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ENGLISH

BROOKFIELD'S ISAGEN: A CASE STUDY ON THE NEED FOR CHANGE IN THE GLOBAL TAX SYSTEM

ISAGEN - REPRODUCTION

Sogamoso Hydroelectric Plant.

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This report is the product of cooperation between the below entities

Centre for International Corporate Tax Accountability and Research

The sale of a majority stake in the electricity company ISAGEN in 2016 to a subsidiary of Canadian investor Brookfield was the second largest privatisation deal in Colombian recent history. Since then, ISAGEN has reduced investment and increased profits, and appears to use debt repayments to distribute income to Brookfield subsidiaries in Bermuda, resulting in low tax payments in Colombia, and low investment in the company's workforce. Tax transparency is needed to know with certainty what is happening to these resources that, up until recently, were considered a public good.

For the purposes of this report, the words "tax dodging", "tax avoidance", "tax minimisation" or other similar derivatives refer to a range of strategies, many of which are legal. This report makes no specific allegations of illegal activity or behaviour but does highlight areas that may be cause for further scrutiny and draws broader conclusions about the need for reform in national, regional, and global tax systems.

The key findings of this report, along with some specific requests for additional information, were shared with Brookfield in advance and in response they have provided a statement which is included in full at the end of the report.

WHO IS BROOKFIELD?

Brookfield Asset Management is one of the world's largest investment managers, specialising in private equity,[1] real estate and the energy sector. Brookfield has more than US$900 billion[2] in assets under management across more than 30 countries – including some U$59 billion in South America – and a large part of these investments come from workers' deferred wages, in the form of public-sector pension funds. In 2023, Brookfield reported revenues of US$96 billion.[3]

In the energy sector, companies under Brookfield's control have an installed capacity of 31,800 megawatts (MW) worldwide, with hydropower generation making up a quarter (8,275 MW) of this capacity, split across 237 facilities.[4]

Brookfield is in the business of buying public infrastructure. In 2016, it acquired a 57.61% stake in ISAGEN (then held by the Colombian government), and later increased its shareholding to 99.7% over the course of several transactions. ISAGEN is the second largest power generator in the country, with 23.8% of the market (2022), and a net effective capacity of close to 3,000 MW.[5]

