

More T in ESG: Tax as a Crucial Component of ESG

LISA CHEN[†]

ESG is a framework used to assess the sustainability of a company and to measure financial risk arising from potential environmental, social, and governance issues. Investors and consumers typically rely on ESG ratings generated by third-party ratings agencies to evaluate a company's ESG quality. Critics of ESG assert that ESG ratings are misleading because neither the rating agencies nor the ESG disclosures used to generate ratings are regulated. Despite these criticisms, demand for ESG-related products has grown four-fold in the last decade, reflecting the change in societal expectations regarding corporate behavior.

Given this demand, U.S. companies have rushed to adopt ESG policies. Most of these policies, however, overlook a critical component of ESG: responsible tax practice. Furthermore, to the extent that ESG rating providers include tax in their metrics, they fail to consider responsible tax practices beyond mere tax transparency. Responsible tax practices are essential to ESG for both measuring a company's sustainability impact and assessing a company's financial risk, and any ESG policy or ESG rating that fails to meaningfully consider tax is incomplete. This Article analyzes the existing proposals for ESG standards and proffers suggestions to remedy the deficiency in the current ESG framework through ESG tax standards for U.S. companies.

[†] J.D., Class of 2023, University of California, College of the Law San Francisco (formerly UC Hastings); tax attorney. I would like to thank my family and dear friends for their support, Professor Heather Field and Professor Manoj Viswanathan for their invaluable guidance and the editors of *UC Law Journal* for their hard work.

TABLE OF CONTENTS

INTRODUCTION	1248
I. ESG IS A STRATEGIC FRAMEWORK THAT IMPACTS BUSINESS	
BEHAVIOR	1248
A. THE ORIGINS OF ESG	1249
B. ESG DEFINED	1250
1. <i>Sustainability of the World</i>	1251
2. <i>Sustainability of the Company Itself</i>	1252
3. <i>Long-Term Value Creation Hinges on Societal Concerns</i> ..	1252
C. THE ESG RATINGS INDUSTRY	1253
D. WHAT ESG RATINGS ARE SUPPOSED TO MEASURE	1253
1. <i>External Impact on Society and the World</i>	1254
2. <i>Internal Impact on Company and Shareholders</i>	1254
3. <i>ESG Ratings Reflect the Internal Impact View</i>	1255
E. CRITIQUES OF ESG	1256
II. TAX IS A CRUCIAL, YET OVERLOOKED COMPONENT OF ESG	1258
A. DEFINING TAX IN ESG	1259
B. TAX IS OVERLOOKED IN ESG	1260
1. <i>U.S. Companies Fail to Actively Include Tax</i> <i>in Their ESG Policies</i>	1260
2. <i>Tax Is Not Adequately Included or Measured</i> <i>in ESG Ratings</i>	1261
C. TAX IS A CRITICAL COMPONENT OF THE ESG CONCEPT	1262
1. <i>Tax Implicates Both the Social and Governance</i> <i>Prongs of ESG</i>	1262
2. <i>Tax Is Connected to ESG Principles</i>	1263
a. <i>Maternity leave example</i>	1264
b. <i>Tax planning example</i>	1264
D. TAX IS ESSENTIAL TO BOTH VIEWS OF MEASURING ESG	1267
1. <i>External Impact Cannot Be Properly Assessed</i> <i>Without Considering Tax</i>	1267
2. <i>Tax Is Integral to Measuring Internal Impact</i>	1268
3. <i>Tax Should Be Meaningfully Incorporated in ESG</i> <i>Policies and Ratings</i>	1269
E. CRAFTING TAX-RELATED ESG EFFORTS RESPONSIVE TO THE PRINCIPLES AND CRITICISMS OF ESG	1270
III. EXISTING PROPOSALS FOR ESG TAX STANDARDS	1271
A. OVERVIEW AND METHODOLOGY	1271
B. DISCLOSURE-BASED PROPOSALS	1272
1. <i>Origins and Contents of Disclosure-Based Proposals</i>	1272

2.	<i>Policy Evaluation of Disclosure-Based Proposals</i>	1273
a.	<i>Meeting ESG tax goals</i>	1274
b.	<i>Achieving the benefits of ESG</i>	1274
c.	<i>Vulnerability to ESG ratings-related criticisms</i>	1275
C.	BEHAVIOR-BASED PROPOSALS	1276
1.	<i>Origins and Contents of Behavior-Based Proposals</i>	1276
2.	<i>Policy Evaluation of Behavior-Based Proposals</i>	1278
a.	<i>Meeting ESG tax goals</i>	1278
b.	<i>Achieving the benefits of ESG</i>	1279
c.	<i>Vulnerability to ESG ratings-related criticisms</i>	1280
IV.	RECOMMENDATIONS FOR U.S. ESG TAX STANDARDS	1281
A.	THE IMPLEMENTATION OF A U.S. ESG TAX STANDARD.....	1281
B.	THE SUBSTANCE OF A U.S. ESG TAX STANDARD	1282
1.	<i>Tax Transparency: U.S. Companies Should Commit to GRI 207</i>	1283
2.	<i>Non-Aggressive Tax Planning: Targeting Vulnerable Tax Positions</i>	1284
3.	<i>Relationships with Stakeholders: Shareholder Audits</i>	1285
4.	<i>Tax Governance: Internal Whistleblower Program for Employees</i>	1285
	CONCLUSION	1286

INTRODUCTION

In the last several years, the world has experienced a global pandemic, increased warnings regarding climate change, and threats to social institutions such as American democracy. In light of these existential threats, investors and consumers are increasingly turning to investment products and companies that consider critical environmental, social, and governance (ESG) issues in their business models. This has led to the explosive growth of the ESG market in recent years.

In the last three decades, the total value of U.S. assets under management that incorporate ESG factors has grown twenty-five-fold (from \$639 billion in 1995 to \$17 trillion in 2020), with 40 percent of that growth occurring between 2018 and 2020.¹ Given this demand, asset managers and companies are increasingly adopting ESG policies both to appeal to investors and customers and as a risk management strategy, while third-party agencies have developed proprietary ESG ratings that purport to measure ESG quality.

While U.S. companies have rushed to adopt policies based on the ESG framework, companies and ESG rating providers alike have neglected a critical component of ESG: tax. To the extent that they have adopted such policies, U.S. companies should include tax in their ESG policy considerations because tax is (1) fundamental to the concerns underlying ESG² and (2) crucial to accurately measuring a company's ESG quality. Consequently, any ESG policy or ESG rating that fails to meaningfully consider tax is incomplete.

To remedy this deficiency, this Article offers preliminary considerations for the adoption of ESG tax standards by U.S. companies and proceeds in four Parts. Part I provides an overview of the ESG landscape, including a discussion of the two ways of measuring ESG and ESG ratings, as well as discussing accompanying criticisms. Part II argues that tax is an integral aspect of ESG and should be meaningfully incorporated in the ESG policies of U.S. companies and in the ratings generated by ESG rating agencies. Part III describes and analyzes the existing proposals for ESG tax standards in light of ESG policy considerations. Finally, Part IV presents preliminary recommendations related to the substance and implementation of an ESG tax standard for U.S. companies.

I. ESG IS A STRATEGIC FRAMEWORK THAT IMPACTS BUSINESS BEHAVIOR

This Part introduces the concept of ESG by tracing its origins and defining ESG. It then contextualizes ESG in the real world by describing the ESG ratings

1. US SIF FOUND., REPORT ON US SUSTAINABLE AND IMPACT INVESTING TRENDS 2020 1 (2020), <https://www.ussif.org/files/Trends%20Report%202020%20Executive%20Summary.pdf>.

2. Proponents of ESG are concerned with the long-term sustainability of business and the environment they operate in (that is, the planet and all its stakeholders, whether or not they are direct shareholders of any particular company). See discussion *infra* Part I.B.

industry, explaining the two views of measuring ESG quality and the criticisms of ESG.

A. THE ORIGINS OF ESG

The notion that businesses have a responsibility to society is not new.³ There have been many attempts to articulate the social responsibility of businesses, which “encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time.”⁴ One recent movement is ESG, which is rooted in the concept of Corporate Social Responsibility (CSR) that emerged in the 1950s⁵ and gained global traction in the 1990s.⁶ In general, CSR refers to voluntary corporate efforts to include environmental, social, and stakeholder considerations alongside economic considerations in business practices.⁷ It is commonly viewed as a strategy for enhancing corporate reputation.⁸ Companies implement CSR by engaging in corporate social initiatives such as corporate philanthropy and cause-related marketing (that is, making contributions to causes based on product sales).⁹

CSR and ESG are often used interchangeably with the term sustainability.¹⁰ However, the two concepts are distinct despite their overlap: “While CSR aims to make a business accountable, ESG criteria make such business’ efforts measurable.”¹¹ How ESG measures CSR and other sustainability efforts is discussed in the following subsections.

3. Mauricio Andrés Latapí Agudelo, Lára Jóhannsdóttir & Brynhildur Davídsdóttir, *A Literature Review of the History and Evolution of Corporate Social Responsibility*, 4 INT’L J. CORP. SOC. RESP. 1, 1 (2019).

4. Archie B. Carroll, *A Three-Dimensional Conceptual Model of Corporate Performance*, 4 ACAD. MGMT. REV. 497, 500 (1979).

5. Latapí Agudelo et al., *supra* note 3, at 3.

6. *Id.* at 7–9.

7. See Alexander Dahlsrud, *How Corporate Social Responsibility Is Defined: An Analysis of 37 Definitions*, 15 CORP. SOC. RESP. & ENV’T. MGMT. 1, 4 (2008); Federico Fornasari, *Knowledge and Power in Measuring the Sustainable Corporation: Stock Exchanges as Regulators of ESG Factors Disclosure*, 19 WASH. U. GLOB. STUD. L. REV. 167, 177 (2020).

8. Latapí Agudelo et al., *supra* note 3, at 9, 11, 13; see generally PHILIP KOTLER & NANCY R. LEE, *CORPORATE SOCIAL RESPONSIBILITY: DOING THE MOST GOOD FOR YOUR COMPANY AND YOUR CAUSE* (2005) (discussing several corporate social initiatives).

9. See generally KOTLER & LEE, *supra* note 8 (discussing engagement in corporate social initiatives).

10. See Lynn M. LoPucki, *Repurposing the Corporation Through Stakeholder Markets*, 55 U.C. DAVIS L. REV. 1445, 1462 (2022); *New York Stock Exchange ESG Guidance: Best Practices for Sustainability Reporting*, NYSE, <https://www.nyse.com/esg-guidance> (last visited Apr. 20, 2023); *Sustainability Principles and Objectives (SPO) Framework*, BSR, <https://spo.bsr.org> (last visited Apr. 20, 2023).

11. Piyush Gupta, *Understanding and Adopting ESG – An Overview: Part I: The Evolution of ESG from CSR*, RHTLAW ASIA, <https://www.rhtlawasia.com/wp-content/uploads/2021/11/ESG-Part-I-The-Evolution-of-ESG-from-CSR.pdf> (last visited Apr. 20, 2023); see Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESF Integration*, 90 U. COLO. L. REV. 731, 741 (2019).

B. ESG DEFINED

Given its relative novelty, ESG is a difficult concept to define. The consensus is that ESG is a framework that “seeks to expand upon a traditional analysis of corporate value”¹² by measuring a company’s environmental, social, and governance practices and risks.¹³ ESG is “intended to counter the existential threats posed by social inequality and climate change,” as well as “combat the risks posed by poor [business] practices that threaten the stability of capital markets and the economy [at] large.”¹⁴ The environmental prong addresses impact on the physical environment by looking at matters such as greenhouse-gas emissions and waste management.¹⁵ The social prong is concerned with practices that create a more equitable society, such as fair labor standards and diversity policies.¹⁶ Lastly, the governance prong assesses a company’s internal system of practices for self-governance and effective decision-making, including board practices and tax strategy.¹⁷ Together, these three factors are used by socially conscious investors and consumers to measure the sustainability of investment products and companies.¹⁸

At its core, ESG is about driving long-term value creation by asking companies to consider sustainability in decisionmaking,¹⁹ but there is no consensus in academic literature or dialogue on what exactly “sustainability” refers to: sustainability of the world (an understanding that better aligns with the

12. Ellen Kennedy, *What Is ESG?*, KIPLINGER (Nov. 11, 2022), <https://www.kiplinger.com/investing/esg/what-is-esg>.

13. *The Key Differences Between SRI, ESG and Impact Investing*, PITCHBOOK BLOG (Aug. 31, 2021), <https://pitchbook.com/blog/what-are-the-differences-between-sri-esg-and-impact-investing> (“ESG refers to a framework or set of criteria used to evaluate a company’s environmental, social and governance risks and practices”). Though all three are investment strategies that use nontraditional factors as a part of business decision-making, ESG is distinct from Socially Responsible Investing (“SRI”) and impact investing. SRI is a process of “excluding the securities of certain otherwise attractive companies from an investor’s portfolio because the companies are judged to be socially irresponsible, and including the securities of certain otherwise unattractive companies because they are judged to be behaving in a socially laudable way.” John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 73 (1980). In contrast, impact investing is investing that focuses deliberately on seeking both financial return and specific environmental or social results. Gary, *supra* note 11, at 742–45.

14. Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1925 (2020).

15. Witold Henisz, Tim Koller & Robin Nuttall, *Five Ways that ESG Creates Value*, MCKINSEY Q. (Nov. 14, 2019), <https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value>.

16. *Id.*

17. *Id.*

18. George Serafeim, *Social-Impact Efforts that Create Real Value*, HARV. BUS. REV., Sept.–Oct. 2020, at 38, 40, 48, <https://hbr.org/2020/09/social-impact-efforts-that-create-real-value>.

