

# Kluwer International Tax Blog

## Are Aggressive Tax-Planners ESG-Compliant?

Anne Kleithi (Legal secretary (référéndaire) at the Luxembourg administrative Court) · Tuesday, April 5th, 2022

What does the notion of “aggressive tax strategy” mean for the quest for tax justice and what are its consequences on environmental, social and governance matters?[1] In my opinion, an enterprise’s tax strategy should be considered when assessing whether that enterprise meets the so-called “ESG” criteria. I explain why in this blog.

### 1. A justification for the legal concept of “aggressive tax strategy”

Can you identify what the two trends marking the Luxembourg’s financial sector for months have in common?

On the one hand, there is a **craze for investments presented as virtuous**.<sup>[2]</sup> Under a plethora of more or less explicit names – “green”, “sustainable”, “impact” investing –, they have the stated objective of not only making a profit in monetary terms, but also having a positive impact on the environment, society and/or governance (the “ESG sphere”).

On the other hand, in the wake of cases such as “Lux Leaks” or “Pandora Papers”, we witness an **increasingly virulent criticism of the tax strategy of some companies**, based on a search for tax optimization that is deemed excessive.<sup>[3]</sup> One may already feel the practical consequences of this criticism, in particular through the adoption and implementation of the so-called **“DAC6” directive**. The latter aims to oblige certain service providers, such as lawyers and tax advisors and, failing that, taxpayers themselves, to declare to the competent tax authorities that they have designed or implemented **“potentially aggressive cross-border tax-planning arrangements”**.

“Virtue” on the one hand, “aggressiveness” on the other: through these two trends, morality is invited into the realm of law – and rightly so. It is true that law and morality are autonomous. However, **for the norm laid down by the legislator to be legitimate, it must be in conformity with natural law, which could be summed up as the imperative to recognize the dignity of every human being and to act accordingly**, i.e., “act towards one another in a spirit of brotherhood”, as commended by article 1 of the [Universal Declaration of Human Rights](#). (Positive) law must find its ultimate foundation in absolute values (moral values), without which society would ultimately be governed only by power relations (or, as the Pope emeritus Benedict XVI said, quoting Saint Augustine, “a State which is not governed according to justice would be just a bunch of thieves”).<sup>[4]</sup>

Though imbued with ethics, **“aggressive tax strategy” is a legal concept**. So what? As a fund manager or a tax advisor, should you pay any attention to this? Yes, you should. To put it simply: **a company that adopts an aggressive tax strategy should not be able to claim to be carrying out activities promoting ESG objectives and attract investors on that basis.**<sup>[5]</sup> Why is that?

## 2. Taxation has an impact on the ESG sphere

To understand why tax practitioners should care about the ESG, let us first quickly study the impact of taxation on the ESG sphere.

- **Taxes and the “E” of “ESG”**

On the one hand, environmental taxes are perfectly consistent with the objective of collecting resources by the public authorities. On the other hand, such taxes may aim at changing behaviour, by making practices that the legislator wishes to discourage more onerous.

Taxation is thus recognised as a **lever for action in environmental matters**, but at the same time there is a contradiction between the two above-mentioned objectives – the more revenue a State is able to collect from “green taxes”, the less it is able to change behaviour, and vice versa.

- **Taxes and the “S” of “ESG”**

Taxation is an **instrument for redistributing wealth**. Several fundamental principles of the Luxembourg legal system support the promotion of taxation as a mechanism for the controlled collection of taxpayers’ resources in order to achieve social objectives: the principle of equality before the law and, more particularly, equality before public charges, the principle of legality of taxation, the ability to pay principle and the principle of solidarity.

At EU level, the European Commission has recognised the important role of taxation in the **effective implementation of the 2030 Agenda for Sustainable Development.**<sup>[6]</sup> It was launched by the United Nations and includes 17 goals such as “no poverty”, “zero hunger” and “quality education”, which obviously require a proper mobilization of tax revenues to be achieved.

A tax that fulfils its **distributive purpose** thus **responds to the thirst for social recognition** and serves to **increase social cohesion.**<sup>[7]</sup>

- **Taxes and the “G” of “ESG”**

Governance is an art of decision-making characterized by the involvement of all stakeholders and the visibility of decision-making processes, with a view to pacification and the acceptance of decisions. Such traits are also reminiscent of democracy.

