

# ESSAYS

## The Missing “T” in ESG

Danielle A. Chaim\*  
Gideon Parchomovsky\*\*

*Environmental, social, and governance (“ESG”) philosophy is the zeitgeist of our time. The rise of ESG investments came against the perceived failure of the government to adequately promote socially important goals. And so, corporations are now being praised and credited for stepping up where the government has fallen short. In this Essay, we contend that the standard narrative of ESG suffers from a major flaw. The reason for this discrepancy is taxes. The companies that are widely perceived as saviors of the ESG era are in fact the cause of some of the main deficiencies ESG seeks to redress. Astoundingly, public corporations—many of which have the highest ESG scores and are the largest recipients of ESG fund investments—are also the biggest tax avoiders. As this Essay shows, through the exploitation of legal loopholes and other grey areas, these companies increasingly deprive governments of the funding needed for the provision of public goods and the promotion of important societal policies, exacerbating administrative inefficiencies and deepening societal inequality—outcomes that are starkly at odds with ESG principles. To address this paradox, this Essay advocates incorporating tax-avoidance behavior into ESG ratings. It also argues that tax considerations should be accorded considerable weight not only by ESG rating agencies but also by institutional investors who shoulder part of the fault for the existing state of affairs. Implementation of this proposal would not only rectify incongruities*

---

\* Assistant Professor, Bar-Ilan University.

\*\* Robert G. Fuller, Jr. Professor of Law, University of Pennsylvania Law School; Wachtel, Lipton, Rosen & Katz Professor of Corporate Law, the Hebrew University Faculty of Law. For valuable comments, we thank Elizabeth Pollman, Zohar Goshen, Adi Libson, and participants at the Harry Radzyner Faculty Seminar, the Environmental Regulation and Sustainability Workshop at Bar-Ilan University, and the Israeli Law, Climate and Sustainability Conference 2023. We are grateful to Itay Flohr and Chisom Nwakama for their excellent research assistance.

*within ESG investment but also provide the public with a more robust and accurate representation of a company's genuine ESG standing.*

INTRODUCTION.....	790
I. THE ESG BLIND SPOT.....	799
A. <i>ESG Ratings</i> .....	801
1. Is Tax Behavior Incorporated into ESG Scores?.....	803
2. How Is Tax Behavior Weighted in ESG Scores?.....	807
B. <i>ESG Funds and Fund Families</i> .....	810
1. ESG Funds' Holdings.....	810
2. Pro Tax-Avoidance Stewardship .....	814
C. <i>Companies' Tax-Related Disclosures</i> .....	824
II. INCORPORATING TAX CONSIDERATIONS INTO ESG RATINGS .....	825
A. <i>Corporate Taxation as an ESG Issue</i> .....	826
B. <i>Redesigning ESG Ratings</i> .....	829
CONCLUSION.....	835
APPENDIX.....	837

## INTRODUCTION

It is difficult to think of a corporate law topic that has attracted as much scholarly attention as environmental, social, and governance (“ESG”) investing.<sup>1</sup> The term “ESG” encompasses a wide spectrum of meanings from the integration of ESG factors into investment analysis to value-laden notions of corporate social responsibility,<sup>2</sup> and many view ESG principles as the only path to a better future.<sup>3</sup> The push for ESG activism stems from the belief that our political system is broken,<sup>4</sup>

---

1. On the history of the term ESG and its main usages, see Elizabeth Pollman, *The Making and Meaning of ESG* (Eur. Corp. Governance Inst., Working Paper No. 659, 2022), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4219857](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4219857) [<https://perma.cc/Z4M2-NQ7H>].

2. *Id.* at 1.

3. See, e.g., Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401 (2020) (describing the effectiveness of ESG investing in promoting social and environmental goals); Michal Barzuzza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020) (arguing that ESG activism by index funds has proven useful in addressing significant ESG concerns such as board diversity and climate change).

4. See, e.g., Jonathan R. Macey, *ESG Investing: Why Here? Why Now?* 11 (Law & Econ. Ctr. at Geo. Mason Univ. Scalia L. Sch., Working Paper No. 22-013, 2021), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3942903](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3942903) [<https://perma.cc/KJL9-4C38>] (“Put

and that the government that has traditionally been responsible for the promotion of the greater good in our society is no longer up to the task.<sup>5</sup> Hence, society must pin its hope for a better future on corporations, expecting them to step into the void left by our dysfunctional government and take over its responsibilities.

This growing belief has been augmented by changes in the capital markets—specifically in the asset management industry—that have ushered new market actors into the ESG arena: large asset management institutions. BlackRock Group, State Street Global Advisors, and Vanguard Group, colloquially known as the “Big Three,”<sup>6</sup> own substantial stakes in most publicly traded corporations and have begun to assume quasi-regulatory functions, pushing their portfolio companies to address ESG issues.<sup>7</sup>

At the risk of a mild exaggeration, it can be said that the ESG literature portrays corporations—and, by extension, institutional investors as their largest shareholders—as modern-day saviors of the world that represent society’s only chance for a better future.<sup>8</sup> In this

---

simply, the ESG movement is radically libertarian. It is an attempt to achieve social, environmental goals in a world in which government is assumed either not to exist or to be completely non-responsive to ESG concerns.”); Dorothy S. Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. 77, 90–92 (2022) (theorizing that demand for regulation has outstripped supply and that regulatory capture ossification and deregulation have weakened the regulatory infrastructure in the United States, which in turn led many to look for solutions in the form of private regulation by asset managers).

5. Lund, *supra* note 4, at 90 (“[T]he traditional levers of the regulatory state—formal and informal rulemaking, in addition to rule enforcement—have come under stress in modern times. Various pathologies have led to the reality that even laws with strong popular support fail to pass or get serious consideration.”).

6. The Big Three are among the world’s top five asset management firms and rank within the top four in the United States. *America’s Top 50 Asset Managers*, ADV RATINGS, <https://www.advratings.com/top-us-asset-managers> (last visited Mar. 7, 2024) [<https://perma.cc/UZ49-SWZN>]; *World’s Top Asset Management Firms*, ADV RATINGS, <https://www.advratings.com/top-asset-management-firms> (last visited Mar. 7, 2024) [<https://perma.cc/4JNX-5KUN>]. All three specialize in passive investing and are increasingly marching in lockstep on a variety of corporate governance issues. See Jackie Cook, *How Can Fund Providers Protect the Future for Worker-Investors?*, MORNINGSTAR (Jan. 9, 2020), <https://www.morningstar.com/articles/961552/how-can-fund-providers-protect-the-future-for-worker-investors> [<https://perma.cc/ZU3R-REYK>] (showing that in 177 separate proposals related to environmental and social issues from the 2019 proxy season, funds owned by the Big Three voted similarly).

7. See Lund, *supra* note 4, at 95–127.

8. See *supra* note 4 and accompanying text. On the role of corporations in promoting ESG goals, see COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD (2019); Martin Lipton, *Stakeholder Capitalism and ESG as Tools for Sustainable Long-Term Value Creation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 11, 2022), <https://corpgov.law.harvard.edu/2022/06/11/stakeholder-capitalism-and-esg-as-tools-for-sustainable-long-term-value-creation/> [<https://perma.cc/SF5B-QQ4G>] (“Stakeholder capitalism recognizes that corporations do not exist in a vacuum, but rather each relies on a multitude of stakeholder contributions and interests from employees, customers, suppliers, communities and, more broadly, society and the environment at large in order to operate effectively and create value.”); and Leo E. Strine, Jr., Response, *Restoration: The Role Stakeholder Governance Must Play in Recreating a*

Essay, we wish to highlight a fundamental problem that has so far evaded scholars and goes to the core of ESG theorizing. We argue that actions undertaken by corporations and large institutional investors—groups that are often perceived as panaceas to governmental shortcomings—have systematically contributed to many of the problems that the ESG movement seeks to address. Not least, these groups may well exacerbate the government’s inability to live up to expectations. The reason for all this? Tax.

An analysis of the tax performance of many U.S. corporations lauded for being the promoters and stewards of ESG goals reveals that they grossly underpay taxes, leading to unprecedented levels of corporate tax avoidance.<sup>9</sup> This tax-avoidance behavior encompasses practices that result in a deliberate decrease in a company’s tax liability by exploiting unintended loopholes in the tax code.<sup>10</sup> This activity resides in a legal grey area; while the law does not expressly forbid such tax-planning strategies—as it does with tax evasion—it does not explicitly condone them either. Therefore, such practices are often seen as breaching the intended spirit of the law.<sup>11</sup>

For decades, the largest and most profitable corporations in the country have found ways to shelter their profits from federal income taxation. Apple, for example, the most valuable public company of all time, for years artificially shifted large amounts of its domestic profits into tax havens.<sup>12</sup> This tax-dodging strategy allowed Apple to avoid

---

*Fair and Sustainable American Economy—A Reply to Professor Rock*, 76 BUS. LAW. 397 (2021), which argues that all business entities of societal significance—public and large private companies—should use their power in a socially responsible manner and be accountable for their treatment of employees, environments, consumers, and society.

9. For example, in the last few years, the number of publicly held companies that successfully zeroed out their federal income taxes has roughly doubled. See Matthew Gardner, Robert S. McIntyre & Richard Phillips, *The 35 Percent Corporate Tax Myth*, INST. ON TAX’N & ECON. POL’Y, at i (Mar. 2017), <https://itop.org/wp-content/uploads/35percentfullreport.pdf> [<https://perma.cc/3HG5-RRLU>]; see also Kathryn Kranhold, *Twice as Many Companies Paying Zero Taxes Under Trump Tax Plan*, NBC NEWS (Apr. 11, 2019, 5:00 AM), <https://www.nbcnews.com/business/taxes/twice-many-companies-paying-zero-taxes-under-trump-tax-plan-n993046> [<https://perma.cc/URC4-88E3>]. Moreover, in at least one tax year over the years 2018–2020, more than seventy companies on the S&P 500, including profitable giants such as Nike, Netflix, and General Motors, paid no federal taxes on an aggregate of over \$200 billion in profits. Matthew Gardner & Steve Wamhoff, *Corporate Tax Avoidance Under the Tax Cuts and Jobs Act*, INST. ON TAX’N & ECON. POL’Y app. at 1–2 (July 2021), [https://itop.sfo2.digitaloceanspaces.com/Corporate-Tax-Avoidance-2018-2020\\_Appendices.pdf](https://itop.sfo2.digitaloceanspaces.com/Corporate-Tax-Avoidance-2018-2020_Appendices.pdf) [<https://perma.cc/V63G-JXXJ>].

10. See, e.g., Eric C. Chaffee, *Collaboration Theory and Corporate Tax Avoidance*, 76 WASH. & LEE L. REV. 93, 95–96 (2019).

11. *Id.*; see also Assaf Likhovski, “*Training in Citizenship*”: *Tax Compliance and Modernity*, 32 LAW & SOC. INQUIRY 665, 691 (2007) (“Tax avoidance . . . is . . . the attempt to follow the letter of the law ignoring the legislator’s intention (or the ‘spirit’ of the law).”).

12. *Fact Sheet: Apple and Tax Avoidance*, INST. ON TAX’N & ECON. POL’Y 1 (Nov. 2017), <https://itop.sfo2.digitaloceanspaces.com/applefactsheet1117.pdf> [<https://perma.cc/C4NX-RRNC>] (finding that between 2008 and 2015, Apple earned \$305 billion before taxes and paid a foreign

paying U.S. taxes on over \$300 billion in profits while also paying very little in foreign taxes.<sup>13</sup> Other profitable tech giants, such as Meta, Netflix, and AT&T paid zero taxes (or less) in at least one of the tax years over the last decade and a half.<sup>14</sup> And, while aggressive tax behavior is common among tech companies,<sup>15</sup> it is certainly not limited to this sector. Many other companies from a broad spectrum of industries are also heavily engaged in tax avoidance. For example, General Motors, Nike, FedEx, and T-Mobile, to name just a few, did not pay any federal income taxes in at least one tax year over the period 2018–2020.<sup>16</sup> According to estimates, tax-avoidance strategies by large multinationals deprive the U.S. government of hundreds of billions of dollars per year (which is about 30% of the U.S. corporate tax revenue),<sup>17</sup> preventing these amounts from ever reaching the public fisc.<sup>18</sup>

---

tax rate of only 5.8%, a tax outcome that was made possible due to the shifting of a large portion of its profits into its three Irish subsidiaries, two of which were structured so that, for tax purposes, they weren't “residents” of either Ireland or the United States, allowing them to pay almost nothing to either country).

13. *Id.*

14. *See, e.g.,* Gardner et al., *supra* note 9, at 5–6. The authors show that 100 out of the 258 companies on the S&P 500 stock index that were consistently profitable over the period 2008–2015 paid zero or less in federal income taxes in at least one year during these years. *Id.* at 4. The list of companies includes leading tech companies such as Netflix and Facebook (now Meta). *Id.* at 5–6.

15. *See* VINCENT DELUARD, STONEX, THE ESG BUBBLE: SAVING THE PLANET, DESTROYING SOCIETIES 4–5 (Feb. 2021), <https://www.politico.com/f/?id=00000177-adf8-d713-a777-edfe93f90000> [<https://perma.cc/J8EH-VW2U>] (explaining that the almost inverse relationship between companies' ESG ratings and their ETRs is attributed to the fact that many high-ESG-rated companies are tech companies that tend to have low ETRs and “can easily arbitrage differences in tax regimes between the many countries they operate in and reduce their tax liabilities via transfer pricing and locating their intangible assets in the most favorable tax jurisdiction”).

16. *See* Gardner & Wamhoff, *supra* note 9; *see also* Gardner et al., *supra* note 9, at ii (“The sectors with the lowest effective corporate tax rates over the eight-year period were Utilities, Gas and Electric (3.1 percent), Industrial Machinery (11.4 percent), Telecommunications (11.5 percent), Oil, Gas, and Pipelines (11.6 percent), and Internet Services and Retailing (15.6 percent).”).

17. *See* Kimberly A. Clausing, *The Revenue Effects of Multinational Firm Income Shifting*, 130 TAX NOTES 1580, 1585 (2011).

18. *The State of Tax Justice 2020: Tax Justice in the Time of COVID-19*, TAX JUST. NETWORK 13 (Nov. 2020), <https://globaltaxjustice.org/wp-content/uploads/2022/08/2020-11-20-Click-here-to-download-it.-EN-PDF.pdf> [<https://perma.cc/9GKV-5YF9>]:

Leading studies on the extent of profit shifting have estimated multinational corporations to be shifting between US \$600 billion to \$1,100 billion a year. That corresponds to around 40 per cent of the profits made abroad by multinational corporations. The corresponding tax revenue losses range from \$90 to \$280 billion a year from direct profit shifting. These manipulations also affect public finances indirectly by fostering a race to the bottom on corporate tax, whereby jurisdictions reduce corporate income tax rates in a typically self-defeating attempt to retain or attract subsidiaries of multinational corporations. These indirect effects (or strategic spillovers) increase the tax revenue losses to \$500 to \$650 billion a year.

Public corporations, however, are not the only responsible parties. As we show, their largest shareholders—asset managers such as the Big Three—shoulder a big part of the blame. According to recent empirical studies, the increased ownership of these broadly diversified investors has causally contributed to higher corporate tax-avoidance levels.<sup>19</sup> This aggressive tax behavior, it appears, sits well with large institutions, and some commentators argue that these investors may actively push for such behavior.<sup>20</sup>

Furthermore, despite their campaigns on various ESG issues, large asset managers have so far abstained from articulating any stance on the matter of corporate tax avoidance. In fact, even when some of their largest portfolio companies were involved in high-profile tax-avoidance cases, they chose to remain silent. More recently, the Big Three and other prominent asset managers voted against shareholder proposals of three giant tech companies—Amazon, Cisco, and Microsoft—to disclose each company’s public country-by-country report (“CbCR”), which contains aggregate data on the global allocation of income, profits, and taxes paid among tax jurisdictions in which the company operates.<sup>21</sup>

These proposals, if accepted, could have relaxed the incentives for the companies to shift profits to low-tax havens.<sup>22</sup> Yet, large institutions did not support the initiatives. Given the broad economic and social implications of corporate tax avoidance, the inclination of asset managers to, at best, tolerate or, at worst, favor the rising levels of aggressive tax behavior reflects the illusory promise of asset managers as ESG regulators.

ESG rating agencies, another important market player in the ESG landscape, further facilitate the detachment of ESG and tax behavior. Despite academic criticisms of ESG ratings,<sup>23</sup> they are

---

(footnote omitted).

19. See *infra* notes 178–182 and accompanying text.

20. See, e.g., Danielle A. Chaim, *The Common Ownership Tax Strategy*, 101 WASH. U. L. REV. 501, 507 (2023) (theorizing that broadly diversified institutional investors push their portfolio companies to simultaneously increase their tax-avoidance levels, thus facilitating a systemic noncompliance strategy called “corporate flooding”).

21. Stephen Foley & Patrick Temple-West, *Companies Pressed to Reveal More About the Taxes They Pay*, FIN. TIMES (Apr. 9, 2023), <https://www.ft.com/content/7a3e5a4b-2025-4f42-834b-22dfa8bc281e> [<https://perma.cc/5V63-WSQH>].