19. See *supra* notes 12–14 and accompanying text.

term's common usage²⁰) or sustainability of the companies themselves?²¹ Compounding the confusion, actions to promote sustainability of the world can impact the sustainability of the company and vice versa.²²

1. *Sustainability of the World*

When the term ESG was first introduced in a 2004 publication by the United Nations Global Compact, sustainability of the world was of primary concern.²³ Noting that long-term value creation by businesses ultimately depends on a “sustainable planet,” the UN Global Compact concluded that it was in a company’s best interest to make decisions that contribute to “sustainable development of global society,” (that is, of the planet and those who live in it) even if it meant sacrificing some short-term profits.²⁴ Since then, growing societal concern over the sustainability of the world has increased stakeholder demand for companies to consider these moral issues.²⁵ Companies have an incentive to respond to these concerns because “[w]hile helping non-shareholder stakeholders may not always generate short-term value for a company, helping non-shareholder stakeholders may generate long-term value.”²⁶ Thus, actions taken by a company to directly promote the sustainability of the world may ultimately contribute to the sustainable development of the business itself because (1) there can be no business if the planet collapses and (2) long-term business success may depend on satisfying non-shareholder stakeholder demand.

20. Sustainability is defined as “the use of natural products and energy in a way that does not harm the environment.” *Sustainability*, OXFORD LEARNER’S DICTIONARIES, <https://www.oxfordlearnersdictionaries.com/us/definition/english/sustainability?q=sustainability> (last visited Apr. 23, 2023).

21. See Kenneth P. Pucker & Andrew King, *ESG Investing Isn’t Designed to Save the Planet*, HARV. BUS. REV. (Aug. 1, 2022), <https://hbr.org/2022/08/esg-investing-isnt-designed-to-save-the-planet>.

22. See discussion *infra* Part I.B.1–2.

23. U.N. GLOB. COMPACT, WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD ii, 1 (2004), https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf [hereinafter WHO CARES WINS].

24. *Id.* at 3.

25. See Sherry Frey, Jordan Bar Am, Vinit Doshi, Anandi Malik & Steve Noble, *Consumers Care About Sustainability and Back It Up with Their Wallets*, MCKINSEY (Feb. 6, 2023), <https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/consumers-care-about-sustainability-and-back-it-up-with-their-wallets>.

26. Kasey Wang, *Why Institutional Investors Support ESG Issues*, 22 U.C. DAVIS BUS. L.J. 129, 145 (2021). The argument that advancing stakeholder interests may increase long-term shareholder value has been explored by many academics. See, e.g., Shlomitt Azgad-Tromer, *Corporations and the 99%: Team Production Revisited*, 21 FORDHAM J. CORP. & FIN. L. 163, 189 (2016) (addressing the needs of non-investor stakeholders can improve a firm’s financial performance); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1459 (2006) (“A firm’s long-run profits may depend significantly on satisfying the social demands of consumers, employees and local communities.”).

2. *Sustainability of the Company Itself*

Over time, industry discussion of ESG has shifted to a focus on the sustainability of companies themselves. Increasingly, companies are incorporating the ESG framework for the primary purpose of “generat[ing] sustainable, long-term financial returns.”²⁷ This adoption is primarily driven by three factors.²⁸ First, recent studies suggest that companies that consider ESG in decision-making improve their risk management and generate “returns that are not inferior” to returns from purely profit-seeking business operations.²⁹ Second, growing societal concern over ESG issues (specifically, concerns about the sustainability of the world)³⁰ has led to increasing demand for ESG-related products, which in turn impacts corporate performance.³¹ Third, companies have shifted from short-term perspectives on risks and returns, “so as to better reflect longer-term sustainability in investment performance.”³²

While companies focused on the sustainability of their operations are not directly concerned with the sustainability of the world, certain actions taken to promote sustainable business operations may indirectly promote sustainable global development. One example is the Facebook Cambridge Analytica scandal, which revealed Facebook’s practice of exploiting user data without contractual user consent.³³ Because the public (including Facebook users and non-users alike) heavily frowned upon this invasion of privacy despite its legality, Facebook disavowed the practice in order to repair its reputation and preserve the viability of its brand and business.³⁴ Had Facebook acted without restraint, those disfavored business practices (meaning, the violation of fundamental privacy rights) could be detrimental to the long-term development of society.

3. *Long-Term Value Creation Hinges on Societal Concerns*

Despite the lack of clarity on the meaning of sustainability in ESG, a common thread can be extracted from the above discussion. Both rationales for long-term value creation assume that external factors such as societal norms can

27. RICCARDO BOFFO & ROBERT PATALANO, OECD, ESG INVESTING: PRACTICES, PROGRESS AND CHALLENGES 6 (2020), <https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf>.

28. *Id.*

29. *Id.*

30. See Jonathan R. Povilonis, *Contracting for ESG: Sustainability-Linked Bonds and A New Investor Paradigm*, 77 BUS. LAW. 625, 633 n.54 (2022) (“[I]nstitutional investors’ interest in ESG is motivated by social values, and that thus ‘[t]here are good reasons to believe that [their] purpose [in seeking mandatory ESG disclosure] is in part to pursue public policy goals outside the normal political process.’”).

31. BOFFO & PATALANO, *supra* note 27, at 6.

32. *Id.*

33. Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1437 (2020).

34. *Id.* at 1437–38.

impact business performance. Thus, whenever a company prioritizes either sustainability of the world or its own sustainability, that company should act in accordance with societal concerns and, at the very least, refrain from engaging in conduct disfavored by society.

C. THE ESG RATINGS INDUSTRY

As appetite for ESG-related products has increased, third-party ESG rating agencies, relying on publicly available information gathered from company disclosures, such as CSR reports³⁵ and government databases, have developed ESG ratings to meet the demand for ESG information.³⁶ Generated under a variety of different methodologies, these ESG ratings purport to measure a given company, fund, or security's performance with respect to ESG issues.³⁷ Additionally, these ratings are calculated by comparatively ranking industry peers rather than on ranking based on universal standards, which can result, oddly enough, in fossil fuel companies having better ESG ratings than makers of electric vehicles.³⁸ Finally, companies do not pay to be rated;³⁹ any company can receive an ESG rating so long as there is sufficient data to assess the company and sufficient demand from investors for that information.⁴⁰

D. WHAT ESG RATINGS ARE SUPPOSED TO MEASURE

ESG ratings are intended to measure a company's ESG quality.⁴¹ However, just as there are divergent views on the meaning of sustainability when it comes to ESG,⁴² ESG quality also "does not have a single agreed-upon definition."⁴³ The discourse around ESG reveals two seemingly opposing views on ESG

35. LoPucki, *supra* note 10, at 1481.

36. David F. Larcker, Lukasz Pomorski, Brian Tayan & Edward M. Watts, *ESG Ratings: A Compass Without Direction*, STAN. CLOSER LOOK SERIES 5 (Aug. 2, 2022), https://www.gsb.stanford.edu/sites/default/files/publication/pdfs/cgri-closer-look-97-esg-ratings_0.pdf.

37. *See, e.g.*, MSCI ESG RSCH. LLC, MSCI ESG FUND RATINGS METHODOLOGY 4 (2023), <https://www.msci.com/documents/1296102/34424357/MSCI+ESG+Fund+Ratings+Methodology.pdf>; SUSTAINALYTICS, ESG RISK RATINGS METHODOLOGY ABSTRACT 4 (2021), <https://connect.sustainalytics.com/esg-risk-ratings-methodology>. *See generally* FTSE RUSSELL, FTSE ESG RATINGS, <https://research.ftserussell.com/products/downloads/FTSE-ESG-Methodology-and-Usage-Summary-Full.pdf> (last visited Apr. 21, 2023) (describing FTSE's ESG ratings methodology).

38. Pucker & King, *supra* note 21.

39. *See* Huw Jones & Simon Jessop, *Regulators Turn Spotlight on Company Sustainability Ratings*, REUTERS (July 26, 2021, 8:42 AM PDT), <https://www.reuters.com/business/sustainable-business/regulators-turn-spotlight-company-sustainability-ratings-2021-07-26>.

40. Jaelyn Foroughi, *ESG Is Not Impact Investing and Impact Investing Is Not ESG*, STAN. SOC. INNOVATION REV. (Nov. 10, 2022), https://ssir.org/articles/entry/esg_is_not_impact_investing_and_impact_investing_is_not_esg.

41. Larcker et al., *supra* note 36, at 2.

42. *See* discussion *supra* Part I.B.

43. Larcker et al., *supra* note 36, at 2.

quality,⁴⁴ each equally valid. This Subpart first describes the two views—what I term “external impact” versus “internal impact”—applying the same hypothetical scenario to illustrate the differences between the two approaches. It then discusses the misperception that results from the lack of awareness of the two views: While most stakeholders believe that ESG ratings reflect a company’s external impact on the world, in practice, ESG ratings measure the internal impact of the world on the company. Consequently, there is significant confusion and doublespeak where ESG ratings are concerned.

1. *External Impact on Society and the World*

Those who believe that ESG focuses on the sustainability of the world take the view that ESG ratings reflect a company’s impact on society and the world (“external impact”).⁴⁵ In other words, ESG metrics indicate the impact a company has on the welfare of its stakeholders—such as employees, suppliers, customers, or members of the local community—and the environment.⁴⁶ “Under this definition, a company can improve its ESG standing by withdrawing from activities that are harmful to stakeholders or improving business practices in affected areas to benefit these constituents.”⁴⁷ Here, the short-term cost of changing its business behavior is borne by the company’s shareholders, while the long-term financial impact is uncertain or unstated.⁴⁸

For example, imagine that Z Corporation owns and operates a fossil-fuel burning factory. To determine Z Corporation’s ESG quality under the external impact view, some factors considered would be the amount of carbon emissions and the extent to which resulting pollution harms employees or residents in the local community where the factory is situated. To improve its ESG rating, Z Corporation could choose to transition away from fossil fuels by investing in clean energy alternatives, with the goal of operating a carbon-free factory by a certain date.

2. *Internal Impact on Company and Shareholders*

By contrast, those who believe ESG is about promoting the sustainability of the company itself take the competing position that ESG ratings reflect the impact of the world on a company and its shareholders (“internal impact”).⁴⁹ Stated differently, ESG metrics indicate the amount of financial risk a company incurs from potential ESG issues.⁵⁰ These financial risks include reputational

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *See id.*

50. *Id.*; BOFFO & PATALANO, *supra* note 27, at 6.

and regulatory risks that can impact financial performance.⁵¹ Under this definition, ESG provides a set of risk factors that a company can address through “strategic planning, targeted investment, or a change in operating activity.”⁵² Here, the short-term cost of addressing the ESG risk factors is gladly borne by shareholders in exchange for long-term financial benefit to the company and shareholders.⁵³

Returning to our example, to determine Z Corporation’s ESG quality under the internal impact view, the financial risks of owning and operating a fossil-fuel burning factory must be assessed. Considerations include financial risk from the unpredictability in price, availability, and quantity of fossil fuel; reputational risk from continuing to rely on an energy source increasingly disfavored by society; and regulatory risk from a potential cap or ban on emissions, or mandated shift to clean energy sources. To reduce financial exposure and improve its ESG rating, Z Corporation could undertake many different actions, including integrating a hybrid energy system or fully transitioning away from fossil fuels.

3. *ESG Ratings Reflect the Internal Impact View*

Driven by concerns regarding sustainability, many investors seeking ESG-related products rely on ESG ratings to determine a company’s external impact on society.⁵⁴ However, most of these investors are unaware that ESG ratings do not actually reflect external impact.⁵⁵ Instead, ESG ratings typically only measure internal impact—that is, a company’s financial risk from ESG factors.⁵⁶ It is unclear why most ESG rating agencies choose not to include external impact assessments in their ratings.⁵⁷ One reason may be a lack of reliable, self-reported

51. See generally Larcker et al., *supra* note 36 (discussing the regulatory risk impact on financial performance).

52. *Id.* at 2.

53. *Id.*

54. *Id.* at 1.

55. Bernhard Bartels, *Impact Instead of Risk: Paradigm Shift in ESG Ratings Necessary*, SCOPE RATINGS (Oct. 17, 2022), <https://www.scooperatings.com/ratings-and-research/research/EN/172410>; see Cam Simpson, Akshat Rathi & Saijel Kishan, *The ESG Mirage*, BLOOMBERG (Dec. 10, 2021), <https://www.bloomberg.com/graphics/2021-what-is-esg-investing-msci-ratings-focus-on-corporate-bottom-line>.

56. *Making Sense of Environmental, Social and Governance (ESG) Ratings*, RBC WEALTH MGMT., <https://www.rbcwealthmanagement.com/en-eu/insights/making-sense-of-environmental-social-and-governance-esg-ratings> (last visited Apr. 20, 2023).

57. Some ESG ratings agencies purport to include impact on world in ratings. See Bartels, *supra* note 55; see also Tom Groenfeldt, *Beyond ESG—Rating Corporations’ Impact on Society and the Earth*, FORBES (Dec. 9, 2022, 7:35 AM EST), <https://www.forbes.com/sites/tomgroenfeldt/2022/12/09/beyond-esg--rating-corporations-impact-on-society-and-the-earth>. However, critics are skeptical that a company’s impact on the world can be accurately captured or quantified. See Pucker & King, *supra* note 21.

information from companies, which could stem from the inherent difficulty in measuring external impact.⁵⁸

As a result of investors' and even companies' fundamental misunderstanding of what ESG ratings measure, there is significant doublespeak in ESG ratings discourse.⁵⁹ For example, while some companies do not realize their ESG ratings reflect internal financial risk rather than external impact on society, many companies that are aware exploit the misunderstanding by touting their ESG rating as a reflection of their impact on society to investors.⁶⁰ Furthermore, this misunderstanding is exacerbated by the media, as news articles and other discussions rarely identify the distinction between the two views when discussing ESG quality, let alone articulate to which view they are referring.⁶¹

Despite the muddled discourse regarding ESG ratings, the two views of ESG quality can be reconciled. As previously noted, companies that prioritize their own viability should act in accordance with societal concerns because societal concerns drive business performance.⁶² Thus, because there is a moral component to the internal impact view, ultimately, both measurements of ESG can be investor-facing.

