CORPORATE GOVERNANCE WITH RESPECT TO TAXATION

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ABSTRACT

The need for analysing the relationship between tax systems and corporate governance concerns was previously stated in Principles of Corporate Governance. From a tax standpoint, the aforementioned overlaps and conflicts may stymie not just the attainment of fundamental corporate governance goals but also those of a sustainable and effective tax system and economic neutrality. There is a scarcity of research on the relationship between corporate governance and taxation. Some specific factors, such as tax restrictions relating to director salaries or control activities made in the course of takeover bids, receive additional attention. . This article provides a compact analysis of the meaning of corporate governance, the influence of taxation on corporate governance, corporate governance and tax reforms, tax incentives or penalties, and tax laws. This article provides a brief insight into golden parachute contracts as well. Taxation may not be the most practical approach to improving governance, but it is worthwhile to track the consequences.

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1. INTRODUCTION

Company law, accounting and auditing standards, insolvency law, securities regulation, the law of contracts, labour law, and tax law are all legal areas that have an influence on corporate governance demands and activities. Under these circumstances, there is a possibility that the variety of legal effects may result in unintentional overlaps, if not outright confrontations, obstructing the ability to carry out essential corporate governance aims. Policymakers must recognise the danger and take actions to reduce it. Legislators may see the prospect of more effective regulatory actions as a result of a better understanding, and corporate governance specialists may become more informed about the broader implications of company strategy. In future corporate governance literature, a better understanding of tax policy and tax administration is necessary.

2. CORPORATE GOVERNANCE: MEANING AND CONCEPT

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Corporate governance is the practice of controlling and supervising the behaviour of businesses, as well as the legal and factual framework that impacts or rules this activity[1]. Corporate governance is a set of laws, supervisions, and courses of action that regulate how well a company's board of directors controls and monitors its activities; concepts of openness, accountability, and safety are all part of corporate governance. Investors value corporate governance because it demonstrates an industry's vision and business credibility. The establishment of trust among investors and the general public is aided by corporate governance. Thus, corporate governance helps to ensure economic stability by giving long-term investment opportunities to market participants. Poor corporate governance can cause a corporation to fall short of its stated goals at best, and it can lead to the company's demise and significant financial losses for stakeholders at worst[2]. Corporate governance is exemplified by the Anglo-American model, the German model, and the Japanese model.

2.1 The influence of Taxation on corporate governance:

[1] Michail Nerantzidis, John Filos & Themistokles G. Lazarides, *The Puzzle of Corporate Governance Definition(s): A Content Analysis*, 8(2) CORPORATE BOARD: ROLE, DUTIES & COMPOSITION (2012)

[2] Samiksha, *Issues and Challenges of Corporate Governance in India*, 6(3) INT'L J. L. MGMT. & HUMAN. (2023)

Taxation as a cost element operates as an incentive or disincentive for management behaviour and hence may be utilised by legislators to influence managerial decisions in numerous ways. Because the primary corporate governance problem has been defined as the separation of ownership and management, tax regulations should be structured in such a manner that they do not encourage management behaviour that is in contradiction with the shareholders' interests or the firm itself. The tax system tries to connect management goals with stockholder goals in a variety of ways, as well as to reduce inefficiencies that might arise from the separation of ownership and management. In the Western world, two distinct corporate governance systems have arisen. While in the United States, management control in the interests of shareholders is mostly achieved through a market of corporate influence, in other nations, such as Germany, the corporate governance system is still heavily affected by a tightly knit network of cross-affiliated enterprises[3]. On the intersection of taxation and corporate governance in the U.S., the focus is mostly on CEO compensation in relation to takeovers. In Germany, on the other hand, a tax reform aimed at decartelizing a substantial portion of the country's incorporated sector was debated in light of corporate governance.[4]

3. CORPORATE GOVERNANCE AND TAX REFORMS

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When lawmakers try to stimulate corporate investment through tax reforms, especially by lowering company tax burdens, it's crucial to evaluate if the key person for the investment choice is the company and its management or the shareholders. Which taxes will be taken into consideration will be determined by the response to this question. As a result, legislators should evaluate the real corporate governance framework before reorganising tax systems, as the two systems otherwise would affect investment decisions in an irregular manner. Any logical and consistent tax reform requires a basic grasp of company governance systems. Taxes may only have the desired impact on investment decisions if they are included in the decision.

