Corporate Sustainability Reporting Directive: What's in It for Tax?

Francesco De Lillo | **IBFD European Knowledge Group**

The author can be contacted at f.delillo@ibfd.org

The Corporate Sustainability Reporting Directive (2022/2464) (CSRD), as part of the EU Green Deal, represents a significant milestone in the European Union's commitment to sustainability and transparency. It requires around 50,000 entities to disclose detailed information about their sustainability practices to improve the quality and consistency of sustainability reporting. But does tax play a role under the CSRD framework? This note explores the implications of the CSRD for tax risk management and compliance.

1. Overview of the CSRD

1.1. Background

The CSRD, adopted at the end of 2022, intervened on the framework laid down by the Non-Financial Reporting Directive (NFRD), substantially broadening its scope and further detailing sustainability reporting requirements.

Under this framework, in-scope companies are required to disclose information relating to a broad range of environmental, social and governance (ESG) matters. This includes, for instance, climate-related risks, equal treatment of employees and working conditions, anti-corruption and bribery, and the composition of company boards.

1.2. Key provisions

- **Scope**
  While the NFRD applied only to large listed undertakings, the CSRD expanded the scope of the sustainability reporting requirements to:
  - large (non-listed) undertakings;
  - listed SMEs (excluding micro-undertakings);
  - parent undertakings of large groups; and
  - third-country undertakings that either issue transferable securities admitted to trading on an EU regulated market or that conduct business in the European Union above certain thresholds.

Special rules apply to credit institutions and insurance companies.

- **Sustainability reporting requirements**
  In-scope undertakings must report on how sustainability issues affect their business and how their business impacts society and the environment.

  This sustainability statement must be included in a specific section of the undertaking's management report, prepared in XHTML format and published according to current publication rules. Additionally, EU parent undertakings of large group and third-country undertakings with a presence in the European Union or conducting business in the European Union above certain thresholds are required to report sustainability information at the group level. In the latter scenario, the sustainability statement must adhere to more limited requirements.

The reporting timeline is as follows:

Reporting dates	Type of undertaking
2025 (for financial years beginning on or after 1 January 2024)	Large listed undertakings, including third-country issuers
2026 (for financial years beginning on or after 1 January 2025)	Large undertakings and EU parents of a large group
2027 (for financial years beginning on or after 1 January 2026)	Listed SMEs
2029 (for financial years beginning on or after 1 January 2028)	In-scope third-country non-listed undertakings

- **Sustainability reporting standards**
  Under the CSRD, the European Commission is tasked with adopting delegated acts providing for specific European sustainability reporting standards (ESRS), based on the technical advice of the European Financial Reporting Advisory Group (EFRAG).

  The ESRS, which consist of a combination of both sector-agnostic and sector-specific standards, ensure the quality and the consistency of reported information across the EU Member States and are reviewed at least every 3 years.

  So far, the Commission has adopted only a first set of general standards by means of Delegated Regulation (EU) 2023/2772.

- **Assurance**
  The reported information must obtain assurance from third-party auditors or an independent assurance services provider (IASP).

1.3. Transposition status

EU Member States had to transpose the provisions of the CSRD into their domestic law by 6 July 2024. To date, 15 Member States have adopted national transposing instruments, namely Bulgaria, Croatia, Czech Republic, Denmark, Finland, France, Hungary, Ireland, Italy, Latvia, Lithuania, Romania, Slovak Republic, Slovenia and Sweden.

Meanwhile, as stated in a press release dated 26 September 2024, the European Commission has initiated infringement procedures against those Member States that have not yet transposed the CSRD. Additionally, on 16 December 2024, the Commission issued a reasoned opinion urging Sweden to correctly transpose the CSRD provisions.

2. Taxation within the CSRD Framework

2.1. The interplay between tax and sustainability

Taxes are a primary source of public revenue. Consequently, the taxes paid by corporations substantially contribute to the economic and social development of the jurisdictions in which they conduct business, by funding public goods and infrastructures. On the other hand, strategies to minimize tax burdens reduce government resources, leading to decreased public spending and higher public debt. Moreover, tax avoidance practices have broader repercussions on the overall compliance culture among taxpayers.