Returning to our example a final time, Z Corporation has now decided to transition from using fossil fuels in its factory given the associated financial risks. An investor who knows that ESG ratings reflect financial risks understands that Z Corporation's decision to transition away from fossil fuels is driven by concerns about its bottom line. However, the transition still results in benefits that the investor cares about (that is, the reduction of carbon emissions in the environment, which will positively impact society), and thus the ESG rating still has value to the investor.

E. CRITIQUES OF ESG

Criticism of ESG abounds. Detractors contend that investing in ESG costs more without delivering meaningful social or environmental impact or better returns.⁶³ They assert that it perpetuates the “[f]antasy of [m]arket [b]ased

58. See Bartels, *supra* note 55.

59. Pucker & King, *supra* note 21.

60. Joel Makower, *The Secret Life of ESG Ratings*, GREENBIZ (May 9, 2022), <https://www.greenbiz.com/article/secret-life-esg-ratings>.

61. See Pucker & King, *supra* note 21.

62. See discussion *supra* Part I.B.3.

63. Pucker & King, *supra* note 21; Certain critics, such as Vivek Ramaswamy, who recently launched a longshot bid for the 2024 Republican presidential nomination, have taken this view to the extreme by asserting that ESG is a threat to American democracy because ESG efforts distract society from the real wrongdoings undertaken by corporations. Sheelah Kolhatkar, *Vivek Ramaswamy, the C.E.O. of Anti-Woke, Inc.*, NEW YORKER (Dec. 19, 2022), <https://www.newyorker.com/magazine/2022/12/19/the-ceo-of-anti-woke-inc>.

[v]oluntary [a]ction.”⁶⁴ They also argue that ESG ratings cannot measure impact on social welfare⁶⁵ (as the ratings were never intended to measure impact on society,⁶⁶ this critique highlights the jumbled discourse around ESG and ESG ratings). While each of these critiques are worthy of lengthy discussion, this Article focuses only on criticisms related to ESG ratings. Assuming that investors know ESG ratings measure financial risk and that the ratings can in fact measure financial risk, the strongest argument against ESG is that it misleads investors because the ESG ratings that investors rely on are inaccurate.⁶⁷

There are two reasons why ESG ratings are perceived as inaccurate. First, ESG rating agencies are unregulated,⁶⁸ and each ESG rating agency has its own methodology for calculating ESG scores.⁶⁹ Many of the major ESG rating agencies, such as MSCI and Sustainalytics, publish their methodologies,⁷⁰ but the majority of rating agencies do not.⁷¹ This results in a significant divergence in ESG scores.⁷² In fact, a recent study comparing 6 major ratings agencies revealed correlations between ESG ratings ranging from 0.38 to 0.71,⁷³ “on a scale from minus 1 (meaning total disagreement) to 1 (meaning full agreement).”⁷⁴

Second, the data underlying ESG ratings is incomplete, often dated, and mostly unaudited and unregulated.⁷⁵ ESG rating agencies have historically relied heavily on companies’ self-reporting of ESG practices via public disclosures such as the Form 10K, in addition to data gathered from the government and non-governmental organizations (“NGOs”), in calculating ESG scores.⁷⁶ However, to the extent that the ESG scores can accurately reflect financial risk,

64. Pucker & King, *supra* note 21.

65. *Id.*

66. See discussion *infra* Part I.C.3.

67. See Pucker & King, *supra* note 21.

68. See generally Kurt Wolfe, *Who Regulates the ESG Ratings Industry?*, BLOOMBERG L. (Feb. 22, 2022, 1:00 AM PST), <https://news.bloomberglaw.com/esg/who-regulates-the-esg-ratings-industry> (discussing the unregulated nature of ESG ratings).

69. BOFFO & PATALANO, *supra* note 27, at 22.

70. Larcker et al., *supra* note 36, at 2–3.

71. Javier El-Hage, *Fixing ESG: Are Mandatory ESG Disclosures the Solution to Misleading ESG Ratings?*, 26 FORDHAM J. CORP. & FIN. L. 359, 365 (2021).

72. BOFFO & PATALANO, *supra* note 27, at 27.

73. Florian Berg, Julian F. Kölbel & Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings*, 26 REV. FIN. 1315, 1316 (2022).

74. Florian Berg, *Why Do ESG Ratings Vary So Widely—and How Can Investors Make Sense of Them?*, WALL ST. J. (Nov. 2, 2022, 11:00 AM ET), <https://www.wsj.com/articles/esg-ratings-investing-data-raters-11667229384>.

75. Pucker & King, *supra* note 21.

76. See Kristen Senz, *What Does an ESG Score Really Say About a Company?*, HARV. BUS. SCH.: WORKING KNOWLEDGE (July 21, 2021), <https://hbswk.hbs.edu/item/what-does-an-esg-score-really-say-about-a-company>.

the underlying data must be accurate. Not only is it difficult to verify data provided by third parties,⁷⁷ but there is also significant uncertainty regarding the quality of self-reported information. This is because companies, who acknowledge the benefits of receiving a good ESG rating, know that their disclosures are used to calculate their ratings,⁷⁸ and that these ESG-related disclosures, unlike certain mandated financial disclosures, are not regulated.⁷⁹

II. TAX IS A CRUCIAL, YET OVERLOOKED COMPONENT OF ESG

Though ESG issues have dominated social discourse, “[t]axation [has been] at the periphery of ESG discussions.”⁸⁰ While the integration of tax as an essential pillar in achieving the United Nations Sustainable Development Goals in 2015 increased awareness of tax’s importance in ESG,⁸¹ a 2021 global study found that corporate disclosures on tax still lagged significantly behind reporting on other ESG issues.⁸² Only 34 percent of companies had commitments or policies on tax transparency in place compared to 87 percent for climate change and 98 percent for health and safety.⁸³ Additionally, only 12 percent of companies had committed to complying with and following the spirit of the law in tax planning.⁸⁴

This Part begins by defining what tax as a component of ESG entails. It then asserts that, in the United States in particular, tax is overlooked by companies that adopt ESG policies even though it is a material topic in ESG. It further argues that, to the extent that ESG ratings consider tax, the metrics lack

77. See Kenneth P. Pucker, *Overselling Sustainability Reporting*, HARV. BUS. REV., May–June 2021, <https://hbr.org/2021/05/overselling-sustainability-reporting>.

78. See Makower, *supra* note 60. Furthermore, conflicts of interest may arise if an “ESG [ratings] provider is an affiliated person of the [company].” Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, 87 Fed. Reg. 36654, 36692 (proposed June 17, 2022).

79. Pucker, *supra* note 77. This lack of regulation, however, may be coming to an end. In May 2022, the Securities and Exchange Commission proposed amendments to disclosures by certain investment advisers and investment funds about their ESG investment practices to “promote consistent, comparable, [and] reliable” information for investors. Enhanced Disclosures by Certain Investment Advisers and Investment Companies, 87 Fed. Reg. at 36659.

80. Alicja Majdanska, *The ESG Standards’ Alphabet Soup: A New Headache for Tax Experts?*, WOLTERS KLUWER INT’L TAX BLOG (Jan. 21, 2022), <https://kluwertaxblog.com/2022/01/21/the-esg-standards-alphabet-soup-a-new-headache-for-tax-experts/>; see Dep’t of Econ. & Soc. Affs.: Sustainable Dev., *Transforming Our World: The 2030 Agenda for Sustainable Development*, U.N. Doc. A/RES/70/1, at 27 (2015), <https://sdgs.un.org/sites/default/files/publications/21252030%20Agenda%20for%20Sustainable%20Development%20web.pdf>.

81. Majdanska, *supra* note 80.

82. EDMUND BOURNE, CHARLES DODSWORTH & JAAKKO KOOROSHY, FTSE RUSSELL, *GLOBAL TRENDS IN CORPORATE TAX DISCLOSURE* 3–4 (2021), https://www.lseg.com/content/dam/ftse-russell/en_us/documents/research/global_trends_in_corporate_tax_disclosure_final_2.pdf.

83. *Id.* at 6.

84. *Id.* at 11.

heft. The need to incorporate tax as a part of ESG has been noted by many tax professionals.⁸⁵ This Part contributes to that literature by articulating tax's connection with the conceptual underpinnings of ESG and its critical role in measuring both the external and internal impact of ESG policies. Given the crucial role of tax in ESG, any ESG policy or rating that does not meaningfully consider tax is incomplete. To that end, this Part concludes by proposing guidelines for assessing whether tax-related ESG proposals will address the principles and criticisms of ESG.

A. DEFINING TAX IN ESG

As a threshold matter, this Subpart defines what “tax as a component of ESG” entails. Because taxation serves a vital role in any society, there can be no discussion of ESG without considering a company's tax compliance or lack thereof.⁸⁶ Issues of tax noncompliance generally involve tax avoidance, conduct that “falls short of clear evasion but, nonetheless, may raise concerns about its appropriateness under the law” (as opposed to tax evasion, conduct that breaks the law).⁸⁷ Tax avoidance behavior falls into a continuum,⁸⁸ and the line between tax avoidance and tax evasion can often be difficult to draw.⁸⁹

Compliance, however, is not the only consideration. A company's tax behavior in the context of ESG is not simply about what a company pays or does not pay in taxes; it is also about the institutional structures that inform the decision-making process related to tax matters.⁹⁰ Empirical studies on CSR and corporate tax behavior suggest that the manner in which a “corporation accounts and directs its systems and processes in respect to the well-being of society as a

85. See Simon Crookston, *The Changing Landscape—ESG and Taxation*, BLOOMBERG TAX (Apr. 22, 2022, 1:45 AM PDT), <https://news.bloombergtax.com/tax-insights-and-commentary/the-changing-landscape-esg-and-taxation>; Eric Janowak, *Where Is the T in ESG?*, KPMG, <https://kpmg.com/xx/en/home/insights/2021/02/where-is-the-t-in-esg.html> (last visited Mar. 4, 2024); William Morris & Edwin Visser, *Tax Is a Crucial Part of the ESG Conversation*, PwC, <https://www.pwc.com/gx/en/services/tax/publications/tax-is-a-crucial-part-of-esg-reporting.html> (last visited Mar. 4, 2024).

86. See Elaine Doyle, *Encouraging Ethical Tax Compliance Behaviour: The Role of the Tax Practitioner in Enhancing Tax Justice*, 85 L. & CONTEMP. PROBS. 137, 139 (2022) (“Within the tax realm, compliance involves filing all information mandated by the relevant taxing authority on an accurate and timely basis and paying tax liabilities when they fall due.”).

87. *Id.*

88. On one end are tax-minimizing transactions that are clearly condoned by the tax regime. On the other end are tax avoidance schemes, sometimes highly elaborate, that typically involve “the exploitation of weaknesses in tax laws and tax administration, or the exploitation of differences in the tax systems of multiple jurisdictions.” *Id.*

89. Sebastian Beer, Ruud de Mooij & Li Liu, *International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots*, 34 J. ECON. SURVS. 660, 662 n.3 (2019).

90. See *infra* notes 95-96 and accompanying text.

whole” could potentially influence its tax aggressiveness.⁹¹ For example, one study found that corporate cultures that feature less responsible CSR activities were associated with more aggressive tax avoidance, while corporate cultures with more responsible CSR activities were associated with less aggressive tax avoidance.⁹² Thus, tax as a component of ESG is concerned with both the *process* (that is, how a company makes decisions related to tax matters) and the *result* (meaning, is the company compliant in paying its fair share of taxes), as being deliberate about process impacts results.

B. TAX IS OVERLOOKED IN ESG

In the United States, companies with ESG policies have not actively included tax in their consideration of good governance. Similarly, ESG ratings agencies also fail to meaningfully include tax in their ratings methodologies.

1. U.S. Companies Fail to Actively Include Tax in Their ESG Policies

Tax has always had some, albeit minor, role in ESG. For U.S. companies, ESG tax issues have typically manifested in the form of business tax credits related to environmental and social concerns. Tax credits aside, these companies have not actively considered tax as a governance issue in their ESG policies and corresponding practices⁹³ even though tax is included as a governance issue in ESG ratings.⁹⁴ While it is possible that U.S. companies are addressing tax-related ESG matters indirectly,⁹⁵ the fact remains that tax itself is not explicitly considered in the ESG practices of U.S. companies.

91. Roman Lanis & Grant Richardson, *Corporate Social Responsibility and Tax Aggressiveness: An Empirical Analysis*, 31 J. ACCT. & PUB. POL'Y 86, 87 (2012). See generally Reuven S. Avi-Yonah, *Corporate Social Responsibility and Strategic Tax Behavior*, in 3 TAX AND CORPORATE GOVERNANCE: MPI STUDIES ON INTELLECTUAL PROPERTY, COMPETITION AND TAX LAW 183 (Wolfgang Schön ed., 2008) (discussing implications of a case on corporations' views of their responsibilities to stakeholders); Mihir A. Desai & Dhammika Dharmapala, *Corporate Tax Avoidance and High-Powered Incentives*, 79 J. FIN. ECON. 145 (2006) (finding that the relationship between incentive compensation and tax sheltering is a function of a firm's corporate governance).

92. Chun Keung Hoi, Qiang Wu & Hao Zhang, *Is Corporate Social Responsibility (CSR) Associated with Tax Avoidance? Evidence from Irresponsible CSR Activities*, 88 ACCT. REV. 2025, 2051 (2013).

