Tax Reporting and Sustainable Development Goals: Why Less Is More

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In this article, Hongler and Berndt analyze whether including tax in the ESG debate has helped achieve the sustainable development goals and demonstrate how current approaches could be amended to be more effective.

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Introduction

Initiatives like the Global Reporting Initiative (GRI) or binding legislation like the EU's Corporate Sustainability Reporting Directive (CSRD) underscore the growing emphasis on business's role in societal and environmental well-being.

Tax behavior of multinational enterprises has played a role in this debate and stakeholders have also begun measuring the sustainability performance of companies in tax matters. The variety of recommendations used in tax matters is astonishing but also a sign that further work is necessary to distill the important from the less important recommendations.

The goal of this article is to contextualize the debate and demonstrate whether including tax has helped to achieve the sustainable development goals (SDGs). We will also outline how current approaches could be amended to be more effective.

We argue that tax behavior is generally a difficult metric for assessing whether an enterprise has a positive effect on the environment, on society, and on the SDGs in general, mainly because paying taxes does not have a direct effect on the SDGs, only an indirect one through governmental spending.

Moreover, we highlight that the possibility of offsetting a good rating in the tax pillar against a bad rating in the environment or the social pillar might even be harmful for achieving the SDGs. This evident risk of window dressing and greenwashing must be considered by policymakers as well as MNEs and their stakeholders.

Finally, the most recent political developments in the United States and the EU require a new contextualization of the entire environmental, social, and governance (ESG) and tax debate.

Measuring Tax Behavior: Current Approaches

Tax has become an important part of the governance pillar in ESG debates. ESG standard setters and ESG rating agencies rely partly on tax behavior to assess the ESG performance of MNEs. However, the variety of recommendations and metrics used is immense. It is not just that the recommendations are different, but also the overall value attributed to tax behavior in an ESG rating (according to our estimates, the tax behavior accounts for between 0 and 8.5 percent of the overall rating)[1]. We identified the following categories of recommended tax behavior while reviewing the most important ESG standards and the methods of the most important rating agencies:[2]

- **Transfer Pricing** — Does the company commit itself not to misuse transfer pricing to lower its tax burden?
- **Tax Rate** — Is the effective tax rate of an MNE significantly lower than its competitors?
- **Controversies** — Is the company involved in any major tax dispute?
- **Tax Havens and Aggressive Tax Planning** — Has the company invested in tax havens?
- **Engagement With Tax Authorities** — Does the company proactively seek to have an open and transparent relation with the tax authorities?
- **Public Country-by-Country Reporting** — Does the company publish its CbC report data?
- **Regulatory Compliance** — Is the company committed to follow not only the letter but also the spirit of the law? This commitment is often published in a tax strategy.
- **Tax Advocacy** — Is the company engaged in the political debate to improve the effectiveness of the tax system?

Within these categories, different recommendations are used to assess the tax behavior of an MNE. Both rating agencies and standard setters have developed their own recommendations for evaluating tax behavior within an ESG analysis. Further, different rating agencies may attribute different values to tax behavior within their ESG analysis, with some focusing only on tax controversies while others use a mix of categories to evaluate the tax performance.

Given this variety of approaches, the specific goal of evaluating tax behavior for ESG purposes is unclear. The two main approaches are:

- whether certain behavior of a company affects the (sustainable) *financial performance* of the company (in other words, a risk-based approach); or
- whether certain behavior of a company has an *impact* on the SDGs.

As we explain below, the two goals are blended.

Risks vs. Impact

Effect on SDGs (Impact)