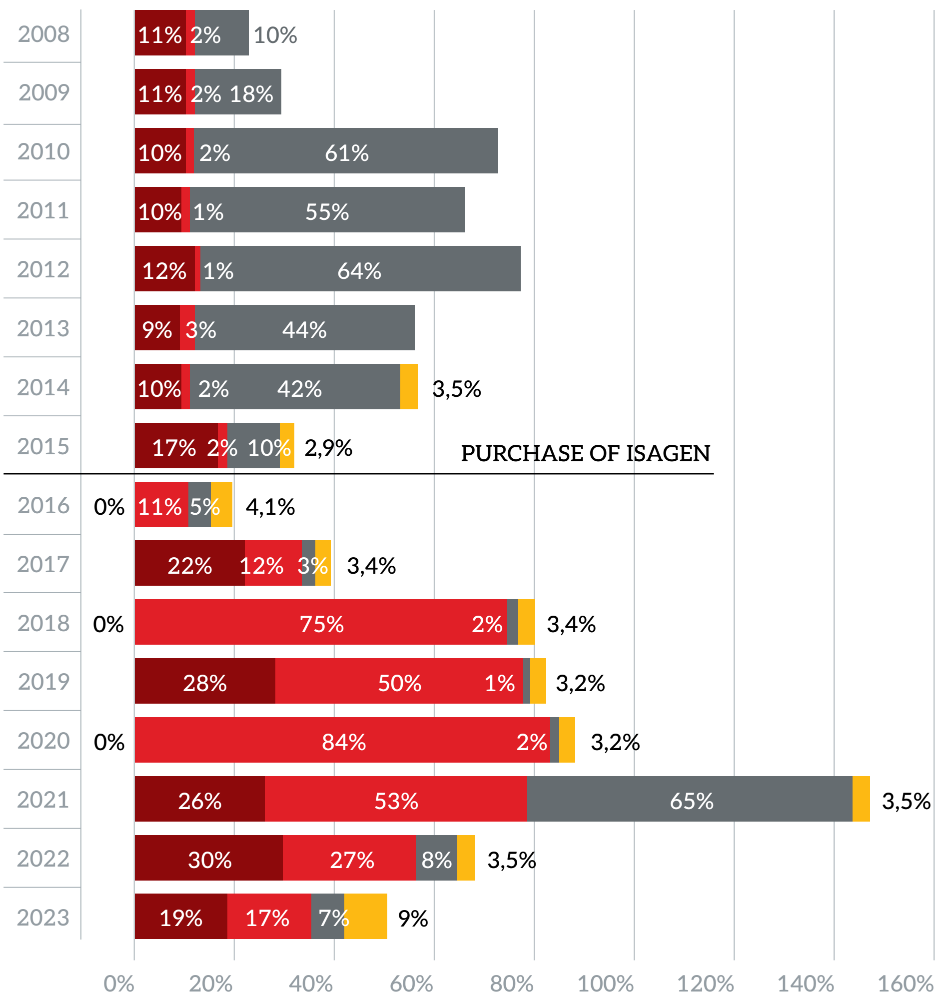
Colombia is facing an energy crisis, with shortages looming, and the cost of energy rising by 30.23% between January 2022 and October 2023.[6] Meanwhile, **ISAGEN's profits almost tripled (198%) between 2021 and 2023, and the company has paid out more than COP 3.4 trillion (US$864 million) in dividends on shares (99.7% of which are held by Brookfield).**[7] The Colombian population appears to be bearing the higher cost of energy due to the climate crisis and El Niño effect, while Brookfield continues to post record profits.[8]

ISAGEN BEFORE AND AFTER THE **BROOKFIELD** ACQUISITION

Even before the energy crisis, there has been a steady increase in ISAGEN's profits since its privatisation. In the eight years since Brookfield bought ISAGEN (2016-2023), the company's profits grew by 53%, and dividend distribution by 183%, compared to the previous eight years (2008-2015). This increase in profits does not appear to have been reinvested in the company, with a 38% decrease in capital expenditure[9] over the same period. Nonetheless, the company does have an investment plan in renewable energy, which could increase this number in the coming years.[10]

ISAGEN's lower rates of investment since privatisation begs the question: where has the money been going? Graph 1 shows the distribution of the company's earnings into four categories: a) dividends to its shareholders; b) debt repayment; c) capital expenditure; and d) income tax. **There is a notable change in the company approach, following the buyout by Brookfield in 2016, with investments declining and dividends and debt repayments increasing,** indicating a shift away from investment in energy infrastructure and towards the payment of dividends. Tax payments have remained stably low over the entire period, even though the available data only starts in 2014.

Graph 1: Dividends, debt repayments, taxes, and capital expenditure as % of total revenues.



