Why tax is essential for comprehensive and transparent CSRD reporting

31 October 2024

With the landscape of corporate sustainability ever evolving, the Corporate Sustainability Reporting Directive ("CSRD") marks a significant step towards greater transparency and accountability. A crucial aspect which may fly under the radar is the role of taxation.

Tax should be considered when assessing a company's environmental, social and governance ("ESG") processes for reporting, investment, or for other purposes. Its inclusion should aid entities in the facilitation of a holistic approach to sustainability being fostered.

By addressing their tax policies and practices, entities can demonstrate their commitments to ethical governance, contribute to societal well-being, and enhance their reputational capital.

This article explores whether tax may need to be viewed as a fundamental component for entities within scope of the CSRD.

Tax may not ultimately be included as a material topic following an initial assessment, however with corporate sustainability reporting requirements becoming more prevalent globally and investors increasingly considering a business' strategy and transition plan in response to actual and potential impacts, risks and opportunities ("IROs"), tax might play a significant role in the response to these IROs.

The European Union has been implementing iterations of corporate sustainability reporting over the last five years, with the European Commission establishing the European Green Deal in 2019 and the Non-Financial Reporting Directive ("NFRD").

The CSRD has been adopted and was due to be transposed into the national laws of EU Member States by 6 July 2024, resulting in new reporting requirements for entities within the scope of same.

Corporate sustainability reporting in accordance with CSRD will be required on a phased basis for financial years commencing 01 January 2024 through to 2028. Pro-active engagement to address reporting requirements as required by CSRD is essential to managing the administrative burden for undertakings.

CSRD requires corporate sustainability reporting in accordance with the European Sustainability Reporting Standards ("ESRS") with double materiality assessments forming part of the mandatory reporting requirements outlined within ESRS 2.

Double materiality assessment

A double materiality assessment ("DMA") is necessary to identify material topics, sub-topics, sub-sub topics or aspects of topics within environmental ("E"), social ("S"), and governance ("G"), which must be disclosed in the sustainability statement, included in the management report of the undertaking's annual report.

How to determine if tax is a material sustainability topic for your business

Is the tax strategy key for sustainability statement stakeholders?

Whilst tax is not a specific topic listed in the ESRS, it is intertwined with business strategy, risk management and governance. It is not possible to state that tax will be a material topic for all undertakings, but it is essential that it is taken into consideration during the DMA.

What is the market dictating?

Governments have been introducing tax incentives to encourage undertakings to adopt more sustainable business practices. Examples include accelerated capital allowances for energy efficient fixed assets, benefit-in-kind relief for company provided vehicles (depending on a vehicle's CO2 emissions and business mileage undertaken) and so forth.

Policies such as EU Carbon Border Adjustment Mechanism ("CBAM") are also being introduced, which creates the need for businesses to continually monitor, assess and report upon their respective carbon impact.

Our tax team's insight

Tax governance policies and procedures are expected to increase. In particular, changes to business models, value chains, and logistic models are expected to be reviewed and updated to limit the overall impact on the planet. Tax governance will play an instrumental role through this transition period of an organisation.

The social and governance aspects of corporate sustainability reporting are closely entwined when looking at these through the lens of taxes. This is due to tax being a key source of government revenue and as such, is central to a country's fiscal policy.

Therefore, the impact of poor tax governance (i.e. policies, processes, procedures, and controls) across sustainable and "traditional" tax initiatives, compliance, reporting, and planning is widely viewed by the public in unfavourable light.

Transparency around adoption of sustainable business models and practices and the associated tax implications as well as corporate sustainability reporting requirements is an area that more businesses are expected to disclose.

Furthermore, businesses are finding themselves with additional tax reporting requirements to be managed in addition to “traditional” tax initiatives to ensure transparency in tax reporting. The additional reporting burden on tax teams is as a result of the implementation of legislation throughout the EU to reach the objectives outlined in the EU Green Deal.

Begin your sustainability tax review now

The new reporting requirements under CSRD compel undertakings to carefully consider their current business strategy and tax processes, policies, procedures, and controls through a sustainability lens.

To achieve a comprehensive business strategy, undertakings should carry out a self-review to:

- Understand the effect that achieving their sustainability agenda will have on their existing business model(s), and
- Understand the effect that their existing business model(s) could have on achieving their sustainability agenda.

The self-review should enable undertakings to determine if their existing business practices are sustainable to aid in the determination of a transition plan, which could include change(s) to operating models and local and global functions to achieve sustainability goals.

For example, undertakings should review their transfer pricing policies in the context of their current operating models to ensure that the operating model and the transfer pricing policies applicable to same are aligned.

Given that how undertakings govern their operations and contribute to society is being increasingly considered by existing and potential stakeholders, undertakings should also consider whether any changes need to be made to their operating models and their associated tax and transfer pricing policies to assist them to achieve their sustainability goals.

How Grant Thornton can help

The Irish tax team has extensive experience across all industries. We deliver sector-specific, relevant and sustainable tax advice and support that meet both increasingly stringent legislation and our client’s business needs.

Our team works closely with the global Grant Thornton network of tax specialists to deliver consistent, pragmatic and effective solutions and advice that transcend international borders. If you have questions about how sustainability reporting frameworks and requirements will affect your tax policies and future planning, please contact a member of our team today.