93. See Crookston, *supra* note 85; Janowak, *supra* note 85.

94. See discussion *infra* Part II.B.2.

95. For example, non-tax aspects of governance such as strong risk management oversight and good accounting practices can contribute to good tax practices. See Lanis & Richardson, *supra* note 91, at 87 (“[O]utside directors are more likely to be responsive to the needs of society and thus might influence the board of directors away from an aggressive tax policy stance.”); Mark S. Beasley, Nathan C. Goldman, Christina M. Lewellen & Michelle McAllister, *Board Risk Oversight and Corporate Tax-Planning Practices*, 33 J. MGMT. ACCT. RSCH. 7, 27 (2021) (finding that greater board risk oversight results in more effective corporate tax-planning practices); Christof Beuselinck, Belen Blanco, Sandip Dhole & Gerald J. Lobo, *Financial Statement Readability and Tax Aggressiveness*, SSRN 2 (Aug. 22, 2018), <https://ssrn.com/abstract=3261115> (finding a “robust negative relation between financial statement readability and various proxies for tax aggressiveness”).

2. *Tax Is Not Adequately Included or Measured in ESG Ratings*

U.S. companies may also be lagging in their tax-related ESG efforts because ESG ratings do not meaningfully include tax as a metric. Tax is typically listed as a governance factor in ESG ratings.⁹⁶ However, as most ESG rating providers do not publish their rating methodologies,⁹⁷ it is unclear to what extent tax actually factors into ESG ratings. Furthermore, to the extent that published methodologies include tax in their metrics, (1) the tax factors are not comprehensive, and (2) it is unclear how tax strategies and practices are being measured and quantified.

For example, MSCI, one of the major ESG rating agencies, includes “Tax Transparency,” under governance as a corporate behavior, as one of the thirty-five ESG “Key Issues” considered in its rating methodology.⁹⁸ MSCI’s assessment of a company’s governance key issue is made using a deduction-based scoring model, whereby each company starts with a “perfect 10” score and deductions are applied based on assessment of key metrics.⁹⁹

While the inclusion of tax considerations in the governance assessment is important, the factors considered within the key issue of Tax Transparency are wanting. MSCI’s Tax Transparency score is based on a company’s involvement in ongoing tax controversies and estimated tax gap.¹⁰⁰ If a company is not involved in any ongoing tax controversies, its governance score will remain unchanged.¹⁰¹ If a company is involved in ongoing tax controversies, a deduction from its governance score will be calculated as a function of the company’s estimated tax gap (the difference between the company’s estimated effective tax rate and the estimated statutory tax rate).¹⁰² Thus, a company involved in tax controversies with an estimated tax gap of 5 percent or below, 5 to 10 percent, or above 10 percent will be given a resulting deduction of -0.8, -1.4, and -2.0, respectively.¹⁰³

Under this calculation, involvement in tax controversies and the estimated tax gap are the only factors that speak to the quality of a company’s tax strategy. This MSCI metric thus grossly oversimplifies the variety of issues at play in

96. See FTSE ESG RATINGS, *supra* note 37, at 5.

97. MZ GRP., NAVIGATING ESG RATING CHALLENGES: MANAGING RISK WITH INSUFFICIENT TRANSPARENCY CONGRUENCY & OTHER CONTRADICTIONS 4 (2022), <https://api.mziq.com/mzfilemanager/v2/d/b6d5d02a-d245-4afb-987b-797f529e3d41/46393403-120f-f82c-f8f3-b5d91d8731aa?origin=>

98. MSCI ESG RSCH. LLC, MSCI ESG RATINGS METHODOLOGY: TAX TRANSPARENCY KEY ISSUE 4 (2023), <https://www.msci.com/documents/1296102/34424357/MSCI+ESG+Ratings+Methodology+-+Tax+Transparency+Key+Issue.pdf> [hereinafter MSCI TAX METHODOLOGY].

99. See MSCI ESG FUND RATINGS METHODOLOGY, *supra* note 37, at 5.

100. MSCI TAX METHODOLOGY, *supra* note 98, at 3.

101. *Id.* at 3, 5.

102. *Id.* at 5.

103. *Id.*

assessing the financial risk that might arise from poor tax-related corporate governance.¹⁰⁴ While it is widely accepted practice to use a company's estimated tax gap as a rough proxy for tax responsibility,¹⁰⁵ "it is the structures and practices of tax planning that are at the heart of tax responsibility, rather than the amount of tax paid, which is an outcome of these practices."¹⁰⁶

Some ESG rating providers that disclose their methodologies do consider a broader range of tax factors in assessing "Tax Transparency."¹⁰⁷ For example, FTSE Russell's Tax Transparency score takes into account policy commitment to tax transparency, tax policy oversight, and alignment of tax payments with revenue generating activity, among other factors.¹⁰⁸ However, its methodology report does not explain how these factors are measured or quantified for inclusion into the governance or overall score.¹⁰⁹

That tax is not an active consideration for U.S. companies that adopt ESG policies or for ESG rating agencies that provide ratings is a cause for concern.

C. TAX IS A CRITICAL COMPONENT OF THE ESG CONCEPT

To establish that tax is a critical component of the ESG concept, this Subpart first explains taxation's impact on the "S" and "G" prongs of ESG. It then demonstrates that tax is tied to the principles underlying ESG as articulated in Part I.B. by analogizing a tax consideration (that is, tax planning) to an issue universally considered within the scope of ESG (that is, maternity leave).

1. *Tax Implicates Both the Social and Governance Prongs of ESG*

The public discourse around tax has historically centered on effective corporate tax rates and little else.¹¹⁰ Distilled to numerical terms, tax may not have appeared at first blush to be an ESG issue. However, companies "now operate in a world where tax is considered a moral issue, with headlines frequently appearing on social media or in the news with regard to how a

104. See discussion *infra* Part II.D.2.

105. Lanis & Richardson, *supra* note 91, at 91 ("[R]ecent empirical tax research has found that ETRs encapsulate tax aggressiveness.").

106. ACTIONAID, TAX RESPONSIBILITY: THE BUSINESS CASE FOR MAKING TAX A CORPORATE RESPONSIBILITY ISSUE 1 (2011), <https://www.ohchr.org/sites/default/files/Documents/Issues/Poverty/ContributionsFiscaltaxpolicy/ActionAid1.pdf>.

107. See Will Morris, Niloufar Molavi, Horacio Peña & Amparo Mercader, *Developing a Sustainable Tax Strategy: The Role of Tax in the Green Transformation*, PWC (Jan. 17, 2023), <https://www.pwc.com/us/en/services/trust-solutions/private-company-services/business-perspectives/esg-tax-transparency.html>.

108. FTSE ESG RATINGS, *supra* note 37, at 5.

109. See generally *id.* (summarizing the "FTSE ESG Ratings methodology" and providing an overview of the range of ways that investors may use FTSE ESG ratings to inform investments).

110. See Janowak, *supra* note 85; Morris & Visser, *supra* note 85.

business manages its tax affairs.”¹¹¹ This increased societal concern reflects the reality that tax directly implicates both the social and governance prongs of ESG. Though traditionally seen as a governance issue, tax paid could be a social factor as the amount of tax a company pays overall or country-by-country may be a measure of social impact (that is, a company’s financial contributions to the local jurisdiction in which it operates).¹¹² Additionally, a company’s tax strategy is an integral governance consideration, as an aspect of assessing responsible self-governance is examining how a company manages its tax-related decisionmaking process.¹¹³

2. *Tax Is Connected to ESG Principles*

The growing societal awareness and investor concern about tax also reflect the fact that the way a company makes decisions related to tax is deeply tied to the principles underlying ESG. The ESG framework is based on the implicit principle that societal concerns (which inform social norms regarding acceptable business behavior) impact business performance and long-term value creation.¹¹⁴ As such, companies adopting ESG frameworks must “accept ethical obligations beyond compliance with the law[,]”¹¹⁵ whether their conception of ESG is focused on promoting sustainability of the world or sustainability of its own operations.¹¹⁶ In other words, it is not enough for businesses to do what is legal to maximize profit—there is some further limit that is legal but disfavored by society.¹¹⁷ Companies typically do not want to exceed that limit because they do not want to jeopardize stakeholder perception that they are “acting in a way

111. Crookston, *supra* note 85; The increasing number of investors demanding tax transparency from corporations demonstrates that society is becoming more concerned about tax issues. In 2014, a tax transparency proposal at Google received only about 1 percent shareholder approval. Google Inc., Current Report (Form 8-K) (May 15, 2014). In 2022, shareholders at Amazon, Cisco, and Microsoft introduced proposals urging country-by-country corporate tax disclosure in line with the Global Reporting Initiative’s 207 tax standard. While none of the proposals passed, they respectively received 21, 27, and 23 percent approval from shareholders. Nana Ama Sarfo, *Investors’ Big Tax Transparency Experiment*, TAX NOTES (Dec. 22, 2022), <https://www.taxnotes.com/opinions/investors-big-tax-transparency-experiment/2022/12/22/7fhr>.

112. See Robert Bird & Karie Davis-Nozemack, *Tax Avoidance as a Sustainability Problem*, 151 J. BUS. ETHICS 1009, 1010 (2018).

113. See generally Arne Friese, Simon Link & Stefan Mayer, *Taxation and Corporate Governance*, in TAX AND CORPORATE GOVERNANCE, *supra* note 91, at 357 (analyzing the interaction of corporate governance and taxation) (on file with Max Planck Institute for Intellectual Property, Competition and Tax Law).

114. See discussion *supra* Part I.B.

115. Hans Gribnau, *Corporate Social Responsibility and Tax Planning: Not by Rules Alone*, 24 SOC. & LEGAL STUD. 225, 225 (2015).

116. See discussion *supra* Part I.B.

117. Gadinis & Miazad, *supra* note 33, at 1437.

that is fair, appropriate, and deserving of trust,” as jeopardizing that trust may reduce long-term value for shareholders.¹¹⁸

a. *Maternity leave example*

California generally mandates up to twelve weeks of unpaid maternity leave.¹¹⁹ A company focused on short-term profit maximization could adopt a maternity leave policy that only provides the legal minimum of unpaid leave. However, it could be argued that such a policy is disfavored by society. As such, Company X, a company focused on promoting sustainability of the world, may instead choose to offer sixteen weeks of *paid* maternity leave. In such a scenario, Company X chooses to incur some amount of financial loss by paying an employee who is on leave and does so because such conduct contributes to sustainable social practices, a move that is also in accordance with certain societal values.

In contrast, Company Y, a company focused on promoting its own sustainability, may also choose to offer sixteen weeks of paid maternity leave, but for a different reason. Perhaps Company Y believes that providing only the legal minimum may result in a talented worker who is a new parent leaving the workforce. As such, Company Y concludes that the long-term financial value that can be extracted from retaining talent is worth more than the short-term cost of offering paid leave. Regardless of its motive, Company Y’s ultimate course of conduct is the same as Company X’s (that is, providing sixteen weeks of paid leave), which enables Company Y to pursue its own priorities while still acting in alignment with societal concerns.

b. *Tax planning example*

An analogy can be drawn between maternity leave and tax planning. Similarly, within the spectrum of legal, profit-maximizing conduct with respect to tax planning, there is legally acceptable but disfavored conduct: aggressive tax planning.¹²⁰ Unlike the prior example, however, it is unclear what the line between illegal and legal tax planning is.¹²¹ Many companies exploit this

118. Lucy Pérez, Dame Vivian Hunt, Hamid Samandari, Robin Nuttall & Krysta Biniek, *Does ESG Really Matter —and Why?*, MCKINSEY Q. (Aug. 10, 2022), <https://mckinsey.com/capabilities/sustainability/our-insights/does-esg-really-matter-and-why>; see ‘Corporate Diplomacy’: *Why Firms Need to Build Ties with External Stakeholders*, KNOWLEDGE AT WHARTON (May 5, 2014), <https://knowledge.wharton.upenn.edu/article/building-relationships-external-stakeholders-2>.

119. See *Family, Medical, and Pregnancy Disability Leave for Employees in California*, STATE CAL. C.R. DEP’T, <https://calcivilrights.ca.gov/family-medical-pregnancy-leave> (last visited Feb. 26, 2024).

120. FAIR TAX FOUND., GLOBAL MULTINATIONAL BUSINESS STANDARD: GUIDANCE NOTES 4–5 (2021), <https://fairtaxmark.net/wp-content/uploads/2022/10/Global-MNC-standard-criteria-print-version.pdf>.

121. This makes societal attitudes toward favored and disfavored tax planning behavior all the more important, as strong social norms likely serve as the only check on questionable tax planning activities. Gadinis & Miazad, *supra* note 33, at 1401–02, 1444–45.

ambiguity by engaging in aggressive tax planning with the justification that they are still abiding by the law.¹²² However, aggressive tax planning is becoming increasingly disfavored by society¹²³ because such conduct erodes voluntary tax compliance, which in turn erodes sustainable development.¹²⁴ Studies have shown that tax compliance is dependent on taxpayers believing the tax system is fair.¹²⁵ Thus, not only does aggressive tax planning deprive governments of rightful revenue,¹²⁶ but it may also lead to reduced compliance by industry competitors who feel pressured to take aggressive positions to lower their effective tax rates¹²⁷ and by other taxpayers who believe that the tax system is corrupt or rewards bad tax actors.¹²⁸

Let's return to Company X, whose ESG practices are focused on promoting sustainability of the world. In the same way that it willingly accepts some amount of financial loss in offering paid maternity leave, Company X should commit to non-aggressive tax planning, even if it leads to some amount of financial loss, since such tax behavior is a social good that generally contributes to sustainable development.¹²⁹ Unsurprisingly, this justification is often cited in literature that attempts to address tax avoidance as a CSR issue.¹³⁰

122. See Bird & Davis-Nozemack, *supra* note 112, at 1010.

123. ACTIONAID, *supra* note 106, at 7.

124. See Bird & Davis-Nozemack, *supra* note 112, at 1021.

125. Maciej A. Górecki & Natalia Letki, *Social Norms Moderate the Effect of Tax System on Tax Evasion: Evidence from a Large-Scale Survey Experiment*, 172 J. BUS. ETHICS 727, 728 (2021) (finding that an increasing tax rate lowers the probability of evasion so long as taxpayers view most other taxpayers as honest, thus highlighting the importance of fairness concerns for tax compliance decisions); Erzo F.P. Luttmer & Monica Singhal, *Tax Morale*, 28 J. ECON. PERSPS. 149, 157 (2014) (finding that fairness is an important component of tax compliance decisions); see Lars P. Feld & Bruno S. Frey, *Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation*, 29 L. & POL'Y 102, 112 (2007) (noting that vertical unfairness of the income tax schedule increased evasion).

