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ESG(T)? Should and can tax performance be a factor in evaluating the ethical, moral and social performance of corporations?

Christina Allen* and Richard Krever**

Abstract

Advocates for greater social responsibility by corporations who support corporate social responsibility or environmental, social and governance standards accounting by large companies increasingly call for tax behaviour to be considered one indicator of desired social behaviour. This advocacy may be based on naivety or a failure to understand the basis of tax avoidance by multinational enterprises. The decision by developed nations to allocate profits of multinational enterprises on the basis of notional arm's length prices effectively endorses and invites companies to shift profits through transfer prices. Since the transactions in question would almost never take place between unrelated companies in a genuine arm's length environment, there can be no comparable for developing an arm's length price. As a result, the law effectively gives companies free rein to nominate arm's length prices that are inherently fictional given the absence of similar transactions outside multinational enterprises. It can be argued, therefore, that it is both unfair and counterproductive to judge companies poorly because they follow the law and accept the invitation inherent in the arm's length system to shift profits and avoid tax. If social responsibility advocates are concerned about tax avoidance by multinational enterprises, they should shift their attention from law-abiding companies to the legislatures and press for replacement of the system for allocating international profits to one that attributes profits to their actual sources based on objective indicators, not an allocation using fictional prices nominated by the companies shifting profits to low-tax jurisdictions.

Keywords: corporate social responsibility, tax avoidance, transfer pricing, environmental, social and governance standards

* Curtin Law School, Curtin University, Perth.
** Law School, University of Western Australia, Perth.

1. WHAT IS THE 'T' IN ESG(T)?

Debate over the intersection of moral obligations and the literal scope of income tax law is as old as the income tax itself. Proponents of narrower readings of taxpayers' obligation to share a portion of revenues with the state that enabled them to realise their profits in the first place[1] often delight in quoting the infamous dicta of leading judges in support of the most constrained responsibility to share profits possible.[2] Proponents of a generous reading of those obligations cite famous dicta supporting the contrary view.[3] Apologists for tax avoidance claim it is inherently ethical[4] while opponents argue it is inherently unethical.[5] The debate has taken new turns in recent years with consideration of the tax obligations of corporations, first in the context of corporate social responsibility (CSR) theory[6] and more recently in terms of environmental, social, and governance (ESG) standards taken into account by investors seeking what they consider to be ethical companies.[7] In particular, a question has been raised as to whether ESG standards should be extended to also include taxation performance, potentially yielding ESG(T) standards. Proponents argue it should be extended in this way to reflect the

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[1] Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2002).

[2] The three most often cited passages may be those of UK jurists Lord Clyde in *Ayrshire Pullman Motor Services and Ritchie v Commissioners of Inland Revenue* (1929) 14 TC 754, 763: 'No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores', Lord Tomlin in *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1, 19-20: 'Every man is entitled if he can to arrange his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be' and US jurist Judge Learned Hand in *Helvering v Gregory* (1934) 69 F 2d 809, 810-811: 'Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes'.

[3] The most famous of these, perhaps, is the comment by Justice Oliver Wendell Holmes, Jr, that became what is possibly the most cited phrase from a dissenting opinion in US tax jurisprudence, 'Taxes are what we pay for civilized society' in *Compañía General de Tabacos de Filipinas v Collector of Internal Revenue*, 275 US 87, 100 (1927).

[4] Lord Houghton, 'The Futility of Taxation by Menaces' in Alfred R Ilersic and Arthur Seldon (eds), *Tax Avoision: The Economic, Legal and Moral Inter-Relationships Between Avoidance and Evasion* (Institute of Economic Affairs, 1979) 89.

[5] Rebecca Prebble and John Prebble, 'Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study' (2010) 55(1) *Saint Louis University Law Journal* 21.

[6] The debate over the relationship between CSR and tax avoidance is reviewed in Shannon Jemiolo and Curtis Fransel, 'Complements, Substitutes or Neither? A Review of the Relation Between Corporate Social Responsibility and Corporate Tax Avoidance' (2023) 45(3) *Journal of Accounting Literature* 474; Grahame R Dowling, 'The Curious Case of Corporate Tax Avoidance: Is It Socially Irresponsible?' (2014) 124(1) *Journal of Business Ethics* 173; Doron Narotzki, 'Corporate Social Responsibility and Taxation: A Chance to Develop the Theory' (2017) 39(4) *Western New England Law Review* 539; Lutz Preuss, 'Tax Avoidance and Corporate Social Responsibility: You Can't Do Both, or Can You?' (2010) 10(4) *Corporate Governance* 365; Burcin Col and Saurin Patel, 'Going to Haven? Corporate Social Responsibility and Tax Avoidance' (2019) 154(4) *Journal of Business Ethics* 1033; Yama Temouri, Giulio Nardella, Chris Jones and Stephen Brammer, 'Haven-Sent? Tax Havens, Corporate Social Irresponsibility and the Dark Side of Family Firm Internationalization' (2022) 33(3) *British Journal of Management* 1447; Prem Sikka, 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance' (2020) 34(3-4) *Accounting Forum* 153; John Hasseldine and Gregory Morris, 'Corporate Social Responsibility and Tax Avoidance: A Comment and Reflection' (2013) 37(1) *Accounting Forum* 1; Prem Sikka, 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance – A Reply to Hasseldine and Morris' (2013) 37(1) *Accounting Forum* 15; Reuven S Avi-Yonah, 'Corporate Social Responsibility and Strategic Tax Behavior' in Wolfgang Schön (ed), *Tax and Corporate Governance* (Springer, 2008) 183.

[7] A wide range of agencies and research and analysis firms provide ESG scores, each using their own methodology to measure performance and each assigning different weightings to the factors considered.

importance of taxation to the maintenance of civil society.[8] The question implicitly rejects the view in some quarters[9] that ESG already reflects tax behaviour through both its social and governance arms.[10]

The three current ESG criteria measure performance not by reference to the legal standards imposed on companies but rather their behaviour above and beyond legal requirements.[11] Environmental consideration, for example, looks at indicators such as company policies regarding climate change, not simply whether the company breaches pollution laws. Social consideration looks at relationships with others in the supply and consumer chain, including employees, not only whether legal contracts are honoured, and governance standards look at a range of corporate management behaviours beyond the strict requirements of the corporate law. Fitting a company's tax performance into this template is challenging. Two possible parameters could be considered, tax transparency – the extent to which a company provides shareholders and the public with details of its tax strategies – and tax payment relative to apparent profitability.

There is little room for evaluation of tax performance in terms of transparency and disclosure. In jurisdictions with tax strategy disclosure systems in place, companies inevitably present their behaviour as immaculate, beginning with an assertion that the company pays all taxes required by law. No tax transparency reports include descriptions of strategies adopted to minimise taxes by way of profit shifting to move profits from parts of a multinational enterprise located in higher-tax jurisdictions to parts located in lower-tax or no-tax jurisdictions.[12]

It is equally challenging to assess companies tax performance in terms of the taxes they paid relative to revenue or apparent profitability. It is simply not possible to pay more tax than that assessed by revenue authorities based on the application of the law. If taxes are minimised by adoption of tax avoidance arrangements – legal reduction of taxes using problematic features of the tax law – the resulting tax liability is the correct tax burden. Moreover, often, a lower tax liability on declared taxable income is the result of socially desirable behaviour. Tax liabilities are lowered for companies that buy the machinery and equipment as promoted by the government and deliberately subsidised by way of accelerated depreciation, credits and other tax concessions. Alternatively, or additionally, they may be reduced again by companies undertaking designated business practices such as engaging in more research and development activities, for which they receive enhanced deductions or tax credits, or adopting better pollution and climate change mitigation practices and equipment, again qualifying for tax subsidies. In all these cases, reduced tax liabilities are likely to equate with laudatory social, environmental and corporate governance behaviour.