22. See *infra* notes 162–163 and accompanying text.

23. See, e.g., David F. Larcker, Lukasz Pomorski, Brian Tayan & Edward M. Watts, *ESG Ratings: A Compass Without Direction*, STAN. CLOSER LOOK SERIES 2–3 (Aug. 2, 2022), [https://www.gsb.stanford.edu/sites/default/files/publication/pdfs/cgri-closer-look-97-esg-ratings\\_0.pdf](https://www.gsb.stanford.edu/sites/default/files/publication/pdfs/cgri-closer-look-97-esg-ratings_0.pdf) [<https://perma.cc/D9WK-Q92T>] (arguing that the effectiveness of ESG ratings in predicting investment risk or returns, as well as their ability to anticipate improvements in stakeholder outcomes, is uncertain).

immensely influential in the real world and often inform investment decisions by individual and institutional investors.<sup>24</sup> In this Essay, we scrutinize the methodologies and scoring systems utilized by five prominent ESG rating agencies, with a specific focus on how they integrate tax-related factors into their evaluations.<sup>25</sup> Our analysis reveals many rating agencies do not include tax-related metrics in their scoring systems.<sup>26</sup> Even those ESG ratings that do consider the tax behavior of a company fail to properly “sanction” companies that pay a low Effective Tax Rate (“ETR”) by reflecting their adverse tax practices in the rankings. To put it differently, a company’s direct involvement in tax avoidance does not materially affect its ESG rating.<sup>27</sup> Moreover, the reference to taxes in the ESG scoring systems of most agencies is placed within the G component of ESG (to take into account potential tax management and governance risks) rather than the S component, suggesting that the broad social and economic consequences of corporate tax avoidance are not reflected in ESG scores.<sup>28</sup>

To further substantiate our assertion concerning the tenuous link between corporate tax avoidance and ESG scores, we also examine the ESG scores of S&P 500 firms that displayed particularly aggressive tax-avoidance behaviors—specifically, those which paid no federal income taxes in 2020.<sup>29</sup> Our findings indicate that these firms received relatively high ESG scores by most agencies.<sup>30</sup> These disturbing findings are in line with a recent study showing that companies that received the highest ESG scores by MSCI, one of the world’s leading ESG rating agencies, pay a much lower tax rate than their peers.<sup>31</sup> In fact, the study unveils a striking inverse relationship between a company’s ESG scores and its ETR: CCC-rated companies (the ones with the lowest ESG rating) pay an average ETR of 27%, which is almost double the rate paid by the highest-rated group, AAA.<sup>32</sup>

The very limited emphasis placed on tax-avoidance behavior within the context of ESG can explain why the upswing in demand for ESG investments, which should have led to a better society, did not live

---

24. See, e.g., Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence from a Global Survey*, 74 FIN. ANALYSTS J. 87 (2018).

25. See *infra* Subsection I.A.1.

26. See *infra* Subsection I.A.1.

27. See *infra* Subsection I.A.1. As we explain, among a couple of ESG rating agencies, to the extent that tax avoidance suggests potential illegal activity, it may lead to a score reduction after all.

28. See *infra* notes 74–76 and accompanying text.

29. See *infra* Subsection I.A.2.

30. See *infra* Subsection I.A.2.

31. See, e.g., DELUARD, *supra* note 15, at 4.

32. *Id.*

up to expectations.<sup>33</sup> In fact, ESG's rising domination of our capital markets has, according to a recent report, indirectly resulted in increased inequality.<sup>34</sup>

The current state of affairs can be best described as a paradox. Corporations and large asset managers are called upon to help solve the very problem they create. Taxes are the lifeblood of any government. When corporations fail to pay their fair share of taxes, societies suffer. Governments must face the difficult choice between putting up with rising deficits and lowering spending on the common good and increasing taxes on other taxpayers to compensate for the lost income. Moreover, a growing body of literature identifies a link between tax avoidance and inequality,<sup>35</sup> one of the issues that ESG-focused investment strives to address. Worse yet, corporations and asset managers receive credit and get to bask in the public glow for making contributions to ESG policies, while at the same time making it very hard for the government to promote many of these goals itself.

When governments are deprived of astronomical amounts of income tax revenue, their ability to craft, enforce, and regulate ESG policies is limited. The government's capacity to effectively address pressing issues like climate change, poverty, and consumer harm is thus significantly curtailed.<sup>36</sup> Indeed, concerns regarding the significant costs associated with initiatives targeting poverty reduction or greenhouse gas emissions mitigation, and their potential impact on

---

33. See, e.g., Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2566–69 (2021) (explaining why the corporate social responsibility movement transformed into shareholder value-oriented ESG approach and arguing that without a major paradigm shift in institutional gatekeepers' orientation, advocacy pushing corporations to consider the interests of stakeholders and the environment will likely fail); Lucian A. Bebchuk & Roberto Tallarita, *Will Corporations Deliver Value to All Stakeholders?*, 75 VAND. L. REV. 1031, 1032, 1035 (2022) (finding that the Business Roundtable 2019's Statement did not bring nor intend to bring any material changes in how they treat stakeholders).

34. See, e.g., DELUARD, *supra* note 15, at 7 (showing that by investing more money in large, wealthy companies, ESG funds are "unconsciously worsening the social and political crisis associated with automation, inequality, and monopolistic concentration").

35. See, e.g., Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data* (Nat'l Bureau of Econ. Rsch., Working Paper No. 20625, 2014), <https://www.nber.org/papers/w20625> [<https://perma.cc/98JR-RZ4N>]; Annette Alstadsæter, Niels Johannesen & Gabriel Zucman, *Tax Evasion and Inequality* (Nat'l Bureau of Econ. Rsch., Working Paper No. 23772, 2017), <https://www.nber.org/papers/w23772> [<https://perma.cc/4CCS-B5HK>]; Frederik Heitmüller, Moran Harari & Markus Meinzer, *Tax Administrations' Capacity in Preventing Tax Evasion and Tax Avoidance*, COFFERS (Oct. 2018), <https://ssrn.com/abstract=3300589> [<https://perma.cc/TAJ5-4RAY>]; Ute Schmiel & Anna-Lena Scherer, *Inequality and Taxation of Multinational Corporate Groups* (Copenhagen Bus. Sch., CBS L. Rsch Paper No. 20-19, 2020), <https://ssrn.com/abstract=3678145> [<https://perma.cc/ZX5M-4AAW>].

36. See, e.g., Michael P. Klain & Leo E. Strine, Jr., *Stakeholder Capitalism's Greatest Challenge: Reshaping a Public Consensus to Govern a Global Economy* (U. Pa. Inst. for L. & Econ., Rsch. Paper No. 23-24, 2023), <https://ssrn.com/abstract=4502705> [<https://perma.cc/U57U-2GTA>].

budget deficits, have hindered the implementation of these crucial programs.<sup>37</sup> This, in turn, holds governments back from building better, more prosperous, sustainable societies. Under these circumstances, a vicious cycle is created: the more corporations avoid paying taxes, the less capable the government is at promoting ESG goals. And, as government competence lessens, our expectations of corporations and their largest institutional shareholders increase.

To fix the problem and break the vicious cycle, we propose implementing changes on three different fronts.<sup>38</sup> First, we advocate for public disclosure of tax-related information among publicly traded companies. In particular, a CbCR should become mandatory for all U.S. public companies. As policymakers, scholars, and international organizations have already acknowledged, such a disclosure is likely to prove extremely useful in disincentivizing large multinationals from engaging in tax avoidance.<sup>39</sup> Moreover, corporations should publicly state if and how their tax behavior reflects their commitment to ESG values.

Next, we turn to asset managers. These key market actors must explicitly state their commitment to responsible tax behavior in their corporate guidelines. Not least, prominent asset managers should classify public CbCR as a best practice and urge companies to provide such disclosure. Given the significance public corporations attach to the annual guidelines issued by the largest institutional investors, which are often viewed as an important passive-governance tool,<sup>40</sup> such acts would have a profound positive effect on corporate tax behavior.

We also think that asset managers should engage with portfolio companies that consistently pay a low ETR or companies that have been involved in high-profile tax-avoidance cases and should implore corporate management to take concrete actions to improve tax compliance. The fact that large institutional investors currently choose

---

37. See, e.g., Paul Krugman, *On Very Serious People, Climate, and Children*, N.Y. TIMES (Oct. 4, 2021), <https://www.nytimes.com/2021/10/04/opinion/budget-deficits-climate-child-poverty.html> [<https://perma.cc/ZA6C-4MFY>].

38. See discussion *infra* Section II.B.

39. For example, in its letter supporting mandatory CbCR disclosure in the European Union, the United Nations’ Principles for Responsible Investment (“U.N. PRI”) expressed the view that “this policy measure is timely given the EU proposal for a new Corporate Sustainability Reporting Directive (CSRD), and vital to strengthen tax transparency and accountability while reducing the prevalence of tax avoidance practices that continue to challenge global economies and their pursuit of sustainability goals.” Letter from Fiona Reynolds, CEO, Principles for Responsible Inv., to Ms. Regner, Rapporteur, Legal Affs., Eur. Parliament & Mr Garcia del Blanco, Rapporteur, Econ. & Monetary Affs., Eur. Parliament 1 (May 26, 2021), [https://dwtyzx6upklss.cloudfront.net/Uploads/u/m/t/investorsignonletteronpubliccbr\\_signatories\\_final\\_758353.pdf](https://dwtyzx6upklss.cloudfront.net/Uploads/u/m/t/investorsignonletteronpubliccbr_signatories_final_758353.pdf) [<https://perma.cc/4A2Q-Y2FL>] (footnote omitted); see also *infra* notes 162–163 and accompanying text.

40. See *infra* note 168 and accompanying text.

to stay silent on the issue of tax avoidance—and, in some cases, even unequivocally renounce any prerogative regarding corporate tax practices, as BlackRock recently did<sup>41</sup>—allows them to enjoy both worlds. On the one hand, they proclaim to integrate ESG considerations into their investment decisions to attract investors. On the other hand, they enjoy the high returns resulting from the aggressive tax practices of their portfolio companies, practices that could be perceived as conflicting with their institutions' socially responsible commitments. As we explain, by taking a passive approach toward the pressing issue of corporate tax avoidance, institutional investors are signaling their implicit support for this behavior.<sup>42</sup> To encourage a more proactive approach, we also propose that institutional investors divest from companies whose tax behavior falls below industry peers.

Finally, the third facet demanding attention pertains to the role of ESG rating agencies in addressing the tax blind spot of ESG. In keeping with the goals of ESG, we call for a broader incorporation of tax behavior into ESG ratings. As noted, at present, the mere involvement of a company in aggressive tax behavior would very rarely (and minimally) affect its ESG score.<sup>43</sup> We therefore contend that corporations must be directly evaluated based on their ETR. For example, corporations whose ETR is close to the statutory rate and who display high levels of tax compliance should receive a perfect score in the tax-avoidance metric, and vice versa. Moreover, the agencies should be transparent about the weight they assign to tax considerations when generating a company's ESG score.

Before proceeding, we would like to emphasize two points. First, we do not argue that corporate tax-avoidance practices that allow companies to lower their ETRs are illegal. As we explain below, tax avoidance encompasses a wide variety of tax-planning strategies with varying degrees of legal legitimacy. However, while tax avoidance can be lawful, it very often involves the exploitation of legal loopholes in a manner that contradicts the spirit of the tax laws and is therefore often considered to be ethically dubious. Our argument is different: even if corporations are entitled to lower their tax liability within the limits of the law, that decision should be reflected in their ESG rating, similar to other choices they make. Companies should know that their decision to engage in tax avoidance comes with an ESG price tag. The point and purpose of the ESG movement is to reward corporations that promote

---

41. See *infra* note 174 and accompanying text.

42. See *infra* Section I.B.

43. See *infra* Section I.A.

important social and sustainability goals,<sup>44</sup> not to reward corporations for not breaking the law. That corporations must abide by the law is trivial. Thus, only ESG evaluation systems that include tax behavior can reflect the true ESG profile of firms.

Second, it is critical for us to emphasize that we do not challenge or even question the importance of ESG values or the role of corporations and asset management institutions in their promotion. We wholeheartedly endorse the idea that corporations should play an active role in securing a better future for our society. We accept the premise that the government cannot attain this goal on its own. The political process suffers from many imperfections and limitations. Corporations and other private actors are indeed capable of remedying many of the government’s failures. That said, the forces that shape decisionmaking in public corporations and the distorted preferences of their largest institutional shareholders—which can be inferred from the tax behavior of such corporations—are also imperfect. Furthermore, corporations lack the broad perspective that the government has. As a result, if the promotion of ESG goals is left solely to corporations, many important issues will be left unaddressed. For this reason, keeping the government in the ESG arena is imperative. Only a policy that draws on the respective advantages of the government, on the one hand, and corporations, on the other, is liable to produce an optimal framework for promoting ESG values.

This Essay proceeds as follows. Part I unveils the various tax-related blind spots in the ESG discourse. It shows that despite the theoretical clash between the values promoted by the ESG movement and the societal impacts of tax behavior, three important market actors in the ESG arena—public corporations, institutional investors, and ESG rating agencies—virtually disregard corporate tax payments as a component within the ESG framework. Part II begins by demonstrating that corporate tax payments constitute a sustainability issue. It then develops a policy reform that would dramatically alter the approach of corporations, institutional investors, and rating agencies to the issue of taxes. A short conclusion ensues.

## I. THE ESG BLIND SPOT

Recent years have seen a sea of change in the public attitude toward corporate tax behavior. Increased social interest in the tax

---

44. See, e.g., Catherine Brock, *What Is ESG Investing & What Are ESG Stocks?*, MOTLEY FOOL, <https://www.fool.com/investing/stock-market/types-of-stocks/esg-investing/> (last updated Jan. 12, 2024, 1:19 PM) [<https://perma.cc/LV7N-F2QY>]. On the different *supra* definitions of the term ESG, see Pollman, *supra* note 1, at 3.

affairs of well-known multinationals and media scrutiny of dubious tax-planning practices, such as the use of tax shelters and insidious accounting practices to avoid income taxes, have pushed corporate tax avoidance to the fore of public debate.<sup>45</sup> The growing public perception—largely bolstered by the mounting body of evidence on the adverse economic and societal impacts of tax avoidance—is that a company’s tax behavior serves as a powerful indicator of how the business views its role in society and supports the communities in which it operates and the stakeholders with whom it engages.<sup>46</sup>

Over a broadly similar period, the ESG movement has gained significant momentum. Driven by investors’ desire to generate societal and environmental improvements along with financial returns, ESG investment has emerged as the fastest-growing segment of the asset management industry.<sup>47</sup> Today, more than half of the investors in capital markets invest in ESG products, representing assets worth approximately \$34 trillion.<sup>48</sup> These individuals seek to align their investments with ethical values and promote more sustainable business practices by the corporations in which they invest.<sup>49</sup>

Despite the apparent congruence between the social responsibility perspective of corporate tax avoidance and ESG values, the current ESG discourse fails to recognize the significance of corporate tax payments as a crucial component within the ESG framework. As this Part shows, ESG rating agencies tend to overlook tax avoidance in their evaluation of companies’ ESG profiles; institutional investors are remarkably tolerant of aggressive tax planning (and to some extent may even encourage it); and the great majority of public companies, many of which tout their ESG credentials, rarely communicate their tax approach and payments to stakeholders. Thus, and somewhat ironically, the same market players who claim to promote sustainable behavior actually display high levels of corporate tax avoidance.

---

45. See *supra* note 12 and accompanying text; *infra* notes 109–119 and accompanying text.

46. See *infra* Section II.A.

47. Harriet Agnew, Adrienne Klasa & Simon Mundy, *How ESG Investing Came to a Reckoning*, FIN. TIMES (June 5, 2022), <https://www.ft.com/content/5ec1dfcf-eea3-42af-aea2-19d739ef8a55> [https://perma.cc/7NEA-HFMK].

48. *ESG-Focused Institutional Investment Seen Soaring 84% to US \$33.9 Trillion in 2026, Making up 21.5% of Assets Under Management: PwC Report*, PWC (Oct. 10, 2022), <https://www.pwc.com/gx/en/news-room/press-releases/2022/awm-revolution-2022-report.html> [https://perma.cc/L25S-6C97] [hereinafter *PwC Report*].

49. Sharon Hannes, Adi Libson & Gideon Parchomovsky, *The ESG Gap* 2–3 (U Pa. Inst. for L. & Econ., Rsch. Paper No. 23-22, 2022), <https://ssrn.com/abstract=4293914> [https://perma.cc/CW38-JAFN].

### A. ESG Ratings

In the past decade, there has been an exponential increase in the demand for ESG information.<sup>50</sup> Public and professional attention has significantly shifted toward assessing companies’ ESG practices and policies. Addressing this growing demand, various market actors have emerged as key players in providing ESG-related information, with ESG rating agencies and data providers taking the lead.<sup>51</sup>

ESG rating agencies are private firms that specialize in evaluating and scoring the ESG performance of companies, states, and organizations. Within the ESG rating industry, there are a multitude of agencies, among which MSCI, Sustainalytics, FTSE Russell, ISS, and Refinitiv hold significant prominence.<sup>52</sup> Each agency employs its own distinctive methodology to evaluate companies’ ESG performance. The resulting ratings are commonly presented through a letter or numeric grading system, which denotes a company’s ESG risk or performance. For instance, MSCI utilizes a seven-point scale ranging from AAA (highest) to CCC (lowest) to assess ESG performance.<sup>53</sup> These ratings “aim to measure a company’s resilience to long-term, financially relevant ESG risks.”<sup>54</sup> Others, such as Sustainalytics, categorize ESG risk ratings across five risk levels, which range from 0 (negligible risk) to 40+ (severe risk), to measure how a company’s economic value may be at risk due to ESG factors.<sup>55</sup> These varying approaches to rating

---

50. See *PwC Report, supra* note 48; see also Saijel Kishan, *ESG by the Numbers: Sustainable Investing Set Records in 2021*, BLOOMBERG (Feb. 3, 2022), <https://www.bnnbloomberg.ca/esg-by-the-numbers-sustainable-investing-set-records-in-2021-1.1717971> [<https://perma.cc/LMA4-BWZJ>] (discussing the numerics behind ESGs).

