Seven principles of good taxation for climate finance

Practical proposals for immediate application

December 2024

TAX JUSTICE NETWORK

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Acknowledgements

This briefing was written by Alex Cobham and Franziska Mager. We gratefully acknowledge the valuable discussions with many actors from the tax justice and climate justice movements in the global South and North that we have been privileged to be able to draw upon, and the insightful comments of Maria Ron Balsera (CESR) and Michael Jarvis (TAIC). We intend this to be a living document, and do not see the seven principles as the final word. Please share comments and reflections via franziska at taxjustice dot net.

Seven principles of good taxation for climate finance

As the process towards a UN framework convention on international tax cooperation (UNFCITC) moves forward, much can be learnt from climate justice movement and the United Nations Framework Convention on Climate Change (UNFCCC) process. As the search gathers pace for realistic and sustainable sources of large volumes of climate finance, there may be valuable synergies from combining the insights of the tax justice and climate justice movements.

The urgency and scale of the climate transition makes it vital that we collectively propose and enact taxes that are capable both of generating significant revenues and of being rapidly and effectively implemented. These criteria must be supplemented by a shared set of principles of good taxation for climate finance, to ensure that the proposals pursued are able to deliver fully (and that potentially counterproductive options are avoided). This note presents a preliminary draft for discussion, towards a common basis for assessing and shaping proposals in the crucial decision phase on climate finance currently unfolding. The same principles will have important application in the negotiation of the UNFCITC. As such, these are not simply notional, nice-to-haves; rather, they could form critical elements of international policy decisions upon which our collective future may depend.

The proposal combines lessons from three areas: the foundation of reparative climate finance (loss and damage); the basis of sound taxation; and the core components of equitable international decision-making processes, including relevant human rights instruments. We set these out briefly next, and then identify seven principles that emerge from this combined perspective.

Loss and damage

It is a well-established position that those responsible for environmental damage should bear the economic costs, including full mitigation – the 'polluter pays' principle. But while this might be straightforwardly applied to a limited chemical spill, for example, the planetary damage inflicted by humanity is global, rather than local; historic as well as immediate; and likely far beyond what can be mitigated. To date, the international response to the climate crisis is clearly not characterised by concrete enactment of the 'polluter pays' principle.

The simple internalisation of economic costs which are direct, local, and immediate is evidently insufficient. It results in the consistent under-resourcing of those most urgently in need of funds to support adaption and mitigation of the crisis. Climate finance measures now under active consideration should be assessed for their alignment with the polluter pays principle, understood – crucially – within the broader context of loss and damage: that is, of the consequences of planetary damage that go beyond mitigation or what people can adapt to. Recognising and reflecting on historic responsibilities is vital. So too is responding fully to the inequalities between and within countries that reflect the uneven exploitation of resources over centuries.

Tax, our social superpower

Effective taxation delivers the 5 Rs of tax. Tax generates *revenues*, and can deliver *redistribution* to curb inequalities. It is a tool for *repricing* public goods and 'bads', disincentivising polluting industries, and can provide the basis for *reparations* for past wrongs, including overuse of planetary resources. Perhaps most importantly, tax is crucial to strengthening political *representation* through the social contract between states and citizens.

Direct taxes – those on incomes, profits and capital – are key to each area, and especially important over time, research shows, for building accountable governments. The share of (direct) taxes in government expenditure is consistently associated with stronger representative government and reduced corruption. Money raised through tax not only contributes additional public funds, it also goes further by delivering better outcomes for the same level of spending.

Overall, tax is our social superpower: allowing us to choose to live better, longer, healthier lives together, and delivering results in line with human rights, the Sustainable Development Goals, to promote human dignity, equality and prosperity, to protect the planet from degradation, to foster peaceful, just and inclusive societies.

Decisions over tax, including for climate finance, should be rooted in respect for the potential of tax as our social superpower, and designed to strengthen this role so that all can enjoy the benefits of effective and accountable states. It does not necessarily follow that all climate finance must come from taxation. To the extent, however, that climate finance options are evaluated for their full contribution to sustainable, social progress, tax sources will – and should – dominate.