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[8] Faith Harako, 'Tax: The Silent T in ESG' (Speech for the 15th International Tax Administration Conference, 5 April 2023) <https://www.ato.gov.au/media-centre/tax-the-silent-t-in-esg>.

[9] Alexander Szívós, 'Sustainability in Finance' (2022) *Regional Law Review* 255.

[10] Conklin and Ceballos consider tax avoidance in the context of 'S' in Michael Conklin and Ruben Ceballos, 'The Ethics of Investing in Cryptocurrencies' (2022) 21 *Florida State University Business Review* 69; Martinho places tax avoidance in 'G' in Sandra Martinho, 'Looking at the "Tax" in ESG through a Sustainable Investor Lens' [2022] (2) *Intergovernmental Organisations In-House Counsel Journal* 29.

[11] See Hasseldine and Morris, above n 6, distinguishing between (legal) tax avoidance and (illegal) tax evasion.

[12] Bronwyn McCredie, Kerrie Sadiq and Richard Krever, 'The Effectiveness of Voluntary Corporate Tax Disclosures: An Australian Case Study' (2021) 36(4) *Australian Tax Forum* 573.

What, then, is the (T) that many would like to see added to the ESG standard? Primarily, it is the tax that would have been paid had profits not been shifted abroad to low- or no-tax jurisdictions before taxable income is calculated. In these tax avoidance transactions, now commonly labelled 'base erosion and profit shifting' (BEPS) arrangements, subsidiaries of multinational companies located in higher-tax jurisdictions shift profits to lower-tax jurisdictions by way of inflated payments to acquire trading stock (inventory) or services (for example, marketing or management services) or to access intellectual property (for example, patents, copyright and other intangible rights) from related companies abroad. As a consequence of BEPS transactions, very large gross revenues in the higher-tax jurisdiction can yield small or even negligible net taxable income, with 'expenses' paid to related companies deducted from gross revenue when calculating taxable income. The tax paid on the amount left in the jurisdiction is likely to be very close, if not equal, to the notional statutory tax rate imposed on corporate taxpayers.

The dilemma faced by tax authorities is that profit shifting by way of transfer prices paid to related parties in low-tax jurisdictions is perfectly legal so long as the taxpayer can demonstrate the payments fall within a reasonable 'arm's length' price range, that is, they are similar to prices that would be paid by unrelated parties undertaking similar transactions. In some cases, authorities that challenge transfer prices secure small adjustments from the prices nominated by taxpayers but even in the most significant victories, companies have been allowed to shift significant profits abroad after adjustments.[13] In other cases, courts have allowed the taxpayer's nominated transfer prices to stand simply because there would never be transactions of the type used in the open market, allowing taxpayers to cherry-pick whatever comparables or transfer pricing methodology they choose to justify their prices.[14]

The inability of revenue authorities to prevent BEPS by disputing transfer prices has led to a host of attempts to stymie profit shifting by other means. One of the most notable of these is the attempt by the European Commission, the executive body for the European Union (EU), to attack competition-distorting profit shifting arrangements within the EU by invoking the prohibition of 'state aid' within the Union to dispute private rulings by complicit jurisdictions that enabled profit shifting from higher-tax jurisdictions. Appeals to the European courts by multinationals such as Apple,[15]

[13] *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation* (2017) 105 ATR 599.
[14] *Federal Commissioner of Taxation v Glencore Investment Pty Ltd* (2020) 112 ATR 378.
[15] *Commission Decision (EU) 2017/1283 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple* [2017] OJ L 187/1. The Commission's decision was annulled by the General Court of the EU in *Ireland and Others v European Commission* (Joined Cases T-778/16 and T-892/16, EU:T:2020:338, 15 July 2020) but the Commission ultimately prevailed before the Court of Justice of the European Union in *European Commission v Ireland and Others* (Case C-465/20 P, ECLI:EU:C:2024:724, 10 September 2024).

Starbucks,[16] Amazon,[17] Nike,[18] and IKEA[19] revealed the state aid path to be of limited assistance, with the Commission losing as often as it won. If anything, the cases showed the futility of central authority administrative efforts to combat profit shifting when the transfer prices used by the multinationals in question were accepted by the countries losing tax revenue as a result of the BEPS transactions.

The frustration of tax administrations is seemingly not shared by legislatures that have endorsed rules allowing multinationals to shift profits at will, provided they can construct a plausible arm's length argument for the prices they nominate. In the face of apparent legislative endorsement of an international tax system that seemingly allows multinational enterprises to shift profits at will, is there a convincing case for ESG-conscious investors to seek different tax performance from socially responsible companies? Put in practical terms, the question might be rephrased to ask whether ESG-conscious investors should expect multinationals not to shift profits in a manner that is accepted and arguably even endorsed by legislatures.

This article seeks to answer that question with a three-pronged investigation. An initial issue is whether ESG evaluators can actually identify the extent to which a company avoids tax. The second issue is whether it is possible to identify what element of company governance might be responsible for tax avoidance. The third issue is whether investors or any other group sees company tax avoidance as undesirable behaviour. If it is not possible for evaluators to identify with a degree of certainty whether a company is avoiding tax, what governance factors or actors facilitate or inhibit tax avoidance, or whether any possible users of ESG evaluations are concerned about the level of tax avoidance in which a company engages, the case for extending ESG to ESG(T) must be very weak.

2. THE CHALLENGE OF IDENTIFYING TAX AVOIDANCE

Only two entities know the true extent of tax minimisation resulting from corporate profit shifting: the companies that shift profits and local tax authorities who collect information on taxpayer payments to associated enterprises. As tax information is confidential and the secrecy is guarded carefully by these two bodies, researchers looking to study the relationship between the views of shareholders, directors and customers need to find a surrogate indicator of tax avoidance. The one settled on by the vast majority of studies is the 'effective tax rate' (ETR) of companies being studied, a measurement that can be calculated by outsiders on the basis of publicly released

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[16] *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks* [2017] OJ L 83/38. The General Court annulled the Commission decision in *The Netherlands v Commission* (Joined Cases T-760/15 and T-636/16, EU:T:2019:669, 24 September 2019) ('*Starbucks*').

[17] *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon* [2018] OJ L153/1. On appeal, the General Court annulled the Commission decision in *Luxembourg, Amazon EU Sàrl and Amazon.com, Inc v European Commission* (Joined Cases T-816/17 and T-318/18, EU:T:2021:252, 12 May 2021). The Commission contested the judgment before the ECJ where its appeal was dismissed in *Commission v Amazon.com and Others* (Case C-457/21 P, EU:C:2023:985, 14 December 2023).

[18] European Commission, 'State Aid: European Commission Opens In-Depth Investigations into Tax Treatment of Nike in the Netherlands' (Press Release, 10 January 2019).

[19] European Commission, 'State Aid: European Commission Opens In-Depth Investigations into the Netherland's Tax Treatment of Inter IKEA' (Press Release, 18 December 2017).

information, at least in the case of companies listed on a stock exchange and thus required to make some financial information available to the general public.

The financial statements used to calculate a company's ETR may yield results quite different from taxable income on which tax is levied. Financial accounting may, for example, allow deductions that are not permitted for tax purposes (for example, for payments for fines or bribes), may allow deductions for commitments not recognised as outgoings for tax periods (for example, for accrued employee leave obligations), may require amortisation and recognition over time of expenses that can be expensed immediately for tax purposes or vice versa, and, in the case of unconsolidated accounts, will allow deductions for payments to related parties in low-tax jurisdictions that are not recognised for tax purposes.