51. A 2020 survey conducted by SustainAbility found that ESG ratings are the primary source of information that institutional investors commonly rely on to evaluate the environmental, social, and governance performance of companies. See CHRISTINA WONG & ERIKA PETROY, SUSTAINABILITY, RATE THE RATERS 2020: INVESTOR SURVEY AND INTERVIEW RESULTS 17 (Mar. 2020), <https://www.sustainability.com/globalassets/sustainability.com/thinking/pdfs/sustainability-ratetheraters2020-report.pdf> [<https://perma.cc/8JSG-7CGS>]. The survey revealed that 65% of investors surveyed use ESG ratings at least once a week. *Id.* at 18.

52. Larcker et al., *supra* note 23, at 4.

53. *ESG Ratings Methodology*, MSCI 5 (June 2023), <https://www.msci.com/documents/1296102/34424357/MSCI+ESG+Ratings+Methodology+%28002%29.pdf> [<https://perma.cc/8MP4-MUHQ>].

54. *Id.*

55. Aymen Karoui, Liam Zerter, Piotr Podgorny, Stéphane Alloiteau, Elpida Louka & Marie Gausseron, *ESG Risk Ratings: A 360° Review*, MORNINGSTAR 7 (June 2023), [https://connect.sustainalytics.com/hubfs/INV/Ebooks/ESG%20Risk%20Ratings%20-%20360%20Report%20eBook/MS\\_ESG\\_RR\\_360\\_Review\\_Ebook\\_Final.pdf](https://connect.sustainalytics.com/hubfs/INV/Ebooks/ESG%20Risk%20Ratings%20-%20360%20Report%20eBook/MS_ESG_RR_360_Review_Ebook_Final.pdf) [<https://perma.cc/4R6M-DP5W>].

methodologies add to the diversity within the ESG rating landscape and can explain the variance in ESG evaluations.<sup>56</sup>

ESG scores can take either an absolute or industry-relative approach, depending on the rating agency. In an absolute scoring system, companies are evaluated based on specific ESG criteria and assigned scores that reflect their performance against those criteria. ESG scores are absolute in nature if they solely represent the company's performance on each individual criterion, regardless of how other companies in the market or the relevant industry are performing.<sup>57</sup> In contrast, a relative scoring system assesses companies by comparing their performance to that of their peers,<sup>58</sup> providing a benchmark for evaluating ESG performance within specific sectors.

ESG scores play a pivotal role in facilitating comparisons among companies, serving as a valuable tool for investors by allowing them to identify and assess ESG risks and opportunities within their investment portfolios. By utilizing ESG scores, investors can make well-informed decisions that align with their ESG objectives. Additionally, the heightened scrutiny of companies' ESG practices has resulted in companies proactively managing and improving their ESG profiles to align with evolving stakeholder expectations.<sup>59</sup>

Given the paramount importance of ESG ratings in today's capital markets, it becomes crucial to comprehend the influence of tax practices on a company's ESG score. In the remainder of this Section, we focus on the five most prominent rating agencies in the ESG rating industry<sup>60</sup> and examine their evaluation and scoring systems. This inquiry is designed to address two fundamental questions: First, does the payment of corporate taxes factor into a company's ESG score? Second, if it does, how is it weighted within the overall assessment framework? In seeking to answer these questions, we aim to shed light on the treatment of tax-avoidance factors within the ESG rating landscape.

---

56. On such diversity and its consequences, see, for example, Larcker et al., *supra* note 23, at 2–3.

57. *Id.* at 3–4.

58. *Id.*

59. See, e.g., Rochelle Toplensky, *Corporate Sustainability Becomes a Team Sport*, WALL ST. J. PRO (Mar. 15, 2023, 12:26 PM), <https://www.wsj.com/articles/corporate-sustainability-becomes-a-team-sport-e7c5534c> [<https://perma.cc/U8AN-BZQJ>].

60. See Larcker et al., *supra* note 23, at 2–3 (providing a list of the five ESG ratings firms that are frequently utilized in the creation of ESG funds and are referenced in the media, which reflect the same ESG rating agencies on which we focus).

## 1. Is Tax Behavior Incorporated into ESG Scores?

ESG rating agencies typically assess a company’s ESG performance by examining three distinct domains: environmental (“E”), social (“S”), and governance (“G”). The environmental aspect focuses on a company’s impact on the natural environment, including its initiatives to mitigate carbon emissions, conserve water resources, and enhance energy efficiency.<sup>61</sup> The social dimension evaluates a company’s influence on and perception within society, taking into account factors such as diversity and inclusion practices, human rights policies, and community involvement.<sup>62</sup> Finally, the governance component scrutinizes a company’s leadership, management practices, and oversight mechanisms, encompassing elements like board structure, executive compensation, and transparency in decision-making.<sup>63</sup>

ESG rating agencies employ a proprietary methodology to determine an aggregate ESG score by assigning weights to and consolidating multiple factors, the number and nature of which differ across rating agencies. For instance, the ESG scoring system of FTSE Russell incorporates more than 300 distinct indicator assessments tailored to each company’s specific circumstances to calculate an absolute score.<sup>64</sup> Refinitiv utilizes over 600 company-level ESG measures to assess relative ESG performance while considering the company’s specific sector as well as its country of incorporation.<sup>65</sup> Sustainalytics’s scoring system is comprised of a quantitative score and a risk category; both consider more than 250 ESG indicators.<sup>66</sup> The quantitative score represents the level of unmanaged ESG risk, which is measured on an open-ended scale ranging from zero to fifty.<sup>67</sup> Based

---

61. See, e.g., MSCI, *supra* note 53, at 7–9 (listing themes that are encapsulated by the environmental aspect); *Understanding the “E” in ESG*, S&P GLOB. (Oct. 23, 2019), <https://www.spglobal.com/en/research-insights/articles/understanding-the-e-in-esg> [<https://perma.cc/9K GK-6B7C>] (pinpointing the different considerations taken into account when evaluating the E component).

62. See, e.g., MSCI, *supra* note 53, at 6; Cole Horton, *Explainer: What Is the ‘S’ in ESG Investing?*, REUTERS, <https://www.reuters.com/business/sustainable-business/what-is-s-esg-investing-2022-07-19/> (last updated July 19, 2022, 10:16 AM) [<https://perma.cc/NA7W-H8HR>].

63. See, e.g., MSCI, *supra* note 53, at 10; *Environmental, Social and Governance Scores from Refinitiv*, REFINITIV 10 (May 2022), [https://www.refinitiv.com/content/dam/marketing/en\\_us/documents/methodology/refinitiv-esg-scores-methodology.pdf](https://www.refinitiv.com/content/dam/marketing/en_us/documents/methodology/refinitiv-esg-scores-methodology.pdf) [<https://perma.cc/DTG8-JLX8>].

64. *ESG Scores*, FTSE RUSSELL, <https://www.ftserussell.com/data/sustainability-and-esg-data/esg-ratings> (last visited Mar. 7, 2024) [<https://perma.cc/8B57-9SLS>].

65. REFINITIV, *supra* note 63, at 3.

66. Karoui et al., *supra* note 55, at 4; *Understanding and Applying Sustainalytics’ ESG Risk Ratings’ Material ESG Issues*, SUSTAINALYTICS, <https://www.sustainalytics.com/material-esg-issues-resource-center> (last visited Mar. 7, 2024) [<https://perma.cc/8RAL-E7UR>].

67. Karoui et al., *supra* note 55, at 4.

on these quantitative scores, companies are grouped into one of five absolute risk categories (negligible, low, medium, high, or severe).<sup>68</sup>

While a few rating agencies offer access to their ESG metrics for a fee, the precise factors that each agency considers and the weight assigned to them are generally proprietary and undisclosed.<sup>69</sup> Consequently, understanding the impact of a company's tax behavior on its ESG score requires comprehensive data collection and analysis.

Our initial investigation involved seeking publicly available information regarding the methodologies and scoring systems employed by the five rating agencies under examination. Each agency has a high-level overview of its ESG score calculation process outlined on its website. These methodology documents generally provide insights into the data inputs, scoring systems, and evaluation procedures employed by the agencies when determining a company's ESG score. Although the documents neither explicitly disclose the hundreds of factors included in the scoring systems nor elaborate on the weighting of each factor, they typically identify the broad categories (sometimes called "themes") within the E, S, and G components, albeit with varying levels of specificity.

In our examination of the publicly available documents, we found that two of the rating agencies—MSCI and FTSE Russell—made mention of tax-related issues in the context of "tax-transparency."<sup>70</sup> Tax transparency pertains to a company's level of public disclosure regarding its tax policies and control mechanisms.<sup>71</sup> The overarching aim of tax transparency is generally to assess a company's governance, regulatory, and reputational risks associated with tax avoidance.<sup>72</sup>

---

68. *Id.* at 7.

69. See Larcker et al., *supra* note 23, at 3–4 (explaining how firms analyze the components and subcomponents of ESG to develop proprietary frameworks).

70. MSCI, *supra* note 53, at 34; FTSE RUSSELL, *supra* note 64.

71. Corporate income tax transparency is defined as "the state or outcome achieved by tax disclosure," whereas tax disclosure is defined as "the communication of initially private tax-related information by an issuer to one or several recipients, either on a mandatory or voluntary basis." Raphael Müller, Christoph Spengel & Heiko Vay, *On the Determinants and Effects of Corporate Tax Transparency: Review of an Emerging Literature 2* (ZEW, Ctr. for Eur. Econ. Rsch., Discussion Paper No. 20-063, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3736747](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3736747) [<https://perma.cc/2PG5-3E7M>].

72. See, e.g., Edmund Bourne, Charles Dodsworth & Jaakko Kooroshy, *Global Trends in Corporate Tax Disclosure*, FTSE RUSSELL 4 (June 2021), <https://www.unpri.org/download?ac=13650> [<https://perma.cc/FZP2-KKM9>].

With corporate taxation and tax transparency currently high on the policy agenda both in the US and Europe, investors too are increasingly focused on the financial, regulatory and reputational risks associated with poor tax practices. However, disclosure limitations remain a significant roadblock to measuring and managing tax risks across portfolios and factoring them into investment decisions.

According to FTSE Russell, the emphasis lies on evaluating risk exposure, the control environment, and the potential impact of tax practices on long-term shareholder value.<sup>73</sup> Corporate tax avoidance and its broader societal implications fall *outside* the scope of tax transparency as addressed in FTSE Russell’s overview of the tax-transparency theme.

The emphasis on tax risk management and governance structures in the context of tax transparency is also evident from the placement of the tax-transparency parameter within the G component of ESG rather than the S by both MSCI and FTSE Russell.<sup>74</sup> This suggests that the focus is primarily on assessing a company’s ability to effectively manage tax-related *risks* (i.e., exposure to liability) and establish robust governance structures with respect to its tax affairs. Remarkably, the involvement of a company in tax avoidance or its failure to pay taxes in the regions where it operates does not seem to directly impact its ESG score, despite the potential consequences for stakeholders and society at large.<sup>75</sup> A decline in a company’s ESG score attributed to tax-avoidance practices is a requirement imposed by a very limited number of rating agencies. In such cases, such a reduction typically transpires only when these practices signal potentially unlawful activities that might pose a threat to shareholder value, such as tax-related litigation.<sup>76</sup>

This approach to tax is consistent with the goal of investment risk reduction, a prevalent theme among ESG providers that recognizes the financial materiality of various risk factors.<sup>77</sup> Problematic tax practices and inadequate tax management are considered risk factors that could lead to long-term financial losses, and thus, it is argued that they should be incorporated into ESG scores.<sup>78</sup> This viewpoint presents

---

73. *Id.* at 10–12.

74. See MSCI, *supra* note 53, at 6 (placing tax transparency within the Governance Pillar); FTSE RUSSELL, *supra* note 64 (placing tax transparency within the Governance Pillar).

75. As noted later, FTSE Russell confirmed that the payment of taxes is not by itself an ESG criterion. See *infra* note 87 and accompanying text.

76. According to the methodology employed by MSCI, a company’s estimated tax gap, calculated as the difference between the estimated ETR and estimated statutory tax rate (which is an indicator of involvement in tax avoidance), regardless of its size, will only affect the ESG score of a company if the company is involved in a tax controversy. See *MSCI ESG Ratings Methodology: Tax Transparency Key Issue*, MSCI 3–5 (July 2023), <https://www.msci.com/documents/1296102/34424357/MSCI+ESG+Ratings+Methodology+-+Tax+Transparency+Key+Issue.pdf> [<https://perma.cc/7EBT-7QJQ>].

77. See Larcker et al., *supra* note 23, at 3 (“A common theme among ESG providers is investment risk reduction. The assumption is that ESG quality improves financial performance by reducing social and environmental factors that pose a risk to the company’s business model or operations.”).

78. See, e.g., Bourne et al., *supra* note 72, at 4–6 (“Perhaps more than many other sustainability factors, poor tax practices can have an immediate, quantifiable impact on corporate

a notable problem as it diverges from the perception held by many individuals regarding ESG investment. For most ESG investors, ESG principles represent a stakeholder-focused framework, calling for companies to prioritize considerations beyond mere shareholder value maximization<sup>79</sup> or basic compliance with the law.<sup>80</sup>

It is worth noting that FTSE Russell considers a company's tax-transparency performance partially by examining its disclosures regarding tax compliance. According to FTSE Russell, it evaluates a company's commitment, as stated in its public disclosures, to "[a]lign tax payments with revenue generating activity, or reduce or refrain from the use of offshore secrecy jurisdictions for the purposes of tax planning."<sup>81</sup> Consequently, it is reasonable to infer that because companies are assessed based on such commitments, they would be incentivized to promote more sound tax practices and potentially reduce tax avoidance. However, this potential second-order implication is not the focus of the tax-transparency theme. More importantly, there is no explicit documentation of an immediate ESG "penalty" in the form of a score deduction for a low ETR or involvement in tax avoidance.

As to the rest of the ESG rating agencies we looked at, Refinitiv takes into account several "controversy" measures, one type of which is "tax fraud controversies."<sup>82</sup> The tax fraud controversies factor measures the "number of controversies published in the media linked to tax fraud, parallel imports or money laundering."<sup>83</sup> This is the only reference to tax issues we were able to find in Refinitiv's publicly available methodology documents.

Sustainalytics did not include any reference to taxes in its methodology documents. Nonetheless, it stated that it holds dialogue with (only) twenty-one information technology and pharmaceutical companies on the topic of corporate taxes, with the aim of improving

---

earnings; in addition to posing material legal, regulatory, and reputational risks to companies." On the difficulties of this approach, see, for example, Cam Simpson, Akshat Rathi & Saijel Kishan, *The ESG Mirage*, BLOOMBERG (Dec. 10, 2021), <https://www.bloomberg.com/graphics/2021-what-is-esg-investing-msci-ratings-focus-on-corporate-bottom-line/> [https://perma.cc/NZQ8-AFN2] ("MSCI, the largest ESG rating company, doesn't even try to measure the impact of a corporation on the world. It's all about whether the world might mess with the bottom line.").

79. See Larcker et al., *supra* note 23, at 2 (describing one view of ESG as reflecting "the impact a company has on the welfare of its stakeholders").

80. See, e.g., Asaf Raz, *The Legal Primacy Norm*, 74 FLA. L. REV. 933, 935 (2022) (arguing that corporate law in its current state places stakeholders at its very center by demanding corporations to strictly comply with positive law in areas that lie outside of corporate law itself, such as tort or environmental law).

81. Bourne et al., *supra* note 72, at 9.

82. REFINITIV, *supra* note 63, at 26 (emphasis added).

83. *Id.*

“transparency as it relates to corporate tax planning.”<sup>84</sup> Here again, the rationale behind tax disclosure is to allow investors to evaluate how companies manage risks associated with corporate tax planning.<sup>85</sup>

Among the five rating agencies we examined, ISS stood out as the only one that referred to taxes in the context of the S component of ESG. According to ISS, it evaluates “responsible tax practices” as part of the S pillar.<sup>86</sup> Although this statement is somewhat vague, it implies that ISS considers the societal impacts of tax practices, looking beyond the risks they may pose to the company and its shareholders. This possibly indicates a broader perspective on tax practices that encompasses social considerations within the ISS ESG framework. Consequently, it is reasonable to expect that a company’s involvement in tax-avoidance activities or the payment of lower taxes than legally owed would affect the ESG score assigned to such a company by ISS.

To further assess the correlation between tax payments and ESG scores, we took the next step of directly contacting the five ESG index providers and querying about the impact of tax payments on ESG scores. Regrettably, only two of the rating agencies we contacted responded to our emails. Of the two, FTSE Russell clarified that the ETR of a company is not factored into its ESG score.<sup>87</sup> Sustainalytics declined to provide a clear answer to our question.<sup>88</sup>

## 2. How Is Tax Behavior Weighted in ESG Scores?

As previously discussed, among most rating agencies, the inclusion of tax-related matters in ESG scores is limited to the context of tax transparency. Given that tax transparency primarily focuses on tax disclosure and risk management, its direct influence on companies’

---

84. David Frazer, *Two Sides of the Corporate Taxation Debate*, SUSTAINALYTICS (Nov. 27, 2020), <https://www.sustainalytics.com/esg-research/resource/investors-esg-blog/two-sides-of-the-corporate-taxation-debate> [https://perma.cc/9ZA9-V3SF].

85. *Id.* (“Without appropriate disclosures, investors may have difficulty assessing how corporations are managing the risks associated with corporate tax planning, including regulatory and reputational risks.”).

86. *ESG Corporate Rating*, ISS, <https://www.issgovernance.com/esg/ratings/corporate-rating/> (last visited Mar. 7, 2024) [https://perma.cc/6NJU-FFB3].

87. In response to our inquiry, FTSE Russell acknowledged that the ETR of a company “is not currently included in our ESG scores—this is because we try as far as possible to align with the main tax transparency standard for corporates which is published by GRI. That said, we are investigating how effective tax rate and other metrics could complement our existing approach.” E-mail from Edmund Bourne, London Stock Exch. Grp., to Danielle Chaim, Assistant Professor, Bar-Ilan Univ. (Apr. 24, 2023, 7:14 PM) (on file with author).