International decision-making

Core elements of the basis for international decision-making already exist. International decisions such as those needed over climate finance should be taken in accordance with the principles and purposes of the UN charter and the objectives for international cooperation set forth in Article 55 (e.g. economic and social progress and development as well as universal respect for, and observance of, human rights and fundamental freedoms). In the event of conflict with any other source, States' obligations to cooperate under the UN Charter must prevail, in accordance with Article 103 of that instrument.

Decisions should align fully with the commitment in the Universal Declaration of Human Rights that "everyone is entitled to a social and international order in which the rights and freedoms set forth in that

Declaration can be fully realized" (A/RES/41/128). This commitment can only be achieved, inter alia, through international tax cooperation that allows countries to raise the required tax revenue. More broadly, the existing positions make clear that all countries, and by extension all peoples, should be fully included in decision-making over international issues of climate finance.

The understanding and evidence developed over time, from each of the three areas – climate justice, tax justice and international cooperation – give rise to seven common principles of good taxation for climate finance.

I. Progressive redistribution

The world is characterised by deep inequalities both between and within countries. Between-country inequalities reflect in no small part the histories of historic economic extraction that made some rich at the expense of others. In addition, the failures of international tax rules play out in ways that both reflect and deepen these inequalities. Tax has the potential to revert these inequalities through domestic and international reforms.

Today's tax rules have been shaped over a century by the most powerful countries. With their dependent territories, these countries are now responsible for the majority of the global revenue losses that stem from the resulting cross-border tax abuse by multinational companies and by individuals hiding assets and income streams offshore. At the national level, those revenue losses account for a systematically larger share of tax revenues in lower-income countries than in richer countries.

The human costs of planetary damage are disproportionately felt and borne by the people of lower-income countries, who are also least responsible for that damage. Extractive industries bear a particular responsibility, including but not limited to the fossil fuel sector, and the associated pattern of *wealth* extraction has often benefited higher-income countries. As such, there is clear alignment on the principle of progressive redistribution: international tax measures must address global inequalities in taxing rights between states, and climate finance measures must seek to repair the historic and ongoing inequalities in responsibilities and exposure.

At the individual level too, it is now well established that the wealthiest households are responsible for an entirely disproportionate share of planetary damage; while those most exposed to the resulting human costs include, disproportionately, women and already marginalised ethnic groups, disabled people and other minoritised groups.

The principle of progressive redistribution aligns with the 'polluter pays' and 'beneficiary pays' principles. The overlapping inequalities in responsibility and in exposure demand that progressive redistribution within countries be at the heart of climate finance measures – just as the importance of direct taxation to the social superpower of tax demands it. At each level, the reform or implementation of tax policies has the potential to generate significant climate finance. The urgency of the climate crisis posits a specific policy space within which reforms can be swiftly implemented, and which mirrors the polluter pays principle.

II. Inclusive decision-making and inclusive benefits

All countries should enjoy on an equitable basis the benefits of international measures on tax cooperation including for climate finance, and they should participate on equal footing in standard setting.

Failures of inclusiveness lead to failures of effectiveness and fairness. Global revenue losses due to cross-border tax abuse by multinationals and wealthy individuals are estimated at US$480 billion a year. This is despite, or perhaps because of, the OECD's dominance of tax rule-setting since 1960, during which corporate lobbyists have been able to exert much greater influence than ordinary citizens.

The resulting failures of both fairness and effectiveness are clear: losses suffered due to cross-border tax abuse account for a much bigger share of public spending in lower-income countries, while it is OECD member countries – and so their peoples – that suffer the greatest revenue losses in absolute terms.

A related pattern in climate policy has also led to the prioritisation of rich country concerns and the ultimate failure to take decisions that are either effective or fair. The pre-eminence of corporate tax incentives with devastating environmental consequences is only one example. There is clear scope for all to benefit from a process that is fully inclusive and brings with it the potential to be both effective and fair. The climate crisis requires nothing less.

