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Building a Sustainability-Driven Tax Environment in the EU Area: Reality or Wishful Thinking?

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1. **Introduction: some uneasy questions**

Taxation is at the core of the UN 2030 Agenda since it is an essential element to build a more equal, as well as more prosperous, society and provides the "fuel" needed to realize all the ambitious plans required to decrease our impact on the environment.[1] Therefore, **good tax governance is supposed to be the ultimate expression of sustainability-driven businesses**, meaning that a company cannot truly claim to pursue any Sustainable Development Goals (SDGs) unless it has also implemented a tax policy aligned with its sustainability purposes. On the contrary, there is no actual sustainability in a business that, on the one hand, showcases the pursuit of some SDGs whilst, on the other hand, adopts aggressive tax strategies which drain resources from the public, thus undermining on a higher scale the fulfilment of those very goals which it pretends to pursue.

Then what is the scenario in the EU area when it comes to corporate taxation? What role has corporate tax governance played so far in the discourse about sustainability? **Does the EU legislation prompt and support taxpayers in order to enact "fairer" corporate tax policy and publicly report on it?**

2. **The marginal role played (so far) by "tax" in sustainability reports**

Properly reporting about the company's achievements in the 3 areas of environmental, social, and governance (ESG) – as the matter of sustainability has been organized over the last two decades – is as important as the achievements themselves. Indeed, the pursuit of the SDGs relies greatly on having consumers and investors choose those players who have accepted the challenge of creating value for all stakeholders instead of caring only for their own shareholders; hence the importance of making the general public aware of what the company has fulfilled in terms of limiting the social and environmental impact of its business and contributing to sustainable growth. This is the reason why, since the early 2000s, NGOs and advocacy groups have thrived on developing dozens of sustainability reporting standards to help businesses disclose information on ESG issues.

It is worth noting, though, that **only recently "tax" has made its appearance among the topics**

usually covered by standards setters with the publication of the GRI 207: Tax 2019 by the Global Reporting Initiative (GRI). By applying the new standard, a company can report, firstly, about its tax management approach (with regard to the tax principles adopted; tax risk assessment and management; stakeholders' and tax authorities' engagement); secondly, about the tax jurisdictions in which the organization's entities are resident for tax purposes.

Likewise, with its 2020 White Paper on Measuring Stakeholder Capitalism, the World Economic Forum (WEF) acknowledges that tax-related information should play a pivotal role in assessing the companies' achievements in the pursuit of the SDGs. Indeed, to assess the sustainability of corporate tax policies, the WEF outlines 3 different useful metrics: total tax paid, tax collected by the company on behalf of other taxpayers, and total tax paid by country for significant locations, which shows the company's "contributions to governmental revenues and support for tax collections in countries where it has significant business operations".

Lately, in November 2021, another private initiative, the Fair Tax Mark accreditation – initially available only to businesses headquartered in the UK – has introduced a Global Multinational Business Standard for corporate tax disclosures informed by the following principles: "pay the right amount of taxes (but no more) in the right place at the right time according to the spirit of the law" and "be transparent and accountable before the public".

Despite being shaped according to the different agendas set by the groups they belong to, all the initiatives mentioned above show some patterns where they acknowledge that:

- putting corporate tax governance at the service of the SDGs entails going beyond just "playing by the rules", being more a matter of "fairness" than of legal compliance;
- there is a need to fill an information gap in corporate tax policies, above all – as far as multinationals are concerned – providing all stakeholders with data about the jurisdictions in which the company's entities have their residence and pay their taxes.

Hence, the **key items** in the discourse about tax and ESG appear to be **voluntariness**, **transparency** and **curbing profit shifting**.

Indeed, the ones pointed out above are not characteristics exclusively belonging to the matter of sustainability: voluntariness and transparency are at the basis of the Tax Control Framework (TCF), a tool well known and applied by most companies in the OECD area,[2] while counteracting any form of profit shifting has been the goal of the OECD's Base Erosion and Profit Shifting (BEPS) Project as well as some EU directives, such as the Council Directive (EU) 2018/822 of 25 May 2018 on mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (DAC 6).

There is a difference, though: while data gathered within the company's TCF or to prepare a country-by-country report under BEPS Action 13 or to comply with DAC 6 is confidential, when it comes to sustainability that same data is supposed to be offered to public scrutiny. Thus, we can infer that the **companies' unwillingness to make that data public** may be the reason it took so long to first introduce "tax" among the topics covered by sustainability reporting standards and still few companies have chosen to disclose that kind of data.