88. In its response to our email, Sustainalytics explained that it “mainly supports corporate clients, therefore, [it has] limited information to provide for academic purposes.” E-mail from Corp. Enquiries, Sustainalytics, to Danielle Chaim, Assistant Professor, Bar-Ilan Univ. (Mar. 27, 2023, 11:52 PM) (on file with author).

ESG ratings may not offer substantial insights into the relationship between tax payments and ESG scores. However, we sought to understand the significance of the tax-transparency theme in the overall calculation of ESG scores, as it can elucidate the level of importance attached to tax issues within the ESG framework. Based on the evidence we have gathered, which is constrained by the proprietary nature of the ESG factors and their weights, the impact of tax transparency on ESG scores appears to be fairly modest.

For instance, FTSE Russell's analysis of the tax-transparency theme highlights a weak correlation between tax-transparency performance and ESG scores. In fact, the number of data points associated with tax transparency is the lowest among the fourteen themes considered by FTSE Russell.<sup>89</sup> To illustrate, while there are only six data points under the tax-transparency theme, there are fifty-eight data points related to customer responsibility and forty-nine data points related to climate change.<sup>90</sup> This scarcity of tax-related data points is not unique to FTSE Russell; it also exists in other rating agencies.<sup>91</sup> A recent study by Vincent Deluard, a global market strategist at StoneX, examined 1,945 data points from Bloomberg and found that only five data points (less than 0.2%) were connected to taxes.<sup>92</sup>

Furthermore, it is evident that a significant number of companies are not assessed on their tax-transparency performance. FTSE Russell has identified tax transparency as one of three themes with a notably low level of completeness, which refers to the percentage of companies in the FTSE Russell ESG database that are scored on these particular themes.<sup>93</sup> In the case of tax transparency, only 15% of the companies evaluated by FTSE Russell receive a score for this aspect.<sup>94</sup>

---

89. Kevin Ratsimiveh & Ruben Haalebos, *ESG Scores and Beyond*, FTSE RUSSELL 5, tbl.2 (Apr. 2021), [https://content.ftserussell.com/sites/default/files/esg\\_scores\\_and\\_beyond-part\\_2\\_final.pdf](https://content.ftserussell.com/sites/default/files/esg_scores_and_beyond-part_2_final.pdf) [<https://perma.cc/L69U-XSWK>].

90. *Id.*

91. See Larcker et al., *supra* note 23, at 4 (noting that reporting frameworks developed by third-party organizations “are often similar to the proprietary frameworks developed by ESG ratings providers”).

92. DELUARD, *supra* note 15, at 1. Note that Bloomberg offers a wide range of ESG data points and analytics through its Bloomberg Terminal. These data points cover various aspects of ESG performance for companies. The platform also includes access to ratings and reports from other ESG providers, such as MSCI and Sustainalytics. See Dean Emerick, *What Is Bloomberg ESG?*, ESG THE REP. (Nov. 19, 2021), <https://www.esgthereport.com/what-is-bloomberg-esg> [<https://perma.cc/68BT-P533>] (explaining Bloomberg ESG).

93. Ratsimiveh & Haalebos, *supra* note 89, at 10.

94. See *id.*

Considering the limited emphasis on tax-transparency factors and the absence of explicit references to tax payments in the agencies’ methodology documents, it is reasonable to conjecture that the issue of taxes, including corporate tax payments, is an inconsequential component, if at all, of ESG metrics. The payment of taxes, therefore, does not constitute a basis for comparison among companies. Nonetheless, to further verify this inference, we undertook an additional examination of the issue.

Our next and final step was to obtain the ESG scores of companies known for their aggressive tax-avoidance practices, specifically those that paid no federal income tax in 2020.<sup>95</sup> We hand collected the ESG scores assigned to these companies by four rating agencies: MSCI, ISS, Sustainalytics, and Refinitiv. We excluded FTSE Russell from this examination as we had already obtained explicit confirmation that tax payments are not considered an ESG factor, and because FTSE Russell’s ESG scores are not publicly available.

As presented in Table 1A, the ESG score assigned to these tax-avoiding companies by three of the four ESG rating providers—MSCI, Sustainalytics, and Refinitiv—were notably high, both in absolute terms and relative to their industry peers. For instance, among the thirty-seven corporations in the sample covered by MSCI, three companies received AAA scores, twelve received AA scores, and ten received A scores. The fact that most companies in the MSCI sample achieved an A-range score—despite paying no taxes at all in 2020—confirms our prediction that the payment of taxes is not a significant ESG component, if it is at all.

The weak correlation between ETRs and ESG scores was also identified in several recent studies and reports. One such report from 2021 analyzed the MSCI ESG scores of 606 companies listed on the Russell 1000 index. The findings revealed that companies with a CCC ESG score paid an average tax rate of 27%, which was nearly double the rate paid by the highly rated AAA group.<sup>96</sup> The report suggests an inverse relationship between tax payments and ESG scores, indicating

---

95. The list was published by The Institute on Taxation and Economic Policy (“ITEP”) and included all corporations on the S&P 500 index that paid no federal corporate income taxes in 2020 despite enjoying substantial pretax earnings. See MATTHEW GARDNER & STEVE WAMHOFF, ITEP, 55 CORPORATIONS PAID \$0 IN FEDERAL TAXES ON 2020 PROFITS 3 (Apr. 2, 2021), <https://itep.sfo2.digitaloceanspaces.com/040221-55-Profitable-Corporations-Zero-Corporate-Taxes.pdf> [<https://perma.cc/WYA4-N9T3>] (providing a list of fifty-five companies on the S&P 500 that paid no corporate income tax on their 2020 pretax income and explaining how they did so). The original list included fifty-five corporations, however, three of them are no longer public, and their ESG scores are therefore unavailable. *Id.*

96. DELUARD, *supra* note 15, at 4.

that companies with lower tax payments may have higher ESG ratings.<sup>97</sup>

ISS stands as an outlier in terms of the relationship between tax payments and ESG scores. The ESG scores assigned by ISS to the companies in our sample were relatively low.<sup>98</sup> None of the companies achieved scores in the A-range, with thirty-eight companies falling in the C range and five in the D range, out of the total fifty-one companies covered by ISS.<sup>99</sup> These findings align with ISS's unique approach, which takes a holistic perspective by considering the broader societal impact of a company's tax activities.<sup>100</sup> As a result, tax-aggressive companies may face repercussions in the form of lower ESG scores. Regrettably, this approach deviates from the standard industry practice adopted by most leading ESG rating agencies.

### *B. ESG Funds and Fund Families*

In the prior Section, we demonstrated that corporate tax payments exert very minimal effects on ESG ratings, if any at all. In this Section, we show that this crucial issue is overlooked not only by ESG rating agencies but also by ESG funds and their corresponding fund families. The pattern that emerges suggests that numerous institutional investors, including those steering the helm of the nation's largest mutual ESG funds, not only fail to advocate for responsible corporate tax citizenship but may actually be fueling tax-avoidance behavior.

#### 1. ESG Funds' Holdings

ESG funds are investment vehicles that prioritize ESG considerations in their investment focus and strategy. Typically, these funds favor securities and bonds of companies that align with a specific ESG ethos, and whose operations contribute positively to both the environment and society at large.

In recent years, the world of institutional investment has witnessed an extraordinary rise in ESG-centric allocations. In 2021 alone, more than \$500 billion was directed into ESG-integrated funds, marking a 55% growth in assets under management ("AUM") within

---

97. *Id.*

98. *See infra* Table 1A.

99. *See infra* Table 1A.

100. *See supra* note 86.

this segment of the asset management industry.<sup>101</sup> The global ESG-related AUM in that same year totaled more than \$18 trillion, with expectations of reaching nearly \$34 trillion by 2026, representing a projected compound annual growth rate of almost 13%.<sup>102</sup>

However, an incongruity surfaces when juxtaposing the professed commitments of these ESG funds to advance ESG objectives with evidence demonstrating their substantial investments in companies implicated in extensive tax avoidance. A revealing 2021 study compared the holdings of the largest U.S. equity exchange-traded funds (“ETFs”), aggregating these holdings by market value to create an ESG composite portfolio.<sup>103</sup> In a striking finding, the study discovered that companies populating the ESG portfolio paid fewer taxes than their counterparts within the S&P 500 index.<sup>104</sup> Indeed, the average ETR of the profitable companies within the ESG portfolio languished at 4.6% *below* that of the companies on the S&P 500 index.<sup>105</sup>

The perplexing inclination of ESG funds to invest in tax-avoiding companies is further exemplified by examining the identities of companies drawing the highest levels of ESG investment. Take, for example, the 2020 list of the top ten companies with the highest ESG fund investment.<sup>106</sup> This list includes many companies exhibiting conspicuously low ETR. Microsoft, the largest recipient of ESG investment—amassing a colossal \$2.34 billion as of December 31, 2019—generated over \$276 billion in cash flow from 2013 to 2020.<sup>107</sup> Yet, the company paid less than \$50 billion in taxes during those years, reflecting an ETR of 16%.<sup>108</sup> For years, Microsoft has deftly diverted billions in profits to subsidiaries in low-tax jurisdictions, where the corporate tax rate was as low as 0%.<sup>109</sup> This deprives the nations where

---

101. Jennifer Wu, *ESG Outlook 2022: The Future of ESG Investing*, J.P. MORGAN (Jan. 2, 2022), <https://am.jpmorgan.com/dk/en/asset-management/liq/investment-themes/sustainable-investing/future-of-esg-investing/> [<https://perma.cc/5ZRC-D4H8>].

102. See *PwC Report*, *supra* note 48.

103. DELUARD, *supra* note 15, at 6.

104. *Id.* at 7.

105. *Id.*

106. John Detrixhe, *Microsoft Stock Is the Biggest Winner from Environmental and Socially Responsible Investing*, QUARTZ (Feb. 18, 2020), <https://qz.com/1803716/microsoft-is-the-biggest-recipient-of-esg-rsi-stock-fund-investment> [<https://perma.cc/2H52-M7S4>].

107. *Id.*; DELUARD, *supra* note 15, at 4.

108. DELUARD, *supra* note 15, at 5.

109. See, e.g., Paul Kiel, *The IRS Decided to Get Tough Against Microsoft. Microsoft Got Tougher.*, PROPUBLICA (Jan. 22, 2020), <https://www.propublica.org/article/the-irs-decided-to-get-tough-against-microsoft-microsoft-got-tougher> [<https://perma.cc/DV86-NM4Y>] (“Microsoft had shifted at least \$39 billion in U.S. profits to Puerto Rico, where the company’s tax consultants, KPMG, had persuaded the territory’s government to give Microsoft a tax rate of nearly 0%.”); Matt Day, *How Microsoft Moves Profits Offshore to Cut Its Tax Bill*, SEATTLE TIMES,

it operates and does business of billions of dollars of deserved tax revenues.<sup>110</sup> As a matter of fact, a comprehensive 2022 study by the Centre for Corporate Tax Accountability and Research posits that over 80% of Microsoft's total overseas income is funneled to tax havens.<sup>111</sup>

Similarly, Alphabet, Google's parent company and the second-largest recipient of ESG fund investments with total ESG holdings amounting to \$1.8 billion,<sup>112</sup> has consistently drawn substantial regulatory scrutiny over its aggressive tax practices. Over the years, Alphabet has engaged in a myriad of tax-avoidance and profit-shifting maneuvers, some of which are described as "world-leading" anti-avoidance measures.<sup>113</sup> One notorious strategy is the "Double Irish, Dutch Sandwich" scheme, an ingenious design that allowed the company to shift hundreds of billions of dollars to tax havens and reduce its tax bill.<sup>114</sup> In the wake of these practices, Alphabet has found itself paying billions to tax authorities worldwide to reconcile disputes surrounding its tax dealings and failure to remit appropriate levels of tax.<sup>115</sup>

The media and entertainment giant Walt Disney, ranked third among the top ten entities for ESG fund holdings in 2019,<sup>116</sup> has likewise gained notoriety for its involvement in aggressive, clandestine tax arrangements. Through these tactics, the company adeptly

---

<https://www.seattletimes.com/business/microsoft/how-microsoft-parks-profits-offshore-to-pare-its-tax-bill/> (last updated Dec. 16, 2015, 4:10 PM) [<https://perma.cc/9Z3B-BNA9>].

110. CTR. FOR INT'L CORP. TAX ACCOUNTABILITY & RSCH., MICROSOFT: GAMING GLOBAL TAXES WINNING GOVERNMENT CONTRACTS 27 (Oct. 2022), [https://static1.squarespace.com/static/636a46c59a62847f542195d2/t/64663a6d04a2067694b4c486/1684421237564/CICTAR\\_MICROSOFT-FINAL.pdf](https://static1.squarespace.com/static/636a46c59a62847f542195d2/t/64663a6d04a2067694b4c486/1684421237564/CICTAR_MICROSOFT-FINAL.pdf) [<https://perma.cc/4T7X-J4DV>] ("TaxWatch UK recently criticised tech companies, including Microsoft, for failing to properly collect value-added taxes (VAT) in African countries, depriving these nations of much-needed revenue.")

111. *Id.* at 11–12.

112. Detrixhe, *supra* note 106.

113. *See, e.g.*, Jon Ungeod-Thomas & Toby Helm, *Osborne's 'Google Tax' on Overseas Profits Now Raises Zero Revenue, Treasury Reveals*, OBSERVER (Oct. 31, 2021, 5:00 AM), <https://www.theguardian.com/politics/2021/oct/31/osbornes-google-tax-on-overseas-profits-now-raises-zero-revenue-treasury-reveals> [<https://perma.cc/T9TZ-9HW2>].

114. *E.g.*, Bart Meijer, *Google Shifted \$23 Bln to Tax Haven Bermuda in 2017—Filing*, REUTERS (Jan. 3, 2019, 11:11 AM), <https://www.reuters.com/article/google-taxes-netherlands/google-shifted-23-bln-to-tax-haven-bermuda-in-2017-filing-idUSL8N1Z3403> [<https://perma.cc/DZ5G-SHL3>].

115. *See, e.g.*, Simon Carraud & Mathieu Rosemain, *Google to Pay \$1 Billion in France to Settle Fiscal Fraud Probe*, REUTERS (Sept. 12, 2019, 12:08 PM), <https://www.reuters.com/article/us-france-tech-google-tax-idUSKCN1VX1SM> [<https://perma.cc/Z2RM-CZY7>] ("Google agreed to pay close to 1 billion euros (\$1.10 billion) to French authorities to settle a fiscal fraud probe . . ."); *see also* Murad Ahmed, Vanessa Houlder & George Parker, *Google Tax: The 6-Year Audit That Ended in a Political Storm*, FIN. TIMES (Jan. 29, 2016), <https://www.ft.com/content/f1c5ca30-c677-11e5-b3b1-7b2481276e45> [<https://perma.cc/PC7A-6MAK>] (describing that Google "had reached a £130m settlement with the UK's revenue service . . . after six years of being audited").

116. Detrixhe, *supra* note 106.

redirected hundreds of millions in profits to tax havens, skillfully evading the U.S. tax net.<sup>117</sup> It is particularly striking to note that in 2019—the very year Disney clinched the third spot in ESG fund holdings—Disney paid a paltry 0.1% of its profits to the IRS.<sup>118</sup> Over the four-year period from 2018 to 2021, Disney reportedly paid federal corporate income taxes amounting to only 7.7% of its \$33.1 billion in profits.<sup>119</sup> The stark discrepancy between the company’s ESG investments and its tax contributions further underscores the growing dichotomy in ESG fund behavior and investment choices.<sup>120</sup>

The trend of ESG funds gravitating toward companies that implement questionable tax-planning strategies, paying meager taxes despite racking up sizable profits, unveils an additional disquieting blind spot in the realm of ESG investing.<sup>121</sup> Rather than acting in accordance with expectations—that is, taking punitive measures against these dubious tax practices—ESG funds seem to take a converse approach.<sup>122</sup> Perversely, they appear to reward companies that indulge in such practices, adding a new layer of complexity to the ongoing dialogue about the genuine impact and role of ESG investing.<sup>123</sup>

As ESG funds progressively dictate the direction of capital allocation in public markets, the repercussions of this blind spot grow progressively more concerning. The potential oversight in ESG investments could foster an investment climate that not only tolerates but indeed encourages corporate tax avoidance and raises significant questions. Particularly, it casts a cloud of doubt over the role of ESG funds in driving sustainable corporate behavior. As we illustrate next, many institutional investors, including those that manage the largest

---

117. See, e.g., Jonathan Berr, *Does This Disney Tax Strategy Go Too Far?*, CBS NEWS (Dec. 10, 2014, 5:45 PM), <https://www.cbsnews.com/news/does-disneys-luxembourg-tax-strategy-go-too-far/> [<https://perma.cc/637G-WGS6>] (describing Disney’s practice of transferring “profits around the world to a finance arm called Wedco Participations SCA in Luxembourg, enabling the unit to pay an effective tax rate of 0.3 percent on more than 1 billion euro in profit”); Kenneth Rapoza, *Why Berkshire Hathaway, Apple, Disney Lead List of S&P 500 Companies Paying Under 10% in Taxes*, FORBES (Sept. 24, 2020, 5:52 PM), <https://www.forbes.com/sites/kenrapoza/2020/09/24/berkshire-hathaway-apple-disney-lead-list-of-sp-500-companies-paying-under-10-in-taxes> [<https://perma.cc/RU3A-DAML>].

118. Rapoza, *supra* note 117.

119. Matt Gardner & Steve Wamhoff, *Twenty-Three Corporations Saved \$50 Billion So Far Under Trump Tax Law’s “Bonus Depreciation” That Many Lawmakers Want to Extend*, ITEP 2 (Nov. 10, 2022), <https://itep.sfo2.digitaloceanspaces.com/ITEP-Bonus-Depreciation-brief-2022.pdf> [<https://perma.cc/AT5S-WU7E>].