Dividends

Debt Repayments

Capital Expenditure

Income Tax Paid

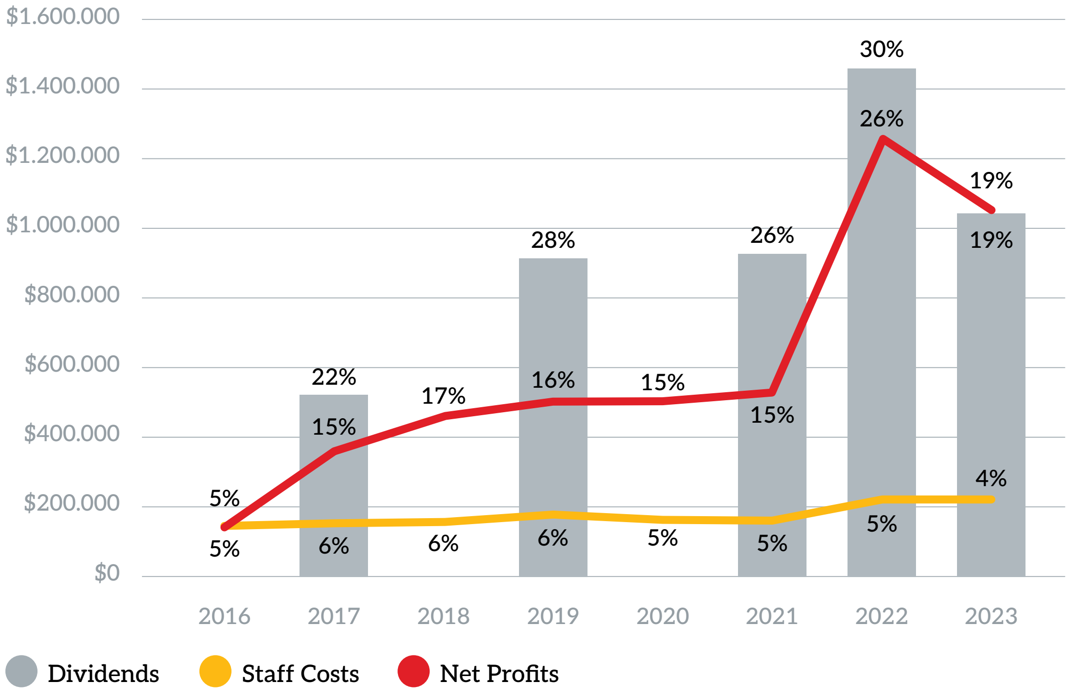
Source: S&Ps Capital IQ.

SALARIES LAG BEHIND PROFITS

ISAGEN's ballooning profits have outpaced staff costs by a factor of thirteen: while net profits have increased by 635% between 2016 and 2023, staff costs increased by only 49%. Over this period, the labour share of income – staff costs as a proportion of total revenue – has decreased from 5% in 2016 to 4% in 2023, while profits increased from 5% to 19%, and dividends from 0% to 19% in the period, as shown in Graph 2.

Graph 2: ISAGEN's Staff Costs, Dividends and Net Profits.

Values in millions of COP. Percentages in relation to ISAGEN's total revenue.