Since **tax justice is essential to a democratic, stable and peaceful society**<sup>[8]</sup> – think of the French Revolution and the “yellow vests” (*gilets jaunes*) protests –, it is clear that taxation plays an important role in relation to governance.

## Clues to a better identification of an aggressive tax strategy

Now that we have seen that taxation plays a crucial role in the ESG, why should we care about “aggressive tax strategies”? By “aggressive tax strategy”, I mean all decisions made by the management of a company to obtain a specific tax treatment (in particular a certain effective tax rate) by **using mechanisms that appear legal, but which are contrary to the spirit of the law.**<sup>[9]</sup>

The reason why we should pay attention to “aggressive tax strategies” is because they can have a negative impact on **tax fairness**. The importance of fairness in the political discourse on taxation is undeniable given the recurrence of the term “justice” in that discourse.<sup>[10]</sup> In addition, the intent of tax law is (or at least should be) in principle ultimately to reach tax justice. True, “tax justice” is hardly ever defined, which makes it difficult to ensure that the objective of tax fairness is met. The task of defining “tax justice” is certainly beyond the scope of this contribution, but the “work of reason”<sup>[11]</sup> – namely the truly human work carried out in particular by the authors of doctrine, who use their minds, guided by their conscience and without being subject to political imperatives, to confirm consistency or to point out contradictions in the formulation of the law – nevertheless makes it possible to identify elements included in this concept. In my opinion, aggressive tax strategies undermine these elements of tax fairness, including the principle of equality.

A series of questions can be used to assess the aggressive nature of a tax strategy.<sup>[12]</sup> For example, in the light of the principle of equality before the law, has a company received a more favourable tax treatment because it has taken advantage of its size and its impact on the country’s economy? As for the equality before public charges and the ability to pay principles, does the company pay a tax on the profits it has made? In order to reduce its tax burden, does it seek to exploit loopholes in one or more tax systems? Where the legislator has provided for an exemption or a preferential tax regime, for example a regime to support research and development, has the company artificially created the conditions to benefit from it? A [2012 EU Commission recommendation on aggressive tax planning](#) defines artificiality as a lack of commercial substance and suggests measuring it in several ways, for example by assessing whether an arrangement “includes elements which have the effect of offsetting or cancelling each other”.

Our understanding of the concept of “aggressive tax strategy” can also be deepened **in light of the above-mentioned impacts on the ESG sphere:**

1. **in environmental matters**, if for example the legislator introduces a “carbon tax” to increase the price of polluting products and thus reduce their import, we could argue that a company’s tax strategy is aggressive if it continues to import polluting products and simply decides to pass on the price increase to the consumer. Such conduct will enable it to unduly reduce its tax burden: in the end, it will not suffer the negative tax consequences that the legislator wanted to attach to the importation of polluting products while continuing to adopt the behaviour that the legislator wanted to discourage;
2. **from a social point of view**, a company will have an aggressive tax strategy if it avoids the collection of resources decided by the legislator. Corporate tax evasion in the EU is estimated to amount to more than EUR 35 billion per year, which means that resources cannot be spent on social spending, hampering the mechanisms for redistributing wealth.<sup>[13]</sup> Relevant criteria in this context are similar to those mentioned with regard to the **ability to pay and equality before public charges principles**, since these principles underlying tax justice are also intrinsically
- 3.

linked to the social sphere. **Double non-taxation** and the **deduction of a charge not followed by the inclusion of a corresponding income** within a group of companies are particularly illustrative;

- **in terms of governance**, an aggressive tax strategy may cause **financial damage** in the event of litigation with the tax authorities and cause **serious damage to the company's reputation**, which is difficult to qualify as good governance. Moreover, such a strategy relies on **operations that knowingly go against the will of the legislator** and thus shows **disregard for the legitimate governance structures of the society**. For example, are decisions really made where the company says they are, or is the company using the tax residence rules to artificially obtain tax resident status in a specific jurisdiction or even not to be considered tax resident anywhere?

In light of the above, **it would be paradoxical if a company could claim to be the “Robin Hood of the ESG” by pretending to act virtuously in the ESG sphere to remedy the State's inaction, even though it deprives the State of its means of action by implementing an aggressive tax strategy**. The next question I briefly analyse in this blog is thus: “How is this concern reflected in current ESG regulations?”

#### 4. **Interpreting existing ESG regulations to prevent aggressive tax-planners from claiming they are ESG-compliant**

Within the legally binding regulations, two texts seem particularly important for the ESG sphere: on the one hand, **EU regulation 2019/2088 on sustainability-related disclosures in the financial services sector** and on the other hand, **EU regulation 2020/852 on the establishment of a framework to facilitate sustainable investment** and amending EU regulation 2019/2088.