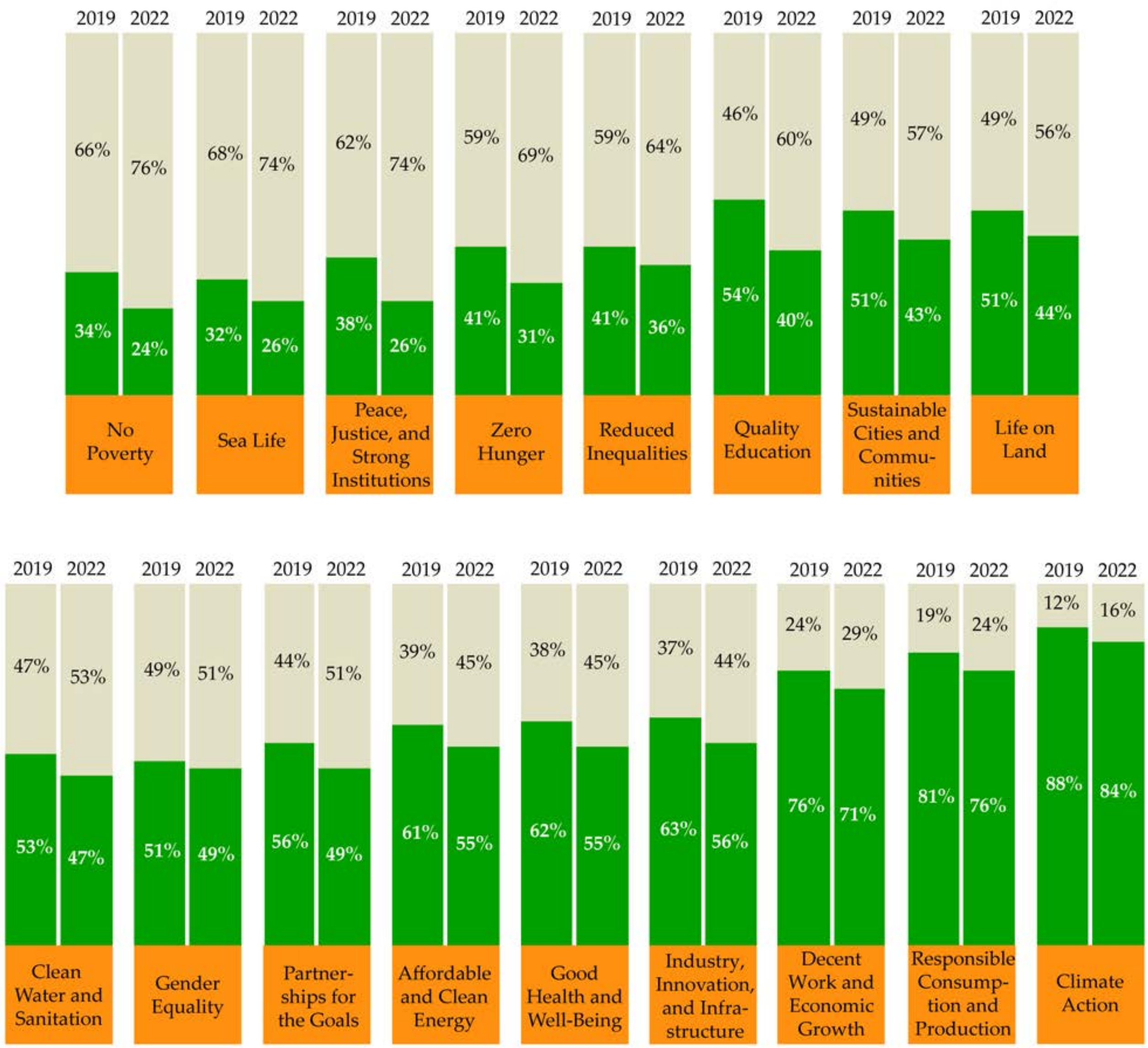
Because there are so many, the goal of this discussion is to distill recommendations that have an SDG-enhancing effect from others.

SDGs are an important part of the sustainability report, at least for MNEs: According to a study published by the World Business Council for Sustainable Development, around 94 percent of companies refer to them. However, as the figure shows, not all SDGs are addressed to the same extent. There are also sometimes significant changes over time as to which goals are considered material. Companies

[1] For a detailed study in cooperation with the European Business Tax Forum, see Peter Hongler, Thomas Berndt, and Alexander Sigg, "Tax and Sustainability Study 2022/2023 — A Qualitative Analysis of the Regulatory Environment Complimented by Empirical Insights" 18 (last visited Feb. 5, 2025). Note that the approaches of rating agencies might have changed since publication.

[2] For the full list, see *id*. at Annex A.

Percent of Companies Referring to Each SDG



Source: Adapted from World Business Council for Sustainable Development, "Reporting Matters: 10th Anniversary Edition," at 21 (2022).

report on a different number of goals: Around a third report on 5 to 8 goals, others on fewer; only in rare exceptions are all goals reported on. The analysis also shows that the location of the company's headquarters influences whether and which SDGs are reported on.

The difficulty of linking tax behavior to fulfilling the SDGs is that paying taxes only has an indirect effect through governmental spending. This means whether a tax payment is SDG enhancing or reducing depends on how the government spends the revenue. Therefore, assessing the effect a company has on the SDGs by, for example, just looking at the amount of taxes paid, is ineffective.[3] We must be careful. The argument is not that tax payments do not have a positive effect, but we cannot measure the full effect of an enterprise by simply looking at the tax payments or whether a company engages in any tax-reducing activities, like using tax havens.