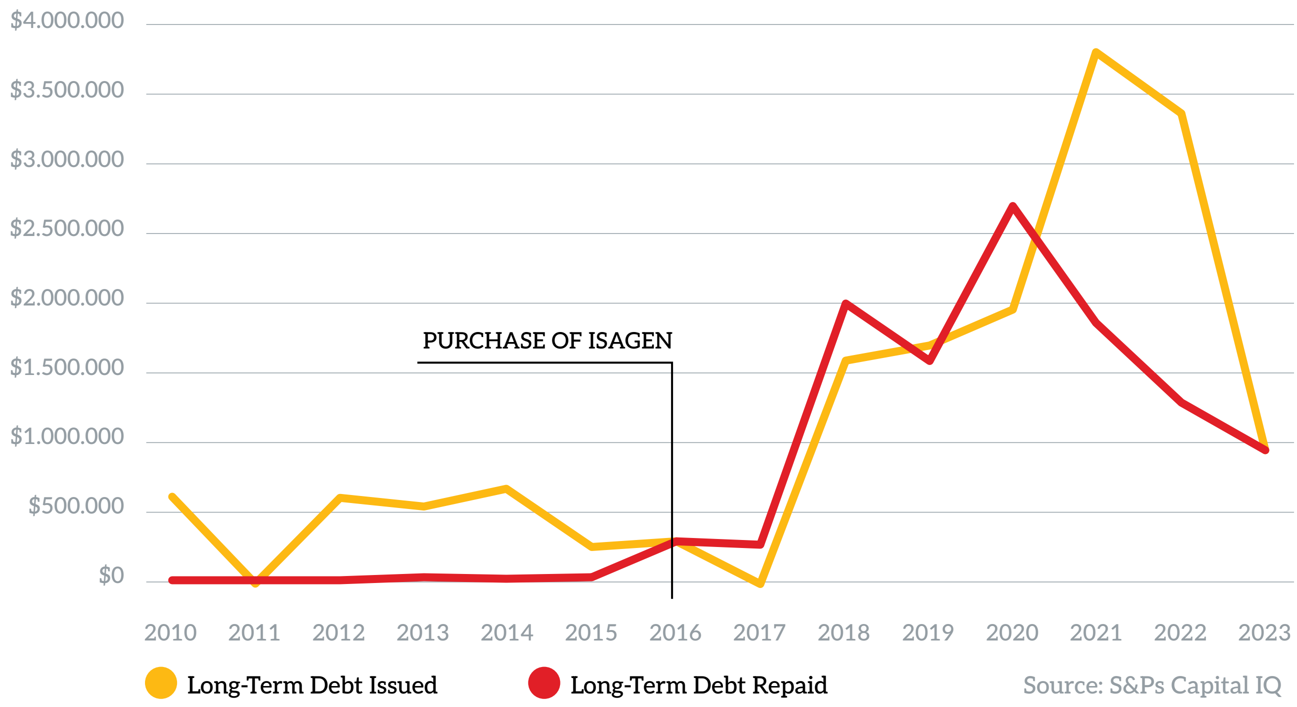
Source: ISAGEN, Financial statements

As required by the Colombian government, part of ISAGEN's revenue is directed to the regions most impacted by its projects. Since the passage of Law 99 in 1993, hydroelectric plants must transfer 6% of their gross sales to the municipalities and Regional Autonomous Corporations in the areas affected by their installations. The company has increased its payments in line with the increase in its revenues in recent years,[11] but local communities believe this remains insufficient to fully compensate the impacts produced by electricity generation in these areas.[12]

WHY SO MUCH DEBT – WITH BROOKFIELD?

The biggest difference in ISAGEN's finances before and after the Brookfield acquisition is the level of debt, which has increased greatly, both in terms of long-term debt issued and the cost of repayments. The company has justified the spike in debt in its 2021 financial reports by pointing to the acquisition of new assets.[13] However, this pattern of debt issuance and repayment is not new; it started shortly after Brookfield's purchase of ISAGEN and continues to this day, as shown in Graph 3.

Graph 3: Long-term debt - issued and redeemed.
Values in millions of COP.