While different terminology is used by different researchers and there are some small variations in the measurement formula, all ETR measurements rely on the same basic calculation. The effective tax rate borne by a company on its actual profits is calculated as the tax paid by the company on its taxable income calculated using the tax law as a percentage of its accounting income, that is, its net profits measured using accounting principles. Where the tax rate on accounting profits is low compared to the tax as a percentage of taxable income, the company is assumed to be engaged in tax avoidance.

Variations of the ETR measurement as a proxy indicator of tax avoidance include adjustments for different financing factors and a measurement that compares the reduction from accounting profits to taxable income as a proportion of the company's assets.

The assumption that a low ETR equates with tax avoidance may be problematic in many cases. While recent international initiatives by the Organisation for Economic Co-operation and Development (OECD) and the European Union have led to much greater access by national tax authorities to the financial accounts income of related entities abroad, and authorities can request consolidated accounts, information gaps remain. And even if full consolidated accounts were available, the ETR of the entire group may be lower than that in any particular country simply as a result of different statutory tax rates in different jurisdictions.

Within a single jurisdiction, at one end of the spectrum, as noted earlier, an ETR lower than the statutory tax rate may actually indicate that a company is adopting policies in line with and encouraged by the government. A company may, for example, deliberately invest in assets for which the government provides accelerated depreciation or even immediate write-offs to encourage greater investment in these assets, engage in subsidised activities such as research and development that attract special enhanced deductions or credits, derive income from transactions that qualify for lower or nil tax rates, or take steps to achieve government goals such as environmental protection or reduced emissions and that qualify for targeted tax expenditures. If the reduction of tax by use of measures positively endorsed and promoted by the government is regarded as a form of tax avoidance, it is 'state-induced avoidance'[20] that arguably should be applauded, not condemned.

[20] Simone de Colle and Ann Marie Bennett, 'State-Induced, Strategic, or Toxic? An Ethical Analysis of Tax Avoidance Practices' (2014) 33(1) *Business and Professional Ethics Journal* 53.

At the other end of the spectrum, depending on the company's accounting practices, a low ETR may indicate serious tax avoidance. For local subsidiaries of multinational enterprises headquartered elsewhere, accounting profits are profits of a company *after* tax avoidance has taken place as all profit shifting payments to affiliates are treated as ordinary deductible business expenses. They thus reduce the profit in the jurisdiction in which the profits were originally sourced and increase the profits in the lower-tax jurisdiction to which they flowed. In a perfectly executed profit shifting arrangement, the company in the higher-tax jurisdiction will have shifted a large portion of its profits to a tax haven and paid tax on the amount left. The ETR of the local subsidiary calculated using the remaining accounting profits will be very close to, if not the same as, the statutory tax rate imposed on taxable income.

The story may be different in the jurisdiction in which the head company of a multinational enterprise is resident. If company law or stock exchange listing rules require the use of the International Financial Reporting Standards (IFRS), the headquarters company will be required to present consolidated accounts of the company and its subsidiaries, including those in low-tax jurisdictions. This could lead to an ETR lower than the statutory rate in the headquarters jurisdiction. However, the IFRS only requires the inclusion of the group's 'controlled' subsidiaries in the consolidated accounts, leaving the company free to ignore subsidiaries owned by sister companies or entities higher up the ownership chain. And, in any case, the ETR based on consolidated accounting profits will differ from the statutory rate even if no transfer pricing takes place if tax rates differ in the jurisdictions in which profits are actually derived (as opposed to the jurisdictions to which profits are transferred). Any study of relationships between independent variables and tax avoidance must be regarded with scepticism if tax avoidance is equated with a low ETR in the study.

Ironically, studies that investigate the attitudes of shareholders, directors and the general public including customers and tax avoidance may be measuring exactly the opposite of what they set out to measure as a result of the flawed proxy for tax avoidance. Companies that the researchers view as tax avoiders are more likely to be those most closely aligning with the government's social and economic objectives by engaging in the activities that qualify for government tax subsidies, recorded in the government's budget documents as 'tax expenditures'. At most, the studies can show a particular group is largely indifferent to tax behaviour or reacts to one measurement of tax behaviour. They can also show connections between various independent variables such as ownership type (including the proportion of institutional, state, family, foreign, managerial and dual equity-owning and debt-owning shareholders) and a measurement of tax avoidance.[21]

Not all studies of factors affecting the views of different parties on corporate tax minimisation use the problematic ETR variations. One alternative is the use of revenue authority audits as a proxy for non-compliance[22] and another is the use of publicly

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[21] Patrick Velte, 'Ownership Structure and Corporate Tax Avoidance: A Structured Literature Review on Archival Research' (2024) 25(3) *Journal of Applied Accounting Research* 696. See also Bryce C Tingle, 'What Do We Know about Shareholders' Potential to Solve Environmental and Social Problems?' (2023) 58(1) *Georgia Law Review* 169, 186.

[22] Lillian F Mills, 'Book-Tax Differences and Internal Revenue Service Adjustments' (1998) 36(2) *Journal of Accounting Research* 343; Lillian F Mills and Richard C Sansing, 'Strategic Tax and Financial Reporting Decisions: Theory and Evidence' (2000) 17(1) *Contemporary Accounting Research* 85, finding audit adjustments increase as book-tax differences increase.

available evidence of tax shelter use, a term denoting arrangements to take advantage of arrangements with no justifiable commercial purpose other than to defer recognition of taxable profits.[23] Other proxies used include tax disputes,[24] tax disclosures in CSR reports,[25] and evidence of corporate connections with affiliates (or head offices) based in tax havens.[26] The vast majority, however, use a version of ETR as the proxy for tax avoidance.

In short, there is no simple way to determine the extent to which a company may be avoiding tax. But without an accurate understanding of a company's level of tax avoidance, it would be impossible to correctly identify their tax behaviour in an ESG context.

3. WHO IS RESPONSIBLE FOR TAX AVOIDANCE?

Companies are artificial entities created in the interest of investors who seek to maximise returns on their invested capital by directing their funds into multi-owner and multi-part enterprises that enjoy synergies and reduced transaction costs which are not available to individual traders.[27] Multinational companies are able to enhance these advantages significantly by extending sales and supply chains globally. In a world yet to extend ESG evaluations to include (T) considerations, it might first be asked who is responsible for a company's tax avoidance. The company itself, of course, has no operating mind but pressure to avoid tax may come from another source – perhaps shareholders, the general public including customers, employees, or company directors, all of whom might, in theory, gain if the company's after-tax earnings were enhanced. The company itself also, again, of course, has no knowledge of tax avoidance schemes. The arrangements themselves must come from external sources, usually professional tax advisors, and be authorised by the board of directors,[28] though it remains a question whether they act in their own interest or at the behest of, or in the interest of, others.

There are, of course, connections between the interests. Directors wishing to retain their positions and remuneration are likely to adopt policies favoured by the shareholders who elect them and shareholders are likely to support policies favoured by customers whose purchases yield the profits shareholders seek. What do these three parties think about companies that pursue or forgo tax minimisation strategies? The answer to that question, as it turns out, has been the subject of a remarkably large number of studies, all of which, unfortunately, start with a severe handicap – the proxy used to identify tax avoidance is as likely to reflect admirable tax compliance as it is morally questionable

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[23] Petro Lisowsky, Leslie Robinson and Andrew Schmidt, 'Do Publicly Disclosed Tax Reserves Tell Us About Privately Disclosed Tax Shelter Activity?' (2013) 51(3) *Journal of Accounting Research* 583, finding public disclosures reflect tax shelter participation disclosed to the IRS.
[24] John R Graham and Alan L Tucker, 'Tax Shelters and Corporate Debt Policy' (2006) 81(3) *Journal of Financial Economics* 563, finding less debt used by corporations engaging in tax sheltering.
[25] Inga Hardeck, Kerry K Inger, Rebekah D Moore and Johannes Schneider, 'The Impact of Tax Avoidance and Environmental Performance on Tax Disclosure in CSR Reports' (2024) 46(1) *Journal of the American Taxation Association* 83.
[26] Petro Lisowsky, 'Seeking Shelter: Empirically Modeling Tax Shelters Using Financial Statement Information' (2010) 85(5) *The Accounting Review* 1693; Preuss, above n 6; Grantley Taylor and Grant Richardson, 'International Corporate Tax Avoidance Practices: Evidence from Australian Firms' (2012) 47(4) *The International Journal of Accounting* 469.
[27] RH Coase, 'The Nature of the Firm' (1937) 4(16) *Economica* 386.
[28] Nubia Evertsson, 'Is the Top Leadership of the Organizations Promoting Tax Avoidance?' (2016) 23(2) *Journal of Financial Crime* 273.

tax avoidance. The links purportedly demonstrated in the studies are therefore as likely to reflect the opposite of what they claim to do as they are to reflect the apparent findings.