Moreover, if we try to measure the overall impact a company has (for example, in an ESG rating process) we face the challenge of heterogeneous goals. For instance, a company can have a positive effect on inclusiveness and equal treatment of its employees but produce harmful greenhouse gas emissions. The question is how (and whether) to offset a good assessment in one area with a bad assessment in another area. This is a key concern of existing rating approaches because they aim to develop a single rating for MNEs that considers a wide variety of indicators. It would be different if rating agencies would, for example, only assess the environmental performance of an MNE.

If we look at the SDGs' indicators — as potential accepted metrics — it is challenging to find any indicators with a direct link to taxation. Assessing the official U.N. SDG indicators,[4] the following seem to be relevant:

- 12.6.1: number of companies publishing sustainability reports;
- 16.5.2: proportion of businesses that had at least one contact with a public official and that paid a bribe to a public official, or were asked for a bribe by those public officials during the previous 12 months;
- 16.6.2: proportion of population satisfied with their last experience of public services; and
- 17.3.1: foreign direct investment (FDI), official development assistance and South-South cooperation as a proportion of total domestic budget.

However, not all these indicators can be directly influenced by enterprises through their tax behavior. Their effect on the SDGs might also differ. We see the following issues:

- Indicator 12.6.1: It seems per se SDG-enhancing if a company publishes a sustainability report; however, the indicator does not contain any specifics on the role of tax-related reporting.
- Indicator 16.5.2: The involvement of the private sector is obvious, as on one hand the private sector will be important to collect data on bribery incidences, but certain recommendations could lead to reduced risk of bribery activities within the tax administration, as we will discuss below.
- Indicator 16.6.2: The involvement of MNEs is more limited because satisfaction with public service is mainly achieved through improving the public sector and not through changing the behavior of the private sector; nevertheless, specific cooperative frameworks like a code of conduct between the taxpayer and tax authorities or introducing a tax ombudsperson could help to increase the quality of public service by the tax authorities.
- Indicator 17.3.1: It seems obvious that higher tax payments in developing states are helpful and an effective tool to achieve the SDGs; however, as it was outlined already, it is difficult to measure the exact effect of such tax payments. Moreover, it is difficult to derive clear recommendations in this regard because the distortive effect can be significant, meaning measuring tax payments higher in developing states would lead to an incentive to shift tax payments from the developed world to the developing world and vice versa.

Risks

If we look at risks as another way to assess the tax behavior of an enterprise, we could define certain actions that could reduce business risks taken by a company. Tax-related recommendations may help to reduce reputational and financial risks.

The effectiveness of recommendations for reducing reputational risks depends on stakeholder perceptions. For instance, some stakeholders may prioritize a company's

[3] See, however, with further references Reuven Avi-Yonah, "ESG Irony: Why Corporate Tax Avoidance Must Be Considered," *Tax Notes Int'l*, Feb. 3, 2025, p. 739.

[4] *See* G.A. Res., Work of the Statistical Commission pertaining to the 2030 Agenda for Sustainable Development, A/Res/71/313 Annex (July 10, 2017).

avoidance of tax planning, while others may focus on other recommendations so that a company does not use offshore structures. Moreover, the stakeholder perception can change over time. In 10 years, it could be perceived as a good thing if a company has a lower ETR than its competitors. Therefore, each company must perform an assessment of which tax recommendations might be of particular importance for its stakeholders and, as mentioned, these perceptions can change. It is important to highlight that there are no unconditional recommendations that would always lead to significant reduction of reputational risk.

Regarding financial risks, there seems to be a strong case for recommendations aiming at a reduction of tax risks understood as unintended tax payments in the future. For instance, recommendations for better tax governance in an MNE will help to reduce financial risks. Therefore, by requiring compliance with some recommendations, stakeholders could indeed achieve a more sustainable development of the stock price, although limited to areas of tax risk mitigation. Measuring risk mitigation is challenging because it is difficult to attribute a particular value to the various actions of an enterprise in the tax field. For instance, what is the value of no aggressive tax planning? What is the value of a solid governance structure that reduces the risk of higher tax payments in the future?

There are some recommendations that help to reduce both financial and reputational risks. However, measuring them is extremely difficult. Therefore, we should be reluctant to use numeric metrics to assess whether a company outperforms other companies in this area.

Financial and Impact Materiality

Recently, the focus in sustainability reporting has turned to "double materiality."[5] However, double materiality is closely related to the risk vs. impact debate as outlined above. Double materiality means that both an inside-out perspective and an outside-in perspective must be considered.