126. See Bird & Davis-Nozemack, *supra* note 112, at 1010. See generally Prem Sikka, *Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance*, 34 ACCT. F. 153 (2010) (describing the ways companies, who make promises of responsible conduct, indulge in aggressive tax avoidance that may arguably be considered tax evasion).

127. Michelle Hanlon & Joel Slemrod, *What Does Tax Aggressiveness Signal? Evidence from Stock Price Reactions to News About Tax Shelter Involvement*, 93 J. PUB. ECON. 126, 127 (2009); see Reuven S. Avi-Yonah, *Corporate Taxation and Corporate Social Responsibility*, 11 N.Y.U. J.L. & BUS. 1, 3 (2014).

128. See LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* 8, 14–15 (2002); Bird & Davis-Nozemack, *supra* note 112, at 1016.

129. This assertion assumes that tax is paid to a jurisdiction with a well-run government. Interestingly, much of the literature that asserts that tax should be incorporated into CSR takes the position that more tax paid is an absolute social good and does not consider nuanced situations such as payment of taxes to a corrupt government. See Kayal Munisami, *The Role of Corporate Social Responsibility in Solving the Great Corporate Tax Dodge*, 17 FLA. ST. U. BUS. REV. 55, 75 (2018). See generally Bird & Davis-Nozemack, *supra* note 112 (discussing that tax avoidance could be understood as a sustainability problem, and also considering corporate social responsibility and taxation).

130. See Avi-Yonah, *supra* note 127, at 12 (“[I]f engaging in CRS is a legitimate corporation function, then corporations can also be expected to pay taxes to bolster society as a part of their assumption of CSR.”); Bird &

In contrast, Company Y, whose ESG practices are focused on promoting its own sustainability, may also choose to refrain from engaging in aggressive tax planning if it determines that the long-term financial benefits of such conduct outweigh the costs. This may be a more difficult scenario to posit given that aggressive business tax planning already involves risk assessment absent an ESG framework.¹³¹ However, a recent 2022 study revealed that companies that engage in aggressive tax planning tend to be inefficient in their labor investment (that is, they do not hire to meet their workforce needs).¹³² The study strongly suggests that tax-aggressive firms were less inclined to engage in long-term investments such as hiring due to sensitivity over their risk position.¹³³ This finding illustrates that aggressive tax strategies that result in short-term financial gain may still damage a company's bottom line in the long run if the resulting labor inefficiency costs more than the taxes saved.¹³⁴

Additionally, large regulatory shifts may lead to financial exposure to aggressive tax behavior. For example, say Company Y operates in a jurisdiction that falls under the European Union's new country-by-country tax reporting mandate.¹³⁵ There is literature that suggests that more tax aggressive companies generally provide less tax-related disclosure¹³⁶ while corporations that provide

Davis-Nozemack, *supra* note 112, at 1010 (“[T]ax avoidance represents a socially irresponsible practice that is inconsistent with a firm’s obligations to society.”); Munisami *supra* note 129, at 56; Doron Narotzki, *Corporate Social Responsibility and Taxation: The Next Step of the Evolution*, 16 HOUS. BUS. & TAX L.J. 167, 168 (2016). See generally Grahame R. Dowling, *The Curious Case of Corporate Tax Avoidance: Is It Socially Irresponsible?*, 124 J. BUS. ETHICS 173 (2014) (analyzing how tax avoidance can be perceived as socially irresponsible).

131. Firms and shareholders typically welcome some amount of tax aggressiveness to maximize the bottom line, and business tax planning accounts for the increased risk associated with aggressive tax positions. Accordingly, financial risk from ESG issues related to tax would not be the direct financial risk from aggressive tax planning (*i.e.*, risk of penalties/fines). See Hanlon & Slemrod, *supra* note 127, at 126.

132. See generally Simone Traini, Nathan C. Goldman & Christina M. Lewellen, *Aggressive Tax Planning and Labor Investments*, J. ACCT., AUDITING & FIN. (2022), <https://journals.sagepub.com/doi/10.1177/0148558X221089638> (finding that firms that use aggressive tax planning are associated with hiring inefficiency).

133. See *id.* at 20.

134. See *id.* at 7.

135. Member States are required to transpose the country-by-country reporting mandate (the “Directive”) into national legislation by June 22, 2023. Directive (EU) 2021/2101 of the European Parliament and of the Council of 24 November 2021 Amending Directive 2013/34/EU as Regards Disclosure of Income Tax Information by Certain Undertakings and Branches, art. 48b, 2021 O.J. (L 429) 1, 7, 13. This Directive compels mandatory tax disclosures for “multinational groups with total consolidated revenues exceeding EUR 750 million for each of the last two consecutive financial years if the group’s ultimate parent undertaking is either: based in the EU, or based in a third-country and operates in the EU through a qualifying subsidiary or branch.” *EU Public Country-by-Country Reporting Implementation – Where We Are*, KPMG (Nov. 22, 2022), <https://kpmg.com/xx/en/home/insights/2022/11/etf-493-eu-public-country-by-country-reporting-implementation.html>.

136. See Karthik Balakrishnan, Jennifer L. Blouin & Wayne R. Guay, *Tax Aggressiveness and Corporate Transparency*, 94 ACCT. REV. 45, 46 (2019) (documenting “that tax-aggressive firms have lower corporate transparency”).

more CSR disclosure generally have lower levels of corporate tax aggressiveness.¹³⁷ As such, Company Y may choose to refrain from aggressive tax planning so that its mandatory tax disclosures reflect the values of its shareholders and stakeholders. Such an action would thus increase Company Y's reputation as a good tax actor and bolster shareholder faith in corporate management. In this instance, the act of refraining from aggressive tax planning activity would be the result of Company Y's self-serving motives yet would still reflect society's demand for more responsible tax behavior from businesses.

D. TAX IS ESSENTIAL TO BOTH VIEWS OF MEASURING ESG

Not only is tax a critical component of the ESG concept, but it is also essential to both views of measuring ESG quality. This Subpart asserts that neither external impact nor internal impact can be accurately assessed without accounting for tax's impact on social welfare (in the case of internal impact) and financial risk (in the case of external impact). Accordingly, tax must be meaningfully incorporated in the ESG policies of U.S. companies and in ESG ratings.

1. *External Impact Cannot Be Properly Assessed Without Considering Tax*

Tax is a key factor in measuring a company's impact on societal welfare.¹³⁸ At a fundamental level, tax revenue is what enables well-functioning governments to provide stable environments in which business activity can flourish.¹³⁹ Although more taxes paid does not necessarily equate to more positive societal impact, the payment of taxes is certainly one factor in measuring "the economic contribution that companies provide to society and communities in which they operate."¹⁴⁰

Furthermore, companies "have an obligation to comply with tax legislation, and a responsibility to their stakeholders to meet expectations of good tax practices."¹⁴¹ Companies that undertake aggressive tax avoidance schemes may deprive the government of its rightful revenue.¹⁴² Such revenue loss may lead to reduced investment in public infrastructure and services, increase in government debt, shifting of the tax obligation onto other

137. Lanis & Richardson, *supra* note 91, at 86.

138. Bird & Davis-Nozemack, *supra* note 112, at 1010.

139. See MURPHY & NAGEL, *supra* note 128, at 3.

140. Carlo Luison, *Responsible Tax: An Essential Part of the ESG Agenda*, BDO (Sept. 21, 2021), <https://www.bdo.global/en-gb/insights/global-industries/sustainability/responsible-tax-an-essential-part-of-the-esg-agenda>.

141. GLOB. REPORTING INITIATIVE, GRI 207: TAX 2019 4 (2019), <https://globalreporting.org/pdf.ashx?id=12434&page=10> [hereinafter GRI 207].

142. Doyle, *supra* note 86, at 139.

taxpayers,¹⁴³ or even impact the “E” and “S” prongs of ESG as government resources are diverted from environmental and social investments.¹⁴⁴

Perceptions of tax avoidance by an organization could also undermine tax compliance more broadly, by driving other organizations to engage in aggressive tax planning based on the view that they might otherwise be at a competitive disadvantage.¹⁴⁵ A cascade of such behavior could lead to increasing costs associated with tax regulation and enforcement, thus placing an even greater burden on governments.¹⁴⁶

2. *Tax Is Integral to Measuring Internal Impact*

Tax, which implicates both the social and governance prongs,¹⁴⁷ is crucial for assessing a company’s financial exposure to potential ESG issues.¹⁴⁸ As previously noted, however, ESG-related financial exposure is unlikely to stem directly from the company’s tax positions.¹⁴⁹ Companies and tax professionals are sophisticated actors who have crafted tax strategies that already account for the minimization of financial risk.¹⁵⁰ For example, a company that has taken a great number of “substantial authority” or “reasonable basis” positions may experience significant financial exposure if enforcement efforts by the Internal Revenue Service or a tax authority in another jurisdiction dramatically increased. However, to the extent that tax aggressiveness is deemed by tax authorities to constitute noncompliance, that company likely has reserves set aside specifically for such a scenario. Accordingly, it is unclear whether financial fallout from increased scrutiny from tax authorities would change the company’s financials as presented.

Instead, financial risk is more likely to arise from certain business conduct related to tax that may lead to reputational damage or regulatory scrutiny,¹⁵¹ which may ultimately impact a company’s financial performance.¹⁵² Generally,

143. *Id.*

144. See Majdanska, *supra* note 80.

145. Doyle, *supra* note 86, at 139–40; see Katharina Gangl & Benno Torgler, *How to Achieve Tax Compliance by the Wealthy: A Review of the Literature and Agenda for Policy*, 14 SOC. ISSUES & POL’Y REV. 108, 108 (2020) (focusing on how the wealthy differ from other types of taxpayers).

146. See Bird & Davis-Nozemack, *supra* note 112, at 1016.

147. See discussion *supra* Part II.C.1.

148. See BOURNE ET AL., *supra* note 82, at 6 (“Perhaps more than many other sustainability factors, poor tax practices can have an immediate, quantifiable impact on corporate earnings; in addition to posing material legal, regulatory, and reputational risks to companies.”).

149. See Hanlon & Slemrod, *supra* note 127, at 126.

150. See Doyle, *supra* note 86, at 139–40.

151. FAIR TAX FOUND., *supra* note 120, at 4.

152. Mark Beasley, Nathan Goldman, Christina Lewellen & Michelle McAllister, *Make Tax Planning a Part of Your Company’s Risk Management Strategy*, HARV. BUS. REV. (Nov. 13, 2020), <https://hbr.org/2020/11/make-tax-planning-a-part-of-your-companys-risk-management-strategy>; see BOURNE ET AL., *supra* note 82, at 6.

companies are wary of the potential reputational and political costs of being labeled a bad tax citizen.¹⁵³ There is literature on “tax signaling” that suggests that a company’s tax practices can provide information on the overall quality of the business (that is, a firm that is a bad tax actor is likely to be engaging in other activities of dubious legitimacy).¹⁵⁴ Moreover, a 2007 study found that news about a company’s involvement in tax shelters typically results in stock price declines (though the declines are typically much smaller than declines for major accounting scandals or other corporate misdeeds).¹⁵⁵ It also found that firms in the retail sector experience a greater-than-average stock price decline, which “suggest[s] that part of the reaction may be a consumer/taxpayer backlash.”¹⁵⁶ A recent 2022 experimental study further supports the notion of customer backlash to bad tax actors.¹⁵⁷ The study found that, at the highest level of tax transparency (*i.e.*, when market participants are informed which firms are illegally avoiding taxes¹⁵⁸ and what their total revenue is, and the resulting total loss and individual loss in tax income), “consumers show[ed] a stronger proclivity to boycott tax avoiding firms, even if these firms offer cheaper prices.”¹⁵⁹

Accordingly, to the extent that mandatory tax disclosures (for instance, the European Union’s country-by-country reporting mandate)¹⁶⁰ increase the level of tax transparency, tax may become a greater factor in assessing internal impact. If a company’s tax practices become widely known due to regulatory requirements, financial risk increases due to the potential backlash from both investors and consumers.¹⁶¹ Additionally, any failure to comply with the disclosure requirement or problematic information disclosed may lead to increased regulatory scrutiny and further increase financial exposure. However, more research is necessary to explore the potential long-term financial effects associated with the disclosure of a company’s involvement in tax misdeeds.

3. Tax Should Be Meaningfully Incorporated in ESG Policies and

153. See Hanlon & Slemrod, *supra* note 127, at 126–27.

154. Emily A. Satterthwaite, *Tax Signaling*, 74 TAX. L. REV. 259, 259–60 (2021).

155. Hanlon & Slemrod, *supra* note 127, at 126.

156. *Id.*

157. See generally Michael Razen & Alexander Kupfer, *The Effect of Tax Transparency on Consumer and Firm Behavior: Experimental Evidence*, 104 J. BEHAV. & EXPERIMENTAL ECON. (2023) (noting customers’ tendency to boycott tax-avoiding actors).

158. Such behavior is properly categorized as tax evasion. However, the authors only use “tax avoidance” throughout the paper and do not define the term with any great precision. See *id.* at 1 (characterizing tax avoidance as tax optimization strategies that exploit a wide range of legal loopholes).

