on practice evolves over time within the relevant tax community on the interpretation and application of these rules. An important factor for us is the prevailing practice and attitude of the relevant tax authority.

We have one structure in place where cross-border transactions are not priced at arm's length. We have set up a financing operation in Ireland which is recognized by the tax authorities in Ireland and the UK and is subject to UK tax. These companies finance our global operations, are compliant with local laws, and are fully disclosed to the tax authorities concerned, in line with our tax principles.

## Tax havens

There are many different definitions of what constitutes a "tax haven." Pearson does not seek to avoid tax by the use of tax havens. For this purpose, we define a tax haven as a country with a corporation tax rate of 10% or less. We assess group entities as being in a tax haven if they are tax resident in that country.

In some instances, we have inherited some structures with operations in tax havens which we unwind when we can do so at a reasonable cost.

In line with our principle on tax havens, we no longer have a presence in Luxembourg. As of April 2017, the group has five corporate entities based in tax haven countries, of these:

- Two were established as holding companies in the Cayman Islands and British Virgin Islands prior to acquisition by Pearson. Neither company is trading and no tax benefit is derived from them, but disproportionate costs would be incurred to close them.
- One is a small trading entity in Hungary which pays tax at the local rate of 10%.
- One is an investment in Learn Capital IIIA, incorporated in the Cayman Islands. Learn Capital is a third-party impact venture capital fund that invests in innovative start-up companies around the world. Pearson is a minority investor and does not oversee the operations or



administration of the fund. The fund is also registered in the United States and all income is reported and taxed in the United States; therefore, no tax benefit is obtained.

- We operate a captive insurance company domiciled in Bermuda. This company fulfills a commercial purpose for us, covering third -party risks often required by our customers. We do not gain any tax benefit from being based in Bermuda, as all profits are subject to UK tax. We are domiciled there for regulatory reasons and it is a recognized global insurance center.



## Governance and risk management

The board has delegated responsibility for the integrity of financial reporting and risk management to the audit committee. This includes setting tax strategy and monitoring tax risk.

The Tax Department reports at least biannually to the audit committee.

Tax is part of the Pearson Finance function, reporting to our chief financial officer, who receives regular updates throughout the year from the tax team. The chief financial officer provides regular updates to the board on tax matters.

### Risk management

Pearson has a structured enterprise risk management framework to support the identification and effective management of risks across the group. As part of our disclosures in the annual report, we set out our principal risks and uncertainties, one of which is tax. Principal risks are defined by Pearson as having a potential financial impact greater than £50m or a significant impact on strategy, operations, or reputation. Executive responsibility for tax sits with the chief financial officer.

➔ See our annual report for more information [www.pearson.com/corporate/ar2016](http://www.pearson.com/corporate/ar2016)

*We considered tax risk as having increased slightly in 2016. Our overall assessment is that the probability of change is almost certain, reflecting the introduction of new legislation as well as the dynamic nature of tax regulation and continued public concern around tax issues.*

We assessed the impact on the group to be moderate. This overall assessment is informed by a longer list of tax risks which are monitored and reviewed throughout the year by the tax team. For each individual tax risk, we decide on our risk appetite or the tolerance we have to each type of risk. Some risks such as those relating to legislative change we accept, while others such as compliance we seek to mitigate or avoid. Pearson manages these risks through the application of our tax principles.

**Management of our tax affairs**

As set out in our global tax principles, in managing our tax affairs we seek to protect value for our shareholders, comply fully with legal and regulatory requirements, and align with business activities.

**Tax Department**

Pearson has teams of tax professionals in the United States, the United Kingdom, and China as our largest markets by revenue, along with accountable individuals drawn from the finance function responsible for tax in other markets.

Over the last few years, as part of our wider company strategy to integrate and simplify our corporate functions, we have expanded the tax team to introduce global oversight in areas such as transfer pricing.

Our tax team leads on engagement with governments, tax authorities, and stakeholders on tax-related issues.