The inside-out perspective reflects the impact side as described above. Therefore, it must be assessed what impact an enterprise has on sustainability matters, like on the SDGs. The outside-in perspective reflects the financial side; however, the assessment is limited to sustainability matters and their effect on the business, not on any issues that could affect business development. For example, the IFRS Sustainability Standard S1 "General Requirements for Disclosure of Sustainability-related Financial Information" and IFRS S2 "Climate-related Disclosures," both issued in 2023 by the International Sustainability Standards Board, relate only to the financial side of sustainability-related risks and opportunities but not on the impact materiality. Therefore, as required by IFRS S1 paragraph 3 an entity must only "disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term." Financial materiality is primarily useful for the decision making of financial report users, especially investors.

Because reporting should not be excessive and should focus on the most important parts, at least in the European context, mandatory sustainability reporting has been limited mostly to material aspects.

Risk of Window Dressing and Greenwashing

The problem with any tax metric used is that it can also be misused to achieve a better rating while simultaneously not having a genuinely positive effect. This is the case if sustainability matters are mixed and if, for instance, a company can offset a bad environmental assessment with a good rating in the governance pillar.

In particular, the governance pillar of ESG ratings seems to be a gateway for window dressing and tax behavior is often part of it.[6] As stated above, we must be careful when assessing

[5]European Sustainability Reporting Standards 1 (ESRS 1), section 21 et seq. (published in Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council regarding sustainability reporting standards).

[6]Hongler, Berndt, and Sigg, *supra* note 1, at 7.

the tax behavior of a company because it could be misused to offset bad ratings in other areas.

There are a few options to reduce the risk of window dressing and greenwashing:

- **Regulate ESG ratings:** Regulate the ESG rating market and develop a framework for how companies should be assessed from an ESG perspective. At the end of 2024, the EU adopted the regulation on the transparency and integrity of ESG rating activities.[7] In essence, it is about being authorized and supervised as an ESG rating provider by the European Securities and Markets Authority and fulfilling transparency requirements, particularly regarding methods, rated items, relevant key performance indicators per ESG factors, and weighting sources of information and potential shortcomings of the method.
- **Develop new harmonized standards with an unconditional positive impact on the SDGs**: Develop standards that cannot be misused for window dressing.

We focus on the second option below. We will approach the topic by looking at one non-binding approach (GRI 207) and one binding approach (the CSRD in the EU).

GRI 207

The GRI standards are likely the most important sustainability reporting standards. These standards contain a specific tax standard — GRI 207, including the following four elements (in simplified terms):

- Disclosure 207-1 Approach to tax: An MNE should describe and publish its tax strategy. Therein, it should clarify which governing body is competent to review and approve the tax strategy. It should also publish its approach to regulatory compliance and how tax is linked to the sustainable development strategies of the organization.
- Disclosure 207-2 Tax governance, control, and risk management: The main recommendation of GRI 207-2 relates to a governance question; in other words, how does an MNE set up a tax governance and control framework to reduce tax risks?
- Disclosure 207-3 Stakeholder engagement and management of concerns related to tax: Companies should describe their approach to engagement with tax authorities, their public policy approach, and how they collect the views and concerns of their stakeholders (internal and external).
- Disclosure 207-4 CbC reporting: The last disclosure standard contains (public) CbC reporting.

GRI 207 focuses on disclosures and reporting, not actions. For instance, it does not contain any specific regulations on whether companies should use certain tax practices (for example, using tax havens for tax planning). It also does not evaluate whether having a higher ETR than competitors is a particular goal. The focus is on disclosures. It is not made transparent by GRI how these disclosure requirements affect the SDGs.

Of course, disclosing the aforementioned information — like the CbC reporting under GRI 207-4 — can help stakeholders better understand how MNEs value the topic of tax. However, that does not necessarily have any connection to the SDGs.

European Sustainability Reporting Standards

Introduction

Next, we review whether the European Sustainability Reporting Standards (ESRS), as published July 31, 2023, consider tax an important metric. These reporting standards are probably the most important binding sustainability-related standards and could therefore serve as a role model.

On December 14, 2022, the EU approved the Corporate Sustainability Reporting Directive (CSRD).[8] Importantly, the CSRD contains the framework for sustainability reporting in the EU. However, it delegates the competence of defining

[7] *See* European Council release, "Environmental, Social and Governance (ESG) Ratings: Council Greenlights New Regulation" (Nov. 19, 2024).

[8] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU regarding CSRD.

the exact standards to the EU Commission.[9] The commission has fulfilled this obligation by publishing the ESRS.

It is unclear whether the EU adheres to the CSRD in the future or whether implementation in the member states will be postponed. Also unclear is whether its scope will be limited (to just the largest companies in the EU) as part of a general decluttering initiative within the EU.