120. See *id.*

121. DELUARD, *supra* note 15, at 1.

122. See *id.* at 4.

123. See *id.*

ESG funds, exploit their sway over their portfolio companies in a way that promotes more tax avoidance and less tax transparency.<sup>124</sup>

## 2. Pro Tax-Avoidance Stewardship

The financial crisis of 2008 ushered in a significant capital shift toward the asset management industry, resulting in the ascension of several prominent asset management institutions.<sup>125</sup> The Big Three emerged as leaders. As of 2022, these titan institutions collectively managed assets worth \$22 trillion.<sup>126</sup> Their vast management portfolio spans across hundreds of index funds and ETFs that track market indices, alongside actively managed funds and ESG funds.<sup>127</sup>

In recent years, the Big Three have pledged a robust commitment to ESG advocacy.<sup>128</sup> Due to their sizable stakes across the public equity market, they have been instrumental in championing a multitude of ESG initiatives across corporate America, such as workplace equality, carbon emissions reduction, and enhanced ESG disclosure.<sup>129</sup> Their proactive, ESG-focused stewardship has even led some scholars to view these financial powerhouses as private regulators who stepped in to fill the void left by regulatory deficiencies in addressing ESG objectives.<sup>130</sup>

The Big Three's marked emphasis on ESG-centered stewardship has lured many investors keen on committing their capital to more sustainable assets. This has triggered significant capital influx into

---

124. See *infra* Subsection I.B.2.

125. Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 299 (2021).

126. Farhad Manjoo, *What BlackRock, Vanguard and State Street Are Doing to the Economy*, N.Y. TIMES (May 12, 2022), <https://www.nytimes.com/2022/05/12/opinion/vanguard-power-blackrock-state-street.html> [<https://perma.cc/2V9D-R6WU>].

127. As of July 31, 2023, BlackRock has over 500 equity funds. *Number of Funds Owned by Blackrock Globally as of July 31, 2023, by Fund Type and Asset Class*, STATISTA, <https://www.statista.com/statistics/1256783/blackrock-number-funds-asset-class-fund-type-worldwide> (last visited Mar. 7, 2024) [<https://perma.cc/7PY5-A5E7>]. As of July 31, 2022, Vanguard has over 204 equity funds. *Number of Investment Funds Owned by Vanguard Globally as of July 31, 2022, by Region*, STATISTA, <https://www.statista.com/statistics/1256951/vanguard-number-funds-region-worldwide/> (last visited Mar. 7, 2024) [<https://perma.cc/3DED-5AVR>]. As of January 22, 2024, State Street has over 300 funds. *Fund Finder*, STATE ST. GLOB. ADVISORS, <https://www.ssga.com/us/en/intermediary/ic/fund-finder?type=etfs> (last visited Mar. 7, 2024) [<https://perma.cc/FF2B-JACF>].

128. See Lund, *supra* note 4, at 115.

129. See *id.* at 105–23 (providing a detailed overview of recent initiatives undertaken by the Big Three with respect to climate change and board diversity).

130. See *id.* at 105.

their funds, both ESG and non-ESG alike.<sup>131</sup> However, an increasingly compelling body of evidence indicates that, at least when it comes to corporate taxes, these institutional investors may not live up to their promises.<sup>132</sup> These financial giants not only appear to turn a blind eye to aggressive tax-avoidance strategies employed by their portfolio companies but also seem to endorse stewardship practices that potentially encourage such behavior. To support this assertion, we delve into several aspects of stewardship that appear to facilitate tax avoidance: (a) institutional investors’ stance on tax transparency, (b) the absence of tax-related voting guidelines, and (c) the correlation between institutional ownership and corporate tax-avoidance levels.

\* \* \*

*Institutional Investors’ Stance on Tax Transparency.* Over the past two years, several multinational corporations have been subject to escalating shareholder pressure over their public tax-disclosure transparency.<sup>133</sup> Several shareholder groups—predominantly comprised of foreign funds and international civic society organizations—have put forth shareholder proposals requiring giant companies notorious for their low tax rates to furnish more comprehensive tax-related data.<sup>134</sup>

A key aspect of these proposals is the public disclosure of CbCR by these companies.<sup>135</sup> These reports, prepared by multinational

---

131. See Barzuza et al., *supra* note 3, at 1300 (arguing that since large money managers such as the Big Three are competing to win the soon-to-accumulate assets of the millennial generation—who place a significant premium on ESG issues—they deploy their voting power and even create new financial products in a way that aligns with the social preferences of the millennial generation). According to recent data, BlackRock is currently the largest ESG fund manager, accounting for twenty ESG funds with total AUM of \$110 billion. See Shanny Basar, *Opimas Identifies Largest ESG Fund Managers*, BEST EXECUTION (Jan. 9, 2023), <https://www.bestexecution.net/opimas-identifies-largest-esg-fund-managers> [<https://perma.cc/H5PS-E6GW>]. Vanguard oversees the third largest ESG fund. See Rumi Mahmood, *The Top 20 Largest ESG Funds—Under the Hood*, MSCI 5 (Apr. 2021), <https://www.msci.com/documents/1296102/24720517/Top-20-Largest-ESG-Funds.pdf> [<https://perma.cc/CDL6-XAUZ>].

132. See, e.g., Lucian A. Bebchuk & Roberto Tallarita, *The Perils and Questionable Promise of ESG-Based Compensation*, 48 J. CORP. L. 37 (2022); Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. 511 (2023); Hannes et al., *supra* note 49.

133. See Nana Ama Sarfo, *Microsoft and Cisco Face Shareholder Pressure over Public Disclosures*, FORBES (June 28, 2022, 11:09 AM), <https://www.forbes.com/sites/taxnotes/2022/06/28/microsoft-and-cisco-face-shareholder-pressure-over-public-disclosures> [<https://perma.cc/67JH-Z6XX>].

134. Such organizations include, for example, the Pensions & Investment Research Consultants Ltd. (“PIRC”) and the Centre for International Corporate Tax Accountability and Research. See *id.*

135. The shareholder proposals also called for disclosure of tax governance policies and a disclosure of policy on global approach to responsible tax. See *id.*

corporations, incorporate a detailed breakdown of their financial-, economic-, and tax-related data with respect to each jurisdiction in which they operate.<sup>136</sup>

In 2013, the Organization for Economic Co-operation and Development (“OECD”) launched an international initiative—the Base Erosion and Profit Shifting (“BEPS”) project—to curb tax avoidance by large multinational corporations and thwart artificial profit shifting to low- or no-tax jurisdictions.<sup>137</sup> According to the OECD, over 135 countries and jurisdictions collaborated on the implementation of the BEPS project.<sup>138</sup>

The BEPS project is composed of fifteen distinct action points that address various aspects of international tax rules and practices.<sup>139</sup> This framework equips governments of participating countries and jurisdictions with the domestic and international instruments necessary to tackle tax avoidance.<sup>140</sup> Moreover, participants are able to work with OECD and G20 (an intergovernmental forum comprising nineteen countries, the European Union, and the African Union) to review and monitor the implementation of the BEPS framework.<sup>141</sup>

Under the BEPS Action 13 Report, entitled “Transfer Pricing Documentation and Country-by-Country Reporting,” all large multinational enterprises that meet certain criteria are mandated to prepare a CbCR and submit it to local tax authorities in all of their jurisdictions of tax residence.<sup>142</sup> The underlying goal of Action 13 is to bolster tax transparency related to the global allocation of incomes, taxes paid, and economic activities.<sup>143</sup> This enhanced clarity aims to facilitate tax authorities’ identification of potential base erosion and profit-shifting activities (i.e., tax-planning strategies in which multinationals shift their profits or revenues from higher-tax

---

136. *Id.*

137. *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD (Oct. 8, 2021), <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> [<https://perma.cc/6UDG-M7W2>]; see *OECD/G20 Base Erosion and Profit Shifting Project*, OECD, [https://www.oecd-ilibrary.org/taxation/oecd-g20-base-erosion-and-profit-shifting-project\\_23132612](https://www.oecd-ilibrary.org/taxation/oecd-g20-base-erosion-and-profit-shifting-project_23132612) (last visited Mar. 7, 2024) [<https://perma.cc/3EFP-VP6W>] (noting date of adoption).

138. *What Is BEPS?*, OECD, <https://www.oecd.org/tax/beps/about/#tools> (last visited Mar. 7, 2024) [<https://perma.cc/Y27U-WK9C>].

139. *Id.*

140. *Id.*

141. *Id.*

142. *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13*, OECD 6 (Oct. 2022), <https://web-archiver.oecd.org/2022-10-17/407167-guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf> [<https://perma.cc/BNZ7-DXNR>].

143. *Id.* at 32.

jurisdictions to lower-tax or tax-free jurisdictions, effectively “eroding” the tax base of the higher-tax countries).<sup>144</sup> Shedding light on these practices equips tax authorities with the information necessary to tackle aggressive tax-avoidance strategies more effectively.<sup>145</sup>

However, since the CbCR under the BEPS project is only required to be disclosed to the relevant tax administrators in the respective operational jurisdictions,<sup>146</sup> public companies are not obligated to include a jurisdictional breakdown of income taxes paid or accrued in their publicly available financial statements. Consequently, despite the introduction of the BEPS project, the general public’s lack of understanding of a company’s tax practices, payments, and potential engagement in tax avoidance continues to impede the comprehensive evaluation of the company’s true commitment to fiscal responsibility and transparency.

In an effort to bridge this information void and elevate public consciousness around these issues, several nongovernmental organizations have advocated for the public disclosure of CbCR.<sup>147</sup> The most robust voluntary public tax-disclosure initiative to date has been spearheaded by the Global Reporting Initiative (“GRI”), an independent international organization dedicated to establishing global best practice standards for public reporting on a wide array of economic, environmental, and social impacts.<sup>148</sup> GRI’s rigorous standards aim to foster greater transparency and responsibility, pushing corporations to be more accountable for their actions.<sup>149</sup>

In 2019, GRI introduced the GRI 207: Tax standard.<sup>150</sup> The GRI 207 standard requires companies that have endorsed GRI standards and identified tax as a material topic to disclose tax-related information in their public filing.<sup>151</sup> This includes CbCR along with

---

144. *Id.* at 37.

145. *Id.* at 6.

146. *Id.*

147. *See, e.g., International Corporate Tax Transparency Update: September 2023*, FIN. ACCOUNTABILITY & CORP. TRANSPARENCY COAL. 4, 8 (Sept. 2023), [https://thefactcoalition.org/wp-content/uploads/2023/09/Tax-Transparency-Update\\_-September-2023.pdf](https://thefactcoalition.org/wp-content/uploads/2023/09/Tax-Transparency-Update_-September-2023.pdf) [<https://perma.cc/452S-RS8T>]; *Do Corporate Claims on Public Disclosure Stack Up?*, TRANSPARENCY INT’L 24 (July 2016), [https://transparency.eu/wp-content/uploads/2016/10/Impact\\_of\\_Public\\_Reporting\\_FINAL.pdf](https://transparency.eu/wp-content/uploads/2016/10/Impact_of_Public_Reporting_FINAL.pdf) [<https://perma.cc/9CJ5-LJJ3>].

148. *About GRI*, GRI, <https://www.globalreporting.org/about-gri/> (last visited Mar. 7, 2024) [<https://perma.cc/M3A4-V9Z7>].

149. *Id.*

150. Barbara Strozzilaan, *Item 04—Final Version of GRI 207: Tax 2019*, GLOB. SUSTAINABILITY STANDARDS BD. 1 (Sept. 10, 2019), [https://www.globalreporting.org/standards/media/2369/item\\_04\\_-\\_final\\_version\\_of\\_gri\\_207\\_tax\\_2019.pdf](https://www.globalreporting.org/standards/media/2369/item_04_-_final_version_of_gri_207_tax_2019.pdf) [<https://perma.cc/AQ2G-CCA9>].

151. *Id.* at 14.

information on tax governance and strategy.<sup>152</sup> Nonetheless, it is essential to note that GRI standards serve as voluntary reporting guidelines—they do not impose a binding obligation on companies.<sup>153</sup> In the United States, companies retain the discretion to adopt the GRI standards and disclose information.<sup>154</sup>

In reality, the percentage of U.S. companies that voluntarily provide public CbCR is remarkably low. To date, only two American companies—the oil company Hess Corporation and the mining company Newmont Corporation—disclose this information.<sup>155</sup>

---

152. *Id.* at 14, 21.

153. *Id.* at 11. Note that in Europe, the nonmandatory nature of CbCR recently changed when EU legislators reached a provisional political agreement on a directive that would mandate public CbCR of corporate tax paid for multinationals with turnover of over €750 million. *Public Country-by-Country Reporting by Big Multinationals: EU Co-legislators Reach Political Agreement*, COUNCIL OF THE EU (June 1, 2021), <https://www.consilium.europa.eu/en/press/press-releases/2021/06/01/public-country-by-country-reporting-by-big-multinationals-eu-co-legislators-reach-political-agreement/> [<https://perma.cc/2ZA4-2A7R>]; see *Country-by-Country Reporting*, KPMG, <https://kpmg.com/xx/en/home/services/tax/regional-tax-centers/eu-tax-centre/country-by-country-reporting.html> (last visited Mar. 7, 2024) [<https://perma.cc/8U4V-MYWA>];

The new rules will require multinational groups with a total consolidated revenue of EUR 750 million to report either if they are EU parented or otherwise have EU subsidiaries or branches of a certain size. . . . The information must be broken down for each EU Member State where the group is active and also for each jurisdiction deemed non-cooperative by the EU or that has been on the EU's "grey" list for a minimum of two years. Information concerning all other jurisdictions may be reported on an aggregated level. Reports are to be published in an EU Member State business register, but also on companies' websites, where they should remain accessible for at least five years.

This initiative entered into force in December 2021. *Id.*

154. In the United States on the other hand, although a similar bill was introduced to the House of Representatives in 2021, see *Disclosure of Tax Havens and Offshoring Act*, H.R. 3007, 117th Cong. (2021), which would oblige companies with annual revenues over an amount to be set by the SEC to publicly report country-by-country tax data, such bill has yet to pass, and companies are currently not required to publicly disclose CbCR. Since 2016, however, ultimate parent entities of multinational enterprise groups with annual revenue for the preceding annual accounting period of \$850 million or more are subject to annual country-by-country reporting requirements under IRS regulations. Treas. Reg. § 1.6038-4(h).

155. Tim Hirschel-Burns, *Two US Companies Commit to Tax Transparency. When Will Others Make the Move?*, OXFAM (Oct. 6, 2022), <https://politicsofpoverty.oxfamamerica.org/two-us-companies-finally-commit-to-tax-transparency-when-will-others-make-the-move/> [<https://perma.cc/4KFD-2J4U>]. Note that, due to its voluntary nature, companies that choose to adopt the GRI 207 standard tend to interpret it flexibly. *A Material Concern: The Investor Case for Public Country-by-Country Tax Reporting*, FIN. ACCOUNTABILITY & CORP. TRANSPARENCY COAL. 44 (July 28, 2022), [https://thefactcoalition.org/wp-content/uploads/2022/07/FACT-Report-Final-Final\\_-\\_Reduced.pdf](https://thefactcoalition.org/wp-content/uploads/2022/07/FACT-Report-Final-Final_-_Reduced.pdf) [<https://perma.cc/BJG9-8KAX>]. A recent report analyzing the tax disclosure of foreign companies voluntarily complying with the GRI 207 standard, such as Shell, BHP, Phillips, and Vodafone, reveals that these companies selectively omit pertinent data, and under specific frameworks even ignore the standard reporting requirements entirely. *Id.* at 12. It is worth mentioning that the Financial Accounting Standards Board ("FASB") during its August 2023 board meeting considered and affirmed a decision mandating disaggregated tax and financial disclosures in a proposed Accounting Standards Update, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures. Improvements to Income Tax Disclosures*, FIN. ACCT. STANDARDS BD.,

Against this backdrop, shareholder activism advocating for tax transparency has seen a sharp rise over the last two years.<sup>156</sup> Most notably, in 2022, Amazon, Microsoft, and Cisco Systems were the target of shareholder proposals requiring them to include CbCR in their financial statements.<sup>157</sup> All three proposals, which received a support rate of over 20%, met a roadblock and were ultimately rejected.<sup>158</sup> The fact that the world’s largest asset managers—including BlackRock and Vanguard, who hold significant equity stakes in these companies—voted against the proposal was a pivotal factor in determining these outcomes.<sup>159</sup>

The position taken by large institutional investors constitutes a stark contradiction of their publicly expressed commitment to ESG values.<sup>160</sup> Public CbCR serves as a critical starting point for informed analysis of companies’ contributions to the countries in which they operate and can catalyze more responsible tax practices. By rendering tax information publicly accessible, accountability is enhanced not only toward tax authorities but also toward investors, stakeholders, and the broader public.<sup>161</sup> This level of transparency invites a higher degree of scrutiny, which companies must be prepared to withstand.

The United Nations’ Principles for Responsible Investment (“U.N. PRI”), a key player in promoting the integration of ESG factors into investment decisionmaking, observed that scrutiny could help curb “the prevalence of tax avoidance practices that continue to challenge

---

<https://www.fasb.org/Page/ProjectPage?metadata=fasb-Targeted%20Improvements%20to%20Income%20Tax%20Disclosures> (last updated Sept. 7, 2023) [<https://perma.cc/6XXH-B7AJ>]. The Board “directed the staff to draft a final Accounting Standards Update for vote by written ballot”—should this proposal be approved, it would bring about substantial changes to income tax disclosure requirements. *Id.*

156. See Foley & Temple-West, *supra* note 21.

157. *Id.* More recently, oil giants were subject to similar pressure over CbCR. See Patricia Ainembabazi, *New Shareholder Resolutions Turn up Pressure for Country-by-Country Reporting from U.S. Oil Giants*, FIN. ACCOUNTABILITY & CORP. TRANSPARENCY COAL. (Dec. 2, 2022), <https://thefactcoalition.org/new-shareholder-resolutions-turn-up-pressure-for-country-by-country-reporting-from-u-s-oil-giants/> [<https://perma.cc/5SJX-BRX5>].

