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Clarifying the relationship between ESG and tax and empowering corporate tax governance

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Abstract: *ESG performance is a key indicator for enterprises to fulfil their environmental and social responsibilities, improve corporate governance, and implement the dual-carbon goal, while corporate tax governance is an important means to drive green economic growth and help achieve the goal of sustainable development. In order to explore the theoretical logic of corporate tax governance and the realisation path of ESG-enabled corporate tax governance, this paper discusses the significance of ESG performance on corporate tax governance and explores the impact mechanism of corporate tax governance on ESG performance. In the new era, ESG concepts should be effectively integrated into corporate tax governance and potential opportunities should be explored, so as to achieve the goal of high-quality and sustainable development of China's economy through the optimization of tax strategies, the improvement of tax management and the enhancement of tax transparency.*

Keywords: *ESG; Taxation governance; Sustainable development*

1. Introduction

With the rapid development of the global economy, enterprises are increasingly focusing on their environmental, social, and governance (ESG) performance alongside pursuing economic benefits. ESG, emerging as a pivotal business aspect, has transformed into a crucial indicator of sustainable development and is akin to a license to operate. It significantly bolsters corporate image, attracts investors, and mitigates risks[1]. However, some enterprises have deficiencies in ESG performance, leading to a series of negative impacts, such as environmental pollution, lack of social responsibility, and unsound governance structure. Therefore, how to improve corporate ESG performance has become one of the important issues facing enterprises today. In this context, corporate tax governance, as an important part of corporate management, has gradually received attention for its impact on ESG performance. Tax governance involves the enterprise's tax strategy, risk management, internal control and other aspects, and has an important impact on the economic efficiency and compliance of the enterprise. As one of the most important decisions of enterprises, corporate tax departments should consider the relationship between ESG and tax, and clarify the mechanism of corporate tax governance on achieving ESG objectives, in order to help enterprises better carry out tax governance, effectively manage tax risks, fulfil their social responsibilities, improve ESG performance, and achieve long-term sustainable development of enterprises.

2. Drivers of the widespread interest in ESG

ESG first appeared in its entirety in 2004 in the UN Global Compact's Who Cares Wins report, which stated that financial institutions were expected to integrate ESG considerations into their investment activities and that companies should incorporate environmental, social and governance (ESG) considerations into business decision-making. 2006 saw the establishment of the UN's Principles for Responsible Investment (PRI), an organisation dedicated to the use of ESG as an indicator of corporate sustainability. As an indicator of corporate sustainability. As a result, ESG has evolved into a mainstream global investment norm and a new type of standard.ESG focuses on the environmental, social and governance effectiveness of corporate behaviour and operations. Specifically, the environmental dimension focuses on how a company adopts sustainable and effective environmental management measures to improve its pollution control capability[2]. The social dimension focuses on whether enterprises can maximise the value of investors, suppliers, employees and other stakeholders[3] .

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The governance dimension focuses on the ability of executives to coordinate and allocate various resources and the way the firm operates. Theoretically, the concept of ESG can be attributed to "stakeholderism", which opposes "maximising shareholder value", so why has ESG received so much attention? The main reasons are as follows:

2.1 Attention to environmental issues

The World Economic Forum's Global Risks Report states that over the next 10 years, the top three of the top ten global risks will be climate and environmental risks. Environmental issues have attracted global attention and provoked companies to establish a strategic awareness of long-term business operations. The promotion of ESG concepts is aimed at guiding investors to invest their capital in greener areas, thereby contributing to the improvement of the environment and the development of society. By incorporating ESG considerations into their long-term development strategies, companies can continue to create and unlock value in the environment, the economy and society, and realise the goal of sustainable development.

2.2 Driven by social responsibility and return on investment

As society develops and public awareness rises, corporate performance in terms of social responsibility is receiving more and more attention. Investors have recognised that including ESG performance in their consideration criteria can help to achieve long-term sustainable investment returns. At the same time, ESG investments have driven companies to pay more attention to social issues such as human rights and employee welfare, and this emphasis on social responsibility coincides with current societal values and expectations, hence the attention.

2.3 Stakeholder needs

All internal and external stakeholders, from corporate employees and managers to customers, suppliers, consumers, and the public, put forward higher requirements and expectations for corporate ESG performance, prompting companies to continuously strengthen their ESG awareness. For enterprises themselves, good ESG governance can attract talent, acquire resources, develop markets, build brand reputation, and enhance the value of corporate sustainability[4]. For clients, customers prefer to establish long-term relationships with companies with good ESG performance. At the same time, companies with high ESG scores not only do a good job of ESG management in their own segments, but also drive up the ESG performance of the entire industrial value chain by setting a series of upstream and downstream access conditions. Millennial consumers are more concerned about the ESG attributes of products and services, and are more willing to pay for green, low-carbon and environmentally friendly products.