At the margin, some studies might best be euphemistically characterised as eccentric – an example being as a study purporting to show a link between tax avoidance and company CEO facial masculinity[29] – but there is no shortage of studies looking for links between tax avoidance behaviour and other company management attributes including the CEO's native language,[30] gender or tenure,[31] pre-career exposure to religion,[32] or a combination of tenure and financial experience.[33] Contrasting studies show there is no apparent relationship between CEO characteristics and tax avoidance.[34] Other studies show that tax avoidance is more likely for larger firms,[35] or when less quantitative data is shown in financial statement footnote disclosures;[36] and less likely when the tone is set by higher executives,[37] when directors have more tax expertise or performance-based incentives,[38] when entrenched managers hold a higher level of shares,[39] or when companies pursue sustainability policies.[40] Studies find that the tenure of individual audit committees and the size of audit committees also matter.[41] The results of more mainstream studies are sufficiently inconsistent to cast doubts about possible links

[29] Iman Harymawan, Nadia Anridho, Adib Minanurohman, Sri Ningsih, Khairul Anuar Kamarudin and Yulianti Raharjo, 'Do More Masculine-Faced CEOs Reflect More Tax Avoidance? Evidence from Indonesia' (2023) 10(1) *Cogent Business and Management* 2171644.
[30] Ke Na and Wenjia Yan, 'Languages and Corporate Tax Avoidance' (2022) 27(1) *Review of Accounting Studies* 148.
[31] Faith Ogagaoghene Obarolo, Mary Josiah and Omimi Ejoor, 'Chief Executive Officer (CEO) Attributes and Tax Avoidance Insight from Listed Non-Financial Firms in Nigeria' (2023) 5(9) *International Journal of Management and Entrepreneurship Research* 718; Ofuan James Ilaboya and Edosa Joshua Aronmwan, 'Chief Executive Officer's Attributes and Tax Avoidance: Evidence from Nigeria' (2023) 20(1) *International Journal of Disclosure and Governance* 99.
[32] Yu Chen, Ruchunyi Fu, Yi Tang and Xiaoping Zhao, 'CEOs' Pre-Career Exposure to Religion and Corporate Tax Avoidance' (2024) *Journal of Management Studies* (advance).
[33] Jiaojiao Qin, Jun Lin and Yan Xin, 'Corporate Tax Avoidance: The Impact of Performance Above Aspiration and CEO Experience' (2023) *Asia Pacific Journal of Management* (advance).
[34] Pieter van der Spuy and Phillip de Jager, 'Corporate Tax Avoidance: Is South African Society Negatively Affected by Chartered Accountant CEOs?' (2023) 119(11/12) *South African Journal of Science* 15549.
[35] Md Shamim Hossain, Md Sobhan Ali, Md Zahidul Islam, Chui Ching Ling and Chorng Yuan Fung, 'Nexus Between Profitability, Firm Size and Leverage and Tax Avoidance: Evidence from an Emerging Economy' (2024) *Asian Review of Accounting* (advance), finding large firms are more likely to engage in tax avoidance activities.
[36] Hanni Liu, 'Tax Aggressiveness and the Proportion of Quantitative Information in Income Tax Footnotes' (2022) 20(2) *Journal of Financial Reporting and Accounting* 352.
[37] Scott D Dyreng, Michelle Hanlon and Edward L Maydew, 'The Effects of Executives on Corporate Tax Avoidance' (2010) 85(4) *The Accounting Review* 1163. See, similarly, Mostafa Monzur Hasan, Gerald J Lobo and Buhui Qui, 'Organizational Capital, Corporate Tax Avoidance, and Firm Value' (2021) 70 *Journal of Corporate Finance* 102050.
[38] Grantley Taylor and Grant Richardson, 'Incentives for Corporate Tax Planning and Reporting: Empirical Evidence from Australia' (2014) 10(1) *Journal of Contemporary Accounting and Economics* 1; Mihir A Desai and Dhammika Dharmapala, 'Corporate Tax Avoidance and High-Powered Incentives' (2006) 79(1) *Journal of Financial Economics* 145.
[39] Ahmed A Sarhan, 'Corporate Social Responsibility and Tax Avoidance: The Effect of Shareholding Structure – Evidence from the UK' (2024) 21(1) *International Journal of Disclosure and Governance* 1.
[40] Patrick Velte, 'Sustainable Institutional Investors, Corporate Sustainability Performance, and Corporate Tax Avoidance: Empirical Evidence for the European Capital Market' (2023) 30(5) *Corporate Social Responsibility and Environmental Management* 2406.
[41] Manon Deslandes, Anne Fortin and Suzanne Landry, 'Audit Committee Characteristics and Tax Aggressiveness' (2020) 35(2) *Managerial Auditing Journal* 272.

between any independent variables and company tax avoidance.[42] It has further been suggested that companies with more foreign directors and more outside members on the board are more likely to avoid tax[43] while those with more women on the board are less likely to do so.[44] Other studies suggest companies with non-controlling large shareholders[45] on the share registers are less likely to avoid tax, results inconsistent with studies that show shareholders have no significant role in determining a company's tax behaviour.[46]

While a high ESG score and appropriate proxies such as high CSR ranking or environmental and sustainability scores may correlate with a greater willingness to pay taxes on profits,[47] the opposite may also be true, with companies using CSR reporting

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[42] See literature reviews in Jemiolo and Farnsel, above n 6; Francesco Scarpa and Silvana Signori, 'Understanding Corporate Tax Responsibility: A Systematic Literature Review' (2023) 14(7) *Sustainability Accounting, Management and Policy Journal* 179; Jost Kovermann and Patrick Velte, 'CSR and Tax Avoidance: A Review of Empirical Research' (2021) 18(2) *Corporate Ownership and Control* 20; Francesco Scarpa and Silvana Signori, 'Ethics of Corporate Taxation: A Systematic Literature Review' in Jacob Dahl Rendtorff (ed), *Handbook of Business Legitimacy: Responsibility, Ethics and Society* (Springer, 2020) 459; Robert B Whait, Katherine L Christ, Eduardo Ortas and Roger L Burritt, 'What Do We Know About Tax Aggressiveness and Corporate Social Responsibility? An Integrative Review' (2018) 204 *Journal of Cleaner Production* 542; Xin Chang, Kangkang Fu, Yaling Jin and Pei Fun Liem, 'Sustainable Finance: ESG/CSR, Firm Value, and Investment Returns' (2022) 51(3) *Asia-Pacific Journal of Financial Studies* 325.

[43] Badar Alshabibi, Shanmuga Pria and Khaled Hussainey, 'Nationality Diversity in Corporate Boards and Tax Avoidance: Evidence from Oman' (2022) 12(3) *Administrative Sciences* 111; Roman Lanis and Grant Richardson, 'The Effect of Board of Director Composition on Corporate Tax Aggressiveness' (2011) 30(1) *Journal of Accounting and Public Policy* 50.