Materiality Assessment

Overview

According to the ESRS, a company shall report its sustainability matters based on the double materiality principle.[10] So there is a legal requirement to disclose information, but only to the extent it is based on a double materiality analysis. This does not mean that a company might not publish information going beyond such requirement. Nevertheless, the standards require some mandatory information that is typically related to ESRS 1 and 2, the so-called cross-cutting standards. For example, ESRS 1 requires companies to provide information on governance, strategy, and management of impacts; risks and opportunities; and metrics and targets related to climate change, regardless of the results of their materiality analysis.

Double materiality means that the starting point is the assessment of impacts. However, there might also be material issues that are not related to the impacts of a company — in other words, issues that only concern financial materiality.[11] Before discussing the two parts of double materiality (financial and impact materiality), we briefly assess the key elements of materiality as part of the ESRS in general. Initially, it is important to review which sustainability matters can be material, then why the standards are concerned with materiality per se.

According to the ESRS, the materiality assessment is necessary "to identify the material impacts, risks and opportunities to be reported." The focus shall be "on areas where impacts, risks and opportunities are deemed likely to arise."[12] The standards seem to suggest an evaluation mechanism that focuses on the principal impacts, risks, and opportunities an MNE has, meaning the principal impacts are equal to the material impacts under the double materiality standard.[13] This means there is no legal obligation to report all impacts, risks, and opportunities, only the material ones. There is a clear distinction between identifying and analyzing an issue and the reporting requirement. One reason is that the users of sustainability reports shall be able to assess the principal risks, opportunities, and impacts of an MNE. A too comprehensive and too generic reporting might even be counterproductive, as it could lead to window dressing.

For the materiality analysis it is key to understand who is affected or can be affected by the MNE. Here the term "stakeholders" is used.[14] The stakeholders are not identical to the users of the sustainability reports. Important stakeholders are those who are affected or could be affected by the business activities.[15] The enterprise must engage with the affected stakeholders through an ongoing due diligence process.[16] This due diligence process is defined in detail in section 4 of ESRS 1. It is, however, not the case that what stakeholders claim is material is automatically a material topic. Stakeholder engagement means understanding *"how they may be impacted,"* but stakeholders might also help in "target setting for each material sustainability matter."[17]

Impact Materiality

The ESRS define impact materiality using the following terms: a sustainability matter that (a) pertains to the company's (b) material actual or potential impact or (c) negative or positive *impacts*

[9] CSRD, *supra* note 8, art. 29b.

[10] ESRS 1, *supra* note 5, section 21.

[11] *Id.* at section 38.

[12] *Id.* at section 39.

[13] *Id.* at section 41.

[14] For a definition, see *id.* at section 22.

[15] See also the definition in Annex II of Commission Delegated Regulation 2023/2772.

[16] ESRS 1, *supra* note 5, section 24.

[17] ESRS 2, section 79 (e) (published in Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards).

(d) on people or the environment (e) over the short, medium, or long term**.**

It is explicitly stated that impacts include items in the upstream and downstream value chain (including through business relationships). These are not limited to contractual relationships.[18] The ESRS foresees a three-step assessment procedure:[19]

1. Understand the context, including assessing activities, business relationships, and stakeholders.
2. Identify actual and potential impacts.
3. Assess the materiality of the actual and potential impacts, including defining a threshold for material impacts to be reported.

For actual negative impacts the materiality assessment is based on the severity of the impact.[20] The severity is assessed based on the following factors: (i) the scale and (ii) the scope and irremediable character of the impact.[21] For potential negative or positive impact, the likelihood must be considered as well.

Financial Materiality

According to the ESRS, financial materiality is defined as follows:

> The financial materiality assessment corresponds to the identification of information that is considered material for primary users of general-purpose financial reports in making decisions relating to providing resources to the entity. In particular, information is considered material for primary users of general-purpose financial reports if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the undertaking's sustainability statement.[22]

It is decisive to review "if it triggers or could reasonably be expected to trigger material financial effects."[23] Financial materiality is not limited to matters "within the control of the undertaking" — it also includes risks and opportunities attributable to business relationships.[24] The financial materiality criteria are therefore expanding the scope of the information in the financial statements.[25]

For example, dependencies on natural, human, and social resources might trigger financial material risks and opportunities. This is the case if these influence the "ability to continue to use or obtain the resources needed in its business processes"[26] and these "may affect the undertaking's ability to rely on relationships needed in its business processes on acceptable terms."[27] Both the "likelihood of occurrence and the potential magnitude" of the risks must be considered.[28]

Tax Behavior and Materiality

Existing Opinions

The question of whether any tax behavior that has been detected and outlined above is material from an impact perspective must be assessed for each enterprise separately. Some authors have already dealt with the question of whether tax (reporting) is material — for example, the analysis of Bronte Klein and Eelco van der Enden. Their main arguments for why tax can (and should) be material are:[29]

1. The question has already been answered by other standard setters such as GRI.
2. Stakeholders, particularly investors, "most certainly consider tax to be material."
3. Tax is more frequently used by ESG rating agencies.

