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A FRAMEWORK ON MANDATING VERSUS INCENTIVIZING CORPORATE SOCIAL RESPONSIBILITY

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There are two primary but different methods of controlling behavior, whether it is the behavior of individuals or corporations: to incentivize it or to regulate it. Governments are in a unique position to employ either or both options because of their ability to pass regulatory schemes and to extend tax incentives. This Article analyzes the two methods of shaping corporate behavior, examining the regulation issue through the case of the conflict minerals provision of the Dodd–Frank Act and examining the taxation issue through several examples of corporate tax incentives.

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I. INTRODUCTION

An extensive network of laws, including tax incentives, aims to increase corporate efforts toward socially desirable goals. Although there has been a significant debate in the literature regarding the appropriateness or even possibility of corporate social responsibility given the corporate structure,[1] the federal government has continued to seek increasing corporate social responsibility through the reach of its laws.[2]

There are several areas in which global companies have been encouraged to exhibit increased corporate social responsibility. These include labor standards, environmental stewardship,[3] and recognition of human rights,[4] with implications for important issues like global poverty, eradication of worldwide diseases, and reduction of violence in conflict regions.[5] Corporate social responsibility may entail promotion of ethical guidelines, incorporation of stakeholder concerns, and efficient internalization of externalized costs.[6] This differs from corporate accountability, which includes internal monitoring mechanisms, transparency, and disclosure.[7]

There are two primary but different methods of controlling behavior, whether it is the behavior of individuals or corporations: to incentivize it or to regulate it. Governments are in a unique position to employ either or both options because of their ability to pass regulatory

1. "For centuries legal, political, social, and economic commentators have debated corporate social responsibility ad nauseam." Henry N. Butler & Fred S. McChesney, *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195, 1195 (1999) (emphasis omitted).

2. This coincides, or may be prompted, by an increased call by society for corporate social responsibility. "The growing popularity of corporate social responsibility ('CSR') is premised on the belief that modern corporations have the financial resources, human capital, and global influence to advance progressive causes." Aaron K. Chatterji & Barak D. Richman, *Understanding the "Corporate" in Corporate Social Responsibility*, 2 HARV. L. & POL'Y REV. 33, 33 (2008).

3. *See, e.g.*, Cherie Metcalf, *Corporate Social Responsibility as Global Public Law: Third Party Rankings as Regulation by Information*, 28 PACE ENVTL. L. REV. 145, 146 (2010). Environmental stewardship includes matters such as "environmentally responsible products and production methods, responsiveness to community concerns, recycling, conservation, waste management practices, and energy conservation." *Id.* at 151.

4. *See id.* at 150.

5. *See* Chatterji & Richman, *supra* note 2, at 33.

6. Amiram Gill, *Corporate Governance as Social Responsibility: A Research Agenda*, 26 BERKELEY J. INT'L L. 452, 458, 461 (2008).

7. *Id.* at 458, 461. Gill suggests that corporate social responsibility and corporate accountability are merging. *Id.*

schemes and to extend tax incentives. The question, therefore, arises whether desirable corporate behavior should be incentivized or regulated.

This Article analyzes why legislators may choose to incentivize versus regulate corporate behavior, examining the issue through the case of the conflict minerals provision in the Dodd–Frank Act. Accordingly, Part II examines the goals and effectiveness of mandated corporate social responsibility, using recent conflict minerals legislation as a case study. Part III analyzes the alternative of incentivization, focusing on tax regulation. Finally, Part IV compares the two methods of controlling corporate behavior, seeking a framework governing their uses.

II. REGULATING CORPORATE BEHAVIOR

Corporations deal with numerous regulations every day, including regulations aimed at requiring good corporate citizenship or social responsibility. These regulations, often tailored to corporations in particular industries, regularly are in tension with the overriding corporate priority of maximizing profit for shareholders. Positive law plays a major role in establishing standards and boundaries for corporate behavior. In addition, a number of regulations aimed at increasing corporate social responsibility require corporate disclosure of behavior, with the result that consumers and the market force shifts in corporate behavior. Both avenues of directing corporate behavior have benefits and drawbacks but represent the wide range of tools the government has in shaping corporate behavior and encouraging corporate social responsibility.

A. *Positive Law Governing Corporate Social Responsibility*

Promoting and mandating corporate social responsibility through regulation is not a new concept.[8] However, corporate social responsibility is often considered a moral imperative rather than a regulatory one.[9] As such, efforts to regulate corporate social

8. *See, e.g.*, David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1 (1979).