[44] Anis Jarboui, Maali Kachouri Ben Saad and Rakia Riguen, 'Tax Avoidance: Do Board Gender Diversity and Sustainability Performance Make a Difference?' (2020) 27(4) *Journal of Financial Crime* 1389; Riguen Rakia, Maali Kachouri and Anis Jarboui, 'The Moderating Effect of Women Directors on the Relationship Between Corporate Social Responsibility and Corporate Tax Avoidance? Evidence from Malaysia' (2024) 14(1) *Journal of Accounting in Emerging Economies* 1; Anissa Dakhli, 'Do Women on Corporate Boardrooms Have an Impact on Tax Avoidance? The Mediating Role of Corporate Social Responsibility' (2022) 22(4) *Corporate Governance* 821; Avit Tri Laksono and Erna Handayani, 'The Impact of Financial Distress, Women on Boards and Profitability on Corporate Tax Avoidance' (2024) 3(3) *East Asian Journal of Multidisciplinary Research* 999.

[45] Nindhita Nisrina Sari and Siti Nuryanah, 'The Role of Shareholders in Controlling Tax Avoidance: Evidence from ASEAN Countries' (2024) 21(3) *International Journal of Disclosure and Governance* 421.

[46] Dirk Kiesewetter and Johannes Manthey, 'Tax Avoidance, Value Creation and CSR – A European Perspective' (2017) 17(5) *Corporate Governance* 803.

[47] Michael Overesch and Sina Willkomm, 'The Relation Between Corporate Social Responsibility and Profit Shifting of Multinational Enterprises' (2024) *International Tax and Public Finance* (advance); Kaishu Wu, 'Corporate Social Responsibility and Tax Planning: Evidence from the Adoption of Constituency Statutes' (2023) 30 *Advances in Taxation* 71; Lassaad Abdelmoula, Salim Chouaibi and Jamel Chouaibi, 'The Effect of Business Ethics and Governance Score on Tax Avoidance: A European Perspective' (2022) 38(4) *International Journal of Ethics and Systems* 576; Jamel Chouaibi, Matteo Rossi and Nouha Abdessamed, 'The Effect of Corporate Social Responsibility Practices on Tax Avoidance: An Empirical Study in the French Context' (2022) 32(3) *Competitiveness Review* 326; Catriona Lavermicocca and Jenny Buchan, 'Role of Reputational Risk in Tax Decision Making by Large Companies' (2015) 13(1) *eJournal of Tax Research* 5; Silvia Bressan, 'ESG, Taxes, and Profitability of Insurers' (2023) 15(18) *Sustainability* 13937; Mashiyat Tasnia, Syed Musa Syed Jaafar AlHabshi and Romzie Rosman, 'The Impact of Corporate Social Responsibility on Stock Price Volatility of the US Banks: A Moderating Role of Tax' (2021) 19(1) *Journal of Financial Reporting and Accounting* 77; Hongli Jiang, Wenjie Hu and Pengcheng Jiang, 'Does ESG Performance Affect Corporate Tax Avoidance? Evidence from China' (2024) 61 *Finance Research Letters* 105056; Tao Zeng, 'Relationship Between Corporate Social Responsibility and Tax Avoidance: International Evidence' (2019) 15(2) *Social Responsibility Journal* 244; Bohyun Yoon, Jeong-Hwan Lee and Jin-Hyung Cho, 'The Effect of ESG Performance on Tax Avoidance – Evidence from Korea' (2021) 13(12) *Sustainability* 6729; Astrid Rudyanto and Kashan Pirzada, 'The Role

as a cosmetic tool to hedge against any reputation risk arising from tax avoidance.[48] Ultimately companies have to generate after-tax returns for the owners and if more has to be spent attaining higher ESG scores, a simple offset could be paying less tax, leading to a correlation between increased ESG performance (or CSR performance) and increased tax avoidance[49] or increased tax and reduced ESG performance.[50] Similarly, an increase in expenses due to environmental taxes may be associated with greater compensatory tax avoidance,[51] or better remuneration of employees might be offset with increased tax avoidance or, perhaps, reflect the risk premium required by employees to be associated with a firm that engages in tax avoidance.[52] This logic could help explain findings that greater geopolitical tensions that increase risk profiles (regional instability,

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of Sustainability Reporting in Shareholder Perception of Tax Avoidance' (2021) 17(5) *Social Responsibility Journal* 669; Astrid Rudyanto, 'Does Tax Disclosure in Global Reporting Initiative (GRI)-Based Sustainability Reporting Mitigate Aggressive Tax Avoidance? Evidence from a Developing Country' (2024) *Journal of Global Responsibility* (advance); Eduardo Ortas and Isabel Gallego-Álvarez, 'Bridging the Gap Between Corporate Social Responsibility Performance and Tax Aggressiveness: The Moderating Role of National Culture' (2020) 33(4) *Accounting, Auditing and Accountability Journal* 825; Stewart Jones, Max Baker and Ben Forrest Lay, 'The Relationship Between CSR and Tax Avoidance: An International Perspective' (2017) 32(1) *Australian Tax Forum* 95; Kiesewetter and Manthey, above n 46; Jaehong Lee, Suyon Kim and Eunsoo Kim, 'Designation as the Most Admired Firms to the Sustainable Management of Taxes: Evidence from South Korea' (2021) 13(14) *Sustainability* 7994; Luca Menicacci and Lorenzo Simoni, 'Negative Media Coverage of ESG Issues and Corporate Tax Avoidance' (2024) 15(7) *Sustainability Accounting, Management and Policy Journal* 1; Mohammed Benlemlih, Jamil Jaballah, Sholom Schochet and Jonathan Peillex, 'Corporate Social Responsibility and Corporate Tax Avoidance: The Channel Effect of Consumer Awareness' (2023) 50(1-2) *Journal of Business Finance and Accounting* 31; Chun Keung Hoi, Qiang Wu and Hao Zhang, 'Is Corporate Social Responsibility (CSR) Associated with Tax Avoidance? Evidence from Irresponsible CSR Activities' (2013) 88(6) *The Accounting Review* 2025; Roman Lanis and Grant Richardson, 'Is Corporate Social Responsibility Performance Associated with Tax Avoidance?' (2015) 127(2) *Journal of Business Ethics* 439.

[48] Souhir Abid and Saîda Dammak, 'Corporate Social Responsibility and Tax Avoidance: The Case of French Companies' (2022) 20(3/4) *Journal of Financial Reporting and Accounting* 618; Tânia Menezes Montenegro, 'Tax Evasion, Corporate Social Responsibility and National Governance: A Country-Level Study' (2021) 13(20) *Sustainability* 11166; Dylan Minor and John Morgan, 'CSR as Reputation Insurance: *Primum Non Nocere*' (2011) 53(3) *California Management Review* 1; David J Emerson, Ling Yang and Ruilian Xu, 'Investors' Responses to Social Conflict between CSR and Corporate Tax Avoidance' (2020) 19(1) *Journal of International Accounting Research* 57.