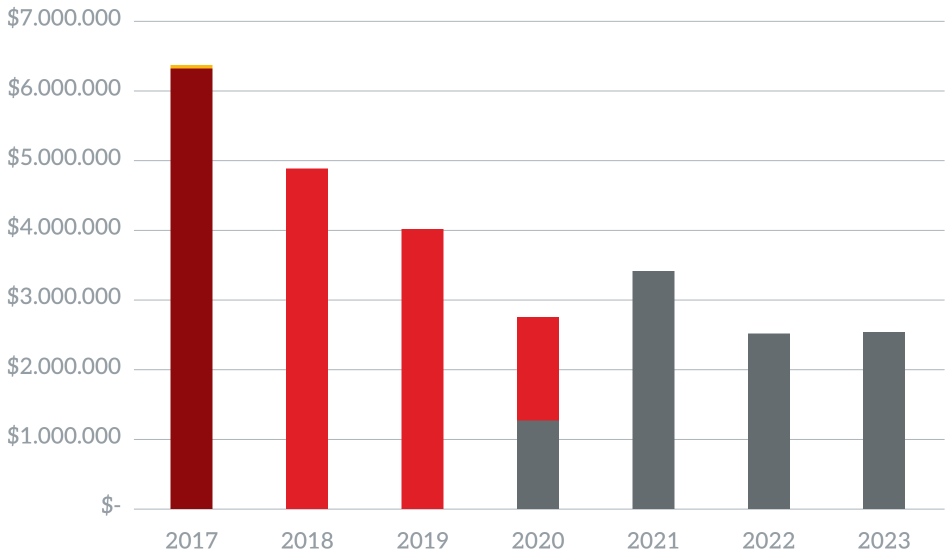
Source: S&Ps Capital IQ

Between 2017 and 2023, **37% of ISAGEN's debt was with Brookfield-shareholding entities in Bermuda, a well-known tax haven often used to minimise tax.** Graph 4 shows ISAGEN's payables to four Bermuda Brookfield group companies since 2017.[14] ISAGEN can pay these debts whenever it wants, and in 2020 alone, the company spent COP 2.6 trillion (US$683 million) on debt repayments, equivalent to 84% of the company's total revenues that year, as already shown in graph on page 4.

The interest rates on these loans are not publicly available, thus it is not possible to know how much these Brookfield loans cost. However, interest payments have increased 357.3% since privatisation. ISAGEN paid COP 1.8 trillion in interest in 2023 – which is more than the net profit for the year and 3.8 times more than what it paid in income taxes – 29.4% of it going to related parties.[15]

Graph 4: ISAGEN's accounts payable with Brookfield's Bermuda companies, 2017-2023.

Values in millions of COP.



Source: Notes to ISAGEN's financial statements

Private equity firms such as Brookfield often borrow money by placing loans and bonds on offshore stock exchanges.[16] When paid to related parties, such as ISAGEN paying loans to Brookfield-controlled entities, the payments of these loans reduce tax revenues where the income is earned, producing tax-free income offshore.

There is a strong indication that the structuring of ISAGEN's debt may be part of a strategy to decrease cash availability in Colombia and therefore taxable income. Put simply, this appears to be a form of profit shifting[17] that both limits demands for worker remuneration and avoids income tax payments in Colombia.

ISAGEN - REPRODUCTION

San Carlos Hydroelectric Plant.

ISAGEN IS AN IMPORTANT CASE STUDY FOR ANALYSING THE EFFECTS OF TAX AVOIDANCE

Sogamoso Hydroelectric Plant.

At 35% in 2023, Colombia has the second highest corporate taxes in the world.[18] However, the Colombian government does not collect enough revenue to adequately fund public services. Workers and consumers, most of whom lack the means to avoid paying taxes, are not to blame. Multinationals are most able to engage in profit shifting using loopholes in the law and lobbying governments for tax breaks.

These practices may be legal, but they deprive the government of much-needed funding for public services and the running of the state. The company's seemingly tight financial position, due to its level of indebtedness, makes it appear that ISAGEN has no money left, in addition to the expected profitability, to improve workers' wages and conditions or to make social investments.

ISAGEN is a highly profitable company owned by a multi-billion-dollar fund manager that may be extracting huge profits from Colombia's population and electricity resources, while avoiding contributing adequately to the funding of public services and failing to improve standards for its workforce.

There is other evidence of tax minimisation practices at Brookfield. As reported by CICTAR,[19] Brookfield has organised its corporate structure through tax havens, including hundreds of subsidiaries in Bermuda. In Canada, the company has one of the lowest effective tax rates[20] of the largest corporations operating in the country. In Australia, Brookfield controls the country's second largest private hospital operator, the Healthscope Group, and despite growing profits, the hospital paid zero tax until 2022.

WE NEED TO CHANGE THE INTERNATIONAL TAX SYSTEM

Brookfield is not unique in implementing tax minimisation strategies. Countries lose an estimated US$480 billion in taxes a year to global tax abuse.[21]

Until recently, the main international organisations acting on this agenda have been the OECD and the G20, which created the Inclusive Framework on Base Erosion and Profit Shifting (BEPS), where more than 140 countries are working together to tackle tax avoidance. Based on BEPS, countries are starting to apply a minimum corporate tax rate of 15% to multinationals.

However, control of the process is in the hands of the wealthy G20 countries, and the rules have loopholes that could be detrimental to the goal of raising tax revenues, especially for the poorest countries. Recently, initiatives have gained steam to move the debate into fora where countries can work together on more of an equal footing, such as the UN Tax Convention.[22]

FLICKR.COM

Bogotá, Colombia.