It is stated in favour of the imputation system that it is feasible to match the corporate income tax load with the weight on other forms of income and to take into consideration both the tax burden of corporations and stakeholders within the scope of the imputation system. Classic company tax systems with two levels of taxes, on the other hand, are questioned as to

[3] Arne Friese, Simon P. Link & Stefan Mayer, *Taxation and Corporate Governance*, SSRN ELEC. J. (2006)
[4] *Id.*

whether they genuinely target important decision-makers. Politicians advocating for corporate tax cuts frequently focus solely on the corporate level, ignoring the equally significant level of shareholder taxes. As a result, it is suggested that the traditional tax system reflects an out-of-date concept of corporate governance due to its focus on the managerial level. As a result, the two-tier system is not thought to be in keeping with the actual corporate governance structure of a robust capital market because the stated "tax cut for corporations" does not represent who actually makes decisions.[5]

4. TAX INCENTIVES OR PENALTIES

Often, tax measures are designed to influence specific behaviours. As a result, it's not unexpected that lawmakers seek to make use of their tax regulations in the framework of corporate governance, whether wanted or undesirable. Apart from those rules that are clearly designed to strengthen corporate governance, there are a number of tax regulations that have unforeseen implications. Tax rules aimed at influencing corporate governance may be used to support particular developments that the legislator wants to foster or believes are important[6]. Conversely, tax rules are intended to discourage specific stakeholders from engaging in behaviour that the lawmaker wishes to prohibit or at least mitigate. "Tax expenditures" are tax policies that try to encourage particular behaviours.

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Deductions, credits, exemptions, exclusions, deferred payments, and preferential tax rates are all examples of tax expenditures. They always have the effect of lowering the cost of a certain course of action. "Tax penalties," on the other hand, are meant to deter specific behaviours. A negative consequence is associated with a specific action, such as the restriction of deductibility on some rather deductible costs or the imposition of a "penalty tax" on a particular activity. The list of unintended implications of tax rules designed to affect company governance is almost certainly limitless. Shifts in power in the relationship between manager and investors or management and supervisory boards, restricted management controllability, profit misallocation, and incentives for managerial misbehaviour are the most important and debated effects of tax legislation on corporate governance.

[5] Jon N. Kerr, Richard Price and Francisco J. Román, *The Effect of Corporate Governance on Tax Avoidance*, 109 PROCEEDINGS (2016)

[6] Onur Bayar, Fariz Huseynov and Sabuhi Sardarli, *Corporate Governance, Tax Avoidance, and Financial Constraints*, 47(3) FINANCIAL MANAGEMENT (2018)

4.1 Tax Law

Tax legislation affects both owners, managers, board members, and other stakeholders on a personal level as well as the corporate level. Tax legislation is often meant to limit managerial behaviour in the case of alleged fraudulent conduct at the individual level. As a result, in the United States, the conversation on taxation and corporate governance is mostly focused on CEO salaries. This underscores a fundamental issue in corporate governance: the separation of managers and owners. When decisions impacting the interests of shareholders are made by their agents, the legislature strives to protect those interests. Such provisions are often found in business law. Legislators frequently use tax legislation to pursue economic policy aims at the company level. Tax legislation can have the same supervisory impact as direct regulation: by modifying the financial implications of a specific behaviour through tax hikes or tax expenditures, the legislator can affect the decision-making process. As a result, the tax system has the potential to have a comparable impact on business decisions as direct corporate governance legislation.[7]