**Public policy**

Pearson is committed to adding its voice to the global debate on tax transparency. We contributed to, and supported, the OECD consultation on country-by-country reporting. We also support the OECD international tax reform work on base erosion and profit shifting (BEPS).

We operate in a global competitive environment and urge tax policymakers to implement international tax reform in a coherent, coordinated way so that there is a level playing field and the risk of paying tax twice on the same income is minimized.

**Q**

**A**

**Q. Has the approach that Pearson takes to tax changed?**

A. We have always aimed to comply with relevant tax laws, regulations and reporting requirements. Pearson looks to operate within the spirit as well as the letter of the law. We consider this approach to be in line with our own values, recognizing our obligations to the wider societies in which we operate.

*Recent areas of international or national policy change affecting Pearson are as follows:*

Policy development	Pearson response
Country-by-country reporting (CBCR)	In addition to complying with CBCR, and the requirement to publish a UK tax strategy, we have decided to voluntarily publish this tax report.
UK voting to leave the EU	A restructuring of certain EU subsidiaries may be required.
US tax reform	Too soon to say.
Ireland corporation tax review	Too soon to say.
State aid	In the last few years, there have been a number of cases of alleged illegal state aid under which governments in a number of jurisdictions have been subject to investigation by the European Commission for entering into special agreements with individual multinational companies. Pearson is not the focus of any related European Commission investigation.

# Financial & tax data

*We are a global business and have trading operations in more than 70 countries around the world.*

Our business pays and collects a wide range of taxes, including employee taxes and sales taxes in addition to tax on business profits. This report focuses on tax on business profits.

2016 was a difficult year for Pearson. We continue to face market challenges in a number of countries, and we expect these challenges to continue through 2017. During 2016, we completed a cost-reduction program and posted an impairment of goodwill of £2,548M, reflecting trading pressures in our North American businesses. As a result, our statutory results showed losses for 2016 in a number of markets. This impacted tax paid in 2016 and will also impact tax due in 2017.

Pearson reports its results by geography. We sell a range of educational products and services to institutions, governments, professional bodies, and individual learners.

*Our country operations are split into:*

## North America

# 65%

65% of revenue. Our largest geography including all 50 US states and Canada.

## Core

# 18%

18% of revenue. Our international business in established and mature education markets including the UK, Australia, Germany, and Italy.

## Growth

# 17%

17% of revenue. Our education businesses in emerging and developing economies including Brazil, India, China, and South Africa.

*Detailed to the right is data for 2016 for our twelve largest countries drawn from all three of our geographies, as measured using 2016 sales revenues.*

We then include a brief explanation of our activities in each country and, if applicable, why tax paid may appear unusual compared to profit levels. We have also provided a summary of tax paid over the most recent five years on a regional basis.

For more explanation on what this data represents, please see the Appendix.



**Q. What determines how much tax on business profits Pearson pays each year?**

A. Broadly speaking, tax paid is based on company profit. However, the calculation method and timing varies depending on the tax rules in different countries. Countries typically ask companies to pay tax on business profits in the same year that profits are generated. The amount paid will either be based on the final amount paid in tax on business profits for the previous financial year or on the best estimate by the company of what profit it expects to make. Based on tax returns submitted once the financial year is complete, companies can benefit from a tax credit or will be required to make an additional payment. Some countries levy tax in the following financial year based on a tax return. This would mean tax paid in 2016 is being levied on 2015 profits rather than 2016 results.

For Pearson, the 4th quarter of the year is the most important for generating revenue and profit. This can make the estimation process challenging.

**Q. What other factors can impact the tax paid?**

A. One area that is significant for Pearson is pensions. Payments into company pension funds in the UK and other jurisdictions are deductible for tax purposes, which reduces the business profits on which tax is payable.