Then, why are companies so little inclined to share information about their tax policies with the stakeholders?

3. **Does reporting on corporate tax policy pay off?**

In his annual letter to CEOs, headed "The Power of Capitalism", BlackRock CEO Larry Fink writes that, today, "a company must create value for and be valued by its full range of stakeholders in order to deliver long-term value for its shareholders", and that "the fair pursuit of profit is still what animates markets; and long-term profitability is the measure by which markets will ultimately determine your company's success", and, eventually, that "we focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients".

It is a clear and pragmatic read of the discourse about sustainability: corporate sustainability must be pursued (also) because it makes a profit for companies, which is why, over the last years, ESG-related financial products have quickly developed from being no more than a niche to represent the core of portfolios.[3] Hence, most companies nowadays voluntarily report on ESG issues because they aim at matching the rising demand for sustainable products and not being marginalized by the market.

Standards setters have followed the evolution of this phenomenon and kept providing companies with sustainability reporting standards aligned with the stakeholders' increasing need for a broader range of information about the company's achievements. We have thus witnessed the gradual publication of dozens of new standards, at first more focused on the matter of the business' impact on the environment, and then extended also to the company's social goals. Lately (as recalled above), also tax has made its appearance among the ESG indicators. An event which has mirrored a fundamental change with respect to the past: if the voluntary implementation of fairer tax policies seemed irreconcilable with the company's natural pursuit of the maximization of the profit,[4] on the contrary, **for the future, undisclosed and/or aggressive tax policies, however compliant with the law, will probably affect negatively the business itself** by alienating most of the company's stakeholders and eventually leading the company to lose market shares.[5]

It is, therefore, worth noting that the European Commission, while proposing the adoption of a more comprehensive Sustainability Reporting Directive, has pointed out that currently there is a "widening gap between the sustainability information companies report and the needs of the intended users of that information", so much so that the achievement of the objectives of the European Green Deal and the efficient functioning of the social market economy are undermined.

Then, if sustainability can be rewarding for businesses and if there is a perceived need for providing stakeholders with more information about companies' ESG risks, **why only few companies have so far exploited the situation in their own interest filling that gap by reporting data on their tax policies, too?**

A recent study examined the capital market reaction after the European Union broke the news that an agreement had been reached on the proposal for a new directive on public country-by-country reporting for large multinationals aimed at enhancing the level of tax transparency in the EU area.[6] The scope of the study was to provide data about costs and benefits of public tax transparency by measuring the change in stock prices of a set of 680 companies which would be affected by the new mandatory tax disclosure.

The outcome of the study is clear and perhaps unexpected: **costs of tax transparency outweigh benefits**. Indeed, although higher tax transparency might theoretically be in the best interest of investors, since it enables more accurate performance forecasts and assessment of tax risks, the announced new public disclosure negatively affected stock prices due to investors' concerns about:

- reputational backlash linked to the perception that the company has applied not-so-fair tax policies;
- competitive disadvantages from competitors accessing sensitive company information.

To put it simply, it seems that, for the time being, sustainability in the field of corporate taxation is not as rewarding for a company as it is, for instance, in the field of environmental protection.

4. **Who is (really) to blame?**

Financial secrecy and low tax (or no tax) jurisdictions are the antithesis of sustainability-driven taxation, since they help enact and make highly remunerative tax avoidance strategies: it is hard for a business to be fair and transparent in a market where its competitors can easily exploit the law to pay less taxes, if any. Which is why policymakers list so called "tax havens" and hamper the use of shell companies and the implementation of tax strategies aimed at artificially shifting profits towards low tax jurisdictions.

Unfortunately, it is not easy for countries to establish a fully coherent strategy to combat base erosion and profit shifting, and the European Union gives a good example of how challenging it might be, if we consider that a few EU countries are currently responsible for a major share of the financial secrecy and cross border tax abuse affecting the EU as a whole.[7]

The problem has been officially acknowledged by the EU institutions themselves.