159. *Id.* at 1.

160. See generally Council Directive 2021/2101, *supra* note 135 (providing for mandatory income tax reporting by ultimate parent undertakings).

161. See Razen & Kupfer, *supra* note 157, at 1.

Ratings

Given the importance of tax to both the underlying principles of ESG and the two views of measuring ESG, any ESG policy (a term which hereinafter includes CSR policies and other sustainability practices that are considered in measuring a company's ESG quality) or ESG rating that does not meaningfully consider tax is incomplete. To the extent that U.S. companies have integrated an ESG framework as a legitimate corporate function, it is normatively appropriate for them to include tax as a part of their ESG policies.¹⁶²

E. CRAFTING TAX-RELATED ESG EFFORTS RESPONSIVE TO THE PRINCIPLES AND CRITICISMS OF ESG

The assertion that tax should be included in ESG policies and ratings then raises two questions. First, what should tax-related ESG efforts strive to achieve? After all, “[d]efining goals before methods is crucial.”¹⁶³ Second, what exactly should those tax-related ESG efforts look like for companies and how can they be measured? The first question will be discussed below, and Part III and Part IV will address the answer to the second question.

First, tax-related ESG efforts should strive to consider both views of measuring ESG quality. If companies were to focus their ESG efforts on maximizing their ESG ratings, then the goal of any tax-related ESG efforts would focus only on the second view of ESG—the minimization of financial exposure. However, such a goal would be insufficient. Because societal concern, as reflected in public discourse, investor understanding, and company marketing of ESG typically references impact on society,¹⁶⁴ the goals of ESG tax initiatives must take into account both views of ESG. Thus, under the two views, tax-related ESG efforts should (1) seek to minimize financial, regulatory, and reputational risk and (2) promote accountability to society and stakeholders and seek to, at a minimum, not negatively impact social welfare.

Given the important role tax plays in an ESG framework and in accurately measuring external and internal impact, any ESG policy that does not actively include tax considerations is incomplete. To accelerate the adoption of ESG tax practices by U.S. companies, an ESG tax standard for these companies must first be articulated. Part III assesses the merits of existing ESG tax proposals, while Part IV takes those evaluations into account to offer preliminary considerations for the development of an ESG tax standard for U.S. companies.

162. Avi-Yonah, *supra* note 91, at 193–94; *see* Gribnau, *supra* note 115, at 225.

163. Alicia E. Plerhoples, *ESG & Anti-Black Racism*, 24 U. PA. J. BUS. L. 909, 912 (2022).

164. *See* discussion *supra* Part I.D.3.

III. EXISTING PROPOSALS FOR ESG TAX STANDARDS

Those who agree that it is normatively appropriate for companies to include tax as a component of CSR have acknowledged the difficulty in asking companies to adhere to such a position without proper guidance¹⁶⁵—in other words, how do companies determine what it means to meaningfully incorporate tax in their ESG policies? Fortunately, the inclusion of tax in the 2015 UN Sustainable Development Goals has increased awareness of tax as a material ESG topic.¹⁶⁶ This recognition has led to the development of various proposals—all contingent on voluntary participation from businesses—from stakeholders that attempt to articulate what tax-related ESG efforts should entail.¹⁶⁷

In light of these developments, this Part provides an overview of the existing proposals for ESG tax standards and evaluates their merits. First, I outline the methodology for the proposals included for discussion and group the proposals by two categories: disclosure-based and behavior-based. Next, I summarize and evaluate the merits of the proposals by category in light of the ESG policy considerations set forth in Parts I and II.

A. OVERVIEW AND METHODOLOGY

Existing proposals for ESG tax standards were included in this Part based on two criteria. First, the proposals must be targeted at businesses and generated specifically with ESG or sustainable business practices in mind. Second, the proposals must be well-known and respected in the ESG space. These conditions narrowed the sample size to four proposals from four different stakeholders in the ESG and sustainable business practice space. For ease of discussion, the four proposals were then grouped into two categories: disclosure-based and behavioral based. Disclosure-based proposals focused on tax transparency via mandatory company disclosure and reporting.¹⁶⁸ Behavior-based proposals focused on tax strategy and policy via suggested best practices.¹⁶⁹ An analysis of each category of proposals follows.

165. See Gribnau, *supra* note 115, at 228 (“In what way should companies that take this kind of responsibility comply with the tax rules? Where can they find guidance when faced with a less than perfect body of rules?”).

166. “GRI 207 emphasized that achieving the [United Nations Sustainable Development Goals] is not possible without including tax as a sustainability topic, with an appropriate standard to report on.” GLOB. REPORTING INITIATIVE, THE GRI PERSPECTIVE: WE NEED TO TALK ABOUT TAX I (2022), <https://www.globalreporting.org/media/amyaycyg/gri-perspective-we-need-to-talk-about-tax.pdf>.

167. See discussion *infra* Part III.B–C.

168. See discussion *infra* Part III.B.

169. See discussion *infra* Part III.C.

B. DISCLOSURE-BASED PROPOSALS

The following Subparts provide a summary of the two disclosure-based proposals for ESG tax standards: GRI 207 and the tax provision of the World Economic Forum's Stakeholder Capitalism Metrics. This Subpart provides an assessment of each proposal's likelihood to meet ESG tax goals, achieve the benefits of ESG, and suffer from the criticism relating to ESG ratings.

1. *Origins and Contents of Disclosure-Based Proposals*

The two disclosure-based tax proposals included in this discussion both originate from the Global Reporting Initiative ("GRI"), an international NGO that publishes and provides the world's most widely used sustainability reporting standards—the GRI Standards.¹⁷⁰ Published in December 2019, GRI 207 provides a set of voluntary mandatory disclosures related to tax and is the first global ESG standard for tax.¹⁷¹ It "was developed in recognition of the vital role that tax contributions have on sustainable development, and in response to widespread stakeholder demands for tax transparency."¹⁷² GRI 207 requires organizations to report their tax strategy by providing information regarding their approach to tax ("GRI 207-1"); tax governance, control, and risk management ("GRI 207-2"); and stakeholder engagement and management of concerns related to tax ("GRI 207-3").¹⁷³ It also requires organizations to disclose information about their revenue, tax, and business activities on a country-by-country basis ("GRI 207-4").¹⁷⁴

Given GRI's stature, portions of the GRI Standards have been adapted for a different sustainability reporting framework developed by the World Economic Forum's International Business Council ("WEF-IBC"), a Swiss international NGO.¹⁷⁵ The WEF-IBC, which consists of a group of more than sixty global business leaders from companies such as Bank of America, Dow,

170. As of 2022, 78 percent of the world's biggest 250 companies by revenue have adopted the GRI Standards for reporting, up from 73 percent in 2020. Of the top one hundred businesses in each of fifty-eight countries (5800 companies total) 68 percent use GRI, up from 67 percent in 2020, when the study used a smaller sample size. *Four-in-Five Largest Global Companies Report with GRI*, GLOB. REPORTING INITIATIVE (Oct. 31, 2022), <https://www.globalreporting.org/news/news-center/four-in-five-largest-global-companies-report-with-gri>.

171. Majdanska, *supra* note 80.

172. *Bringing Tax Transparency into Focus*, KPMG (July 2022), <https://kpmg.com/xx/en/home/insights/2022/07/bringing-tax-transparency-into-focus-extractive-industries.html>.

173. GRI 207, *supra* note 141, at 8–11.

174. *Id.* at 12–15.

175. WORLD ECON. F., CONSULTATION DRAFT: TOWARD COMMON METRICS AND CONSISTENT REPORTING OF SUSTAINABLE VALUE CREATION 8–9 (2020), http://www3.weforum.org/docs/WEF_IBC_ESG_Metrics_Discussion_Paper.pdf [hereinafter CONSULTATION DRAFT].

Nestlé, and Sony,¹⁷⁶ proposed a set of Stakeholder Capitalism Metrics for the purpose of “improv[ing] the ways that companies measure and demonstrate their performance against ESG indicators” in September 2020.¹⁷⁷ The consultation draft initially included a single tax metric: country-by-country reporting under GRI 207-4.¹⁷⁸ After taking comments from WEF-IBC members, however, country-by-country reporting was dropped in favor of metrics adapted from GRI 201-1, a provision measuring general economic performance rather than specific tax attributes.¹⁷⁹ The final version of Stakeholder Capitalism Metrics (“WEF-IBC Tax Metrics”) requires companies to disclose total tax paid, tax remitted, and total and additional tax breakdown by country for significant locations. This change was made “to better reflect the full contribution to public finances made by a corporation.”¹⁸⁰

Finally, GRI 207 and the WEF-IBC Tax Metrics recommend companies disclose tax information annually¹⁸¹ to further GRI and the WEF-IBC’s stated goals of “accelerat[ing] convergence among the leading private ESG standard-setters and [bringing] greater comparability and consistency to the reporting of ESG disclosures.”¹⁸²

2. Policy Evaluation of Disclosure-Based Proposals

In considering the merits of these disclosure-based proposals, the following questions must be addressed. First, to what extent do the proposals meet the two goals of tax-related ESG efforts (meaning, minimization of financial risk and promotion of accountability/minimization of negative impact on social welfare)?¹⁸³ Second, how likely are the proposals to lead to desired ESG benefits

176. Madeleine Hillyer, *Global Business Leaders Support ESG Convergence by Committing to Stakeholder Capitalism Metrics*, WORLD ECON. F. (Jan. 26, 2021), <https://www.weforum.org/press/2021/01/global-business-leaders-support-esg-convergence-by-committing-to-stakeholder-capitalism-metrics-73b5e9f13d> [hereinafter *Global Business Leaders*].

177. Madeleine Hillyer, *Over 50 Companies Reporting on Stakeholder Capitalism Metrics as International Support Grows*, WORLD ECON. F. (Sept. 21, 2021), <https://www.weforum.org/press/2021/09/50-companies-reporting-on-stakeholder-capitalism-metrics-as-international-support-grows-333d623156>. As of January 2024, 158 companies have included the Stakeholder Capitalism Metrics in their mainstream reporting materials, including annual reports and sustainability reports, with fifty-five companies having used the metrics for two years in a row. *Stakeholder Capitalism Metrics Initiative: Over 150 Companies Implement Sustainability Reporting Metrics*, WORLD ECON. F. (Jan. 11, 2024), <https://www.weforum.org/impact/stakeholder-capitalism-reporting-metrics-davos2023>.

178. CONSULTATION DRAFT, *supra* note 175, at 9.

179. WORLD ECON. F., *MEASURING STAKEHOLDER CAPITALISM: TOWARD COMMON METRICS AND CONSISTENT REPORTING OF SUSTAINABLE VALUE CREATION 19* (2020), http://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf [hereinafter *STAKEHOLDER CAPITALISM METRICS*].

180. *Id.*

181. *See* GRI 207, *supra* note 141, at 6; *STAKEHOLDER CAPITALISM METRICS*, *supra* note 179, at 6.

182. *Global Business Leaders*, *supra* note 176; *see* Martinez & Capel, *supra* note 161.

183. *See* discussion *supra* Part II.D.3.

(that is, long-term value creation)¹⁸⁴ and further ESG's importance (that is, compel changes in business behavior that better aligns with societal concerns)?¹⁸⁵ Lastly, assuming that investors know ESG ratings measure financial risk and that ESG ratings can in fact measure financial risk, how likely are the proposals to suffer from the criticisms related to ESG ratings (that is, inaccuracy of ratings due to lack of regulation and incomplete data)?¹⁸⁶ Each of these questions will be considered in turn.

a. *Meeting ESG tax goals*

The act of disclosure generally does not directly address the goal of minimizing financial risk, though it may promote the goal of accountability to society. However, the extent to which disclosure can promote accountability and minimize negative externalities on social welfare depends on the level of detail a company is willing to divulge.

A company that chooses to adopt GRI 207 disclosures must report on its tax practices in significant detail. GRI 207-1 through 207-3 give stakeholders a view into the business's process with respect to tax through disclosures addressing tax strategy, tax governance, and approach to stakeholder concerns. Most importantly, GRI 207-4 requires the reporting of tax activity in each country that a company is a resident of for tax purposes (known as country-by-country reporting). The level of granular reporting demanded by country-by-country reporting (for example, revenues from intra-group transactions with other tax jurisdictions, corporate income tax accrued on profit/loss) allows stakeholders to more accurately assess whether a company that purports to prioritize ESG "walks the talk" with respect to its tax conduct.

In contrast, a company that adopts the WEF-IBC Tax Metrics is only required to share high level tax information related to its total tax paid and remitted, which may not give stakeholders any meaningful insight into the company's tax practices. While inclusion of country-by-country reporting is required for certain jurisdictions of operation, allowing only selective disclosure may permit a company to obfuscate the reality of its tax practices. Thus, while any tax transparency is better than none, the WEF-IBC Tax Metrics are unlikely to provide the level of accountability that GRI 207 would provide.

b. *Achieving the benefits of ESG*

While tax transparency is itself a step forward (assuming companies voluntarily disclose), it is unclear whether disclosure can lead to long-term value creation and change a business's tax conduct to better align with social values.

184. See discussion *supra* Part I.B.

185. See discussion *supra* Part I.D.1.

186. See discussion *supra* Part I.E.

On the one hand, the mere act of disclosure is “unlikely to accomplish, on its own, the transformation that sustainability’s proponents yearn for.”¹⁸⁷ “Disclosure is geared towards deterring a [company] from lying” but “puts no [direct] pressure” on a company to improve its tax practices.¹⁸⁸ If that is the case, then a company’s tax conduct may remain unchanged, and these disclosure-based proposals would not lead to long term value creation.