[49] Nasir Khan, Ogunleye Oluwasegun Abraham, Adegboye Alex, Damilola Felix Eluyela and Iyoha Francis Odianonsen, 'Corporate Governance, Tax Avoidance, and Corporate Social Responsibility: Evidence of Emerging Market of Nigeria and Frontier Market of Pakistan' (2022) 10(1) *Cogent Economics and Finance* 2080898; Vidiyanna Rizal Putri, Nor Balkish Zakaria, Jamaliah Said and Maz Ainy Abdul Azis, 'Do Foreign Ownership, Executive Incentives, Corporate Social Responsibility Activity and Audit Quality Affect Corporate Tax Avoidance?' (2023) 16(2) *Indian Journal of Corporate Governance* 218; Kadarisman Hidayat and Diana Zuhroh, 'The Impact of Environmental, Social and Governance, Sustainable Financial Performance, Ownership Structure, and Composition of Company Directors on Tax Avoidance: Evidence from Indonesia' (2023) 13(6) *International Journal of Energy Economics and Policy* 311; Ones Amri and Hasna Chaibi, 'The Moderating Role of Tax Avoidance on CSR and Stock Price Volatility for Oil and Gas Firms' (2023) *EuroMed Journal of Business* (advance); Xiang-Yuan Ao, Tze San Ong, Roberto Aprile and Assunta Di Vaio, 'Environmental Uncertainty and Digital Technologies Corporate in Shaping Corporate Green Behavior and Tax Avoidance' (2023) 13 *Scientific Reports* 22170.

[50] Liyuan Meng and Yuchen Zhang, 'Impact of Tax Administration on ESG Performance – A Quasi-Natural Experiment Based on China's Golden Tax Project III' (2023) 15(14) *Sustainability* 10946.

[51] Keyu Lai and Xuming Hu, 'The Influence of Changing Emission Charge into Environmental Tax on Firms' Tax Avoidance' in Jiuping Xu, Fausto Pedro García Márquez, Mohamed Hag Ali Hassan, Gheorghe Duca, Asaf Hajiyev and Fulya Altiparmak (eds), *Proceedings of the Fifteenth International Conference on Management Science and Engineering Management, Vol 1* (Springer, 2021) 775.

[52] Sholom Schochet, Mohammed Benlemlih and Jamil Jaballah, 'Is Corporate Tax Avoidance Related to Employee Treatment?' (2022) 69 *Journal of Empirical Finance* 63.

terrorist attack, coups, climate change territorial clashes, etc) are associated with higher levels of tax avoidance.[53]

In conclusion, it can be seen that the factors of company governance that may encourage or discourage corporate tax minimisation are almost impossible to pin down. Without knowing exactly what explains decisions to engage in tax avoidance, it is difficult to rank a company's tax behaviour.

4. DOES ANYONE CARE ABOUT 'T'?

Whether the general public really cares about corporate tax avoidance is unclear. There are, to be sure, movements by global organisations such as the International Monetary Fund, OECD, United Nations and World Bank Group to promote global tax policies that are less susceptible to international tax avoidance[54] and public interest groups such as the Tax Justice Network[55] as well as international charities such as Oxfam[56] regularly criticise corporate tax avoidance behaviour. But while it may be the case that firms are less likely to pursue aggressive tax avoidance in jurisdictions with high levels of social capital in the sense of shared values and beliefs,[57] there is no convincing evidence that the general public is greatly concerned about the level of corporate tax avoidance.[58] Experience suggests that, to the contrary, negative reactions from social constituencies may be both short-lived and ineffective in terms of long-term corporate behavioural change.[59]

One group that should be interested in corporate tax behaviour is that comprising shareholders, though it is difficult to predict the pressure they might exert. On the one hand, greater avoidance could increase after-tax yields.[60] Alternatively, it could increase the risk of tax authority audits or consumer backlashes, yielding lower profits in the

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[53] Vishnu K Ramesh and A Athira, 'Geopolitical Risk and Corporate Tax Behavior: International Evidence' (2024) 20(2) *International Journal of Managerial Finance* 406; Yingzhao Ni, Zhian Chen, Donghui Li and Shijie Yang, 'Climate Risk and Corporate Tax Avoidance: International Evidence' (2022) 30(2) *Corporate Governance* 189.
[54] Alfio Valsecchi, 'What Corporate Tax Policy Has to Do with Sustainability and How Companies Should Deal with It' (2022) 14(1) *World Tax Journal* 113.
[55] John Hasseldine and Gregory Morris, 'Unacceptable Tax Behaviour and Corporate Responsibility' in Nigar Hashimzade and Yuliya Epifantseva (eds), *The Routledge Companion to Tax Avoidance Research* (Routledge, 2018) 430 ('Unacceptable Tax Behaviour and Corporate Responsibility'); Nathan C Goldman and Christina M Lewellen, 'Ethical Considerations of Corporate Tax Avoidance: Diverging Perspectives from Different Stakeholders' in Eileen Z Taylor and Paul F Williams (eds), *The Routledge Handbook of Accounting Ethics* (Routledge, 2021) 258.
[56] Hasseldine and Morris, 'Unacceptable Tax Behaviour and Corporate Responsibility', above n 55.
[57] Justin Chircop, Michele Fabrizi, Elisabetta Ipino and Antonio Parbonetti, 'Does Social Capital Constrain Firms' Tax Avoidance?' (2018) 14(3) *Social Responsibility Journal* 542.
[58] Lisa Baudot, Joseph A Johnson, Anna Roberts and Robin W Roberts, 'Is Corporate Tax Aggressiveness a Reputation Threat? Corporate Accountability, Corporate Social Responsibility, and Corporate Tax Behavior' (2020) 163(2) *Journal of Business Ethics* 197; John R Graham, Michelle Hanlon, Terry Shevlin and Nemit Shroff, 'Incentives for Tax Planning and Avoidance: Evidence from the Field' (2014) 89(3) *The Accounting Review* 991, finding it difficult to test the relationship between reputational concerns and corporate engagement in tax planning. See further the literature review in Kimberly S Krieg and John Li, 'A Review of Corporate Social Responsibility and Reputational Costs in the Tax Avoidance Literature' (2021) 20(4) *Accounting Perspectives* 477.
[59] See, eg, Jia Lynn Yang, 'The British Want to Stop Starbucks from Dodging Taxes. It Won't Work', *Washington Post* (19 April 2014).
[60] Kumari Juddoo, Issam Malki, Sudha Mathew and Sheeja Sivaprasad, 'An Impact Investment Strategy' (2023) 61(1) *Review of Quantitative Finance and Accounting* 177.

longer term. Complicating the calculation is the possible impact of governance factors on shareholder pressure for lesser or greater avoidance behaviour[61] and the moderating effect of shareholder views on corporate social responsibilities and tax.[62] Not surprisingly, studies that purport to show shareholders' views on tax avoidance as evidenced by changes in share prices following tax avoidance disclosures are at best contradictory. Some studies show tax avoidance correlates with reduction in share values[63] and others with rises in share value.[64] The actual impact remains a mystery, though it is possible it depends on the impact of further independent variables and thus differs in each case.

5. THE FOUNDATIONS FOR TAX AVOIDANCE

There is much about corporate tax avoidance that we know. We know that we do not know whether theoreticians think it is good or bad behaviour. We know that we do not know who is the driving force behind companies' tax behaviour. We know that we do not know whether shareholders think it is good or bad for their companies to avoid tax. What do governments, the destination of taxes that are not avoided, think of the practice? The view of states could help us find an answer to the question of whether investors should consider the tax behaviour of corporations when evaluating companies by reference to ESG standards. If governments decry corporate tax avoidance, the behaviour on its face certainly appears anti-social. If, on the other hand, governments make a show of condemning the behaviour while legislatively facilitating it, it would be reasonable to conclude that legislatures believe tax revenues are secondary to the indirect benefits states derive by hosting corporations, and those evaluating company behaviour should not regard avoidance in negative terms.

A full understanding of legislatures' views on tax avoidance requires a trip back in time, to a century ago when the victorious World War I Allies created the League of Nations, a body intended to establish norms of international behaviour. Among the many issues referred to the body by national governments and international organisations was the question of taxing rights over multinational enterprises. Shortly before, during and after the war, almost all developed economies had adopted company income tax regimes and many shared a twin-pronged tax base design: resident companies were taxed on their worldwide income and non-resident companies on their local-source income. The parallel tax bases posed a dilemma for multinational companies that potentially faced double taxation of foreign-source income, in the home country on the basis of their residency and in the source country on the basis of the income's source.