Country	Total revenue*	Profit/(loss) before tax	Tax paid	Employees
	£'M	£'M	£'M	
United States	3,207	(2,668)	11	15,354
United Kingdom	1,049	(45)	14	4,151
China	251	(18)	3	5,332
Canada	172	30	10	663
Brazil	136	3	4	1,229
Italy	95	15	4	328
South Africa	85	(8)	3	1,171
Hong Kong	85	13	8	418
Australia	84	4	0	341
Mexico	48	3	0	340
India	47	(30)	0	1,309
Germany	30	(17)	1	376
Other countries	213	(39)	7	1,707
Group adjustments**	(843)	200	(20)	0
<b>Total</b>	<b>4,659</b>	<b>(2,557)</b>	<b>45</b>	<b>32,719</b>

A reconciliation from adjusted operating profit to statutory loss before tax is shown in the Appendix.

\* Total revenue for each country includes intercompany sales and recharge income, interest, and other income, all of which are excluded from the external sales reported in our Annual Report & Accounts.

\*\* Group adjustments include intercompany eliminations, our share of profit from the Penguin Random House joint venture, and the impact of disposals.

Tax paid per country

	£11M	£14M	£3M
	 <i>United States</i>	 <i>United Kingdom</i>	 <i>China</i>
<b>Key operations</b>	<b>K-12 School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Assessment</li> <li>- Online and blended learning</li> <li>- Curriculum resources</li> <li>- Professional development</li> <li>- Work-based learning</li> <li>- Clinical assessment</li> <li>- Testing</li> </ul>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Assessment and qualifications</li> <li>- Online and blended learning</li> <li>- Curriculum resources</li> <li>- Professional development</li> <li>- Clinical assessment</li> <li>- Work-based learning</li> <li>- Direct delivery (Pearson testing)</li> </ul>	<b>School and Professional</b> <ul style="list-style-type: none"> <li>- Curriculum resources</li> <li>- English language learning</li> </ul>
<b>Factors impacting tax in 2016</b>	Pearson incurred a significant restructuring cost in 2016 in the United States as well as a goodwill impairment relating to the Higher Education courseware business, resulting in a loss before tax for the year. The majority of the cash tax payments made in 2016 were at a state level.	The UK is both our second-largest market by revenue and the location of our head office and central group functions. The UK also raises any external debt required by the group and this is used to fund overseas operations. Pearson also incurred a significant restructuring cost in 2016 in the UK and reported a loss before tax for the year. Tax was paid; however, some of this will be refunded in 2017.	Pearson operations in China are loss-making. In February 2017, we announced our intention to either partner or sell our direct delivery business. We paid tax in 2016 on the disposal of a property.

	£10M	£4M	£4M
	 <i>Canada</i>	 <i>Brazil</i>	 <i>Italy</i>
<b>Key operations</b>	<b>K-12 School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Assessment</li> <li>- Curriculum resources in English and French</li> <li>- Clinical assessment</li> <li>- English language learning</li> <li>- Professional development</li> <li>- Testing</li> </ul>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Online and blended learning</li> <li>- Curriculum resources</li> <li>- Clinical assessment</li> <li>- English language learning</li> <li>- Testing</li> </ul>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Curriculum resources</li> <li>- Professional development</li> <li>- English language learning</li> <li>- Testing</li> </ul>
<b>Factors impacting tax in 2016</b>	Canada is a profitable market for Pearson. We paid tax at the federal and provincial level.	Pearson operations in Brazil include our sistema business and English language learning. Under Brazilian tax legislation we are able to claim an annual tax deduction for amortization of goodwill, which will reduce our tax payments until it is utilized, which is estimated to be in 2022. In 2016, we paid tax on a foreign exchange gain, which is not expected to recur.	Italy is a profitable market for Pearson. We paid tax.

*Tax paid per country*

	£3M	£0M	£8M
	 <i>South Africa</i>	 <i>Australia</i>	 <i>Hong Kong</i>
<b>Key operations</b>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Curriculum resources</li> <li>- Professional development</li> <li>- Clinical assessment</li> <li>- University (CTI Education Group and the Pearson Institute of Higher Education)</li> </ul>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Online and blended learning</li> <li>- Curriculum resources</li> <li>- Professional development</li> <li>- Clinical assessment</li> <li>- English language learning</li> <li>- Testing</li> </ul>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Assessment and qualifications</li> <li>- Curriculum resources</li> <li>- Professional development</li> </ul>
<b>Factors impacting tax in 2016</b>	Our university business in South Africa is loss-making. Student enrollment at CTI Education Group and the Pearson Institute of Higher Education fell 25%, driven by tightening consumer credit. This business was restructured in 2016. Our professional business is profitable and paid tax.	Australia is a profitable market for Pearson. In 2016, we received a refund in respect of 2015.	Our operations in Hong Kong are profitable and we paid £8m of tax in 2016, which covered two years, as due to the calculation method, no payment was required in 2015.