158. Nana Ama Sarfo, *Investors’ Big Tax Transparency Experiment*, FORBES (Dec. 22, 2022, 11:16 AM), <https://www.forbes.com/sites/taxnotes/2022/12/22/investors-big-tax-transparency-experiment/?sh=6b93032a258a> [<https://perma.cc/4RYW-ZZEL>]; see Foley & Temple-West, *supra* note 21.

159. Foley & Temple-West, *supra* note 21.

160. See Lund, *supra* note 4, at 115.

161. Note that multinational corporations are already compiling and sharing this tax-related information with the IRS and other tax authorities, such that making this information public should neither represent an excessive or unreasonable burden for these companies nor impose significant regulatory risk and compliance costs. See Treas. Reg. § 1.6038-4 (as amended in 2016) (requiring annual country-by-country reporting by ultimate parent entities of “multinational enterprise groups that [have] annual revenue for the preceding annual accounting period of \$850 [million] or more”). In this light, the decision of large institutional investors to oppose the proposal is even more disconcerting.

global economies.”<sup>162</sup> Similar sentiments regarding the utility of public CbCR in the context of promoting ESG goals have been echoed by other organizations, including the Financial Transparency Coalition and the Financial Accountability and Corporate Transparency Coalition.<sup>163</sup> These collective voices underscore the critical role tax transparency plays in achieving more sustainable and ethical corporate practices.

By resisting the move toward greater tax transparency, large institutional investors shield companies from public scrutiny of their tax behavior, creating an environment conducive to aggressive tax planning with less fear of backlash.<sup>164</sup> In this light, the voting behavior of these powerful shareholders could be interpreted as a tacit endorsement of companies’ engagement in aggressive tax strategies.

\* \* \*

*The Absence of Tax-Related Guidelines.* In 2003, the SEC adopted the Investment Advisers Act Rule 206(4)-6, which requires mutual funds to disclose the policies and procedures they use to vote proxies relating to portfolio securities.<sup>165</sup> In accordance with this provision, institutional investors such as the Big Three issue annual proxy voting policies and guidelines.<sup>166</sup> These guidelines articulate the

---

162. See Reynolds, *supra* note 39, at 1. Given that many large institutional investors, including the Big Three, are signatories of the U.N. PRI, this makes the stance of large institutions against public CbCR even more puzzling. See, e.g., *Principles for Responsible Investment*, BLACKROCK, <https://www.blackrock.com/corporate/sustainability/pri-report> (last visited Mar. 7, 2024) [<https://perma.cc/G2A5-VX8W>] (acknowledging that BlackRock is a signatory of U.N. PRI); *Public Signatory Reports*, PRI, <https://www.unpri.org/signatories/reporting-and-assessment/public-signatory-reports> (last visited Mar. 7, 2024) [<https://perma.cc/43J9-YERQ>] (listing The Vanguard Group, Inc., Fidelity International, and Fidelity Investments as approved signatories).

163. See *Country-by-Country Reporting*, FIN. TRANSPARENCY COAL., <https://financialtransparency.org/issues/country-by-country-reporting/> (last visited Mar. 7, 2024) [<https://perma.cc/M25E-N6CJ>]; FIN. ACCOUNTABILITY & CORP. TRANSPARENCY COAL., *supra* note 155.

164. In fact, at least among several institutional investors, the desire to protect tax-avoiding companies from such scrutiny is what motivated their opposition. See Foley & Temple-West, *supra* note 21 (citing an institutional investor that objected to the proposal while explaining that “companies that put themselves above the parapet by reporting country-by-country payments risk scrutiny that could damage their reputation”).

165. See 17 C.F.R. § 275.206(4)-6 (2023) (requiring investment advisers to “[a]dopt and implement written policies and procedures that are reasonably designed to ensure that you vote client securities in the best interest of clients, . . . [and] describe to clients your proxy voting policies and procedures”).

166. E.g., *BlackRock Investment Stewardship: Proxy Voting Guidelines for U.S. Securities*, BLACKROCK, (Jan. 2024), <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf> [<https://perma.cc/9W29-YQWY>]; *Proxy Voting and Engagement Guidelines*, STATE ST. GLOB. ADVISORS (Mar. 2023), <https://www.ssga.com/library-content/pdfs/asr-library/proxy-voting-and-engagement-guidelines-us-canada.pdf> [<https://perma.cc/3DCA-J9ZR>]; *Proxy Voting Guidelines*, FIDELITY (Feb. 2023), <https://www.fidelity.com/bin>

institutions’ perspective on a wide range of issues, many of which pertain to ESG factors, and provide a rationale for their voting decisions in shareholder meetings.<sup>167</sup>

As the Big Three have consolidated vast power within the United States and abroad, their guidelines have gained traction among a diverse array of market actors. These include other investors, corporate management teams, proxy advisors, and law firms, all of whom admit to monitoring these guidelines closely.<sup>168</sup> Companies are often advised to review these guidelines when their boards and executives plan for engagement with the Big Three and evidently align their conduct in accordance with these guidelines.<sup>169</sup> It is therefore not surprising that proxy guidelines are now considered a crucial tool of passive governance wielded by institutional investors.<sup>170</sup>

A careful examination of the most recent guidelines released by each of the Big Three reveals a conspicuous absence: tax-related issues.<sup>171</sup> Despite their comprehensive coverage of numerous ESG concerns, such as board diversity and climate-risk disclosure, none of the guidelines contain any substantial reference to corporate taxation.<sup>172</sup> Aspects such as tax policies, tax payments, and tax transparency are glaringly missing from these influential guidelines.<sup>173</sup>

The noticeable absence of any mention of this pressing concern within the guidelines of prominent institutional investors reveals crucial insights into their stance on tax avoidance. Such an omission may be indicative of either a troubling indifference toward the mounting prevalence of corporate tax avoidance or, worse, a subtle endorsement fostering its perpetuation. Either way, the omission of explicit guidelines can be construed as an implicit nod of approval, effectively signaling to companies that they may proceed with tax-avoidance practices without fear of consequence.

---

public/060\_www\_fidelity\_com/documents/Full-Proxy-Voting-Guidelines-for-Fidelity-Funds-Advised-by-FMRCo-or-FDS.pdf [https://perma.cc/DE67-NMRU].

167. See, e.g., FIDELITY, *supra* note 166, at 8 (describing Fidelity’s guidelines on environmental and social issues).

168. Asaf Eckstein, *The Rise of Corporate Guidelines in the United States, 2005-2021: Theory and Evidence*, 98 IND. L.J. 921, 955–75 (2023) (thoroughly analyzing how corporate guidelines are used by a large set of important market players).

169. *Id.* at 963–66.

170. *Id.* at 925–26.

171. See INVESTMENT STEWARDSHIP 2022 ANNUAL REPORT, VANGUARD 4 (2023), [https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/inv\\_stew\\_2022\\_annual\\_report\\_april\\_2023.pdf](https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/inv_stew_2022_annual_report_april_2023.pdf) [https://perma.cc/E2UC-JEJC]; BLACKROCK, *supra* note 166, at 20; STATE ST. GLOB. ADVISORS, *supra* note 166, at 2–18.

172. See *supra* note 171.

173. See *supra* note 171.

The stance taken by BlackRock, explicitly disavowing any involvement in tax-related matters within its guidelines, merits even greater concern. Specifically, in reference to the shareholder proposals pertaining to tax transparency, BlackRock made the following statement:

[W]e note that some shareholder proposals seek to address topics that are clearly within the purview of certain stakeholders . . . . [W]e recognize that topics around taxation and tax reporting are within the domain of local, state, and federal authorities. [We] will generally not support these proposals.<sup>174</sup>

We find it deeply perplexing that BlackRock, despite its professed ESG-focused agenda, explicitly disclaims any prerogative on the issues of corporate taxation and tax transparency. Deeming these issues solely within the domain of tax authorities ignores the many challenges faced by global tax authorities, including those within the United States, in addressing corporate tax avoidance. Furthermore, in its statement, BlackRock fails to consider the key role played by shareholders in shaping a company's tax behavior. As we show next, the identity of a company's shareholders and their tax-avoidance preferences greatly impact the company's tax behavior. In order to foster fairer and more sustainable tax practices, it is imperative that major institutional shareholders actively embrace their responsibility in this domain rather than disclaim it.

\* \* \*

*The Effect of Institutional Ownership on Corporate Tax-Avoidance Levels.* In the realm of tax research, an emerging understanding has recognized the significant influence of ownership patterns on a company's tax behavior.<sup>175</sup>

Two notable studies have examined the impact of quasi-indexer (investment funds that aim to closely replicate the performance of a specific market index) ownership on the tax-avoidance practices adopted by the investee companies.<sup>176</sup> These studies explore the discontinuity in quasi-indexer ownership around the cutoff between the Russell 1000 and the Russell 2000 indexes to understand how

---

174. BLACKROCK, *supra* note 166, at 20.

175. See, e.g., Mihir A. Desai & Dhammika Dharmapala, *Taxation and Corporate Governance: An Economic Approach*, CONF. ON TAX'N & CORP. GOVERNANCE 10–13 (Apr. 2007), <https://ssrn.com/abstract=983563> [<https://perma.cc/3TC3-D9CZ>]; Michelle Hanlon & Shane Heitzman, *A Review of Tax Research*, 50 J. ACCT. & ECON. 127, 144–45 (2010).

176. See Shuping Chen, Ying Huang, Ningzhong Li & Terry Shevlin, *How Does Quasi-indexer Ownership Affect Corporate Tax Planning?*, 67 J. ACCT. & ECON. 278 (2019); Mozaffar Khan, Suraj Srinivasan & Liang Tan, *Institutional Ownership and Corporate Tax Avoidance: New Evidence*, 92 ACCT. REV. 101 (2017).

reconstitution of these indexes (that is, changes in their composition) correlate with tax-avoidance behavior of the companies affected by the reconstitution.<sup>177</sup> The studies compare the tax-avoidance behavior of companies at the bottom of the Russell 1000 (where the levels of quasi-indexer ownership are relatively low due to the value-weighted nature of the indices) with those of companies in the top tier of the Russell 2000 (where the levels of quasi-indexer ownership are considerably higher).<sup>178</sup> By analyzing this particular index cutoff and the resulting differences in quasi-indexer ownership levels, researchers have sought to gain insights into the relationship between institutional ownership patterns and tax-avoidance behavior. That is, the contrasting tax-avoidance behaviors observed between companies at the bottom of the Russell 1000 index and those at the top of the Russell 2000 index provide empirical evidence for the influence of quasi-indexer ownership on tax practices.

Both studies yield compelling findings, demonstrating a significant positive correlation between institutional ownership and corporate tax-avoidance levels. Specifically, the studies use two commonly used financial measures that indicate a firm’s tax-avoidance level—Generally Accepted Accounting Principles (“GAAP”) ETR and Cash ETR.<sup>179</sup> Remarkably, the results show that both are significantly higher among companies at the top of the Russell 2000. According to one of these studies, companies at the top of the Russell 2000 have 5.1% lower GAAP ETR and 7.0% lower Cash ETR than companies at the bottom of the Russell 1000.<sup>180</sup> The other study, which uses the same reconstitution index, finds that the GAAP ETR is 3.2% lower among companies at the top of the Russell 2000 compared to those at the bottom of the Russell 1000, while Cash ETR is 4.8% lower.<sup>181</sup> This translates into millions of dollars in unpaid taxes annually for an average company in their sample.

The significant findings of these studies raise an important question regarding the role of institutional owners in driving the surge of corporate tax avoidance witnessed in recent years. It appears that, rather than advocating for greater tax compliance that aligns more closely with ESG values, institutional investors—allegedly focused on ESG investing—contribute to the intensification of tax-avoidance practices.

---

177. Khan et al., *supra* note 176, at 104; Chen et al., *supra* note 176, at 279.

178. Khan et al., *supra* note 176, at 101–05; Chen et al., *supra* note 176, at 278.

179. Khan et al., *supra* note 176, at 106; Chen et al., *supra* note 176, at 279.

180. Khan et al., *supra* note 176, at 109.

181. Chen et al., *supra* note 176, at 286.

As acknowledged by Khan and co-authors, these heightened levels of tax avoidance in the presence of institutional shareholders can be achieved through various mechanisms, including the influence institutional investors wield on executive equity incentives.<sup>182</sup> Moreover, the observed preferences of influential institutional investors for aggressive tax behavior sheds light on their resistance to measures aimed at curbing such behavior.

### *C. Companies' Tax-Related Disclosures*

As previously discussed, there is a striking lack of tax-related data shared by most U.S. public companies in their public filings. Only two American companies incorporate CbCR in their financial statements,<sup>183</sup> and approximately 40% of public companies in North America provide no material tax disclosure in their reporting.<sup>184</sup>

Sustainability reports are publicly available reports that highlight a company's economic, environmental, and social impacts, whether positive or negative.<sup>185</sup> Although these reports are voluntary, amid the meteoric rise of ESG investing and an increasing demand for ESG-related information, the frequency of companies producing them has been on the upswing. For instance, in 2022, 96% of S&P 500 companies and 81% of Russell 1000 companies published sustainability reports.<sup>186</sup>

Given the importance of taxes as a socially and economically significant aspect of a company's activities, it is reasonable to expect that corporations would address their tax policies and commitments within their sustainability reports.<sup>187</sup> By voluntarily incorporating tax-related information in sustainability reports, companies can enhance

---

182. Khan et al., *supra* note 176, at 104.

183. See Hirschel-Burns, *supra* note 155 (discussing compliance with GRI tax standard by Hess Corporation and Newmont Corporation).

184. See, e.g., Bourne et al., *supra* note 72, at 16 (finding that 61% of North American companies made at least one material tax disclosure in 2020).

185. *GRI 101: Foundation 2016*, GLOB. SUSTAINABILITY STANDARDS BD. 3 (2016), <https://www.globalreporting.org/standards/media/1036/gri-101-foundation-2016.pdf> [<https://perma.cc/WX7E-7BRC>]. Companies use various titles for their impact reports (for example, Sustainable Impact Reports, Sustainability Progress Reports, Corporate Social Responsibility Reports, etc.). See *infra* notes 186–193 and accompanying text.

186. Governance & Accountability Inst., *All-Time High of Sustainability Reports Among U.S. Publicly-Traded Companies: 96% of S&P 500 and 81% of Russell 1000*, SUSTAINABILITY-REPS. (Nov. 17, 2022), <https://www.sustainability-reports.com/all-time-high-of-sustainability-reports-among-u-s-publicly-traded-companies-96-of-sp-500-and-81-of-russell-1000/> [<https://perma.cc/Q94H-B7FT>].

187. Sara Reiter, *Tax Disclosure in Sustainability Reports*, 20 J. ACCT. & FIN. 51, 51–52 (2020).

stakeholders’ understanding of their tax practices and their impact on various stakeholders, including governments and communities.<sup>188</sup>

The current reality diverges significantly from the desired ideal. A recent study focusing on the sustainability reports of 328 S&P 500 companies highlights a stark discrepancy in the inclusion of tax-related issues within these reports.<sup>189</sup> The findings reveal a concerning state of affairs. Only forty-seven companies in the sample (approximately 21%) substantially addressed tax-related issues.<sup>190</sup> Another forty-five sustainability reports merely referenced taxes in the context of financial results, such as non-GAAP disclosure calculations or risk analysis.<sup>191</sup> Significantly, the majority of the sustainability reports analyzed (72%) did not include any reference to taxes whatsoever.<sup>192</sup>

The fact that the great majority of companies fail to include meaningful reference to their tax policies and payments suggests that companies, like ESG rating agencies and large institutional investors, do not include the “T” in ESG.<sup>193</sup>

## II. INCORPORATING TAX CONSIDERATIONS INTO ESG RATINGS

In this Part, we present a case for including tax behavior in the ESG discourse. Tax payments can come under the aegis of each of the three umbrella categories of ESG. Tax revenues can obviously be used to advance environmental goals and sponsor sustainability policies. Tax behavior can also be a measure of sound corporate governance. Yet, as we will show, taxes are most relevant to the social pillar of ESG. It is wrong to think of taxes simply as an obligation that we must avoid complying with if we can. Tax payments are the means by which the government finances its programs and labors toward a better future. Without taxes, we would be left in a world of pure private ordering. In

---

188. *Id.*

189. *Id.* at 52.

190. *Id.*

191. *Id.*

192. *Id.* A more recent study delved into the question of which companies tend to provide more voluntary tax disclosure by looking at tax disclosure in twelve thousand English corporate sustainability and annual reports featuring a dedicated sustainability section and comparing the tax-related disclosure of companies with varying levels of tax avoidance. The study found that firms that are less tax aggressive are more likely to provide voluntary tax disclosures in their sustainability reports. The authors explain this by noting that firms that pay more taxes benefit from highlighting their role as responsible corporate citizens and supporters of societal welfare. See Jillian R. Adams, Elizabeth Demers & Kenneth J. Klassen, Tax Aggressive Behavior and Voluntary Tax Disclosures in Corporate Sustainability Reporting (Dec. 13, 2022) (unpublished manuscript), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4284813](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4284813) [<https://perma.cc/H8U3-3NTR>].

193. See Reiter, *supra* note 187, at 52.

this world, we would have to rely on the beneficence of corporations and the private sector. We believe that our society is not ready for this yet; in fact, we are doubtful that it ever will be.

The remainder of this Part is divided into two Sections. We begin by explaining the contribution of taxes to the social good. We show that any erosion of the tax base prevents the government from implementing socially important policies and imposes a significant cost on the least well-off. We then proceed to provide a comprehensive and detailed proposal for incorporating tax factors into ESG ratings. Our proposal dovetails with the discussion in Part I and aims to include the “T” in ESG.