9. *Case Study: Corporate Social Responsibility in the US*, TRIPLE PUNDIT (Mar. 21, 2011), http://www.triplepundit.com/2011/03/case-study-corporate-social-responsibility/, *archived at* http://perma.cc/UA28-UFDY/ (claiming that corporate social responsibility regulations are framed as a social and moral choice). Notably, many industries in the United States are not as heavily regulated as their European counterparts. *Id.*; *see also* Jan Wouters

responsibility are often based upon a particular issue or social cause and are often met with resistance from those who do not consider the particular issue to be paramount.[10] For that reason, there exists a patchwork of corporate social responsibility regulations as a result of the various resources and lobbying efforts made on behalf of particular social goals.[11]

For example, one of the most prominent areas of corporate social responsibility has been in the field of environmental law and practices. This is in large part due to the fact that the history of the corporate social responsibility movement parallels the environmental movement.[12] As the Earth Day movement came about in 1970, so too arose the populist cry for corporations to enlist in solving some of society's problems, given the seemingly vast amount of corporate resources and the perception that corporations played a significant role in many of society's environmental ills.[13]

Through resulting environmental regulations and the creation of the Environmental Protection Agency (EPA) to police environmental

& Leen Chanet, *Corporate Human Rights Responsibility: A European Perspective*, 6 NW. U. J. INT'L HUM. RTS. 262 (2008) (discussing the regulatory and voluntary approaches to corporate social responsibility and addressing corporate efforts related to international human rights issues); *see also* Laura Albareda et al., *The Changing Role of Governments in Corporate Social Responsibility: Drivers and Responses*, 17 BUS. ETHICS: EUR. REV. 347 (2008) (describing government's role in regulating corporate social responsibility in three European countries—Italy, the United Kingdom, and Norway—that all employ different approaches).

10. *See* Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1432–33 (2006); *see also* Douglas M. Branson, *Corporate Social Responsibility Redux*, 76 TUL. L. REV. 1207, 1221 (2002) (noting that corporate social responsibility is regulated by a variety of statutes and regulatory bodies, including the Nuclear Regulatory Commission, the Community Reinvestment Act, the Freedom of Information Act, and Occupational Health and Safety Administration (OSHA)).

11. *See* Douglas M. Branson, *Corporate Governance "Reform" and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 643 (2001); *see also* Z. Jill Barclift, *Corporate Social Responsibility and Financial Institutions: Beyond Dodd–Frank*, BANKING & FIN. SERVICES POL'Y REP., Jan. 2012, at 13, 15 ("Many financial institutions choose from several initiatives to satisfy corporate social responsibility goals: the elimination of poverty, human rights, workplace diversity, philanthropic contributions, community outreach, and environmental sustainability.").

12. Branson, *supra* note 11, at 611. The discussion over the role of the corporation in general has been around since at least the 1930s, however. As early as 1932, Adolf Berle and E. Merrick Dodd debated whether the corporation's purpose was solely for profit maximization or whether the corporation also should hold social and community responsibilities. *See, e.g.*, A. A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

13. Branson, *supra* note 11, at 611.

regulations, corporations were required to increase their corporate social responsibility as related to the environment.[14] Through the positive law of environmental regulations, corporate social responsibility is not merely encouraged but mandated through threat of governmental sanction. That is, corporations are liable to the government, as well as at risk for potential shareholder derivative suits, if they do not comply with federal and state environmental laws.[15]

Likewise, other statutory provisions require corporate social responsibility in the area of human rights. For example, the Alien Tort Claims Act allows private rights of action against multinational corporations committing human rights abuses abroad.[16] Thus, although corporations with overseas operations may not encounter direct U.S. government oversight abroad, they still face the potential of private lawsuits for human rights abuses.

Another avenue by which the government regulates corporate actions requires companies to comply with various corporate social responsibility measures before being granted licenses for various business activities.[17] This method is used in these contexts as a regulatory tool.

14. Terra Pfund, *Corporate Environmental Accountability: Expanding SEC Disclosures to Promote Market-Based Environmentalism*, 11 MO. ENVTL. L. & POL'Y REV. 118 (2004) (discussing the EPA's role in ensuring corporate compliance with environmental protection laws and arguing for regulation).