[18] For details, see ESRS 1, *supra* note 5, section 43.

[19] *See* ESRS 1, Application Requirement 9.

[20] *See* ESRS 1, *supra* note 5, section 45.

[21] *Id.* at section 45. It is explicitly stated that for negative effects on human rights, the severity takes precedence over the likelihood.

[22] *Id.* at section 48.

[23] *Id.* at section 49.

[24] *Id.*

[25] *Id.* at section 47.

[26] *Id.* at section 50 (a).

[27] *Id.* at section 50 (b).

[28] *Id.* at section 51.

[29] *See* Bronte Klein and Eelco van der Enden, "The Fiscal Materiality Principle," SSRN (posted Oct. 25, 2021; revised Dec. 13, 2021).

The second and third arguments are stronger in the following sense: If an important stakeholder assumes that tax behavior is key for its investment decision, companies must consider that because it may be material in an individual case. However, we assume that this is the exception. It needs to be an anchor investor who clearly announces that if you behave in a certain form, it might trigger a divestment and, therefore, a decrease in the value of a company.

If a stakeholder like an investor (or customers) deems tax behavior to be material, it should be assessed what kind of tax behavior that means. Is it the use of tax havens? Is it not publishing a tax strategy? Is it a tax governance issue? We should avoid reporting too generic information because this is unhelpful for stakeholders and representatives of an enterprise. It can even be dangerous because it might be misused for window dressing.

Besides, the authors also argue:

> Many companies have not yet identified tax as a standard element of their ESG policies. This is unwise, given the significance of taxation for the socioeconomic cohesion of society. Tax behaviour has an impact on society in general and on the various "stakeholders" of companies in particular, such as investors, staff, customers, suppliers, tax authorities and government authorities.[30]

However, the authors do not disclose what exactly the link is between tax behavior and sustainability matters. They only argue there is a generic link between taxation and social cohesion. This is problematic from two angles. First, social cohesion is not per se a sustainability matter (at least under the umbrella of ESRS) and second, it is unclear whether tax behavior has an important effect on society in general and social cohesion in particular.

Own Assessment

Financial Materiality

From a tax perspective, it is important to note that the financials of a company already contain various elements to measure financial materiality. For example, uncertain tax positions according to International Accounting Standard 19 contain material information about potential tax risks.

The question is whether tax behavior could be financially material beyond what a company is already required to disclose under IFRS or another accounting standard. Is there any tax behavior that "could trigger material financial effects" and goes beyond what is already disclosed in a financial statement? Some examples might be helpful.

For instance, GRI 207-1 suggests the following disclosure:

> A description of the approach to tax, including: (i) whether the organization has a tax strategy and, if so, a link to this strategy if publicly available;

Of course, the fact that a tax strategy is published has no impact alone — it all depends on the content of the tax strategy. Tax strategies in general contain the following information:[31]

- A description of the position/function the entity sees itself performing regarding global taxation.
- A statement of willingness to comply with tax/legal/regulatory requirements. Tax strategies often contain a sentence like "we do not only follow the letter of the law but also the spirit of the law" or "we are committed to complying with tax laws in a responsible manner."
- A statement about the management of tax risks. The same is true of a generic statement about the approach toward risks.
- A statement about the approach to tax team management (leadership and governance).

Does disclosing any of this create a material financial risk? Does disclosing any of it reduce a material financial risk?

We are reluctant to confirm either of these questions. The information contained in tax strategies is rather generic. Often the exact same sentences can be found in tax strategies of different companies. It is questionable whether

[30] *Id.* at 13.

[31] *See, e.g.*, PWC, "Public Tax Transparency Establishing Trust in a Digital (Tax) World," at 10 (2020).

users can actually compare enterprises based on this information and whether it is actually relevant for a sustainability assessment.

Impact Materiality

First, it is key to outline the context in which an MNE operates. It seems clear that an enterprise has an impact by paying taxes as well as by engaging with authorities and the public in tax matters. The question, however, is whether any of this is material.

The term impact relates to an effect on people and further, it "indicate[s] the undertaking's contribution, negative or positive, to sustainable development." However, what sustainable development means is undefined, though the sustainability factors can be seen as a common understanding of what it means.[32]

Following this, we assess whether any tax behaviors that an MNE is able to report have a positive or negative impact on one of the sustainability factors. If we look at the various tax reporting elements it is difficult to demonstrate that the impact (if any) is, however, material. For example:

- a description of whether the organization has a tax strategy and, if so, a link to this strategy if publicly available;[33]
- a description of the approach to tax risk, including how risks are identified, managed, and monitored;[34] and
- a disclosure of the approach to engagement with tax authorities.[35]

We do not see that any of these have a material positive or negative effect on either people or the environment. Of course, taxation can help to improve the well-being of people and the environment, but not necessarily. For instance, if a country does not fulfil its obligations under the Paris Accord, paying taxes to that government might even have a negative effect on the environment.