### *A. Corporate Taxation as an ESG Issue*

Corporate tax avoidance—the pursuit of transactions and structures to reduce tax liability in a manner that is contrary to the spirit of the law—undermines a variety of social and sustainability goals espoused by the ESG movement.

First and foremost, corporate taxes—fundamental to the provision of public goods—constitute the backbone of societal structure.<sup>194</sup> They are a crucial source of government revenue that can be used to support necessary government functions such as public welfare, infrastructure, and education.<sup>195</sup> Furthermore, tax revenues also support sustainable governmental initiatives that benefit society, including environmentally friendly projects or initiatives targeted at addressing inequalities or fostering diversity.<sup>196</sup> Unfortunately, the U.S. government’s current unsatisfactory response to ESG challenges could be partially attributed to the erosion of tax revenues and a shrinking corporate income tax base.<sup>197</sup> Corporate tax avoidance, in this context, obstructs the government’s ability to provide essential services both now and in the future and to promote initiatives crucial for achieving a sustainable, well-ordered society.<sup>198</sup>

---

194. See, e.g., Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1, 3 (2006) (“[T]axes are needed to raise revenue for necessary governmental functions, such as the provision of public goods. And, indeed, all taxes have to fulfill this function to be effective . . . [A] government that cannot tax cannot survive.”).

195. See *id.*

196. See *Taxation and the SDGs*, UNITED NATIONS, <https://financing.desa.un.org/what-we-do/ECOSOC/tax-committee/thematic-areas/taxation-and-sdgs> (last visited Mar. 7, 2024) [<https://perma.cc/LW6H-JQFX>] (“Taxation is a powerful tool to help finance achievements of the SDGs, and it can also spur inclusive and sustainable development in other ways. Fiscal policies can simultaneously mobilize resources, reduce inequalities, and promote sustainable consumption and production patterns.”).

197. See, e.g., Klain & Strine, Jr., *supra* note 36, at 25 n.58.

198. See *id.* at 25–29.

Second, corporate tax avoidance is tightly linked to wealth and income inequality.<sup>199</sup> A growing line of research recognizes that the failure of taxpayers—individuals and companies—to pay their fair share of taxes exacerbates income and wealth disparities.<sup>200</sup> When levels of tax avoidance surge, the burden of taxation is invariably shifted onto others, particularly those in lower income brackets.<sup>201</sup> In addition, since tax avoidance by large corporations allows them (and by extension, their shareholders) to accumulate wealth more rapidly, wealthy individuals benefit most from public companies’ amplified earnings.<sup>202</sup> This is because shareholders in public companies tend to be wealthier individuals.<sup>203</sup> The costs of corporate tax avoidance, on the other hand, are borne disproportionately by lower-income individuals in their role as citizens consuming public services.<sup>204</sup> Relatedly, because smaller businesses lack the necessary resources or international presence to exploit the same tax loopholes as large multinationals, larger corporations secure an unfair competitive advantage over their smaller competitors.<sup>205</sup> For example, larger corporations’ lower ETRs

---

199. *Id.* at 10–22 (maintaining that taxation has a redistributive function aimed at reducing the unequal distribution of wealth and income in a market-based economy and explaining that this function becomes even more vital in the era of globalization and technological advancement, phenomena that have led to rising levels of inequality).

200. *See, e.g., supra* note 35.

201. *See* Natasha Sarin, *The Case for a Robust Attack on the Tax Gap*, U.S. DEPT OF THE TREASURY (Sept. 7, 2021), <https://home.treasury.gov/news/featured-stories/the-case-for-a-robust-attack-on-the-tax-gap> [<https://perma.cc/445Y-2XMT>] (noting that individuals at the higher end of the income distribution often use corporate entities and hire professionals to shield them from tax liability while wage and salary workers report nearly all of their income).

202. *See* Edward N. Wolff, *Household Wealth Trends in the United States, 1962 to 2016: Has Middle Class Wealth Recovered?* 19, 34 (Nat’l Bureau of Econ. Rsch., Working Paper No. 24085, 2017), <https://www.nber.org/papers/w24085> [<https://perma.cc/9BSE-TFHT>] (showing that as of 2016, the top 10% of American households held 84% of all stocks, and that while 94% of the wealthiest individuals in the United States maintained substantial investments in publicly held companies—specifically, stakes valued at \$10,000 or more—only a mere 27% of the middle class had comparable holdings).

203. *See id.*

204. *See, e.g.,* Genevieve Giuliano, *Low Income, Public Transit, and Mobility*, 1927 TRANSP. RSCH. REC. 63, 63 (2005) (showing that those who use public transportation on a regular basis have the lowest level of mobility among all population segments); *A New Majority: Low-Income Students Now a Majority in the Nation’s Public Schools*, S. EDUC. FOUND. 2 (Jan. 2015), <https://southerneducation.org/wp-content/uploads/documents/new-majority-update-bulletin.pdf> [<https://perma.cc/39M7-5QED>] (finding that most U.S. public school students come from low-income families).

205. *See* Ryan Fuhmann, *How Large Corporations Avoid Paying Taxes*, INVESTOPEDIA, <https://www.investopedia.com/financial-edge/0512/how-large-corporations-get-around-paying-less-in-taxes.aspx> (last updated Feb. 7, 2023) [<https://perma.cc/6K4A-BYKK>] (“Large companies use a maze of tax breaks and deductions to minimize and often eliminate their corporate income tax . . . . Profit shifting to lower-tax countries reduced taxable income reported in the U.S. by \$300 billion annually, the Congressional Budget Office estimated in 2018 . . .”).

may allow them to keep their prices below those of smaller businesses.<sup>206</sup>

Tax avoidance by large corporations has an additional social drawback: it reduces the trust and confidence of other taxpayers—namely, individuals and small businesses—in our governments and institutions. These taxpayers feel that while they pay their fair share of taxes, big, profitable corporations are manipulating the system and avoiding paying theirs.<sup>207</sup> This erosion poses a significant threat to the integrity and normal functioning of the tax system and may in itself lead to tax avoidance on behalf of taxpayers.<sup>208</sup>

The public commons of taxation—the revenue collected by tax authorities and distributed to society—benefits corporations in many ways. For example, corporations enjoy a well-funded and functioning judicial system, regulated securities markets that encourage fair transactions, a public education system that better prepares and trains future workers, and publicly financed infrastructure that permits the rapid and reliable movement of goods and services. In return, corporations are required to pay to contribute to the societies in which they operate. Thus, paying corporate tax in alignment with the spirit of the law becomes a “litmus test for corporate claims of social responsibility.”<sup>209</sup> As we have shown, many corporations make empty public statements about their commitments to ESG values yet concurrently use questionable tax strategies to reduce tax liabilities.<sup>210</sup> Addressing this contradiction through the ESG lens is an urgent necessity.

---

206. Eric Toder, Urb. Inst. & Urb.-Brookings Tax Pol’y Ctr., *Does the Federal Income Tax Favor Small Business?*, NAT’L TAX ASS’N PROC. 161–64 (2007), <https://ntanet.org/wp-content/uploads/proceedings/2007/018-toder-does-federal-income-2007-nta-proceedings.pdf> [<https://perma.cc/VJ7U-TNRN>].

207. See, e.g., J. Baxter Oliphant, *Top Tax Frustrations for Americans: The Feeling That Some Corporations, Wealthy People Don’t Pay Fair Share*, PEW RSCH. CTR. (Apr. 7, 2023), <https://www.pewresearch.org/short-reads/2023/04/07/top-tax-frustrations-for-americans-the-feeling-that-some-corporations-wealthy-people-dont-pay-fair-share/> [<https://perma.cc/5YZG-HRFM>]; Toder, *supra* note 206, at 159.

208. See, e.g., Inho Andrew Mun, *Reinterpreting Corporate Inversions: Non-tax Competitions and Frictions*, 126 YALE L.J. 2152, 2176 (2017) (“[I]nversion may lead to negative externalities on the tax compliance of American individuals or corporations.”); Orsolya Kun, *Corporate Inversions: The Interplay of Tax, Corporate, and Economic Implications*, 29 DEL. J. CORP. L. 313, 372–74 (2004) (explaining that lack of public confidence in the fairness of the U.S. tax system represents a risk to the system).

209. Prem Sikka, *Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance*, 34 ACCT. F. 153, 154 (2010).

210. See Reiter, *supra* note 187, at 52.

*B. Redesigning ESG Ratings*

As we established in the previous Section, it is inequitable and inefficient to allow public corporations to continue to dodge their tax responsibilities while they continue to receive accolades for their good citizenship based on their contribution to other ESG causes. The current state of affairs shortchanges society for two interrelated reasons. First, although there presently exists no accurate information about the precise amount corporations invest in ESG goals, it appears that those investments fall way short of the amount they save in unpaid taxes.<sup>211</sup> It makes little to no sense to heap praise upon corporations for their relatively modest contributions to societal causes while completely ignoring their tax behavior, which impoverishes the public and deprives the government of the ability to discharge its responsibilities.

Second, even if corporations were to spend their entire tax savings on ESG initiatives—a situation far from the current reality—they could not replace the government as a social planner. As we made clear throughout this Essay, investments in ESG are a blessing and should clearly be encouraged. At the same time, corporations lack the broad perspective of the government. They are inclined to invest in high-visibility ESG initiatives, such as climate change and board diversity, that appeal to their investors.<sup>212</sup> This approach enables companies to attract ESG-focused investors, making the rewards on their ESG investments particularly high.<sup>213</sup> However, this strategy also implies that a disproportionate volume of the money spent by companies on ESG efforts is funneled to the same popular goals. Other important but less publicly visible ESG goals might become significantly underfunded. These could include initiatives targeting social inequality or governance improvements, which, despite their lower public attention, are vital for creating a sustainable and equitable future.

Relatedly, ESG investments are largely influenced by market forces. The government operates differently. Government policies are largely shaped by political dynamics and electoral forces.<sup>214</sup> Decisionmaking processes within the government are far from ideal and

---

211. See Sikka, *supra* note 209, at 163.

212. See Lund, *supra* note 4, at 105–23.

213. See *id.*

214. See, e.g., Robert J. Franzese, Jr., *Electoral and Partisan Cycles in Economic Policies and Outcomes*, 5 ANN. REV. POL. SCI. 369 (2002); see also Tim Wu, *The Oppression of the Supermajority*, N.Y. TIMES (Mar. 5, 2019), <https://www.nytimes.com/2019/03/05/opinion/oppression-majority.html> [<https://perma.cc/PA2G-PEND>] (“In our era, it is primarily Congress that prevents popular laws from being passed or getting serious consideration.”).

are susceptible to the sway of powerful interest groups that exploit their political clout to extract various concessions at the expense of the public at-large. That said, the government is aware of its responsibility toward various disempowered groups in our society and is tasked with the provision of welfare. As we noted, the government depends on tax collection to fulfill its duties.<sup>215</sup> And given the unique role of the government in underwriting social and environmental policies, the tax behavior of corporations must occupy a central place in ESG rankings.

To remedy the existing state of affairs, we advocate a multifaceted approach. The change should begin with ESG rating agencies. Rating agencies ought to require corporations to provide full disclosure of their tax practices. It is startling that most prominent rating agencies do not incorporate tax behavior into their metrics.<sup>216</sup> The small minority of agencies that do factor in tax behavior, such as MSCI, sanction tax-avoiding companies only if such behavior leads to an investigation or a tax controversy.<sup>217</sup> Consequently, corporations have no incentives to pay their fair share of taxes as doing so offers no benefit to their ESG ratings.

It should be emphasized in this respect that corporations, as profit-maximizing entities, have an inherent incentive to pay as little as possible in taxes. True, corporations maximizing their profits are subject to various constraints and incentives, but currently, when it comes to paying taxes, they have no reason to abstain from dubious tax practices as doing so would exert negligible to zero impact on their ESG ratings.<sup>218</sup> Nor do corporations have a reason to disclose their tax payments, especially when their largest institutional shareholders do not deem such disclosures necessary.

This has to change. A significant stride in the right direction would be to require corporations to make their tax payments

---

215. See, e.g., Avi-Yonah, *supra* note 194, at 5–10.

216. See *supra* Subsection I.A.1; see also Peter Hongler, *Is Tax Behavior a Flawed Sustainability/ESG Metric?*, GLOBTAXGOV (Mar. 30, 2022), <https://globtaxgov weblog.leidenuniv.nl/2022/03/30/is-tax-behavior-a-flawed-sustainability-esg-metric> [<https://perma.cc/T6EM-TWZA>] (explaining where rating agencies used corporate tax behavior for between 1% and 3% of their overall ESG evaluations).

217. See MSCI, *supra* note 53, at 3.

218. There is empirical evidence that companies care about their ESG ratings. For example, a recent study shows that when a leading ESG rating agency adjusts its methodology and increases the weight of a certain criterion, firms adjust their behavior in response by changing their raw ESG scores. This impact is more pronounced within companies that have institutional investors and customers who prioritize ESG considerations. Jess Cornaggia & Kimberly Cornaggia, *ESG Ratings Management* (Penn State Univ., Working Paper, Aug. 2023), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4520688](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4520688) [<https://perma.cc/T5PH-446H>]; see also Doron Avramov, Si Cheng, Abraham Lioui & Andrea Tarelli, *Sustainable Investing with ESG Rating Uncertainty*, 145 J. FIN. ECON. 642, 663–64 (2022) (showing how ESG uncertainty affects market premium increases and demand for stocks).

transparent.<sup>219</sup> Specifically, they should include a CbCR in their public filings.<sup>220</sup> At the very least, they should be asked to provide rating agencies with such a report that includes their economic activity, profits, and tax payments in all jurisdictions. The report should cover federal and state tax payments (when applicable), as well as Social Security taxes.<sup>221</sup> The provision of full information about corporate tax payments would allow the rating agencies to evaluate the true social contribution of corporations. But the reform must not stop there.

The principle of transparency must also apply to the rating agencies themselves. Presently, the public cannot determine either the relative or the absolute weights rating agencies assign to different factors. We took a deep dive into the matter of tax considerations and emerged empty-handed. All of our attempts to receive precise information on the issue from the ESG rating agencies were met with courteous deflections. The rating criteria are considered proprietary information that is shrouded by a thick veil of secrecy. We believe that in this case, the veil of secrecy is unjustifiably dense.

One of the main criticisms against the concept of ESG investing is its inherent vagueness, which potentially paves the way for manipulation.<sup>222</sup> Leading academics have highlighted the prospect of corporations and institutional investors taking advantage of the vagueness of ESG by engaging in various “greenwashing” strategies

---

219. This proposal would evidently contradict the principal of tax privacy, which refers to the level of confidentiality and protection afforded to tax information and financial details of business entities. For an interesting overview of the traditional arguments for and against public disclosure of corporate tax information, see Joshua D. Blank, *Reconsidering Corporate Tax Privacy*, 11 N.Y.U. J.L. & BUS. 31, 48–57 (2014).

220. This aspect of the proposal aligns with the SEC’s proposed disclosures related to carbon emissions, as part of a growing awareness of the importance of ESG issues among public companies and investors. See *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors*, U.S. SEC. EXCH. COMM’N (Mar. 21, 2022), <https://www.sec.gov/news/press-release/2022-46> [<https://perma.cc/68KX-HB68>]. According to the proposal, companies would be obligated to incorporate specific climate-related disclosures within their registration statements and periodic reports, encompassing details about climate-related risks. *Id.* The objective of this endeavor is to furnish investors with consistent and useful information for making their investment decisions, a necessity that becomes especially pronounced in periods when ESG considerations gain significance among many investors. *Id.*

221. The Social Security tax is a tax levied on employees, employers, and self-employed workers that is used to fund Social Security programs for the benefit of retired individuals, the disabled, and the dependents of both. See *How Is Social Security Financed*, SOC. SEC. ADMIN., <https://www.ssa.gov/news/press/factsheets/HowAreSocialSecurity.htm> (last visited Mar. 7, 2024) [<https://perma.cc/5UTW-L8UZ>]. The Social Security tax is calculated as a percentage of gross wages. *Id.*

222. See, e.g., Jason Halper, Duncan Grieve & Timbre Shriver, *ESG Ratings: A Call for Greater Transparency and Precision*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 10, 2022), <https://corpgov.law.harvard.edu/2022/11/10/esg-ratings-a-call-for-greater-transparency-and-precision/> [<https://perma.cc/P2X7-SDKK>].

intended to mislead the public.<sup>223</sup> There is truth to the observation that ESG is a malleable concept. This does not mean, however, that ESG rating agencies should make it even more obscure by rendering the specific ESG factors they use to compute an ESG score, and the weight assigned to each factor, impenetrable and indecipherable. On the contrary, agencies should make the criteria they use, and the relative weight assigned to each criterion, transparent to the public. Demystifying the rating system would allow the public to evaluate the different rating agencies and adopt the one that most closely tracks their own preferences. Making the rating criteria public would create real competition among the different rating agencies, spurring them to refine their rating protocols. Currently, it is virtually impossible to determine the quality of the different rating agencies, except impressionistically.<sup>224</sup> This reality may serve the narrow self-interest of the rating agencies, but no one else's. If the rating agencies insist on withholding the rating criteria from the public, they should be ordered to disclose their criteria by regulation.<sup>225</sup> The public should not be kept in the dark.

Next—and this step should be implemented irrespective of the previous one—rating agencies should dramatically increase the weight they accord to tax behavior. Per our examination—which included an evaluation of the agencies' publicly available methodology documents, direct communication with representatives, and hand-collected data on the ESG score assigned to tax-aggressive companies—most rating

---

223. See, e.g., Pollman, *supra* note 1 (explaining that for many, ESG is seen as greenwashing that “misleads investors or stakeholders, inhibits corporate accountability, or displaces other concepts and proposed solutions for societal problems”); see also Adriana Z. Robertson & Sarath Sanga, *Aggregating Values: Mutual Funds and the Problem of ESG*, U. CHI. L. REV. ONLINE ARCHIVE (Mar. 29, 2023), <https://lawreviewblog.uchicago.edu/2023/03/29/robertson-sanga-evaluating-esg-funds/> [<https://perma.cc/45BQ-VUVK>].

