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Tax Law Meets Sustainability

Anne Van de Vijver (University of Antwerp) and Tarcísio Diniz Magalhães (University of Antwerp) · Monday, August 7th, 2023

Sustainability has become a global imperative in recent years, driven by the realization that societies are on the brink of potentially irreversible environmental, economic, and governance collapse. Given the central role of law in shaping commercial activity that impacts communities and the planet, it is crucial to analyse the question of how various legal frameworks could contribute to fostering a more sustainable business environment. In this blog, we consider the relationship between corporate taxation and sustainability from the perspective of ethics and economics theory.

Moral Standards for Tax Lobbying

Corporate lobbying has multiple benefits for democracy, as it provides policymakers with valuable data, specialized knowledge, and relevant expertise. But aggressive lobbying to disproportionately reduce a firm's or group of firms' tax burden is unsustainable for several reasons. Tax benefits can considerably reduce revenues for governments, impacting their ability to fund public services and investment in sustainable policies. Moreover, excessive corporate power undermines the democratic process. Parliamentary debate should ensure that the design of taxes takes into account everyone's interests, not just the interests of powerful and influential taxpayers, with a view to safeguarding the public interest. Building on Immanuel Kant's moral theory, it is possible to derive three standards for guiding responsible corporate tax lobbying.

First, based on Kant's Humanity Principle, corporations and their leaders have a moral duty to be transparent about their lobbying activities. This is because the principle determines that people should never be treated as means but rather as ends in themselves. For stakeholders (e.g., prospective employees), the availability of information about lobbying positions would allow them to evaluate whether having a professional relation with the corporation is aligned with their personal ends and life goals. For example, does working for a corporation that lobbies for secret tax rulings align with the employee's personal life goal of contributing to a better world for all? If the corporation lobbies positions secretly while entering a professional relationship with a person, that person's life goals may be neglected.

Second, based on Kant's Universality Principle, corporations and their leaders have a moral duty to engage in dialogue with their stakeholders, in order to consider the interests and positions of the latter. This is because the principle implies that the rationality of lobbying positions should be judged by their potential to become a universal law. In this sense, the position of paying no (or very little) taxes while benefiting from a state's legal and economic system cannot be conceived as a universal law. Lack of state revenue resulting from a universal tax exemption endangers the functioning and even existence of the state. To evaluate whether a tax position is universally justified, a company should establish a dialogue with stakeholders and the public. For example, tax benefits to encourage innovation are likely to be widely accepted, yet Kant emphasized that citizens should always be able to express their concerns and objections in public, enabling those in power to properly evaluate policies that affect everyone. For corporations, dialogue with stakeholders can also enable them to better manage risks and impacts.

Finally, Kant recognized that transparency and dialogue might not be sufficient to protect the public interest. Those in power may be hypocritical about their motivations, publicly declaring that they are acting on behalf of the public interest when, in fact, they are being self-interested and demanding legal regimes that mostly benefit themselves. A solution to this problem rests on the concept of "evidence-based lobbying". To improve the morality of corporate tax lobbying, corporations should provide evidence that their tax lobbying positions are indeed effective in achieving their publicly stated motives. For example, when lobbying for so-called "patent boxes", companies should provide scientific evidence that the requested tax incentive will effectively increase innovation.

Moving beyond corporate tax lobbying, another key aspect of sustainable taxation concerns the control of negative externalities, as discussed below.

Proper Taxation of Negative Externalities

Since the 1930's classic *The Economics of Welfare* by Arthur C. Pigou, it is widely recognized that taxation is an appropriate and effective tool to control negative externalities, as an alternative to command-and-control regulation or criminalization. Conventionally, tax reform that seeks to counter unsustainable behaviour has focused on reducing consumer demand for goods and services deemed socially and environmentally harmful, by way of increasing retail prices. The primary strategy in this regard has been to adopt special indirect (consumption-based) forms of taxation, notably excise taxes and other targeted environmental levies imposed on things like plastic, batteries, waste, energy, and transport. More recently, multiple governments have been considering the introduction of a carbon tax to address the climate crisis.

However, to the extent that such taxes do not remove the high profitability associated with unsustainable corporate practices of all manner, businesses are incentivized to continue offloading some of their costs onto the public, including in different countries and even in respect to future generations. By avoiding the full present and future costs involved in production and distribution processes, polluters increase their profit margins and effectively reap windfalls which, by definition, are earnings distinct from the normal profit that arises from the productive application of capital, labour, and entrepreneurship under competitive and fair economic conditions.

Think of a product that would cost $100.00 to be sustainably produced, yet the producer decides to dump its waste on local communities or to underpay its workers in order to save $20.00 per unit, which are then sold for a final price of $130.00. Regardless of what the company reports in its income statements, the true profit on each sale is $30.00 because this is the amount left after deducting the real cost of the underlying activity. In turn, the externalized savings of $20.00 turned into extra earnings should be entirely characterized as a windfall that does not belong to the private actor that captured it but to society at large. As an unearned gain extracted from everyone else, the windfall can be taxed away and returned to the public in the form of revenues to correct the externality, compensate victims, and support the green transition, among other societal goals.

Conclusion

As professors and researchers of tax law, we are both interested in understanding how taxation can help build better societies and promote human thriving. This interest is reflected in our publications but also in our teaching. In discussing the two perspectives above with students and young professionals, we were particularly curious to learn whether the issues we raised factored at all into their personal decisions as employees and consumers. When we asked, for example, if they care whether their prospective employers engage in lobbying for lower taxes or produce negative impacts for the environment, the unanimous response was affirmative. This shared concerned with responsible company behaviour bodes well for the future of sustainability and reinforces our belief in the relevance of the topic for tax law.

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Anne Van de Vijver, Professor of Tax Law and director of the Business & Law Research Group, University of Antwerp. Tarcísio Diniz Magalhães, Assistant Research Professor and coordinator of the Working Party on Sustainability of the Business & Law Research Group, University of Antwerp. The authors are also members of the DigiTax Centre of Excellence and Antwerp Tax Academy.

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