15. One need not look any further than the recent oil spill in the Gulf of Mexico to see the potential ramifications of violating environmental laws. BP faces lawsuits from the government, as well as private civil claims. Margaret Cronin Fisk & Jef Feeley, *BP Found Grossly Negligent in 2010 Gulf of Mexico Spill*, BLOOMBERG BUS. (Sept. 4, 2014, 7:18 PM), http://www.bloomberg.com/news/articles/2014-09-04/bp-found-grossly-negligent-in-2010-gulf-of-mexico-spill, *archived at* http://perma.cc/PA89-TYPD. The environmental disaster put a spotlight on existing environmental laws, with many arguing for increased measures to hold corporations accountable. *See* Miriam A. Cherry & Judd F. Sneirson, *Beyond Profit: Rethinking Corporate Social Responsibility and Greenwashing After the BP Oil Disaster*, 85 TUL. L. REV. 983, 1033–34 (2011) (discussing regulatory reforms under Dodd–Frank that benefit environmental concerns).

16. 28 U.S.C. § 1350 (2012); *see also* William Bradford, *Beyond Good and Evil: The Commensurability of Corporate Profits and Human Rights*, 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 141, 159–65 (2012); Ronen Shamir, *Between Self-Regulation and the Alien Tort Claims Act: On the Contested Concept of Corporate Social Responsibility*, 38 LAW & SOC'Y REV. 635 (2004) (analyzing lawsuits brought under the Alien Tort Claims Act against multinational corporations for alleged human rights violations and the resulting effect).

17. Gill, *supra* note 6, at 469–70. Gill cites the policies and actions of administrative agencies like the SEC, OSHA, and EPA that, for example, "grant business licenses and permissions conditioned upon integrity and disclosure performance, [enforce] whistleblower protections, [provide] government-sponsored auditing schemes and tax incentives, and use[] a

Requiring corporate compliance with various normative regulations aimed at shoring up corporate social responsibility is the most direct governmental influence on corporate behavior due to the threat of sanction. Also providing an important tool for governments in regulating corporate behavior are regulations requiring disclosure, as described in more depth below.

B. Disclosure Requirements

In addition to governmental and private rights of action for violations of statutorily mandated corporate social responsibility, corporations are held to socially responsible standards through various regulations requiring corporate disclosure.[18] For public companies, disclosure occurs on a regular basis and must include any information deemed material, as well as any information that is statutorily required to be disclosed.[19] For example, companies must make initial disclosures when new securities are issued to the public.[20] Thereafter, public companies must make periodic disclosures quarterly and annually.[21] Disclosures are also required regarding elections at annual shareholder meetings,[22] as well as when any major corporate event takes place, such as a merger or sale of the business.[23]

Disclosures unrelated to corporate financial stability and instead aimed at providing investors with information regarding various social

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company's implementation of a compliance program as a basis for sentencing guidelines" as meta-regulation related to corporate social responsibility. *Id.* at 469–70.

18. Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999). In this article, Williams outlines that the SEC has the statutory authority in fashioning proxy disclosure to require disclosure either to promote the public interest or to protect investors. *Id.* at 1199; *see also* Jeff Civins & Mary Mendoza, *Corporate Sustainability and Social Responsibility: A Legal Perspective*, 71 TEX. B.J. 368, 370–71 (2008). Civins and Mendoza discuss how specific SEC regulations regarding corporate reporting may impact corporate social responsibility in the environmental realm, noting the difference between mandatory reporting and laws governing truth in disclosures. *Id.* *But see* Michael R. Siebecker, *Corporate Speech, Securities Regulation, and an Institutional Approach to the First Amendment*, 48 WM. & MARY L. REV. 613, 616 (2006) (querying whether "the First Amendment shield[s] politically tinged corporate speech from the compelled disclosure and reporting requirements embedded in the U.S. securities laws").

19. *See* Securities Act of 1933 (codified as amended at 15 U.S.C. §§ 77a–77aa (2012)).

20. *See id.* §§ 5, 7, 10 (codified as amended at 15 U.S.C. §§ 77e, 77g, 77j).

21. *See* Securities Exchange Act of 1934, §§ 12, 13, 15D (codified as amended at 15 U.S.C. § 78l, 78m, 78o-6).