Further Guidance in the Subtopics?

Several ESRS subtopics in the governance pillar could be relevant. Most of the disclosure requirements under ESRS G1 do not, however, have any link to taxation, like G1-1 on corporate culture, G1-2 on management of relationships with suppliers, and G1-6 on payment practices. However, G1-4 (prevention and detection of corruption and bribery) and G1-5 (political influence and lobbying activities) could be relevant. We will separately assess whether tax behavior needs to be disclosed under both subtopics.

ESRS G1-4 Prevention of Corruption and Bribery

ESRS G1-4 requires an MNE to provide information on incidents of corruption or bribery. More precisely, it shall disclose "(a) the number of convictions of anti-corruption and anti-bribery laws and (b) any actions taken to address breaches in procedures and standards of anti-corruption and anti-bribery."[36] There is only an obligation if these incidences and actions are material.

It is obvious that corruption and bribery are unconditionally bad for the development of society. Therefore, highlighting bribery or corruption incidences demonstrates the negative effect an MNE has. Whether the impact is material depends on each case. If corruption or bribery is systemic in a country, it might be more material compared with situations when it is only a single case of corruption. Moreover, MNEs may disclose further information, like:[37]

> (a) the total number and nature of confirmed incidents of corruption or bribery;
>
> (b) the number of confirmed incidents in which their own workers were dismissed or disciplined for corruption or bribery-related incidents;
>
> (c) the number of confirmed incidents relating to contracts with business

[32] See Annex B, Terms defined in ESRS, "Impact."

[33] GRI 207-1(a)(i).

[34] *Id.* at 207-2(a)(ii).

[35] *Id.* at 207-3 (a) (iii).

[36] ESRS G1, section 24 (published in Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards).

[37] *Id.* at section 25.

> partners that were terminated or not renewed due to violations related to corruption or bribery; and
>
> (d) details of public legal cases regarding corruption or bribery brought against the undertaking and its own workers during the reporting period and the outcomes of such cases. This includes cases that were initiated in previous years where the outcome was only established in the current reporting period.

However, the disclosure only includes the direct involvement of employees[38] in the value chain. Besides these disclosure requirements, ESRS G1-3, section 16, contains an obligation for an enterprise to "provide information about its system to prevent and detect, investigate, and respond to allegations or incidents relating to corruption and bribery including the related training."

ESRS G1-5 Political Influence and Lobbying Activities

According to para. 27 of the ESRS G1:

> The undertaking shall provide information on the activities and commitments related to exerting its political influence, including its lobbying activities related to its material impacts, risks and opportunities.

This includes both financial and in-kind support. The latter, for example, can mean that consultancy work for elected politicians or indirect political contribution is covered, including contributions through intermediary organizations like a lobbyist group or support to think tanks and trade associations.

From a tax perspective, we must again differentiate between impact materiality and financial materiality. Political influence and lobbying activities can affect the environment (inside-out perspective) as well as the business development of a company (outside-in perspective).

Representatives for MNEs often engage in a country's political debates. It is also important to develop effective legislation that allows affected enterprises to contribute during the legislative process. Therefore, it is not per se harmful for enterprises to engage in political exchanges. It would also not be effective if any political engagement of representatives of an MNE shall be disclosed. However, applying ESRS G1-5 could follow the following lines from a tax perspective.

In case of legislation, which is highly important for another sustainability matter, lobbying activities shall be disclosed to the largest extent possible. From a tax perspective this means that, for instance, companies that benefit from low oil prices need to disclose if they have engaged in the political debate on the introduction or amendment of a CO_2 tax. Here, it can relate both to impact but also financial materiality, as such legislation could both harm the environment but also the development of the business.

However, if representatives of an undertaking engage in a debate on changing the general tax code — for example, on reducing the tax rate or introducing a new tax expenditure — we do not see a particular need to disclose this. A disclosure is only necessary if an undertaking benefits in a material manner (compared to other undertakings). Stakeholders should be able to understand if an undertaking has potentially influenced the debate on a sensitive topic for an enterprise. The following are examples of MNEs that should disclose their engagement:

- undertakings within the shipping industry, if a country intends to introduce a tonnage tax for the shipping industry;
- undertakings within the banking industry that are potentially affected if a country intends to introduce a windfall profits tax on the banking industry;
- undertakings of the tax consultancy industry, if a country intends to simplify its tax code (or make it more complex) and this leads to material changes in revenue for the consultancy industry.