Public country-by-country reporting and unitary taxation: two proposals key to increasing transparency and tax revenues

Country-by-country reporting is the publication of the profits and taxes paid by multinationals in each country where they operate. Large companies are already obliged to file these reports, but only the tax authorities of OECD member countries have access to them. If they were public, everyone could access information on Brookfield's profits, taxes, employee headcount, and other financial data on ISAGEN and its other operations in Colombia – as well as for every other country where it has operations – in a single report. These would include payments made to related parties in Bermuda and other tax havens. Tax transparency is a viewed as a benefit by many investors, and some companies have already adopted public country-by-country reporting as part of their standard accountability protocols.

Unitary taxation treats each multinational as a single enterprise and taxes them according to their real activities (assets, labour and sales) on a geographical basis. With unitary taxation, it would be possible to ensure that multinationals pay taxes where genuine economic activity takes place, not where profits are artificially shifted to low or no-tax jurisdictions. Taxes paid by ISAGEN in Colombia would increase if unitary taxation were implemented, and with public country-by-country reports, everyone would have access to this information.

Brookfield shareholders tabled a resolution in 2023 to require the company to produce public reporting on a country-by-country basis. Brookfield opposed this resolution and stated that it *"does not believe that Brookfield has any material negative tax-related impacts on the economy, environment and people, including negative impacts on its human rights."*[23] The findings here and elsewhere appear to indicate negative impacts that are material to communities and workers and need to be considered. Despite management opposition, nearly a third of Brookfield's own shareholders voted for greater tax transparency.[24]

In Latin America, the Colombian government has proposed in 2023 a new **Latin American and Caribbean Tax Platform (PTLAC)**,[25] creating a regional space for discussion on international taxation with the aim of identifying areas of agreement. Public country-by-country reporting and unitary taxation are concrete proposals that would address the problems that currently exist. While coordinated global action is necessary, significant progress can also be made to advance these measures at national and regional levels. A united Latin American position on transparency would be a powerful global statement.

Beyond Brookfield, the international debate on tax cooperation and privatisation of public services is gaining momentum. It is time to demand more transparency and accountability from these huge companies that control vast swathes of the global economy. Tax avoidance in any form robs governments of funding needed for essential services. However, it is particularly egregious when formerly public-owned assets are involved, raising costs for consumers (individuals and other businesses), negatively impacting communities and workers, and shifting profits offshore.

The energy and climate crisis in Colombia have brought the privatisation of ISAGEN to the center of the discussion. Both the privatisation itself, which meant the loss of public control over national water and the impact on a market increasingly held in private hands, and the use of the revenues of this sale have recently been criticised by Colombian President Gustavo Petro.[26] In moments of crisis, opportunities for change can also present themselves. Colombia's population should not be the only ones bearing the costs of the crisis. Brookfield's ownership of ISAGEN requires a re-evaluation.

STATEMENT FROM BROOKFIELD

The statements portrayed in this report are misleading without the context.

For example, the company's transformation since being a state-owned enterprise has yielded much greater efficiency across the business and a cultural shift that has created value for all stakeholders. This has resulted in improved financial results and sixfold growth in the amount of tax paid in Colombia.

At the same time, during a period where Colombia requires meaningful investment in new clean energy ISAGEN has delivered significant investment in wind, solar and hydroelectric energy, with over one billion US dollars deployed in the last couple of years increasing the capacity by 450 MW (increasing approximately 20% compared to 2016 capacity) with plans to invest a further 5 billion US dollars in the following ten years, delivering 3 GW of additional capacity.

As the world's largest private capital investor in renewable energy, Brookfield's operational experience and access to capital, reflected in some affiliate loan transactions, continue to support ISAGEN's growth. As the country's only 100% renewable company, we are proud that ISAGEN is leading Colombia's energy transition.