	£0M	£0M	£1M
	 <i>India</i>	 <i>Mexico</i>	 <i>Germany</i>
<b>Key operations</b>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Assessment and qualifications</li> <li>- Online and blended learning</li> <li>- Curriculum resources</li> <li>- English language learning</li> <li>- Testing</li> <li>- School management (Pearson Schools India)</li> </ul>	<b>School; Higher Education and Professional</b> <ul style="list-style-type: none"> <li>- Qualifications</li> <li>- Online and blended learning</li> <li>- Curriculum resources</li> <li>- Testing</li> </ul>	<b>School and Professional</b> <ul style="list-style-type: none"> <li>- Curriculum resources</li> <li>- Professional development</li> <li>- Clinical assessment</li> <li>- English language learning</li> <li>- Examination preparation</li> <li>- Testing</li> </ul>
<b>Factors impacting tax in 2016</b>	Our business in India was restructured in 2016 to discontinue some loss making activities. We continue to invest in the remaining operations to drive growth; however, it is expected to take some time before they become profitable.	Our operations in Mexico broke even in 2016.	During 2016, we closed the unprofitable Wall Street English schools business in Germany. This resulted in a loss and restructuring charge. This reduced the tax paid.

*At a group level, 2016 is the lowest level of corporation tax paid for five years. This is partly a result of business performance and partly a result of business disposals made in previous years, which reduced the ongoing profits of the group and resulted in tax payments on the profit on disposal.*

To analyze the rest of world countries in more detail, the table to the right shows the ten largest rest-of-world (ROW) countries and what their average proportion of rest-of-world tax paid has been in the last five years.