The preamble to both regulations refers to the United Nations' Agenda for Sustainable Development mentioned above. The European legislator did not clearly show whether it was aware that the pursuit of aggressive tax practices could undermine the effective achievement of the environmental and social objectives which it seeks to promote through those regulations, but it seems to me that it is possible to interpret these texts in a manner consistent with such a concern.

For example, “**sustainability risk**” is defined broadly enough to include ESG risks caused by aggressive tax planning: according to article 2, paragraph (22) of EU regulation 2019/2088, “sustainability risk” means “an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment”. Such an inclusive interpretation of this concept would be desirable: it would better take into account the factors that could be detrimental to the achievement of ESG objectives and would thus prevent ESG activities and investments from being a smokescreen instead of the vaunted paradigm shift. The same applies to EU regulation 2020/852, which provides in article 18 for minimum social guarantees to be respected in order to fulfil the definition given in article 3 of “**environmentally sustainable economic activities**”. Article 18 notably requires **compliance with the UN Guiding Principles on Business and Human Rights**, and according to the commentary to Guiding Principle 11, “**Business enterprises should not undermine States' abilities to meet their own human rights obligations**”. As **aggressive tax planning unduly reduces the financial resources of States**, an undertaking using this form of planning should be considered not to comply with the UN Guiding Principles and, consequently, with articles 3 and 18 of EU regulation 2020/852, so that it should not be able to attract funds by relying on the exercise of an

environmentally sustainable economic activity.

## 5. Preparing the future

**Injecting funds to support ESG investments** is important to prepare the future but to be effective, it should be done **in a genuine and coherent way**. Furthermore, my objective is not to demonize tax optimization. In fact, **tax optimization and environmental, social and good governance objectives are not always opposed** – in Luxembourg, think of the exemption mechanisms provided for specific vehicles such as the “societal impact company” (*société d’impact sociétal*) or the deduction of donations to recognized public benefit organizations. Would a company’s commitment to ESG objectives not be more authentic if it used these mechanisms to reduce its tax burden?

**Education** (especially philosophical, moral and religious education) must play a vital role in reviving the **sense of the common good** and teaching us how to identify what constitutes aggressive tax planning. But it also appears necessary to reflect on the reasons for the dissatisfaction felt by citizens with their obligation to pay tax, which then leads to the adoption of aggressive tax strategies. **Acceptance of taxes requires a better analysis of our tax systems and a debate about their ideological foundations.**

Anne Klethi, Legal secretary (*référéndaire*) at the Luxembourg administrative Court; former member of the Luxembourg Bar; LL.M. in International Business Law (King’s College London) and LL.M. in European and International Tax Law (University of Luxembourg). To contact the author, please write to [Anne.Klethi@ja.etat.lu](mailto:Anne.Klethi@ja.etat.lu).

[1] I have explored this question in more details in the following paper : Anne Klethi, *La prise en compte des stratégies fiscales agressives dans l’évaluation du respect par les entreprises des critères environnementaux, sociaux et de gouvernance*, 1 Cahiers de fiscalité luxembourgeoise et européenne 33 (2022).

[2] See e.g., the interview of the president of the association of the Luxembourg fund industry (ALFI): Sébastien Lambotte, « *La transition vers le durable, une opportunité extraordinaire* », Paperjam (28 September 2021), [https://paperjam.lu/article/transition-vers-durable-opport?utm\\_medium=email&utm\\_campaign=28-09-2021%20Matin&utm\\_content=28-09-2021%20Matin+CID\\_ed6c402a3447f8dbe4af3b8f3aa9b5f5&utm\\_source=Newsletter&utm\\_term=La%20transition%20vers%20le%20durable%20une%20opportunit%20extraordinaire](https://paperjam.lu/article/transition-vers-durable-opport?utm_medium=email&utm_campaign=28-09-2021%20Matin&utm_content=28-09-2021%20Matin+CID_ed6c402a3447f8dbe4af3b8f3aa9b5f5&utm_source=Newsletter&utm_term=La%20transition%20vers%20le%20durable%20une%20opportunit%20extraordinaire) (accessed 27 March 2022).