22. Securities Exchange Act of 1934, §§ 14(f), 15 (codified as amended at 15 U.S.C. §§ 78-n(f), 78o).

23. *Id.* § 14 (codified as amended at 15 U.S.C. §§ 78-n).

responsibility issues are becoming more prevalent.[24] Regulations requiring additional disclosure often are enacted after a precipitating event pressured Congress to tighten up its regulatory scheme in relation to corporations. For example, the collapse of Enron and WorldCom ushered in the era of the Sarbanes–Oxley Act of 2002 (Sarbanes–Oxley).[25] Likewise, Congress reacted to the financial crisis of 2008 by enacting sweeping financial reforms in the form of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank).[26] Although both Sarbanes–Oxley and Dodd–Frank were corporate regulations aimed at increasing financial stability, both Acts also included disclosure requirements aimed at enhancing corporate social responsibility.[27] In addition, there are numerous regulations promulgated by discrete agencies regulating particular industries that require disclosure to ensure compliance, such as the Occupational Safety and Health Administration, the Environmental Protection

24. The disclosure regime required by the Securities Act of 1933 and the Securities Exchange Act of 1934 is premised on the notion that disclosure allows for both investor protection and an adequate valuation of securities. Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 145–46 (2006) ("The emphasis in securities law on providing information to the public is premised on the belief that individuals are rational, self-governing actors who are willing and able to process the information wisely. If we assume that investors are rational risk calculators who are consistently capable of weighing the costs and benefits of risky alternatives and selecting the best option, then a system of disclosure makes good sense."). For publicly traded companies, disclosure requirements are triggered if the company learns of any material information, defined as information that would factor into a reasonable investor's investment decision. *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988). With additional non-financial disclosure requirements being statutorily mandated, there is an ongoing debate that Congress and regulating agencies are requiring disclosure of non-material information, rendering the concept of materiality to be more of a check-the-box requirement rather than a qualitative, common law concept. *See, e.g.*, Karen E. Woody, *Conflict Minerals Legislation: The SEC's New Role as Diplomatic and Humanitarian Watchdog*, 81 FORDHAM L. REV. 1315 (2012).

25. Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of the U.S. Code); *see* Mark A. Buchanan, *Social Contract, Corporate Social Responsibility, Counsel and the ISO 26000 Guidance on Social Responsibility*, ADVOCATE, Oct. 2009, at 17, 18 ("The Sarbanes–Oxley Act of 2002 also can be seen as a modification of the social contract in that it increases the duties owed to stakeholders in terms of corporate governance.").

26. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S. Code).

27. For example, as discussed in Part II.D, Dodd–Frank included disclosure requirements related to conflict minerals. In addition, Dodd–Frank required disclosures related to legal payments made abroad by companies in the extractive industries, as well as disclosures related to mine safety—all of which are unrelated to the underlying financial goals of the Act. Dodd–Frank Act, Pub. L. No. 111-203, §§ 1502–1504, 124 Stat. 1376, 2213–22 (codified as amended at 15 U.S.C. §§ 78m(p)–(q), 78m-2).

Agency, and Health and Human Services.[28] Even if some disclosure requirements do not carry strict penalties related to the content of the disclosure, the fact of mandated disclosure forces companies to focus on performing due diligence and remaining in compliance with regulations.[29]

C. The Use of Market Forces

Socially responsible corporate behavior can be induced also by threat of a negative market reaction.[30] A decline in brand recognition or a blow to a corporation's reputation affects a corporation's bottom line and can be as effective a threat to encourage corporate social responsibility as any government mandate.[31] More and more, consumers demand products that are made in socially responsible ways and corporations that act in socially responsible ways.[32] In doing so, consumers create market forces that pressure companies into acting responsibly.[33]

There is a tension within corporate management between catering to customers in order to preserve brand reputation and maximizing profits

28. *See, e.g.*, 29 C.F.R. § 1904 (2014); 40 C.F.R. § 61.153 (2014); 21 C.F.R. § 201.62 (2014).

29. For example, companies that must make conflict mineral disclosures may state in their disclosure that they use conflict minerals, without any threat of SEC sanction. *Cf.* Dodd–Frank Act, § 1502 (codified as amended at 15 U.S.C. § 78m(p)). However, the fact that the company has to perform due diligence and be aware of supply chain issues is a step towards additional corporate social responsibility.

30. *See* David Monsma & Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information*, 26 STAN. ENVTL. L.J. 137, 184 (2007) ("Brand reputation, among other business incentives, drives companies to manage areas that lie beyond regulatory compliance and tangible financial relevance.").