The problem was soon addressed by way of unilateral responses with most home countries providing credits for foreign income tax levied on foreign-source income or

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[61] Mihir A Desai and Dhammika Dharmapala, 'Corporate Tax Avoidance and Firm Value' (2009) 91(3) *Review of Economics and Statistics* 537.

[62] Ann Boyd Davis, Rebekah D Moore and Timothy J Rupert, 'Corporate Social Responsibility and Tax Management: The Moderating Effect of Beliefs about Corporate Tax Duty' (2022) 44(2) *Journal of the American Taxation Association* 35.

[63] Rustandi Rustandi and Etty Murwaningsari, 'The Effect of Environmental, Social and Governance (ESG) Business Strategy on Tax Aggressiveness with Corporate Social Responsibility (CSR) as a Moderation Variable' (2024) 4(1) *Asian Journal of Management, Entrepreneurship and Social Science* 421; Xudong Chen, Na Hu, Xue Wang and Xiaofei Tang, 'Tax Avoidance and Firm Value: Evidence from China' (2013) 5(1) *Nankai Business Review International* 25.

[64] Mouna Guedrib and Ghazi Marouani, 'The Interactive Impact of Tax Avoidance and Tax Risk on the Firm Value: New Evidence in the Tunisian Context' (2023) 31(2) *Asian Review of Accounting* 203.

exempting the income from resident company taxation if it had been subject to tax abroad.[65] The solution clearly favoured source-country taxation over residence-country taxing rights and capital-exporting nations looked for a mechanism that would create a more even allocation of taxing rights. The Finance Committee of the League of Nations was asked to develop a solution and the proposal of the Committee of Experts appointed to devise a solution was the adoption of a global 'formulary apportionment' system to allocate taxing rights over the profits of a multinational enterprise to all the countries in which it had a presence or customers.[66] The proposed system allocated profits using a three-pronged formula with each jurisdiction receiving taxing rights over a share of a multinational's profits based on their share of the global tangible capital, labour costs and sales destinations of the group. The first two factors measured the two inputs that created goods and services sold by a multinational and the third the necessary output, a buyer willing to pay more than the cost of production.

The proposed system has proved robust – it was adopted in a number of federal jurisdictions with subnational income taxes (the US, Canada and Australia) to allocate profits within the jurisdictions and more recently has been proposed for use within the EU.[67] It was not favoured by all members, however, and separately rejected for use at the international level by the US, the country that sponsored the formation of the League of Nations but ultimately decided not to join the global body. The US, unsurprisingly, preferred a system that favoured the allocation of taxing rights to resident companies, that is capital-exporting nations. Despite the fact that the US was not a member of the League, as the world's leading economic power, it had great sway over economic aspects of the organisation and subsequent to the release of the international taxation recommendation had successfully nominated Thomas S Adams, an American academic, as head of the Fiscal Committee. He in turn appointed an American tax lawyer and advisor to the US government, Mitchell B Carroll, to head an investigation into alternative systems to allocate the profits of a multinational enterprise.

Carroll recommended the adoption of an international profit allocation system now known as the separate entity and arm's length system. Under this system, each part of an enterprise would be regarded as a separate entity unrelated to other parts of the same enterprise except that all transactions between the parts would be treated for tax purposes as having taken place at the arm's length price if that differs from the price nominated by the members of the same enterprise. The arm's length price is the price that unrelated entities would charge for a comparable transaction.

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[65] Mitchell B Carroll, 'Evolution of US Treaties to Avoid Double Taxation of Income Part II' (1968) 3(1) *The International Lawyer* 129.

[66] League of Nations, *Report on Double Taxation Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp*, League of Nations Doc No EFS 73/F 19 (League of Nations, 1923). See further C John Taylor, 'Twilight of the Neanderthals, or Are Bilateral Double Taxation Treaty Networks Sustainable?' (2010) 34(1) *Melbourne University Law Review* 268.

[67] The plan was originally presented as a proposal for a 'Common Consolidated Corporate Tax Base' (CCCTB), which was subsequently modified and reissued as the 'Business in Europe: Framework for Income Taxation (BEFIT)' proposal: European Commission <https://taxation-customs.ec.europa.eu/taxation-1/corporate-taxation/business-europe-framework-income-taxation-befit_en>. The evolution is described in European Parliament, 'Legislative Train Schedule, Common Corporate Tax Base (CCTB)' <https://www.europarl.europa.eu/legislative-train/package-action-plan-on-corporate-taxation/file-common-corporate-tax-base-(cctb)>.

Carroll's proposal prevailed and was incorporated into model bilateral tax treaties published by the League of Nations in various iterations until its dissolution in 1946.[68] Faced with other priorities, the successor to the League, the UN, did not take up the League's tax work and the model treaties remained in a state of limbo until 1963 when the newly formed OECD published a model for member nations based on separate entity, arm's length profit allocation principles. The UN subsequently reviewed the impact of treaties between developing and higher income countries[69] before releasing a manual for negotiating tax treaties in 1979[70] and its own model treaty in 1980.[71] The UN model retained the separate entity, arm's length profit allocation system of the OECD model.

The impact of the choice of allocation system was significant for the ESG(T) debate. The operation of the two systems is best illustrated with an example using, say, a technology company that invests considerable labour costs and capital costs in, say, California, to develop a personal hand-held communications device that is sold worldwide, including in Singapore. The customers buy the device for all the features that were developed in California and under the formulary apportionment tax regime first recommended for the international tax system, taxing rights over the profits would be allocated to California and Singapore. Under the separate entity, arm's length approach, the company could transfer its intellectual property to another (and likely low-tax) jurisdiction and then pay itself to use its only trademark, logo, design, copyright, and so forth. It could also borrow money from itself via a finance arm in a lower-tax jurisdiction and pay itself for different services such as marketing services from a subsidiary notionally located in a lower-tax jurisdiction. The result could be very low taxable profits in California or Singapore and very high profits in a tax haven.

Tax authorities have found it almost impossible to unwind these arrangements for tax purposes. The only tool authorities have is the arm's length price rule, arguing that the subsidiaries or branches in higher-tax jurisdictions paid above the arm's length price for services from the low-tax parts of the enterprise.[72] It is, however, almost impossible to

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[68] Christina Allen, 'Disentangling Taxation Rights Rules in Business Taxation: Tracing the Work of International Organisations' (2022) 28(4) *New Zealand Journal of Taxation Law and Policy* 345; Nikki J Teo, *The United Nations in Global Tax Coordination: Hidden History and Politics* (Cambridge University Press, 2023); Sunita Jogarajan, *Double Taxation and the League of Nations* (Cambridge University Press, 2018).

[69] United Nations, *Tax Treaties Between Developed and Developing Countries: First Report*, UN Doc ST/ECA/110 (1969); United Nations, *Tax Treaties Between Developed and Developing Countries: Second Report*, UN Doc ST/ECA/137 (1970); United Nations, *Tax Treaties Between Developed and Developing Countries: Third Report*, UN Doc ST/ECA/166 (1972); United Nations, *Tax Treaties Between Developed and Developing Countries: Fourth Report*, UN Doc ST/ECA/188 (1973); United Nations, *Tax Treaties Between Developed and Developing Countries: Fifth Report*, UN Doc ST/ESA/18 (1975); United Nations, *Tax Treaties Between Developed and Developing Countries: Sixth Report*, UN Doc ST/ESA/42 (1976); United Nations, *Tax Treaties Between Developed and Developing Countries: Seventh Report*, UN Doc ST/ESA/79 (1978).

[70] United Nations, *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (United Nations, 1979).

[71] United Nations, *Model Double Taxation Convention between Developed and Developing Countries* (United Nations, 1980).