III. Special and differential treatment for developing countries

The continuing power imbalances between states in the global North and South will require UNFCITC measures to include common but differentiated responsibilities, just as in the UNFCCC – including in climate finance decisions to come. This might be operationalized by creating groups of countries with obligations with a different scope. States' obligations towards climate funding should reflect historic responsibilities for planetary damage and also their current ability to meet human rights obligations for their peoples. Equally, for example, states providing minimal levels of crossborder financial services or with greater priorities to address extreme rights deficits among their people need not face the same requirements for reciprocity, in respect of the automatic exchange of financial account information, as should significant financial centres.

IV. Self-determination

The right to self-determination recognised in the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights, requires a recognition of the racial component of the right to self-determination for both indigenous people and historically colonised States. Parties to climate finance agreements, and international tax agreements alike, should confirm that the right to self-determination will inform their decision-making.

V. Subject-to-tax principle

Companies and people are often able to escape taxation and other regulations by structuring cross-border schemes to exploit failures of international cooperation. This undermines national taxation, since income, profits and assets can be hidden in order to cheat on the corresponding social obligation to pay a fair share. From the perspective of environmental regulation too, the ability to identify the responsible parties and apply rules fairly is paramount to both their overall effectiveness and their fairness.

For both climate finance and tax, then, persons and enterprises should be taxed on all their income. Where States have been allocated a taxing right, they owe it to the community of States, in line with their Extra-Territorial Obligations (ETO), to use that right – since not using it opens the way to abusive practices that undermine others.

To achieve this result, active income should be taxed where the activities generating it take place. Multinational enterprises should be taxed as single unitary enterprises on their total profits, with profits apportioned between jurisdictions by factors reflecting the real, underlying economic activity to achieve this result.

VI. Non-retrogression

The principle of non-retrogression in the development of international legal instruments prevents agreements that weaken existing commitments. Policies implemented for climate finance or other tax measures, in line with the International Covenant on Economic, Social and Cultural Rights (ICESCR), should therefore not entail the enactment of backwards-looking policies that would make it harder for people to enjoy their rights. This also provides that states should not reduce their degree of international cooperation (including with respect to transparency), nor increase any extraterritorial harms caused by their lack of cooperation. Furthermore, the obligation to use maximum available resources under the ICESCR reinforces non-retrogression by requiring states to mobilize all feasible financial means to protect and progressively realize rights. Climate finance and tax measures must prioritize this duty, as a failure to do so risks undermining rights both domestically and globally.

VII. Transparency

A crucial principle of transparency applies across the board. Transparency of the application of taxes is pivotal to public perceptions of fairness, and to the accountability of tax authorities and policymakers, and so is also a major driver of tax compliance. Political support for climate finance measures is similarly critical to their sustainability and effectiveness. In addition, to the extent that inter-country redistribution via international climate finance measures may generate non-tax revenues for states, the transparency of those funds and their usage becomes an important element of guarding against the risks to accountability that can otherwise be posed. This would include open access to all public contracts and company level data on the provision, use and costs of tax incentives, for example.

The ABC of tax transparency is a set of measures designed to end secrecy around the major aspects of tax abuse and other criminal and corrupt behaviour. Full delivery through the UNFCITC will also provide valuable support to the efficacy of climate finance measures: knowing those responsible for economic activities is crucial to their effective regulation as well as taxation, and to ensuring accountability.

- A is for automatic exchange of information about financial accounts, to end offshore bank secrecy and the associated high risks of tax abuse and corrupt payments.
- B is for beneficial ownership transparency, through public registers that end the potential for anonymous ownership of companies and other legal vehicles which is at the heart of so many cases of corrupt practices and regulatory as well as tax abuse.
- C is for public, country-by-country reporting by multinationals, proven to be a powerful deterrent of cross border tax abuse by revealing discrepancies between the location of their real economic activity and where taxable profits are declared.

Transparency of negotiations is also fundamental, and the full participation of civil society an important element of guaranteeing this.