On the other hand, it is highly possible that disclosure will indirectly result in companies changing their tax behavior. Proponents of tax transparency believe that the value of disclosure “lies in the exercise of self-reflection and self-discipline they require companies to undertake.”¹⁸⁹ Consequently, tax disclosures “can be more of a mirror than a window”¹⁹⁰ and can compel companies to better align their tax conduct with stakeholder expectations. In such a situation, disclosure could then indirectly achieve the goal of minimizing financial risk if a company’s changed conduct improves its reputation or minimizes regulatory scrutiny.

However, the extent to which tax disclosures can function as a mirror depends on the amount of self-reflection a company is forced to undertake. A company that conforms with the WEF-IBC Tax Metrics is less likely to meaningfully consider or feel compelled to change its behavior because it is not required to look particularly deeply into its tax practices. Furthermore, the superficial nature of the WEF-IBC disclosure requirement may mean that the information shared would still fail to meet the goal of accountability to society. In contrast, the comprehensive disclosure regime under GRI 207 forces companies to confront their tax practice head on and is therefore far more likely to lead to changes in business behavior and long-term value creation, as well as further both ESG tax goals.

c. *Vulnerability to ESG ratings-related criticisms*

As previously noted, critics of ESG caution that investors and consumers are being misled by ESG ratings because ESG rating providers are unregulated and the data underlying the ESG ratings is incomplete, outdated, unaudited, and unregulated.¹⁹¹ As a threshold matter, the disclosure-based proposals cannot address the criticism that ESG ratings providers are unregulated, as these proposals tell companies what to disclose but do not provide ESG ratings agencies with guidance on how the information disclosed should be factored or

187. Gadinis & Miazad, *supra* note 33, at 1471.

188. *Id.*

189. *Id.* at 1439.

190. *Id.*

191. *See* discussion *supra* Part I.E.

weighed into calculating ESG tax scores.¹⁹² Accordingly, the two tax disclosure proposals implicate only the criticism related to the quality of the data underlying ESG ratings. The extent to which the WEF-IBC Tax Metrics and GRI 207 will suffer from this criticism will be discussed in turn.

Given its stated shortcomings, disclosure based on the WEF-IBC Tax Metrics, even if universally adopted, regulated, and timely reported, is very likely to be criticized for its data quality. Because this proposal generally only requires high-level tax disclosure and detailed disclosure for specific jurisdictions, the resulting tax data will most certainly be incomplete, and there is greater risk that the information reported under this regime will not accurately reflect a company's true tax conduct. The latter concern may be partially alleviated if the WEF-IBC Tax Metrics included mandatory random audit, but no such provision exists. Accordingly, this proposal is highly vulnerable to ESG ratings related criticism.

In contrast, the extent to which GRI 207 is susceptible to criticism related to its data quality depends on the number of companies that commit to mandatory tax disclosures. Assuming that most companies do adopt GRI 207, the proposal is far less likely to suffer from criticisms related to ESG ratings and poor underlying data because the disclosure requirements of GRI 207 are quite comprehensive. The tax information divulged is therefore more likely to provide an accurate window into company operations (though including a mandatory random audit provision would better support this assertion). Thus, stakeholders would have more assurance that, at the very least, the data underlying companies' ESG tax scores is not incomplete or outdated. However, if very few companies adopt GRI 207, the same criticisms plaguing ESG ratings in general would still apply to ESG tax scores specifically.

C. BEHAVIOR-BASED PROPOSALS

This Subpart provides a summary and a policy evaluation of the two behavior-based proposals for ESG tax standards: the B Team's Responsible Tax Principles and Danish institutional investors' Tax Code of Conduct.

1. *Origins and Contents of Behavior-Based Proposals*

The two behavior-based proposals expounding on responsible tax practices come from two different types of ESG stakeholders. In February 2018, The B-Team, a global nonprofit advocate for sustainable business practices, in conjunction with a group of global business leaders developed Responsible Tax

192. Even if GRI 207 and the WEF-IBC Tax Metrics included this type of guidance for ESG rating agencies, the proposals may still suffer from the same criticism if ESG rating agencies generally decline to follow the proposed ESG tax methodologies.

Principles (“RTP”), a “framework that details what good tax practice should look like and sets a new benchmark for businesses to work towards practicing.”¹⁹³ In August 2019, a group of Danish pension funds (meaning, institutional investors) put forth a Tax Code of Conduct (“TCC”) for the “purposes of promoting responsible tax behavior in connection with unlisted investments through external asset managers.”¹⁹⁴

Though one proposal is aimed at businesses in general and the other at asset management businesses specifically, both proposals generally cover similar grounds. The overlapping guidelines from the TCC and RTP can be combined and distilled into three categories: (1) approach to tax management, (2) relationship to others, and (3) voluntary disclosure.¹⁹⁵ The following Subparts summarize the most important behavior guidelines from each category.

First, with respect to approach to tax management, both the RTP and TCC ask businesses to (1) commit to non-aggressive tax planning; (2) comply with the tax legislation of the countries they operate in; and (3) pay the right amount of tax in the countries where they create value.¹⁹⁶ To effectuate these goals, companies that adopt RTP must, among other actions, “aim for certainty on tax positions, but where tax law is unclear or subject to interpretation, [they must] evaluate the likelihood and where appropriate seek an external opinion, to ensure that [their] position would, more likely than not, be upheld.”¹⁹⁷

TCC is more explicit in its demands to asset managers, providing a non-exhaustive list of acceptable (that is, non-aggressive) and unacceptable (that is, aggressive) tax planning.¹⁹⁸ Acceptable tax planning includes “[g]eneral use of current and historic tax losses to reduce taxable income” and “[u]se of hybrid entities for non-aggressive tax planning.”¹⁹⁹ Unacceptable tax planning includes “[t]ransfer pricing planning for tax avoidance purposes,” “[u]se of financial instruments for aggressive tax planning,” and “[u]se of hybrid entities for purposes of aggressive tax planning.”²⁰⁰

193. *A New Bar for Responsible Tax: The B Team Responsible Tax Principles*, B TEAM (Feb. 9, 2018), <https://bteam.org/our-thinking/reports/responsible-tax-2>.

194. *New Signatories to Joint Tax Code of Conduct*, PENSIONDANMARK (Jan. 20, 2020), <https://www.pensiondanmark.com/en/press/news/2020/tax-code-of-conduct>.

195. See generally B TEAM, A NEW BAR FOR RESPONSIBLE TAX: THE B TEAM RESPONSIBLE TAX PRINCIPLES (2018), <https://bteam.org/assets/reports/A-New-Bar-for-Responsible-Tax.pdf> [hereinafter RESPONSIBLE TAX PRINCIPLES] (listing and explaining responsible tax principles); PENSIONDANMARK, TAX CODE OF CONDUCT (2020), <https://www.pensiondanmark.com/globalassets/dokumenter/investering/new-tax-code-of-conduct.pdf> (explaining tax principles to ensure efficient and sustainable investments).

196. See RESPONSIBLE TAX PRINCIPLES, *supra* note 195, at 4–5; TAX CODE OF CONDUCT, *supra* note 195.

197. RESPONSIBLE TAX PRINCIPLES, *supra* note 195, at 5.

198. See TAX CODE OF CONDUCT, *supra* note 195, at 2.

199. *Id.*

200. *Id.*

Second, both proposals contemplate companies' relationship to other actors. Though RTP and TCC both demand that companies engage openly about their tax practices, the TCC requires open dialogue between asset managers and shareholders only.²⁰¹ Whereas RTP takes a broader view by requiring constructive engagement with tax authorities and other stakeholders such as NGOs and civil society.²⁰²

Finally, on the issue of voluntary disclosure, RTP asks companies to commit to tax transparency via annual disclosure of tax strategy and taxes paid.²⁰³ However, the specific disclosure requirements put forth in that provision are rather vague compared to GRI 207.²⁰⁴ TCC's reporting demands are equally vague, requesting asset managers "to use best efforts to comply" with EU Council Directive 2018/822,²⁰⁵ which mandates annual tax disclosure for companies engaged in certain cross-border arrangements that suggest potential risk of tax avoidance.²⁰⁶

2. *Policy Evaluation of Behavior-Based Proposals*

As with disclosure-based proposals, the behavior-based proposals summarized above must be assessed for their potential efficacy based on the three considerations: (1) whether the proposals meet the two goals of tax-related ESG efforts; (2) to what extent do the proposals achieve the benefits of ESG; and (3) to what extent the proposals are vulnerable to the criticisms related to ESG ratings. The following Subparts address these questions.

a. *Meeting ESG tax goals*

If companies adopt either the RTP or TCC in form and not in substance (for example, to obtain a short-term reputation boost), neither ESG tax goal will be met. However, it is possible for companies that meaningfully commit to either proposal to meet both ESG tax goals. Unlike disclosure-based proposals, behavior-based proposals directly ask companies to change their behavior by providing specific guidance on favored and disfavored behavior. Because the suggested best practices are quite comprehensive, a company that follows either proposal can meet both ESG tax goals. For example, setting standards for

201. *See id.* at 3.

202. RESPONSIBLE TAX PRINCIPLES, *supra* note 195, at 4, 8.

203. *Id.* at 8.

204. RTP asks for information related to a company's tax strategy and for "[a]nnual information that explains [a company's] overall effective tax rate and gives information on the taxes [paid] at a country level, together with information on [their] economic activity." *Id.*

205. TAX CODE OF CONDUCT, *supra* note 195, at 3.

206. DAC6: EU's New Mandatory Disclosure Regime, BLOOMBERG TAX (Mar. 22, 2022), <https://pro.bloombergtax.com/brief/complying-with-dac6/#:~:text=DAC6%2C%20formally%20known%20as%20Council,to%20reportable%20cross%2Dborder%20arrangements>.

transparency between the company and its stakeholders speaks to the goal of accountability while commitment to non-aggressive tax planning is likely to minimize financial risk.

b. *Achieving the benefits of ESG*

There are two reasons why it is unclear whether the RTP and TCC will result in long term value creation and changes in business behavior. First, although they purport to articulate what responsible tax conduct by businesses should entail, neither proposal meaningfully defines the questionable conduct that drives much of societal disapproval: aggressive tax planning. For instance, the TCC, describes “[u]se of hybrid entities for non-aggressive tax planning” as favored tax conduct and “[u]se of hybrid entities for purposes of aggressive tax planning” as disfavored conduct.²⁰⁷ Using the defining terms to identify behavior as such does not provide material guidance to asset managers to change their behavior.

Similarly, the RTP provision that mandates companies “aim for certainty on tax positions, but where tax law is unclear or subject to interpretation, evaluate the likelihood and where appropriate seek an external opinion, to ensure that our position would, more likely than not, be upheld”²⁰⁸ is an equally fuzzy standard that raises more questions than it answers. Who determines when tax law is subject to interpretation? Who in the company is evaluating the likelihood? How much accountability exists if the company determines when external opinions should be sought? This is yet another example that illustrates the incoherence of behavior-based proposals related to tax planning. With respect to the lack of specificity and coherence in the tax planning provisions, the RTP and TCC are unlikely to meaningfully change business behavior, let alone drive long term value creation.

Second, both the RTP and TCC lack teeth because they do not offer an enforcement mechanism or other means to hold companies accountable to the tax conduct to which they have committed. While both proposals include a reporting component, neither disclosure requirement gives stakeholders specific insight on how a company has progressed in their commitment to responsible tax conduct. Without any enforcement or accountability, it is unlikely that companies will change their behavior, and thus neither benefit of ESG would be achieved.

The B Team, however, does make a strong case that there is inherent value in behavior-based proposals: There is a need to deliberately articulate “what a responsible approach to tax looks like, in an effort to drive towards a common

207. TAX CODE OF CONDUCT, *supra* note 195, at 2.

208. RESPONSIBLE TAX PRINCIPLES, *supra* note 195, at 5.

approach over time” (meaning, establish norms) and behavior-based proposals serve that function.²⁰⁹ This argument echoes the stance of the drafters who first introduced the concept of ESG best practices in the UN Global Compact. In the publication, they specifically stated that their recommendations are not (and do not pretend to be) regulation.²¹⁰ Instead, the power of the views set forth in the Global Compact are “discursive, not direct” and speak to the “power of norms and promises in creating changes in corporate practice.”²¹¹

c. *Vulnerability to ESG ratings-related criticisms*

Critics argue that ESG ratings are misleading because ESG rating agencies are unregulated and the data underlying the ratings are unreliable. First, just as discussed with regard to disclosure-based proposals, the RTP and TCC cannot address the criticism that ESG rating providers are unregulated because these behavior-based proposals do not provide any methodology for factoring or scoring ESG tax issues for ESG rating agencies.²¹² Second, the quality of the tax data disclosed by companies that adopt either the RTP or TCC is likely suspect, as both proposals have vague disclosure standards.

The RTP disclosures may give stakeholders useful insight on a company’s tax strategy and engagement approach, but it does not provide quality data on actual taxes paid and country-by-country activity. Asking for “annual information that explains [a company’s] overall effective tax rate and gives information on the taxes [paid] at a country level” means that companies are only required to disclose their overall effective tax rate and are not required to provide any detailed tax breakdowns—instead, companies have discretion to offer “information” on the tax paid at a country level. This information disclosure requirement is even more ripe for abuse than the WEF-IBC’s disclosure framework, as companies have more latitude to cherry-pick tax information for release to the public. Accordingly, the RTP is likely to be criticized on the grounds that the data disclosed under this framework is incomplete, unaudited, and unregulated.

Similarly, the TCC’s requirement that asset managers use “best efforts” to comply with DAC6, the European Union’s mandatory tax disclosure regime related to certain cross-border activity, is another vague standard that has no teeth. The extent to which asset managers will be held accountable for their efforts depends on the tax enforcement (for example, regulation and audit) of DAC6 by EU member states. Furthermore, to the extent that asset managers

209. *Id.* at 4.