2.4 Driven by policies and regulations

Many countries and regions have introduced relevant regulations and policies that require companies to pay more attention to ESG factors and incorporate them into their decision-making and operations. The promotion of policies and regulations not only helps to raise the level of ESG awareness and practice among enterprises, but also facilitates the promotion of sustainable development and green finance, among other aspects. Through the formulation of mandatory and advocacy policies, governments can promote corporate investment and innovation in ESG and push society as a whole towards a more sustainable and inclusive direction.

3. Mechanisms of Corporate Tax Governance on ESG Performance

Corporate tax governance plays a key role in improving ESG performance.ESG is an important criterion for assessing corporate sustainability and social responsibility, while tax governance involves corporate compliance and ethics in tax matters. Effective tax governance reduces a company's tax risk and improves its financial soundness, which in turn provides the company with more resources and capabilities in terms of ESG.

3.1 Tax Governance and Environmental Performance

An enterprise's tax strategy can have a direct or indirect impact on its green behaviour. By reasonably optimising their tax strategies, enterprises can reduce their reliance on high-carbon energy sources and can also be incentivised to make green investments and innovations. Specifically, the enterprise tax department can make use of the tax preferential policy of 100% deduction for green R&D expenses to incentivise enterprises to invest in green technology research and development. Corporate tax departments can make use of preferential policies such as tax credits and reductions to encourage enterprises to invest in renewable energy, emission reduction and other environmental protection projects, so as to reduce carbon emissions and improve the environmental protection image of enterprises[5]. For example, the first three years of qualified environmental protection income can be exempted from enterprise income tax, and the fourth to sixth years of enterprise income tax can be reduced by half. Enterprises can also actively participate in the carbon trading market and flexibly utilise tax strategies to reduce carbon emission costs, such as crediting corporate tax liability for the purchase and installation of clean energy equipment. At the same time, government subsidies, subsidised loans and other fiscal policies can effectively alleviate corporate financing constraints and increase revenue streams, while tax breaks and concessions increase corporate profitability. Both can drive enterprises to invest more funds in green projects, optimise their green and low-carbon behaviours, and improve their decision-making efficiency and environmental performance.

3.2 Tax Governance and Social Responsibility

Tax governance of enterprises is closely related to social development. On the one hand, good tax governance can ensure that enterprises pay taxes in accordance with the law and provide financial support for social development; on the other hand, by optimising tax strategies, enterprises can better fulfil their social responsibilities and improve their social image. Specifically, the enterprise tax department can encourage enterprises and employees to actively engage in public welfare and charitable behaviours and take the initiative to undertake social responsibility through the preferential deduction policy in income tax for public welfare donations and disaster relief donations, and constantly improve the enterprise's financial support for education, poverty alleviation, community development, etc., which will help to realize the common prosperity of the society and enhance the enterprise's social reputation. The enterprise tax department can also make use of the tax preferential policy of additional deduction for employee welfare expenses to motivate enterprises to enthusiastically carry out employee education and training business and sports and cultural activities, and actively pay medical insurance for employees, in order to improve the happiness and sense of belonging of the enterprise employees, promote social harmony, and then enhance the social performance of the enterprise. At the same time, enterprises' sponsorship and support of culture and arts not only get tax incentives, but also reflect the good social value of the enterprises themselves.

3.3 Tax governance and Corporate Governance

The relationship between tax governance and corporate governance is mainly reflected in compliance and risk management. Good tax governance can ensure that an enterprise's tax behaviour complies with relevant regulations, improve the transparency of tax policies and reduce compliance risks. At the same time, effective tax risk management can also help enterprises identify and respond to potential tax risks and safeguard the sound operation of enterprises. Firstly, compliance management and internal control of corporate tax governance can ensure that the tax behaviours of enterprises comply with national tax regulations and relevant policies, prevent irregularities such as false tax returns, tax avoidance or tax evasion, and avoid legal risks and economic losses as a result, so as to improve the level of corporate governance. Secondly, the transparency and credibility of corporate tax governance can enhance stakeholders' trust and recognition of the enterprise. The corporate tax department can elevate corporate governance standards by actively disclosing tax-related information, encompassing tax payment practices, tax planning strategies, and thorough revelations of pertinent initiatives. This enhances the enterprise's credibility and accountability, thereby attracting more partnerships, expanding market share, and boosting profitability. Again, risk management and internal control of corporate tax governance can help enterprises identify, assess and manage potential tax risks. By establishing a sound and complete risk management mechanism and internal control mechanism, enterprises can identify and solve potential tax problems in a timely manner and better prevent and control tax risks in order to improve the level of corporate governance. Finally, through government subsidies and tax relief concessions, enterprises can give the management of the enterprise more

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disposable financial resources, incentivise it to better perform the principal-agent relationship, improve decision-making efficiency, and maximise the value of stakeholders.