31. *See id.*; Ribstein, *supra* note 10, at 1452–56, 1459. *But see* Jason Scott Johnston, *Signaling Social Responsibility: On the Law and Economics of Market Incentives for Corporate Environmental Performance* (Univ. of Pa. Inst. for Law & Econ., Research Paper No. 05-16, 2005), *available at* http://ssrn.com/abstract=725103, *archived at* http://perma.cc/D5H6-W9V3 (arguing that, in the absence of mandatory disclosure, most firms will engage only in "cheap talk" that does not permit meaningful comparisons between firms in an industry).

32. *See, e.g.*, Chatterji & Richman, *supra* note 2, at 48; *see also* Williams, *supra* note 18, at 1199 (explaining that there is an "affirmative case for expanded corporate social transparency and for the SEC's legitimate role in promoting such transparency, both from the perspective of the 'economic' investor . . . and from the perspective of the 'social' investor, who is concerned more broadly with the social and environmental effects of corporate conduct").

33. *See* Rob Harrison, *Corporate Social Responsibility and the Consumer Movement*, 13 CONSUMER POL'Y REV. 127, 128 (2003).

for shareholders.[34] In fact, one of the predominant views in the debate over the role of corporate social responsibility is that of "shareholder primacy," whereby corporate managers "recognize the importance of corporations serving the interests of society as a whole,"[35] but only to the extent that any mandatory corporate social responsibilities are embodied in positive law, as described in Part II.A. In other words, the shareholder primacy theory holds that corporate managers have no social responsibility beyond profit maximization for shareholders, within the contours of existing laws.[36] A stark view of this theory would posit that corporations take on social responsibility when they do what they do best—contribute to the economy by creating employment opportunities, providing goods and services, and generating tax revenue.[37]

Juxtaposed with the shareholder primacy theory is that of stakeholder primacy.[38] Stakeholder primacy is a predominantly progressive theory that espouses the view that corporate managers have an underlying social obligation to stakeholders including employees, consumers, the environment, and the larger community.[39]

34. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001); *see also* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005). This article discusses the economic and social benefits of limiting corporate profits in the public interest and the existing limits on managerial discretion to limit shareholder profits. *Id.* The author concludes that "[m]anagerial discretion to sacrifice corporate profits is both inevitable and affirmatively desirable." *Id.* at 868.

35. Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 713 (2002).

36. *See, e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962). Friedman, of course, is essentially the godfather of conservative and libertarian economic theory, positing that government should not play a role in regulating business or labor practices because government intervention undermines the capitalistic structure of the economy. *See id.* at 22–27. Friedman, however, did not advocate for profit maximization though illegal or unethical methods. *Id.* at 133.

37. *See* Barnali Choudhury, *Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm*, 11 U. PA. J. BUS. L. 631, 655–65 (2009) (outlining various methods and devices for deviating from profit maximization, including (1) the business judgment rule, (2) fiduciary duties, and (3) shareholder proposals). Choudhury also considers that market forces would motivate a corporation to engage in corporate social responsibility. *See id.* at 648–55.

38. Williams, *supra* note 35, at 716.

39. *See id.*; *see also* PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995). The theory of stakeholder primacy is manifested more in European regulations, which tend to hold corporations to higher socially responsible standards than the United States. *See* Peter Nobel, *Social Responsibility of Corporations*, 84 CORNELL L. REV. 1255, 1258–59 (1999);

Scholars espousing both the shareholder primacy theory and the stakeholder primacy theory recognize the role that markets play in corporate behavior because of the potential to affect shareholder value and the economic value of the corporation.[40] Markets can be seen as "authentic norms," gleaned from consumer views and social trends.[41] Corporations, therefore, have economic reason to follow market demand, which is often in the form of consumer demand, but can also be affected by general societal values.[42]

Finally, market pressure also can include pressure from international counterparts, both governmental and corporate. As noted earlier, European regulations often are stricter than those of the United States in relation to certain issues concerning corporate social responsibility.[43] Stricter regulations elsewhere can result in regulatory arbitrage, with capital fleeing toward less regulated markets, but it also can result in pressure to raise the global standard. In other words, organizations like the Organisation for Economic Cooperation and Development (OECD) often promulgate global standards for a variety of social regulations, and member states—of which the United States is one—are expected to have domestic regulations follow the OECD's guidelines.[44]

D. Case Study: Conflict Minerals Legislation

The conflict minerals provision of Dodd–Frank encourages corporate social responsibility through the hybrid of threatened

Mark Roe, S*ome Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993).