If an undertaking is obliged to disclose its lobbying activities, this must include the main positions on these topics and how these interact with the material impacts, risks, and opportunities identified in the materiality

[38] An employee is defined as: "an individual who is in an employment relationship with the undertaking according to national law or practice."

assessment.[39] If the undertaking is registered in a transparency register, the name of that register and the identification number must be disclosed.[40]

Lastly, an undertaking should also disclose if it has retained in an administrative, management, or supervisory capacity an individual who held comparable position in the public administration before joining the undertaking (going back two years).[41]

Tax Behavior as a Tool to Achieve the SDGs

At least in Europe, policymakers have begun decluttering the existing regulation from unnecessary and growth-inhibiting reporting obligations.[42] Moreover, we see that there is significant pressure on governments to cut spending. This raises the question of what tax reporting could look like in the future. There are several options:[43]

The first is to assess the SDG performance of states to see whether the tax payments have had a positive effect. Many argue that tax payments are for the good because governments spend the revenues on education, fighting climate change, or other SDG-related undertakings. However, this approach poses the problem that, if looking at static performance, developed states would outperform developing states and therefore it would be better to pay taxes in the developed world. This is because developed states generally achieve higher ratings for most SDGs.[44] If, however, we look at the relative improvement of the SDG performance, tax payments in states that have already fulfilled most SDGs would receive a poor rating because it is extremely difficult for these states to increase their rating. For example, Finland is rated to have fulfilled the SDGs by over 86 percent and there is not a lot of room to improve, whereas the Democratic Republic of Congo has fulfilled the SDGs by only 48 percent.[45]

The second option focuses on recommendations with a direct, unconditional positive impact on the SDGs, assessed by the performance of companies. As mentioned above, indicators 12.6.1, 16.5.2, 16.6.2, and 17.3.1 could be relevant.

If we design an impact standard for private sector tax matters using these indicators, we must be careful not to enable MNEs to use tax recommendations to offset bad performances in other ESG areas. This is particularly true if we cannot guarantee that the recommendations in the tax area have an unconditionally positive effect on the SDGs.

For example, publishing a tax strategy does not necessarily have a negative impact on the SDGs but it also does not have an unconditionally positive impact. If MNEs receive a more positive ESG rating by publishing a tax strategy, it means they can offset their bad ratings in other areas, like the environment.

Based on the above discussion and with a particular focus on SDG indicator 16.5.2, the following recommendations seem to be an area where an MNE can have an unconditionally positive impact:

- not paying success fees for audit negotiations (i.e., with consultants/tax advisers) in countries with a high level of corruption (success fees increase the risk of corruption);
- extending the supplier code of conduct to tax advisers/legal advisers;
- including in the supplier code of conduct a section on prohibition of corruption and a reporting obligation for bribery attempts;
- not linking employee bonus payments with the ETR of MNEs, because this practice might also increase the risk of corruption; and
- a general reporting obligation for all employees in case of attempts of bribery by tax authorities.

It seems evident that these recommendations would reduce incidents of bribery. Bribery and

39 ESRS G1, *supra* note 36, section 29 (c).

40 *Id*. at section 29 (d).

41 *Id*. at section 30.

42 *See* European Council release, “Budapest Declaration on the New European Competitiveness Deal,” section 4 (Nov. 8, 2024).

43 For a different approach that also considers the weaknesses of the current approach, *see* Vasiliki Koukoulioti, “T for Taxation: The Fourth Pillar in the ESG Framework,” 22 *eJournal of Tax Research* 420, 420-443 (2024).

44 *See* Sustainable Development Report, “Rankings” (last visited Feb. 6, 2025).

45 *Id*.

corruption are key elements of why governments fail to achieve SDGs. This applies to both the developing and developed world.

Importantly, there are many other recommendations that might have a positive effect on the SDGs, but not in an unconditional way. Again, we must be careful not to suggest recommendations that can be misused to achieve higher ESG ratings by not positively affecting SDGs.

Readers might argue these are not progressive recommendations. However, they point to an element that has been forgotten within the ESG debate: the responsibility of governments to achieve the SDGs. Tax is a persuasive example demonstrating the limits of private sector governance.

Conclusions

We are living in extreme but also exciting times. Recent events have shown that we might see seismic shifts in the next weeks and months. We might see a wave of deregulation (or decluttering, to use the more popular term) in the EU as well as the United States. From a tax reporting perspective, this article demonstrates there is room for more effective recommendations and that the focus should be on mitigating corruption as an unconditional improvement toward fulfilling the SDGs. ■