In its 2020 European Semester: Country-Specific Recommendations, the European Commission pointed out that "**certain features of some Member States' tax systems** (i.e. Cyprus, Hungary, Ireland, Luxembourg, Malta and the Netherlands) **are used by companies that engage in aggressive tax planning**", which undermines the effort to recover from the COVID-19 crisis since it generates distortions of competition between firms which operate in the Single Market. Hence it recommended that these countries would "curb aggressive tax planning". Nonetheless, the Commission's following assessment of the national recovery and resilience plan shows that Luxembourg has so far failed to address those "features of the tax system that facilitate aggressive tax planning, in particular by means of outbound payments".

On the other hand, the study on shell companies in the European Union carried out by the European Parliament in 2018 highlights that, while shell companies can be legal and have legitimate purposes, they "can also be used as a vehicle for tax avoidance, tax evasion, and money laundering", and that **some Member States** (Luxembourg, Malta, Cyprus, the Netherlands, and Ireland) **appear to have an extremely high number of "special purpose entities"** (a type of shell companies). A phenomenon which has also been brought to light recently by the well-known Pandora Papers and OpenLux investigations, as recalled by the EU commissioner Paolo Gentiloni, and whose dimension – as far as the Netherlands are concerned – has lately been investigated by the Dutch governmental Committee on Conduit Companies: according to the data reported in November 2021 (referred to 2019), in the Netherlands there are 12,400 conduit companies, which hold total assets of around 4,500 billion euros (which is five and a half times the size of the Dutch economy), but employ only around three to four thousand people and generate tax revenues amounting to only 0.2% of the total, while “impose a disproportionate cost on developing countries in terms of lost tax revenue, and damage the Netherlands’ reputation”.

Then, considering how little protection the EU tax legislation has so far provided for corporate competition in the Single Market – as it emerges from the sources mentioned above –, it is hardly surprising if only few businesses have so far taken on the challenge of tackling the UN 2030 Agenda through the disclosed implementation of fairer corporate tax policies: a company which carried out a cost-benefit analysis of the voluntary implementation of policies able to match the stakeholders’ demand for fairer tax behaviour might still see costs prevail, for the time being.

However, in the foreseeable future things might change, considering how busy the EU agenda on tax avoidance is.

5. **What steps should be taken to build a more sustainable tax environment?**

In a nutshell: to leverage taxation to achieve the UN 2030 Agenda, **policymakers need to make the implementation and the disclosure of fair corporate tax policies more rewarding** than it currently is for the taxpayers, which requires two crucial steps to be taken:

- insure against unfair tax competition, by curbing every form of tax avoidance and making it less remunerative;
- insure against inaccurate or unreliable corporate tax disclosures.

However, since the COVID-19 outbreak, and as a reaction to the following crisis, we have been witnessing the effort put in place by the European Union to improve its legislation under both these perspectives.

It is indeed to empower the action against profit shifting and promote fair taxation – following DAC 6 and the Directive (EU) 2017/952 on hybrid mismatches with third countries (ATAD 2) – that the European Union at last approved the Directive (EU) 2021/2101 of 24 November 2021 on disclosure of income tax information by certain undertakings and branches. This directive will require large EU multinational companies (with a total consolidated revenue of € 750 million) to make their country-by-country reports public. Member States are asked to transpose the directive by 22 June 2023.

Moreover, the 22 December 2021 the European Commission presented two proposals for new directives: one to prevent the misuse of shell entities for tax purposes by providing transparency standards to detect shell companies in the EU that have no or minimal economic activity and ensure that they are unable to benefit from any tax advantages; the other one to ensure a global minimum effective tax rate of 15% for large groups operating in the European Union, according to the global tax reform agreement reached by the OECD/G20 Inclusive Framework on BEPS.

Other projects, scheduled for 2023, include the crucial work on Business in Europe: Framework for Income Taxation (BEFIT) – which replaced the pending proposal for the Common Consolidated Corporate Tax Base (CCCTB) –, aimed at providing a single corporate tax rulebook for the European Union and fairer allocation of taxing rights between Member States.

All these initiatives are inscribed in the broader framework of **the EU’s Tax Good Governance**

agenda, which aims at ensuring fairer taxation and a level playing field in the Single Market and globally as a means to support both the recovery of the European Union from the pandemic and the implementation of the UN 2030 Agenda – as set forth in the Commission's Communication of 15 July 2020 on "Tax good governance in EU and beyond".