224. See Larcker et al., *supra* note 23, at 2–3 (noting that the effectiveness of ESG ratings is uncertain); Halper et al., *supra* note 222 (recognizing that ESG rating agencies have diverging ranking methodologies and issue groupings that lead to questions about how these ratings should be used).

225. There are numerous regulations across various sectors that require the disclosure of information. For example, FDA regulations require that certain information such as nutritional information, ingredients, and potential allergens in food products be disclosed on the packaging of food and pharmaceutical products. *Daily Value on the Nutrition and Supplement Facts Labels*, U.S. FOOD & DRUG ADMIN. 2, <https://www.fda.gov/media/135301/download?attachment> (last updated Sept. 27, 2023) [<https://perma.cc/K2QQ-WJZ3>]; *FDA's Labeling Resources for Human Prescription Drugs*, U.S. FOOD & DRUG ADMIN., <https://www.fda.gov/drugs/laws-acts-and-rules/fdas-labeling-resources-human-prescription-drugs> (last updated Jul. 13, 2023) [<https://perma.cc/Y64K-EM5Y>]. The Truth in Lending Act of 1968 (“TILA”) requires lenders to provide consumers with loan cost information so they can compare various loan and credit offers. Truth in Lending Act, Pub. L. No. 90-321, § 102, 82 Stat. 146, 146 (1968). TILA requires disclosures of information such as the annual percentage rate, term of the loan, and total costs to the borrower. *Id.*

agencies accord no significance whatsoever to tax behavior. With the exception of one rating agency that, despite providing very little guidance on its incorporation of tax-related issues, does seem to sanction companies for paying a low ETR, the great majority of the agencies do not.<sup>226</sup>

The very limited fashion in which tax-related behavior is factored into ESG scores shortchanges the public as it gives corporations no incentive to adopt pro-social tax policies—despite the fact that pro-social behavior forms the bedrock of ESG values. We therefore call on ESG rating agencies to start reflecting tax considerations—both positive and negative—in their rating calculations and assign them significant weight. This can be accomplished in one of several ways. For example, it is possible to reward companies that pay taxes in full. Alternatively, corporations resorting to aggressive tax strategies enabling them to minimize their tax payments could have their scores reduced. Since the ratings are relative, either approach would cast corporations that pay their fair share in taxes in a more favorable light than their peers that do not.

For our scheme to work, ESG rating agencies should not be allowed to suffice themselves with paying lip service to tax considerations. They must give the matter real weight. To ensure that they do, we posit that even if rating agencies refuse to give the public full disclosure of how they rate companies based on ESG performance, they should, at the very least, notify the public about the weight they give to tax considerations. Why should taxes be treated differently? Again, as we have made abundantly clear, we believe that the entire rating system should be completely transparent, yet taxes are special for two reasons. First, taxes serve the crucial purpose of benefiting the public and financing projects that not only align with but actively promote ESG objectives. These objectives encompass a wide spectrum of considerations, such as environmental sustainability, social equity, and responsible corporate governance, which play a pivotal role in advancing societal and ethical imperatives. Second, when companies adopt strategies that reduce their tax payments, other groups in our society have to make up for the shortfall in collection.

One measure ESG rating agencies can use to ensure that tax considerations receive their appropriate weight in the ratings is to examine how much each company invests in ESG relative to its tax “savings.” To this end, it is possible to devise a ratio with the numerator being a company’s annual investment in ESG in proportion to its revenues and the denominator as the difference between a company’s

---

226. *See supra* Section I.A.

ETR and the statutory income tax rate.<sup>227</sup> A very low ratio should raise serious concerns about a company's ESG profile, while a ratio that is close to one or higher than one would constitute a strong indication of the company's commitment to ESG. It is also possible to incorporate said ratio into the existing rating system.

ESG rating agencies are not the only actors that can bring about a change in the tax behavior of public corporations. Institutional investors that have so far been part of the problem can also be part of the solution. It cannot seriously be doubted that institutional investors have a profound impact on the policies and actions of public companies.

In Part I, we demonstrated how institutional investors induce their portfolio companies to minimize their tax payments.<sup>228</sup> In that sense, institutional investors speak from both sides of their mouths. On the one hand, they put in place mechanisms aimed at encouraging corporations to pay as little as possible in taxes, and on the other, they publicly gloat about how they act in a socially responsible manner and ensure that their portfolio companies do the same. Institutional investors are not all talk. They should absolutely get credit for the role they play in diversifying corporate boards and stewarding multiple environmental goals. Yet, there is much ground to cover on the ESG front. Institutional investors, which clearly have the ability to shape the tax behavior of their portfolio companies, must initiate action in the tax arena. An important first step could be the inclusion of a clear reference to socially responsible tax behavior in their guidelines. Calling on companies to meet their fair share of the tax load, without more, can start bringing companies around. Although one might be skeptical about the effectiveness of such a call without an accompanying sanction, scholars have documented the ability of institutional investors to change the norms of the corporate world.<sup>229</sup>

---

227. This formula would apply in cases where the ETR is lower or equal to the statutory tax rate. Because our proposal applies to U.S. companies, the federal income tax rate would be the U.S. federal tax rate. The use of the difference between a company's ETR and the statutory tax rate as a proxy for its level of tax avoidance is consistent with tax practice and research. The underlying assumption is that companies start by leveraging less aggressive tax strategies, and, as the level of ETR declines, they progressively shift toward more aggressive measures on the tax-avoidance spectrum. *See, e.g.*, Khan et al., *supra* note 176, at 103. In that context, it is important to note that variances between a company's ETR and the federal income tax can be attributed to factors like lower tax rates on foreign earnings. Thus, the difference may often be indicative of the utilization of tax havens and establishment of offshore companies.

228. *See supra* Subsection I.B.2.

229. *See, e.g.*, Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders* (N.Y.U. L. & Econ. Working Paper No. 467, 2019), [https://ecgi.global/sites/default/files/working\\_papers/documents/kahanrockfinal.pdf](https://ecgi.global/sites/default/files/working_papers/documents/kahanrockfinal.pdf) [<https://perma.cc/8N2F-F7WE>]; Amil Dasgupta, Vyacheslav Fos & Zacharias Sautner, *Institutional Investors and Corporate Governance*, 12 *FOUNDATIONS & TRENDS FIN.* 276 (2021).

To give more credibility to their emphasis on tax behavior, institutional investors can devise their own rankings of their portfolio companies based on the companies’ tax profiles. They may even communicate with the management of companies whose tax performance does not meet expectations and request explanations for their performance. Companies that lag behind their peers may also be asked to come up with a plan to improve their tax behavior in the future.

Should emphasis on tax payment importance prove ineffective, institutional investors should consider adopting a policy of divestment or abstention from investing in companies that systematically display low ETRs.<sup>230</sup> This measure should be used only against companies whose tax behavior falls way short of their peers. Hence, we propose that divestment should be reserved for companies whose tax payments fall significantly below those of their peers. To this end, we suggest considering a threshold of two standard deviations below the industry’s mean ETR over a three-year timeframe as indicative of a substantial deviation from industry norms. Adopting this policy would spur institutional investors to monitor the tax behavior of their portfolio companies on an ongoing basis. At the end of the day, if institutional investors genuinely care about ESG values, they must take affirmative steps to alter their own policies on taxes and, subsequently, those of their portfolio companies.

## CONCLUSION

There is much to commend about ESG investing, and corporations that advance ESG goals should be lauded. At the same time, we are of the opinion that tax considerations should be part and parcel of the ESG ratings and accorded considerable weight. The rating criteria, as they currently stand, shortchange society and harm its least well-off members by encouraging corporations to pocket astronomical amounts in unpaid taxes, invest a relatively small proportion of these savings in ESG efforts, and then still receive public adulation. Ratings matter. They affect behavior. Once performance metrics are adopted, the subjects to whom the measures apply will strive to do well on those measures and ignore everything else. As long as the rating criteria do

---

230. Several foreign investment funds have already taken actions in the same direction over the last couple of years. See, e.g., Gwladys Fouche, *For First Time, Norway’s Wealth Fund Ditches Firms over Tax Transparency*, REUTERS (Feb. 1, 2021, 3:08 AM), <https://www.reuters.com/article/us-norway-swf-idUSKBN2A11TR> [<https://perma.cc/7HDT-YTU3>] (describing how Norway’s \$1.3 trillion sovereign wealth fund, a well-known leader in the responsible investment space and one of the world’s largest investors, divested from several companies over their aggressive tax planning and lack of transparency).

not give taxes their proper place and weight, the effect of the ratings will be to bolster the inherent incentive of large corporations to minimize their effective tax payments.

An ancient truism maintains that with great power comes great responsibility. Yet, some of our most powerful public corporations, together with the largest institutional investors and the ESG rating agencies, found a way to abdicate their responsibility. Worse yet, by lowering their ETRs to the bare minimum possible, these corporations have hamstrung the government from performing its duties to the citizenry by depriving it of massive funds that could be spent on important social policies. In this Essay, we proposed a way to correct this distortion. The ETR should and can become a key consideration in ESG ratings. The benefits from including tax considerations are considerable and such inclusion can be done at no real cost. The implementation of our proposal will not only provide a much more accurate measure of ESG performance but will also result in more transparent and socially responsible tax behavior. Above all, it will furnish the government with much-needed funds that would allow it to promote societal goals and policies, such as health, welfare, equality, and infrastructure, that fall outside the scope of ESG investing or receive scant attention from market actors.

## APPENDIX

TABLE 1A: ESG SCORES OF S&P 500 COMPANIES THAT PAID ZERO TAX IN 2020<sup>231</sup>

Corporation	ETR in 2020	MSCI	ISS ESG	Sustainalytics	Refinitiv
Advanced Micro Devices	0%	A	B-	20.4 (Medium Risk)  Ranked 64 of 325	70  Ranked 42 of 247
Akamai Technologies	-4.40%	AA	C+	16.5 (Low Risk)  Ranked 120 of 1,098	70  Ranked 78 of 914
Albemarle	-0.30%	BBB	C-	26.1 (Medium Risk)  Ranked 112 of 548	69  Ranked 74 of 445
American Electric Power	-6.40%	A	C	26.3 (Medium Risk)  Ranked 206 of 706	77  Ranked 29 of 296
Archer-Daniels Midland	-37.40%	AA	C	31.7 (High Risk)  Ranked 197 of 609	84  Ranked 12 of 453
Ball	-17.10%	AA	B-	11.1 (Low Risk)  Ranked 4 of 104	73  Ranked 11 of 90

231. The ESG scores presented in the table are accurate as of April 2023. MSCI's ESG ratings span from AAA (leader) to CCC (laggard). ISS ESG ratings range from A+ (excellent) to D- (poor). Sustainalytics adopts a scale from 0 (negligible risk) to 40 (severe risk), whereas Refinitiv's scale ranges from 100 (excellent) to 0 (very poor).

Corporation	ETR in 2020	MSCI	ISS ESG	Sustainalytics	Refinitiv
Booz Allen Hamilton Holding	-0.50%	BBB	C-	16.6 (Low Risk) Ranked 119 of 1,098	62 Ranked 144 of 914
Cabot Corp.	-13.20%	Missing from MSCI ratings	C+	25.9 (Medium Risk) Ranked 99 of 548	81 Ranked 16 of 445
Charter Communications	-0.20%	BB	C-	24.1 (Medium Risk) Ranked 168 of 291	40 Ranked 139 of 260
CMS Energy	-4%	AA	C	21.3 (Medium Risk) Ranked 115 of 706	58 Ranked 25 of 47
Community Health Systems	-0.30%	Missing from MSCI ratings	C	33.9 (High Risk) Ranked 469 of 607	55 Ranked 73 of 203
Consolidated Edison	-0.20%	AA	C	32.4 (High Risk) Ranked 329 of 706	64 Ranked 88 of 296
Danaher	-20.30%	AA	C	11.9 (Low Risk) Ranked 4 of 906	82 Ranked 10 of 353
Dexcom	0%	A	C	23.7 (Medium Risk) Ranked 218 of 607	48 Ranked 122 of 353

Corporation	ETR in 2020	MSCI	ISS ESG	Sustainalytics	Refinitiv
Dish Network	-9.10%	CCC	D+	21.7 (Medium Risk) Ranked 271 of 291	39 Ranked 152 of 285
DTE Energy	-16.10%	AA	C	30.2 (High Risk) Ranked 285 of 706	83 Ranked 16 of 296
Duke Energy	-34%	AA	C+	27.2 (Medium Risk) Ranked 224 of 706	69 Ranked 65 of 296
Ecolab	-52.60%	AAA	C+	19.9 (Low Risk) Ranked 16 of 548	78 Ranked 32 of 445
FedEx	-18.90%	A	C-	20.5 (Medium Risk) Ranked 86 of 395	73 Ranked 16 of 204
FirstEnergy	-1.30%	BBB	C	25.7 (Medium Risk) Ranked 189 of 706	68 Ranked 73 of 296
Fiserv	-2.30%	A	C-	18.7 (Low Risk) Ranked 230 of 1098	61 Ranked 105 of 459
Hologic ETR	-7%	AA	C+	25 (Medium Risk) Ranked 244 of 607	73 Ranked 56 of 353

Corporation	ETR in 2020	MSCI	ISS ESG	Sustainalytics	Refinitiv
Howmet Aerospace	-2.30%	BBB	C	26.2 (Medium Risk) Ranked 13 of 106	65 Ranked 17 of 117
HP	-2.80%	AA	B+	10.7 (Low Risk) Ranked 34 of 661	81 Ranked 38 of 656
Interpublic Group	-18.50%	AA	C-	10.4 (Low Risk) Ranked 8 of 291	58 Ranked 58 of 285
Jacobs Engineering Group	-17.40%	A	C+	Missing from Sustainalytics ratings	84 Ranked 10 of 295
Kinder Morgan	-3.10%	A	C+	36.3 (High Risk) Ranked 110 of 196	86 Ranked 5 of 233
Lincoln National	-14.40%	Missing from MSCI ratings	C-	17.9 (Low Risk) Ranked 34 of 297	67 Ranked 61 of 345
Mowhawk Industries	-38.90%	Missing from MSCI ratings	C	14.3 (Low Risk) Ranked 47 of 235	Missing from Refinitiv ratings
Nike	-3.80%	BBB	B-	19.6 (Low Risk) Ranked 135 of 195	71 Ranked 20 of 151
Nucor	-14.50%	A	C	29.9 (Medium Risk) Ranked 12 of 152	58 Ranked 193 of 647

Corporation	ETR in 2020	MSCI	ISS ESG	Sustainalytics	Refinitiv
Owens & Minor	-6%	Missing from MSCI ratings	C-	18.8 (Low Risk) Ranked 80 of 607	61 Ranked 77 of 353
Penske Automotive Group	-15.50%	Missing from MSCI ratings	D+	12.6 (Low Risk) Ranked 42 of 502	48 Ranked 136 of 286
PPL Corp.	-1%	BBB	C	31.5 (High Risk) Ranked 315 of 706	60 Ranked 19 of 47
Quarate Retail Group	-1.20%	Missing from MSCI ratings	D+	27.7 (High Risk) Ranked 466 of 502	Missing from Refinitiv ratings
Salesforce	-0.50%	AA	B-	12.8 (Low Risk) Ranked 20 of 1,098	68 Ranked 96 of 914
Sanmina-SCI	-1%	Missing from MSCI ratings	C-	11.5 (Low Risk) Ranked 61 of 661	66 Ranked 50 of 247
Seaboard	-36.80%	Missing from MSCI ratings	D	51.1 (Severe Risk) Ranked 596 of 609	13 Ranked 426 of 453
Sealed Air	-4.40%	BBB	C-	16.4 (Low Risk) Ranked 25 of 104	59 Ranked 32 of 90
Telephone & Data Systems	-61.60%	Missing from MSCI ratings	C-	36.9 (High Risk) Ranked 227 of 230	34 Ranked 168 of 260

Corporation	ETR in 2020	MSCI	ISS ESG	Sustainalytics	Refinitiv
Textron	-0.40%	A	C-	33.7 (High Risk)  Ranked 37 of 106	79  Ranked 6 of 117
TreeHouse Foods	-1167.10%	Missing from MSCI ratings	D+	34.0 (High Risk)  Ranked 242 of 609	61  Ranked 133 of 453
Tyler Technologies	-6%	BBB	C-	19.8 (Low Risk)  Ranked 285 of 1,098	62  Ranked 152 of 914
UGI	-20.20%	AAA	C	31.4 (High Risk)  Ranked 313 of 706	62  Ranked 17 of 65
Unum Group	-10.70%	Missing from MSCI ratings	C-	17.4 (Low Risk)  Ranked 30 of 297	61  Ranked 91 of 345
Verisign	-27.70%	A	C-	21.4 (Medium Risk)  Ranked 399 of 1,098	53  Ranked 263 of 914
Voya Financial	-4.60%	Missing from MSCI ratings	D+	24.9 (Medium Risk)  Ranked 142 of 297	73  Ranked 36 of 434
Westlake Chemicals	-91.60%	BB	D+	31.1 (High Risk)  Ranked 226 of 548	51  Ranked 176 of 445

Corporation	ETR in 2020	MSCI	ISS ESG	Sustainalytics	Refinitiv
Williams Companies	-10.40%	BBB	C+	23.1 (Medium Risk) Ranked 17 of 196	71 Ranked 31 of 233
Xcel Energy	-0.90%	AAA	C+	23.6 (Medium Risk) Ranked 150 of 706	82 Ranked 19 of 296