From this point of view, tax can be regarded as a relevant indicator of the impact that corporations have on society. The United Nations (UN) has recognized the importance of taxation in achieving its Sustainable Development Goals (SDGs), and also the EU's Platform on Sustainable Finance has highlighted the relevance of tax to sustainability, as part of the Governance pillar.

Finally, investors are now seeking greater transparency on tax matters to evaluate the financial, governance and reputational risks associated with company tax strategies.

2.2. Should tax information be included in CSRD report?

Under the CSRD and the first set of ESRS, in-scope undertakings are not required to include tax information in their sustainability statements.

However, *ESRS S3: Affected communities notes* that "aggressive strategies to minimise taxation" may have an impact on communities. Also, environmental standards may require disclosing the financial impact of environmental taxes paid.

Furthermore, the CSRD prescribes the inclusion of any additional sustainability information that is specifically relevant to each reporting undertaking, as identified through a double materiality assessment. This assessment takes into account the impact of company operations on people and environment, and of sustainability matters on company strategies.

2.3. Which reporting standards to use?

For material topics not covered by the ESRS, the EFRAG has indicated the possibility of using the standards developed by the Global Reporting Initiative (GRI).

Therefore, for cases in which the double materiality assessment indicates that tax is relevant for sustainability reporting purposes, in-scope undertakings may use the format provided by GRI 207, which comprises the following four disclosure categories:

(1) approach to tax;
(2) tax governance, control and risk management;
(3) stakeholder engagement and management of concerns related to tax; and
(4) country-by-country reporting.

3. Implications for tax risk management and compliance

Determining the materiality of tax for sustainability reporting purposes

The double materiality assessment is a fundamental step in achieving full compliance with the CSRD. In-scope undertakings are therefore required to examine the social and economic impact of their tax approach and stakeholder expectations. This requires cooperation between tax and sustainability departments.

Aligning tax strategies and the tax control framework with ESG Goals

Under the CSRD framework, in-scope undertakings should ensure that their tax strategies align with their ESG objectives. This may involve reevaluating tax practices to ensure they are consistent with transparency and ethical behavior.

In this context, it's worth stressing the link between CSRD and the EU Taxonomy, which is a classification system aimed at identifying environmentally sustainable economic activities. CSRD reports must inform on companies' sustainability performance vis-à-vis the EU Taxonomy.

The Taxonomy includes general information on minimum safeguards, and the Platform on Sustainable Finance provided further details, specifically touching upon taxation, among other topics. Under these guidelines, company tax strategies must "comply with the letter and spirit of tax law […] treat tax governance and tax compliance as important elements of their oversight".

Transfer pricing considerations

Under *ESRS 2 General Disclosures*, in-scope undertakings must report information on their market position, strategy, business model(s) and value chain. This entails that transfer pricing policies, as illustrated in the TP documentation, should match the information disclosed in the CSRD report, to avoid the risk of perceived tax avoidance.

Compliance

In cases in which tax is considered a material topic for CSR purposes, in-scope undertakings must include certain tax information in their sustainability reports. This requires a careful evaluation of which information to include, both from a quantitative and qualitative point of view. Based on the EFRAG recommendations, GRI 207 can serve as a suitable reporting standard.

4. Concluding remarks

The CSRD is a significant step towards greater transparency and accountability in the field of corporate reporting and sustainability, with potential implications for tax risk management and compliance.

Pursuant to the CSRD, companies are required to assess the necessity of incorporating tax information into their sustainability reports. If deemed necessary, they must therefore ensure that their tax strategies are consistent with their sustainability goals.

This increased transparency can represent an opportunity to build or strengthen trust with investors and tax authorities, but also entails new compliance processes and greater public scrutiny of company tax profiles.

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- *Navigating the Future of Tax: Governance, Transparency and Risk Management*, IBFD webinar (30 Sep. 2024).
- For a country-specific overview of CSR developments and requirements, *see* *Tax Risk Management Monitor*.