4. Promoting ESG concepts to empower corporate tax governance

The relationship between corporate tax governance and ESG is a complex and critical area of research, and the use of tax measures to enhance ESG performance is a key strategy when companies are actively involved in sustainability and social responsibility issues. Therefore, corporate tax departments should be more extensively involved in corporate decisions or issues related to ESG, establishing the intrinsic intersection of tax strategies with corporate values and development strategies, and at the same time communicating corporate responsibility for ESG to various stakeholders. Based on the analysis of the mechanism of corporate tax governance to achieve ESG objectives in the previous section, corporations can achieve a comprehensive improvement of ESG performance with the help of tax incentives by actively participating in environmental protection investment, promoting the research and development of green technologies, and supporting social responsibility projects and other actions. In addition to the above realisation paths, corporate tax departments should also consider the following focus points to empower corporate tax governance with ESG concepts:

4.1 Anchoring ESG objectives to optimise corporate tax strategy

Maintaining consistency between ESG objectives and tax strategies is an important aspect that enterprises need to focus on in the process of sustainable development. Enterprises can effectively optimise their tax strategies on the basis of assessing their ESG development objectives to achieve a win-win situation for both tax benefits and ESG objectives. Specifically, firstly, enterprises need to analyse their current tax strategies and ensure that the tax strategy fits with the ESG objectives. For example, if one of the ESG objectives is to achieve a green and low-carbon economy, the enterprise's tax strategy should encourage and reward behaviours that reduce resource consumption and carbon emissions to create synergy with the ESG objectives. Secondly, companies should be adept at identifying ESG benefits and incentives to optimise their tax strategies. ESG-related activities are usually supported and encouraged by governments and regulators, which may provide tax preferences and incentives. For example, the government may provide tax deductions or credits to enterprises that reduce pollution emissions, adopt clean energy or implement resource recycling; to encourage enterprises to carry out technological innovation and research and development in the ESG area, the government may provide additional deduction for research and development expenses, tax credits and so on. Enterprises can adjust their tax planning plans based on this to take advantage of tax incentives and optimise their tax strategies.

4.2 Learning ESG concepts to help corporate tax management

The ESG concept plays an important role in enterprise tax management, which can help enterprises manage tax affairs more comprehensively and effectively, reduce tax risks, improve tax compliance, and provide a strong guarantee for the sustainable development of enterprises. Specifically, firstly, enterprises can make use of the environmental and social factors in the ESG concept to reduce tax risks. For example, for enterprises operating in environmentally sensitive areas, they can pay more attention to tax risks related to environmental protection tax and carbon emission tax, and establish a tax risk early warning mechanism to identify and respond to potential tax risks in a timely manner, and avoid or reduce the occurrence of tax violations. Secondly, enterprises can make use of the governance factors in the ESG concept to enhance tax compliance. For example, enterprises can reduce tax planning risks by establishing a sound corporate governance structure, improving the internal control system, and strengthening internal auditing and supervision to ensure tax planning compliance and reasonableness. Meanwhile, ESG concepts emphasise long-term development of enterprises and help promote collaboration among various departments within enterprises. By learning the ESG concept, enterprises can strengthen internal training and cultural construction, improve employees' understanding of and attention to tax management, and form a good atmosphere of full participation and joint management. This helps to improve the overall level and efficiency of enterprise tax management and provide strong support for the sustainable development of enterprises.

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4.3 Implementing ESG commitments and improving corporate tax transparency

Enterprises should pay taxes in accordance with the law and actively make corresponding visual disclosure, which is a key component for enterprises to implement their ESG commitments. Based on the analysis of the previous content, enterprises can improve tax transparency by establishing a sound tax management system, implementing ESG disclosure including tax information, strengthening internal auditing and monitoring, cultivating employees' ESG awareness and tax compliance awareness, and strengthening cooperation and communication with various stakeholders such as the government and tax authorities. Concurrently, the enterprise's tax department ought to harness diverse information technologies to precisely articulate tax affairs and foster tax transparency. Implementing automation tools like Enterprise Resource Planning (ERP) systems can expedite tax procedures, minimize manual errors and delays, and augment the clarity and precision of tax data, thereby ensuring more precise and transparent tax disclosures.

5. Conclusion

In the current era of globalisation and sustainable development, ESG (Environmental, Social and Governance) performance has become a key and indispensable element of corporate success. Corporate tax governance, as an important means to promote green economic growth and help achieve the SDGs, is closely linked to ESG performance, which is widely recognised as a result of the emphasis on environmental issues, the drive for social responsibility and return on investment, the needs of stakeholders, and the impetus of policies and regulations. Therefore, enterprises should deeply understand the close connection between ESG and tax governance, effectively integrate ESG concepts into tax governance, optimise tax strategies, improve tax management and enhance tax transparency to improve their ESG performance, enhance their long-term competitiveness, achieve win-win results for the economy, society and the environment, and contribute to the high-quality and sustainable development of China's economy.

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