[72] Because profit shifting is consistent with the law provided a plausible arm's length price is offered, it cannot be attacked using conventional general anti-avoidance rules (GAARs). For a description of the role of GAARs, see Judith Freedman, 'United Kingdom' in Michael Lang, Jeffrey Owens, Pasquale Pistone, Alexander Rust, Josef Schuch and Claus Staringer (eds), *GAARs – A Key Element of Tax Systems in the Post-BEPS World* (IBFD Publications, 2016) 741. Australia amended its GAAR to add a 'diverted profits

succeed fully using an arm's length price argument as this requires authorities to show the price used was inconsistent with the price that would have been used by unrelated parties undertaking comparable transactions. By definition, the transactions would only take place within a single enterprise, so there could never be truly comparable transactions. Starbucks does not license unrelated companies to use its logo and name to sell coffee. Nike does not license competitors to allow them to use its Swoosh on their shoes. Apple does not license access to its software to allow third parties to call their phones iPhones.[73] And so on.

Despite the challenges, tax authorities regularly dispute transfer prices nominated by taxpayers and often are able to convince courts to make small adjustments to the transfer prices used by the intragroup parties. Even in their most successful cases, authorities do not stop transfer pricing; at best they reduce the impact slightly.[74] The reality is that the underlying transaction would not have taken place but for the separate entity/arm's length system and any transfer price results in some profit shifting. In this environment, how should ESG proponents evaluate tax behaviour?

6. SHOULD ESG BE EXTENDED TO ESG(T)?

Advocates of ESG evaluations considering an extension of the valuation criteria to include 'T' face a significant initial challenge: no one except the company and to a lesser extent tax authorities know whether a company is avoiding tax. As explained above, the most common proxy for tax avoidance used by researchers appears to be the ETR of companies in higher-tax jurisdictions. This indicator may broadly reflect the tax burden (and tax avoidance) of a multinational enterprise if it is based on comprehensive consolidated accounts of the global reach of the enterprise. Equally, in selected jurisdictions it may reflect positive tax compliance based on adoption of state-induced incentives that align with the local government's social and economic development programs. It is not a useful proxy for ESG(T) purposes.

An apparent alternative source of information is the public tax disclosure statements issued by some companies in some jurisdictions. Unfortunately, however, they tell little beyond the company's narrative of good behaviour.[75] Indeed, the disclosures are as likely as not to exculpate companies if they can, for example, explain away tax haven subsidiaries as legacy holdings inherited in the course of takeovers or past mergers.[76]

In some cases authorities make public the 'country-by-country' reports required by jurisdictions that have enacted local legislation to implement parts of an action plan

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tax' but the provision only catches profit shifts attributable to contrived arrangements and has no application to transfer pricing where a plausible arm's length price is used.

[73] Rachel Brewster, 'Enabling ESG Accountability: Focusing on the Corporate Enterprise' [2022] (6) *Wisconsin Law Review* 1367. This article, discussing ESG accountability from the perspective of corporate enterprise law, starts with two examples of Apple transferring intellectual property and shipping companies incorporating multiple subsidiaries for multiple ships.

[74] See, eg, *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation* (2017) 105 ATR 599, where the Court allowed the taxpayer to deduct intragroup interest payments far above the actual cost to the group of borrowed funds from an external lender.

[75] McCredie, Sadiq and Krever, above n 12.

[76] Vodafone, for example, explains its subsidiaries in jurisdictions identified in various tax avoidance reports as 'legacy' holdings that result from prior acquisitions. See further 'Vodafone, Luxembourg and "Tax Havens"', *Vodafone* (Web Page) <https://www.vodafone.com/about-vodafone/reporting-centre/tax-and-economic-contribution/vodafone-luxembourg-and-tax-havens>.

sponsored by the OECD.[77] While these reports do not provide details of companies' particular profit shifting arrangements, they do contain information on profits derived through low-tax or no-tax jurisdictions and the relative size of those compared to the total profits of the enterprise can be a useful surrogate indicator of tax avoidance. The scope of country-by-country reports is limited, however, and extends to only a small percentage of the world's companies with cross-border arrangements in place.[78]

Identifying companies that avoid tax is just the first step in the evaluation of firms in terms of possible ESG(T) benchmarks. The difficult step is determining whether tax avoidance equates with less ethical, moral or social behaviour. Some of those who advocate most strongly for consideration of tax burdens when evaluating companies' behaviour concede directly or inadvertently that low taxes may be the result of explicit government policies.[79]

To the extent companies take active steps to avoid tax, the most effective and widely used technique is by shifting profits to low-tax jurisdictions by using the international profit allocation rules chosen by the governments of jurisdictions in which they derived their profits. Those governments are well aware of the alternative methodology that could be used to identify the actual source of profits as opposed to the jurisdictions nominated by the companies that minimise their tax burdens but choose not to adopt those systems, even though lower-tier governments in these jurisdictions have adopted the alternative to allocate profits between subnational governments.

In effect, by adopting the separate entity, arm's length system for allocating the global profits of multinational enterprises, governments force companies to nominate the sources of their profits and to arrange internal transactions so they achieve the chosen allocation. How should companies that use the election offered them to reduce tax burdens be judged? Both the policy and letter of the law enable and encourage taxpayers to nominate the source of their profits using whatever criteria the taxpayers choose. Moreover, governments have indicated time and again they have no objection to profit shifting and tax minimisation where the nominated transfer prices used to shift profits fall within their guidelines.[80] If some tax avoidance is state-induced (concessions to

[77] Annet Wanyana Oguttu, 'Curtailing BEPS through Enforcing Corporate Transparency: The Challenges of Implementing Country-by-Country Reporting in Developing Countries and the Case for Making Public Country-by-Country Reporting Mandatory' (2020) 12(1) *World Tax Journal* 167; OECD, 'Country-by-Country Reporting for Tax Purposes' <https://www.oecd.org/en/topics/country-by-country-reporting-for-tax-purposes.html> (accessed 17 October 2024), reporting around 120 jurisdictions have adopted a country-by-country obligation.

[78] Maria Theresia Evers, Ina Meier and Christoph Spengel, 'Country-by-Country Reporting: Tension Between Transparency and Tax Planning' (Centre for European Economic Research Discussion Paper No 17-008, 2016); Michelle Hanlon, 'Country-by-Country Reporting and the International Allocation of Taxing Rights' (2018) 72(4/5) *Bulletin for International Taxation* 209; Felix Hugger, 'The Impact of Country-by-Country Reporting on Corporate Tax Avoidance' (IFO Institute Working Paper 304, 2019); Richard Murphy, Petr Janský and Atul Shah, 'BEPS Policy Failure – The Case of EU Country-by-Country Reporting' [2019] (1) *Nordic Tax Journal* 63.

[79] See, for example, Danielle A Chaim and Gideon Parchomovsky, 'The Missing "T" in ESG' (2024) 77(3) *Vanderbilt Law Review* 789, 792, who cite resources that attribute the doubling of the number of companies in the US that reduced their tax liabilities to zero to deliberate concessional policies legislated by a sympathetic federal government.

[80] Allison Christians, 'How Starbucks Lost Its Social License – and Paid £20 Million to Get It Back' (2013) 71(7) *Tax Notes International* 637.

achieve the state's social or economic objectives), many of the remaining opportunities are state-invited or examples of state acquiescence.

There is logic to evaluating companies by reference to a criterion that has no legal, moral or ethical basis. If governments establish a system that invites companies to arrange their affairs in a way that minimises tax on returns from their investment in capital and workers and the consideration received by consumers happy to acquire the companies' goods and services, the governments must have concluded the welfare gains from investment, employment and consumption exceed the value of the taxes forgone by way of the election offered. ESG evaluators should not second-guess tax policy-makers in respect of this judgment call.