**Total cash tax payments 2012 to 2016**

USA

£413M

UK

£115M

Rest of World

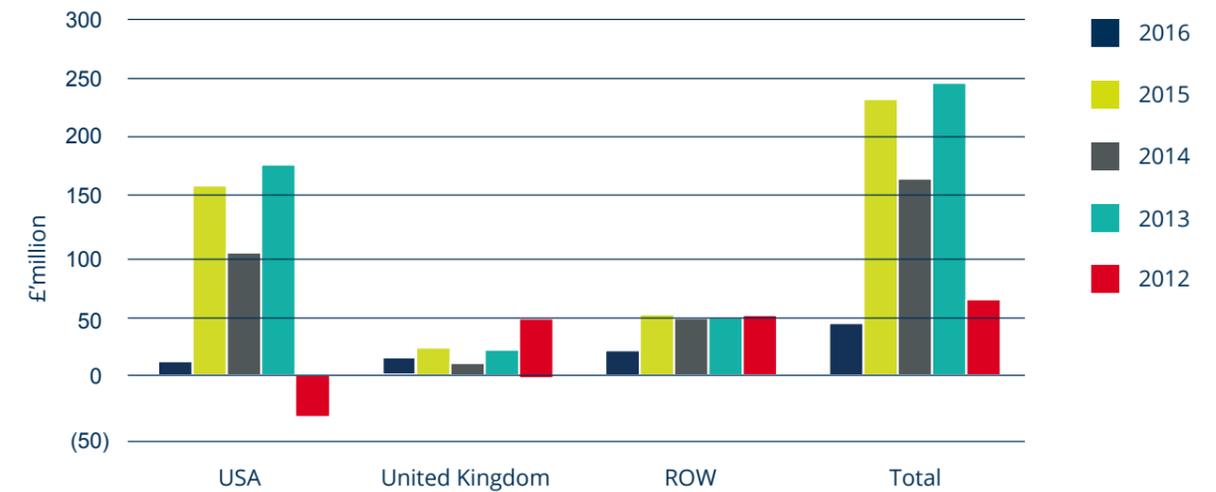
£222M

Total

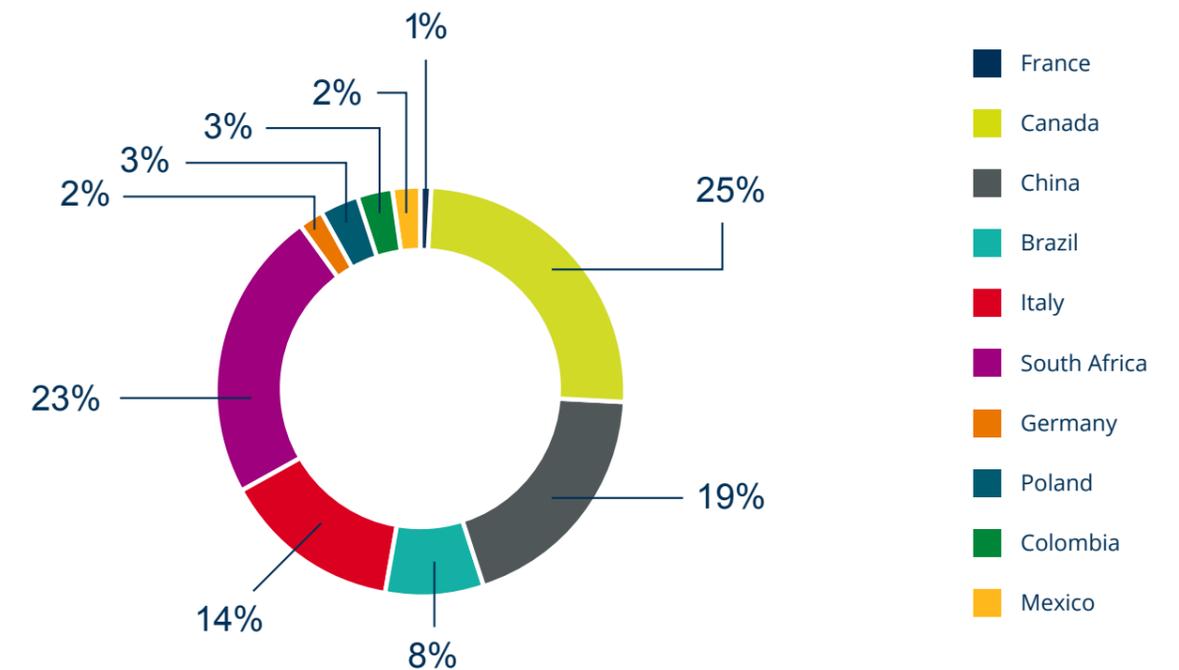
£750M

**Historical cash tax**

Cash tax payments over the last five years



**Proportion of rest-of-world tax paid over last five years**



# Appendix

## About the data

### Country-by-country table

Total revenue: In line with the country-by-country reporting requirements, we have included sales, intercompany transactions, interest and other income within this figure. Total revenue is therefore higher than the external sales number reported in our Annual Report and Accounts.

Profit before tax: This is the profit before tax at a statutory level, which is the starting point to calculate tax on business profits. It differs from the adjusted operating profit measure which we publish in the annual report. Adjusted operating profit is a key financial measure used by management to evaluate performance and allocate resources to business segments. A reconciliation is shown to the right.

### Adjusted operating profit to statutory profit 2016

	£'M
Adjusted operating profit	635
Finance costs	(59)
Cost of restructuring	(338)
Intangible charges	(2,769)
Other net gains and losses	(26)
<b>Statutory loss before tax</b>	<b>(2,557)</b>



We hope you have found this document of use and interest. If you have questions, or thoughts on ways in which we can improve future versions, we would be pleased to hear from you. You can email us at [sustainability@pearson.com](mailto:sustainability@pearson.com)

ALWAYS LEARNING