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In simple words, corporate governance refers to the rules, practices, or supervisions that govern how organisations are run, regulated, and managed. As a result of high-profile situations involving firm power abuse and, in some cases, alleged criminal behaviour by corporate executives, corporate governance has received a lot of attention recently. An effective corporate governance structure includes provisions for civil or criminal prosecution of persons who engage in unethical or unlawful behaviour in the name of the organisation. The purpose of corporate governance is to improve the value of a company's stock. Internal considerations specified by the executives, stockholders, or constitution, as well as external influences such as consumer groups, clients, and government restrictions, govern how businesses are managed, governed, and controlled.

4.2 Golden parachute contracts

The taxation of so-called golden parachute payments is a good example of corporate governance-driven payment taxation in the context of takeovers. Golden parachutes are large pay-outs made to senior executives in the case of a significant change in de facto control or

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[7] I*d.*

when the official's contract is terminated as a consequence of such a transition[8]. Section 280G(b)(2)(A), 4999(b) IRC, requires that the payment have a current value equal to or greater than three times the executive's typical salary. The deductibility of "excess parachute payments" is limited by Section 280 of the Internal Revenue Code. A 20 percent tax is also applied to the taxpayer who gets a golden parachute pay-out under IRC Section 4999. As a result, the code limits deductibility and imposes a direct tax penalty on payments made in conjunction with takeovers. It has an impact on both the bidding firm and the receiving manager. The after-tax expenses of a takeover are raised as a result of both tax penalties (section 280G and section 4999 IRC). As a result, these rewards are less appealing to both the bidding business and the target's management.

Since golden parachutes are complicated and there is a danger of a significant tax obligation, engage with compensation consultants and attorneys when putting together and analysing a golden parachute pay plan[9]. Plan to review the pay package every two to four years to ensure that it is still meeting its goals.

5. CONCLUSION

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In terms of accounting standards, the writers usually advocate the linking of tax and financial accounts, believing that the results provide a more fair and genuine view of a company's financial status. However, because tax rules impact financial accounts owing to reverse authoritativeness, there is a risk of intransparency as a result of unreasonable tax-driven accounting stances.

There are many supervisory impacts for the purpose of agency conflicts and management restrictions, as well as incentivizing or penalising behaviours as a behavioural control mechanism. In the case of director duties, taxes have recently clashed with corporate governance. While determining who is responsible for the responsibilities, it is possible that the question of whether there is a responsibility to minimise the tax burden in light of the risks that tax planning entails arises. Tax evasion is undeniably a popular topic with the potential to tarnish a company's brand. Recent tax controversies affecting corporations such as Starbucks and Amazon show the importance of the link between tax management and

[8] Jocelyn D. Evans and Frank Hefner, *Business Ethics and the Decision to Adopt Golden Parachute Contracts: Empirical Evidence of Concern for All Stakeholders*, 86(10 J. BUS. ETHICS (2009)
[9] Richard B. Press, *Golden Parachutes: Untangling the Ripcords*, 39(4) STANFORD L. REV. (1987)

reputation at the board level. With widespread change, the option for tax evasion might be eliminated, nullifying the fundamental assumption. Or one may acknowledge that while there is currently no legal need to avoid tax, it would be amateurish not to explore minimising one's tax burden for the company's profit rather than merely after a cost-benefit analysis with respect to the dangers (financial and reputational). Companies are willing to take advantage of low-risk legislative tax benefits. The government and regulators want perfect tax compliance; thus, they would never create or condone a governance law that favours efficient tax evasion.

The scope of directors' responsibilities is debatable and diverse. When the two disciplines work together to achieve the same purpose, however, the combination of tax and corporate governance processes may be significantly more successful than each discipline working alone. This will become increasingly essential in the context of CSR and sustainability, where taxes may provide regulation to a large number of people at the lowest cost and with the greatest degree of impartiality, resulting in minimal influence on governance structures and management constraints.

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