

## ESG and Tax: Don't Be Left Behind

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As environmental, social and governance (ESG) considerations become ever more central to doing business, tax is equally becoming a critical ESG factor. This is evidenced, among other measures, by the increased social interest in taxation, government policies and media scrutiny into whether companies are paying the right amount of tax.

### What is ESG?

ESG is the term that generally supports the proposition that long-term value is created by companies that embed ESG concepts into their strategy. With companies needing to be seen to be taking an active interest in, and having policies that relate to ESG, ESG is now a boardroom agenda item and one with which companies need to actively engage.

### ESG and Corporate Tax

As a response to the increased social interest in the way businesses contribute to the broader community and society we live in, businesses are now expected to set out clear tax policies which align with their ESG commitments and follow them through. Incidentally, these commitments and the actions that bring them to fruition have tax consequences, and tax is playing a pivotal role in these developments. A transparent tax policy can be a strong tool for companies to demonstrate their wider ESG contributions and build public and stakeholder trust.

### ESG and Investors

Institutional investors and private equity investors are now seeing ESG as being critical to their investment decisions. Some institutional investors have started excluding companies from their selection criteria who they perceive to be non-compliant from an ESG and tax transparency point of view. For example, a group of Danish pension funds have developed and signed a Tax Code of Conduct to help support goals of responsible tax behaviour in their investments and through their investment partners. Others, not wishing to be associated with negative media publicity, are publicly divesting from companies that have weak or non-existent tax reporting and tax transparency. Recognition of this trend in social responsibility and tax governance scrutiny is likely to become increasingly important not only to multinational companies, but also to small and medium-sized businesses that are looking to grow and expand through private capital.

### ESG and Government Legislation

As economies change and adapt to match emerging decarbonisation goals, taxation is also becoming an important governmental tool to initiate corporate behavioural changes. For example, alongside other countries, the UK government has introduced a range of taxes, levies and other measures to incentivise businesses to adopt improved environmental and sustainability strategies. Some of these include the:

- Climate Change Levy;
  - Streamlined Energy and Carbon Reporting (SECR) Framework (which replaced the Carbon Reduction Commitment Energy Efficiency (CRC) Scheme);
  - UK Emissions Trading Scheme (UK ETS);
  - increased taxes in relation to the Landfill Tax and Aggregates Levy; and
  - Plastic Packaging Tax (which will come into effect from 1 April 2022).
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Following COP26 in Glasgow last year, the UK government published its “Net-Zero Strategy: Building Back Greener” agenda in which it outlined its green industrial policies to ensure the UK meets its climate change and cleaner energy objectives by 2050. Accordingly, it is likely that further environmental taxes may be announced in the Chancellor’s 2022 Budget or implemented over the next few years, and savvy businesses will start now to prepare how they will adapt and respond to these potential new tax measures.

## ESG and Tax Transparency

Although large companies already have a requirement to consider and publish their tax strategies and be transparent about their tax affairs, there is an increasing shift beyond just being compliant and transparent to seeking to show, for example, why an approach has been adopted and how it connects with the companies’ wider ESG strategies. Furthermore, some small and medium-sized companies, who may not have an obligation to report, are choosing to disclose their approach in order to demonstrate their sustainability and social capital credentials. This approach is reflective of good governance from a morality of tax perspective, but only to the extent that the relevant companies are paying the right amount of tax.

## What Companies Should Do

Due to the increasing shift in ESG considerations, businesses are enhancing their focus on tax risk and tax governance, and ensuring that effective processes and controls are put in place. To this end, ESG needs to start to become an embedded part of any company’s strategy towards tax, and some of the questions that businesses need to ask themselves to help along this path include:

- does their business have a process for identification and implementation of new taxes which will have an impact on the business?
- what is the business’ appetite for tax planning and tax risk?
- has the company done a tax risk statement?
- are the tax risks adequately disclosed in tax returns and other documents? and
- are there voluntary reporting frameworks, such as the Global Reporting Initiative (GRI), that the company should consider reporting under, and what are the tax disclosure requirements under these frameworks?

## Summary

With the global consensus for action against climate change getting stronger by day, the commitments agreed in COP26, and the raft of measures the UK and other western countries are taking or have planned to take to meet their environmental, sustainability and social responsibility obligations, it is likely that ESG will become more prominent over the next few years. Tax will be a critical tool in the development of ESG governmental policies, and to ignore the changes afoot would likely lead to potential operational and reputational damage from adverse publicity and divestment for businesses that haven’t been paying attention.

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## CONTACTS

For more information on ESG considerations and the tax implications, contact your Katten lawyer or either of the following:



**Charlotte Sallabank**  
+44 (0) 20 7776 7630  
[charlotte.sallabank@katten.co.uk](mailto:charlotte.sallabank@katten.co.uk)



**Christy Wilson**  
+44 (0) 20 7770 5241  
[christy.wilson@katten.co.uk](mailto:christy.wilson@katten.co.uk)

*Ugo Onwumelu, a trainee in the Tax practice, contributed to this advisory.*

# Katten

katten.com

Paternoster House, 65 St Paul's Churchyard • London EC4M 8AB

+44 (0) 20 7776 7620 tel • +44 (0) 20 7776 7621 fax

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