ENDNOTES

01. Private equity is an alternative investment class in which a fund or a company acquires controlling power over private, unlisted companies.

02. https://www.brookfield.com/sites/default/files/2024-03/2023_BAM_Annual_Report_0.pdf p.5

03. https://bn.brookfield.com/press-releases/brookfield-corporation-reports-strong-2023-results

04. https://bep.brookfield.com/sites/bep-brookfield-ir/files/Brookfield-BEP-IR-V2/2023/Q4/bep-2023-annual-report-v1.pdf, p2.

05. https://www.larepublica.co/empresas/empresas-lideres-de-produccion-de-energia-3725424

06. https://www.elespectador.com/economia/tarifas-de-energia-subiran-un-30-proyecto-enfrenta-a-gobierno-y-gremios-noticias-colombia/ Sum of monthly inflation of energy services.

07. Unless explicitly stated, this and the other data in the report are taken from the notes to ISAGEN's financial statements and S&P Capital IQ. The conversions from Colombian peso to US dollar are from 19/04/2024 (1 COP = 0.00025 dollar).

08. This could indicate what German economist Isabella Weber has labeled "sellers' inflation", in which companies instrumentalise moments of crisis or shortages to increase prices more than what is needed to compensate for the rise in costs, thus contributing to inflation. This phenomenon has been documented for energy companies in recent years, but more research would be needed to connect it with the Colombian context. For more information: https://scholarworks.umass.edu/econ_workingpaper/343/

09. Capital expenditures or investments are funds used by a company to acquire or improve physical assets such as property, buildings or equipment.

10. https://www.eltiempo.com/economia/empresas/isagen-invertira-600-millones-de-dolares-en-renovables-735932

11. https://www.isagen.com.co/es/web/guest/sostenibilidad/s-social/gestion-con-comunidades/transferencia-de-ley

12. Information about the lack of investment in the communities are based on conversations among unions, workers and communities in impacted regions.

13. ISAGEN S.A. E.S.P.. Notes to the financial statements. As of 31 December 2022 and 2021, p. 74. https://www.isagen.com.co/documents/20123/34941/2212_Notas_EEFF_ISAGEN_2023.pdf

14. All four companies appear in Bermuda's company register, available at https://www.registrarofcompanies.gov.bm/. BRE Colombia Hydro Investment, the parent company of Isagen, was also found in registries in Spain and Colombia.

15. A related party is a company that is linked to another company and usually has some control or influence over that company, e.g. companies in the same corporate group.

16. Offshore refers to a company or bank account based abroad.

17. Profit shifting is a tax planning technique that transfers income from taxpayers located in high-tax countries to low-tax countries.

18. https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database.htm

19. CICTAR. Is Canada's Largest Alternative Asset Manager Dodging Global Taxes? Available here: https://cictar.org/all-research/brookfield-canadas-largest

20. The effective tax rate is the average actual tax payment of an individual or corporate taxpayer.

21. https://taxjustice.net/reports/the-state-of-tax-justice-2023/#:~:text=Keys%20of%20suffering,%20tax%20abuse%20by%20wealthy%20individuals%2020.

22. https://financing.desa.un.org/un-tax-convention

23. Brookfield Corporation, 2023 Management Information Circular, p.89, https://bn.brookfield.com/sites/brookfield-bn/files/BN-IR-Master/MIC/2023/BN%20Management%20Information%20Circular%20-%20May%209%202023.pdf

24. https://www.corporatedisclosures.org/content/top-stories/record-shareholder-support-for-tax-transparency-at-brookfield.html; This was the highest level of support for this type of shareholder resolution at any corporation to date. Twenty-seven percent of all shareholders voted in favour, but more than 8% of the shares are held by insiders. One-third of independent shareholders voted in favour.

25. https://www.cepal.org/es/ptlac

26. https://www.eltiempo.com/politica/gobierno/petro-sobre-vaca-en-antioquia-es-de-una-bellaqueria-lo-que-la-derecha-esta-haciendo-3328812

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