210. Taylor St. John & Daniel Hemel, *Deal or No Deal? Social Responsibility and Corporate Decision Making: A Review of McKinsey’s Global Impact Report*, 5 ST. ANTONY’S INT’L. REV. 122, 122 (2009).

211. *Id.*

212. See *supra* note 192 and accompanying text.

adhere to DAC6, the tax disclosure regime itself is not comprehensive given that it only implicates specific cross-border conduct. Thus, even though tax data generated under the TCC is theoretically regulated and audited, it is still likely to be incomplete. However, TCC tax data is still preferable to RTP tax data, as it relies on DAC6's very specific set of disclosure rules related to capturing potential cross-border tax-avoidance activities while RTP does not require the disclosure of any meaningful granular data on taxes paid and country level activity.

IV. RECOMMENDATIONS FOR U.S. ESG TAX STANDARDS

In light of the extensive discussion of the merits and shortcomings of existing ESG tax proposals, it is obvious that there is no easy nor perfect ESG tax standard that is not susceptible to ESG ratings-related criticisms and would further both goals of ESG while generating long term value and compelling a shift in business behavior. However, we should not let the perfect be the enemy of the good. To accelerate the incorporation of tax in ESG policies, U.S. companies should form a group to accomplish the following: (1) determine ideal ESG tax standards for U.S. businesses; (2) provide guidance to ESG rating providers regarding how to score a company's tax practices; and (3) implement its ESG tax standards by serving as a quasi-regulatory body that conducts randomized audits on companies that adopt the standards. To support the development of a set of comprehensive ESG tax standards for U.S. companies, this Part provides some substantive recommendations for inclusion in that new framework.

A. THE IMPLEMENTATION OF A U.S. ESG TAX STANDARD

To date, none of the existing proposals for ESG tax standards have originated in the United States. While this fact may illustrate the extent to which U.S. companies have lagged in their tax-related ESG efforts, it may also serve as an opportunity for U.S. businesses to carve their own path forward. To accelerate the incorporation of tax in company ESG policies, U.S. companies (that is, U.S. business leaders) should form a group (the "Group") that determines what ESG tax standards for U.S. businesses should be. The Group could be an NGO or a joint venture within an existing U.S. tax organization, such as the American Bar Association Section of Taxation. Whatever the format, U.S. business leaders must recruit tax policymakers and tax attorneys to the Group to ensure that stakeholder interests will be effectively represented. This will increase the legitimacy of the Group and result in the development of ESG tax standards that consider concerns from all stakeholders.

Moreover, the Group should develop guidance for how its ESG tax standards could be factored and weighed by ESG rating agencies. While

providing a tax methodology for rating agencies does not necessarily mean that ESG rating agencies will adopt that guidance, in the absence of regulation, such an action would be a step forward in addressing the criticisms over the inaccuracy of ESG ratings.

Finally, a coalition overseeing ESG tax standards in the United States is essential given that neither the existing disclosure- nor behavior-based proposals could address the issue of lack of audit or regulation of either ESG ratings agencies or their underlying data. By serving as a quasi-regulatory body, the Group can and should enforce its ESG tax standards by conducting randomized audits on companies that adopt the standards. If there is consensus, the Group could also lobby the SEC, who recently released proposed regulations for ESG disclosures related to climate change, to adopt any disclosures put forth in the ESG tax standards as official regulations. If the tax disclosures of U.S. companies are subject to random audit or the SEC's regulatory power, the veracity and reliability of the tax data is likely to increase, thus addressing the criticism that ESG data is unaudited and unregulated.

Alternatively, or additionally, the Group could also lobby the SEC to begin regulating ESG rating agencies. While it is unclear how feasible such an endeavor may be, the threat of potential regulation may compel ESG rating providers to provide more transparency into their ratings process or work amongst themselves to set some general standards that all ratings agencies must follow. To the extent that this may occur, the criticism of ESG rating agencies may be somewhat mitigated.

B. THE SUBSTANCE OF A U.S. ESG TAX STANDARD

To support the development of a set of ESG tax standards for U.S. companies, this Subpart offers some substantive provisions for consideration. Because ideal recommendations may not be realistic, these recommendations focus on promoting incremental change.

After analyzing both disclosure- and behavior-based proposals for ESG tax standards, I conclude that the broader a provision is, the less effective it is in achieving policy goals. Instead, the Group should focus on developing very specific standards that are actionable and measurable. An effective standard must require both behavioral and reporting components by (1) providing detailed guidance on favored practices and (2) corresponding disclosure requirements that allow stakeholders to assess a company's sufficiency in adhering to those practices. Furthermore, each proposed provision must satisfy most or all of the following policy considerations. First, it must further one or more goals of ESG. Second, it must achieve one or more benefits of ESG. Third, it must mitigate the criticism that data underlying ESG is susceptible to by ensuring comprehensive disclosure that deters abuse or obfuscation. While

many suggestions could meet the above requirements, the following are a few for the Group to consider.

1. *Tax Transparency: U.S. Companies Should Commit to GRI 207*

U.S. companies should commit to the GRI 207 disclosures, including the country-by-country reporting in GRI 207-4. The merits and shortcomings of GRI 207 have already been discussed at length. While U.S. companies may be reluctant to agree to committing to this level of tax transparency, disclosure is the absolute bare minimum effort a company can provide.

U.S. companies may argue against such detailed disclosure on the grounds that a company's tax attributes are a part of the business's competitive advantage and should not be divulged. However, to the extent that jurisdictionally mandated business tax disclosures become more common, and more firms are forced to disclose, the potential risk from disclosure decreases as all actors are on an even playing field.

U.S. companies may also argue that the amendments to the WEF-IBC Tax Metrics indicate that global business leaders are also reluctant to adopt country-by-country reporting. However, the regulatory developments in the European Union in the last several years demonstrate that this level of tax disclosure will soon be mandatory rather than optional. The European Union, a trailblazer in corporate sustainability reporting, has adopted mandatory business reporting regimes such as the public Country-by-Country [tax] Reporting Directive for certain large multinational enterprises ("MNEs") and the Corporate Sustainability Reporting Directive, in December 2021²¹³ and December 2022, respectively.²¹⁴ Both EU Directives are likely to impact large U.S. MNEs that conduct business in the European Union and may very well force them to confront their tax strategy and practices.²¹⁵

Finally, as more jurisdictions adopt mandatory tax reporting²¹⁶ or more companies voluntarily adopt mandatory tax reporting, a company's choice to

213. Member States must transpose the Directive into national legislation by June 22, 2024. Council Directive 2021/2101, *supra* note 135, at 13. This EU Directive compels mandatory tax disclosures for "multinational groups with total consolidated revenues exceeding EUR 750 million for each of the last two consecutive financial years if the group's ultimate parent undertaking is either: based in the EU, or based in a third-country and operates in the EU through a qualifying subsidiary or branch." KPMG, *supra* note 135.

214. *Corporate Sustainability Reporting*, EUR. COMM'N, https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en (last visited Apr. 22, 2023).

215. Morris et. al., *supra* note 107.

216. In December 2023, the Financial Accounting Standards Board, the standard setting body for U.S. Generally Accepted Accounting Principles, issued an Accounting Standards Update that "improves the transparency of income tax disclosures by requiring (1) consistent categories and greater disaggregation of information in the rate reconciliation and (2) income taxes paid disaggregated by jurisdiction. It also includes

refrain from disclosing tax data becomes increasingly symbolic. Because the literature has suggested that “tax-aggressive firms have lower corporate transparency”,²¹⁷ we can make a negative inference about the tax practices of a company that chooses not to disclose when disclosure has become the norm.

2. *Non-Aggressive Tax Planning: Targeting Vulnerable Tax Positions*

Companies should commit to taking tax positions that are “more likely than not” (“MLTN”) or greater. Furthermore, if a MLTN position hinges on the inapplicability of an anti-abuse rule (meaning, it is a close call as to whether the anti-abuse rule would apply), companies should treat it as if the anti-abuse rule applies and decline to take the position. To prevent abuse, companies should seek opinions from external actors (preferably tax attorneys affiliated with the Group). Reporting-wise, companies should commit to publishing all tax opinions up to “should” opinions.²¹⁸ Companies may disclose the opinion in line with the IRS’s practice of redacting sensitive information from published Private Letter Rulings.

Aggressive tax planning is an issue that both behavior-based proposals inadequately attempt to address. Rather than make blanket statements regarding how a company should or should not behave with respect to its tax planning, the above proposal, relatively modest compared to the terminology of the RTP and TCC, identifies specific behavior and requires companies to report on it. Accordingly, it can achieve both ESG tax goals because (1) disclosure promotes accountability and (2) financial risk is minimized when a company commits to consulting with external tax actors and to taking less aggressive tax positions. This proposal is also very likely to achieve both benefits of ESG. Not only does it force a company to conduct itself in a less tax-aggressive manner, but it also lowers the company’s risk position. A lower risk profile may allow the company to make more long-term investments (such as hiring talent)²¹⁹ and improves its reputation with stakeholders—both actions that are likely to contribute to long term value creation.

Lastly, requiring the company to publish all opinions up to “should” opinions should result in the release of comprehensive data on tax positions.

certain other amendments to improve the effectiveness of income tax disclosures.” These standards are effective for public business entities for annual periods beginning after December 15, 2024, and for other entities after December 15, 2025. *FASB Issues Standard that Enhances Income Tax Disclosures*, FIN. ACCT. STANDARDS BD. (Dec. 14, 2023), <https://www.fasb.org/news-and-meetings/in-the-news/media-advisory-12-14-23-398823>.

217. See Balakrishnan et al., *supra* note 136, at 46.

218. “Should” opinions as “...used by most [tax] practitioners” tend “to imply a reasonably high level of confidence that the position will be sustained—significantly higher than ‘more likely than not’—but allows for a not insignificant risk of being wrong.” Robert P. Rothman, *Tax Opinion Practice*, 64 *TAX LAW* 301, 313 (2011).

219. See *supra* note 133 and accompanying text.

Furthermore, requiring companies to seek tax opinions from external (*i.e.*, disinterested) service providers should increase the likelihood that the data disclosed is reliable and accurate.

3. *Relationships with Stakeholders: Shareholder Audits*

To the extent that they cannot commit to GRI 207, publicly traded U.S. companies should allow shareholders that own more than a certain percentage of shares to externally audit the company's general tax practices once a year. The results may not be disclosed to the general public. The Group must determine what percentage threshold is appropriate. Reporting wise, public companies must disclose: (1) all shareholders that are eligible to conduct external audits based on the thresholds; (2) when an audit request was made, if any; (3) when the audit request was approved; and (4) which firm served as auditor.

While these shareholders would not be allowed to publicly release the results of the audit, providing key owners the opportunity to examine the company's tax practices will force publicly traded companies to scrutinize their tax practices more closely, thus promoting the ESG tax goals of accountability to society and minimization of financial risk. To the extent that such scrutiny results in a shift in business behavior to better align with societal norms and thus result in long term value creation, this proposal is likely to achieve the benefits of ESG.

4. *Tax Governance: Internal Whistleblower Program for Employees*

U.S. companies should commit to creating and funding whistleblower programs that incentivize employees for reporting tax behavior in violation of the company's articulated tax strategies and principles.

First, companies should formulate a tax strategy and set of principles that apply to their tax practices across all jurisdictions, designate the entity/group that will provide oversight and report back to company management annually/biannually, and put in mechanisms to ensure awareness and adherence to tax strategies and principles. Reporting wise, companies must: (1) disclose their tax strategy and tax practice principles; (2) identify the entity/group in charge of tax oversight; (3) release the reports made to the oversight group (with the Group to determine the standard for redacting information from the report); and (4) describe the mechanism in place to ensure awareness and adherence to tax strategies and principles.

Second, companies should design, fund, and implement a whistleblower program and promote the program to all employees. Furthermore, it should commit to hiring an external actor to investigate any whistleblower allegations. Reporting wise, companies should describe: (1) the design of the program in

detail; (2) the source(s) of funding; (3) how the program is promoted to employees; (4) the number of employees who come forward; and (5) the whistleblower's allegation, the external investigator's full report on the matter, and the company's resolution, including amount paid to whistleblower and changes to company tax practices, if any.

This internal whistleblower program would meet both ESG tax goals. By publishing all information relating to the program and progress, the company holds itself accountable to society. Moreover, by committing to addressing employee concerns through a disinterested third party, the company is more likely to scrutinize its tax practices and minimize areas of risk, thus minimizing financial risk from tax-related ESG issues, which is more likely to result in long term value creation. Furthermore, by empowering employees to report bad behavior, the company is more likely to be compelled to amend its tax practices in line with social norms, thus also achieving another benefit of ESG. Finally, the degree of granularity required in the whistleblower program disclosures ensures comprehensive reporting of data while the use of an independent investigator provides further assurance of the data's reliability.

The above proposals are just a few of the many possible provisions that could be included in a U.S. ESG tax standard. While they may be developed further, they serve as a reference point for the Group to use in developing its standards.

CONCLUSION

Despite its flaws, the ESG movement has demonstrated the power of societal norms to shift business behavior. Companies that have adopted ESG policies have broadly made a commitment to pursue business practices that are sustainable for not only themselves, but the world. Because tax is an essential component of ESG, U.S. companies cannot tout their ESG policies without taking stock of how they manage their tax practices. Moreover, new regulatory frameworks mandating tax disclosure and increasing concern from governments, shareholders, and consumers regarding responsible tax practices put additional pressure on U.S. companies to provide accountability for their tax behavior. While articulating a set of usable ESG tax standards is a tall order, it is an important undertaking that impacts both sustainable global and business development. U.S. companies should take this opportunity to come together with their stakeholders to develop, implement, and further a set of ESG standards tailored to U.S. businesses to address societal concerns and facilitate better tax practices to ensure their own financial stability and longevity.