As far as the second step outlined above is concerned – i.e., improving reliability of corporate sustainability reports –, the fact that common reporting standards are still lacking represents the main obstacle, making any comparability and assurance process hard to be carried out. Therefore, **the implementation of new EU sustainability reporting standards might really be a game changer**.

In this regard, it is worth noting that the European Commission tasked the European Financial Reporting Advisory Group (EFRAG) with developing the drafting of European reporting standards, in order to "ensure that information is comparable and that all relevant information is disclosed" and to introduce a general assurance requirement for reported sustainability information – as it is stated in the proposal for a new directive on corporate sustainability reporting, presented on 21 April 2021, which will amend the current Directive (EU) 2014/95 of 22 October 2014 on mandatory Non-Financial Reporting. A first set of reporting standards is expected to be delivered by June 2022.

Although the new directive will burden only large companies and listed companies, EU reporting standards drawn up with the cooperation of the world's main players in the field of sustainability reporting (such as GRI, which has signed a Statement of Cooperation with EFRAG in July 2021) are likely to be voluntarily applied by all the companies – albeit not falling within the application of the directive – which will aim at effectively taking advantage of the rising demand for more sustainable businesses. Thus, they really could succeed in unifying the requirements for reporting ESG information, in the tax area too.[8]

In conclusion, it seems a reasonable guess that **if the European Union manages to carry out these projects and if all the 27 Member States properly address the new EU corporate tax rules**, aggressive and unfair corporate tax strategies will be less appealing, and unreliable sustainability reports more dangerous, hence **the benefits for companies of voluntarily implementing corporate tax policies "ESG-oriented" and properly reporting on them to all the stakeholders will eventually start outweighing the costs**.

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[1] On how tax measures can support and/or undermine the achievement of the SDGs, see Alice Pirlot, *A legal analysis of the mutual interactions between the UN Sustainable Developments Goals (SDGs) & taxation* (10 October 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3467544 (accessed 8 February 2022).

[2] About the links between TCF and ESG, see Marco Lio, *ESG e fiscalità: il fattore di sostenibilità della governance letto attraverso il Tax Control Framework*, Diritto bancario (20 December 2021), https://www.dirittobancario.it/art/esg-e-fiscalita-il-fattore-di-sostenibilita-della-governance-letto-attraverso-il-tax-control-framework/ (accessed 8 February 2022).

[3] Leading this trend, BlackRock has asked its companies to regularly report on environmental, social and governance matters to their boards (3 May 2021): see the report from Jessica DiNapoli, available at https://www.reuters.com/business/sustainable-business/exclusive-blackstone-asks-its-companies-regularly-report-sustainability-2021-05-03/ (accessed 8 February 2022).

[4] Alice Pirlot, *Les interactions entre la fiscalité et la responsabilité soci(ét)tale des entreprises. Au-delà de la planification fiscale, la fiscalité environnementale comme lieu d'expression de la R.S.E.*, 74 Annales de Droit de Louvain 391, n. 3 (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3720845 (accessed 8 February 2022).

[5] Alfio Valsecchi, *What Corporate Tax Policy Has to Do with Sustainability and How Companies Should Deal with It*, 14 World Tax Journal, n. 1 (2022), https://www.ibfd.org/shop/international-what-corporate-tax-policy-has-do-sustainability-and-how-companies-should-deal-it (accessed 8 February 2022).

[6] Raphael Mu?ller et al., *How do investors value the publication of tax information? Evidence from the european public Country-by-Country Reporting*, ZEW, Centre for European Economic Researc (27 October 2021), Discussion Paper No. 21-077, https://ssrn.com/abstract=3949860 (accessed 8 February 2022).

[7] Petr Janský et al., *Financial secrecy affecting the European Union: patterns across member states, and what to do about it* (Tax Justice Network, 16 October 2018), https://taxjustice.net/wp-content/uploads/2018/09/Financial-Secrecy-affecting-the-European-Union-Policy-Paper-Tax-Justice-Network.pdf (accessed 8 February 2022); *The state of tax justice 2021* (Tax Justice Network, 16 November 2021), https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf (accessed 8 February 2022).

[8] More critical to this point is Alicya Majdanska, *The ESG-standards' alphabet soup: a new headache for tax experts?*, Kluwer International Tax Blog (21 January 2022), http://kluwertaxblog.com/2022/01/21/the-esg-standards-alphabet-soup-a-new-headache-for-tax-experts/ (accessed 8 February 2022);

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