[3] See e.g., Anne Michel, *Evasion fiscale : tout sur les secrets du Luxembourg*, Le Monde (5 November 2014), [https://www.lemonde.fr/evasion-fiscale/article/2014/11/05/evasion-fiscale-tout-sur-les-secrets-du-luxembourg\\_4518895\\_4862750.html](https://www.lemonde.fr/evasion-fiscale/article/2014/11/05/evasion-fiscale-tout-sur-les-secrets-du-luxembourg_4518895_4862750.html) (accessed 27 March 2022).

[4] Benedict XVI, *Encyclical letter Deus caritas est*, Libreria Editrice Vaticana (2005), n°28a), [https://www.vatican.va/content/benedict-xvi/en/encyclicals/documents/hf\\_ben-xvi\\_enc\\_20051225\\_deus-caritas-est.html](https://www.vatican.va/content/benedict-xvi/en/encyclicals/documents/hf_ben-xvi_enc_20051225_deus-caritas-est.html) (accessed 28 March 2022).

[5] Also sharing this view: Alfio Valsecchi, *Building a Sustainability-Driven Tax Environment in*

*the EU Area: Reality or Wishful Thinking?*, Kluwer International Tax Blog (10 February 2022), <http://kluwertaxblog.com/2022/02/10/building-a-sustainability-driven-tax-environment-in-the-eu-a-rea-reality-or-wishful-thinking/> (accessed 29 March 2022).

[6] Communication from the Commission to the European Parliament and the Council on Tax Good Governance in the EU and beyond, 15 July 2020, COM(2020) 313 final, p.15, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0313&from=EN> (accessed 29 March 2022).

[7] In a striking essay, Professor Christian Neuhäuser has sought to show that money is a means of imposing one's will, and that the grip of the wealthiest over societal structures and institutions, their ability to shape them according to their own needs, may undermine human dignity. See Christian Neuhäuser, *Wie reich darf man sein? Über Gier, Neid und Gerechtigkeit*, Ditzingen, Reclam, 2019.

[8] Jeffrey Owens, Marta Olowka, *Dealing With Tax Populism*, Tax Notes International, 1155 (8 June 2020).

[9] My definition of “aggressive tax strategy” is based on the definition of “aggressive tax planning” proposed by the European Commission in its *Annual Report on Taxation 2021: review of taxation policies in the EU Member States*, Publications Office (2021), p. 116, <https://op.europa.eu/en/publication-detail/-/publication/db46de2a-b785-11eb-8aca-01aa75ed71a1/language-en> (accessed 29 March 2022): “Aggressive tax planning consists of taxpayers reducing their tax liability through arrangements that may be legal but are in contradiction with the intent of the law”. Under Luxembourg law, § 6 of the Tax Adaptation Law (*loi d'adaptation fiscale du 16 octobre 1934*) contains precisely this criterion of conflict with the spirit of the law.

[10] See e.g., European Commission, *Annual Report on Taxation 2021: review of taxation policies in the EU Member States*, *op. cit.*, pp.4-5 and 16-20.

[11] On the important role of doctrine in this process of the “work of reason”, see Xavier Dijon, *Le regard du jusnaturaliste: la nature humaine, source du droit*, Les sources du droit revisitées, Bruxelles, Presses de l'Université Saint-Louis, 2012, vol.4, p.844, <http://media.aclj.org/pdf/Xavier-Dijon-Le-regard-du-jusnaturaliste-La-nature-humaine-source-de-droit-ECLJ.pdf> (accessed 4 April 2022).

[12] For more details, see my paper referred to in footnote 1.

[13] Communication from the Commission to the European Parliament and the Council, An action plan for fair and simple taxation supporting the recovery strategy, COM(2020) 312 final, p.5, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020DC0312> (accessed 29 March 2022).

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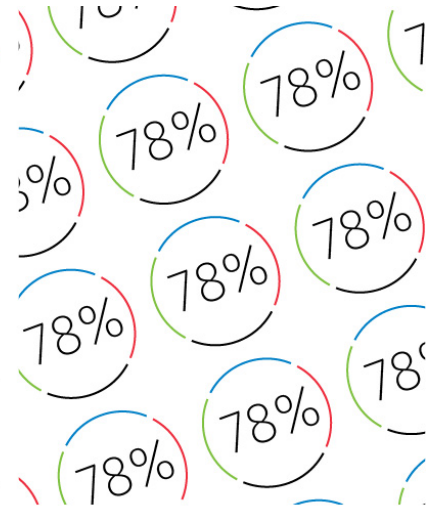
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