40. Ruth V. Aguilera, Deborah E. Rupp, Cynthia A. Williams & Jyoti Ganapathi, *Putting the S Back in Corporate Social Responsibility: A Multilevel Theory of Social Change in Organizations*, 32 ACAD. MGMT. REV. 836 (2007).

41. Thomas W. Dunfee, *Corporate Governance in a Market with Morality*, 62 LAW & CONTEMP. PROBS. 129, 150 (1999); *see also* Kevin T. Jackson, *Global Corporate Governance: Soft Law and Reputational Accountability*, 35 BROOK. J. INT'L L. 41, 67–68 (2010) (discussing extensively "soft-law" or "civil business regulation" that utilizes "private, nonstate, and market-based regulatory regimes" to incentivize corporate social responsibility).

42. See Dunfee, *supra* note 41, at 150 (discussing the relevant market constituencies which the corporation is obligated to appease).

43. *See* Nobel, *supra* note 39, at 1258–59; Roe, *supra* note 39, at 1928; *Case Study: Corporate Social Responsibility in the US*, *supra* note 9.

44. *See About the OECD*, OECD, http://www.oecd.org/about/ (last visited June 6, 2015), *archived at* http://perma.cc/Z5FK-W28H; *Members and Partners*, OECD, http://www.oecd.org/about/membersandpartners/ (last visited June 6, 2015), *archived at* http://perma.cc/D2NB-CQ9H.

regulatory action as well as market forces.[45] Although the provision likely will bring about an increase in corporate social responsibility in the form of increased transparency in supply chains, it is debatable whether the larger goal of the legislative provision will be reached.

1. Background

In 2010, Congress passed a provision of Dodd–Frank aimed at curbing violence in the Democratic Republic of Congo (DRC) through the reduction of trade in conflict minerals.[46] Specifically, section 1502 of Dodd–Frank states that Congress recognizes that perpetrators of extreme human rights violations are funded by control of mineral mines in the eastern region of the DRC;[47] therefore, to cut off the funding to the rebel groups perpetrating crime, Congress mandated that all issuers[48] must disclose to the Securities and Exchange Commission

45. Dodd–Frank Act, Pub. L. No. 111-203, § 1502, 124 Stat. 1376, 2213–18 (codified as amended at 15 U.S.C. § 78m(p) (2012)). The term "conflict mineral" is defined to mean "(A) columbite-tantalite (coltan) [also known as tantalum], cassiterite [also known as tin ore], gold, wolframite [also known as tungsten], or their derivatives; or (B) any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the [DRC] or an adjoining country." *Id.* § 1502(e)(4) (codified as amended at 15 U.S.C. § 78m(p)(5)).

46. *Id.* § 1502(a).

47. The text of section 1502 makes explicit the congressional goal of the provision:

> It is the sense of Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b).

Id.

48. "Issuer" is defined under Rule 13p-1, which states:

> Every registrant that files reports with the Commission under Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78o(d)) of the Exchange Act, having conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by that registrant to be manufactured, shall file a report on Form SD within the period specified in that Form disclosing the information required by the applicable items of Form SD as specified in that Form (17 CFR 249b.400).

17 C.F.R. § 240.13p-1 (2014). This rule, therefore, applies to every issuer required to file reports under either Section 13(a) or Section 15(d), *including voluntary filers*, who must comply. *Dodd–Frank Wall Street Reform and Consumer Protection Act Frequently Asked Questions: Conflict Minerals*, SEC. AND EXCHANGE COMMISSION (last modified May 2, 2014), https://www.sec.gov/divisions/corpfin/guidance/conflictminerals-faq.htm, *archived at* http://perma.cc/K8UH-6ARE. Furthermore, an issuer must file a disclosure on its behalf *as well as* the subsidiaries included in its consolidated financials. *Id.* Mining activities are specifically excluded from the rule because they are not viewed as falling within the definition

(SEC) whether their products contain conflict minerals mined in the DRC or an adjoining country.[49]

Thus, to comply with this disclosure requirement concerning conflict minerals, companies with SEC reporting requirements[50] must perform varying levels of supply chain due diligence to ascertain whether their products contain conflict minerals.[51] Notably, whether the company actually uses conflict minerals is irrelevant to the SEC. There is no penalty for use of conflict minerals but rather for failing to disclose the use of conflict minerals.[52] In other words, the conflict mineral disclosure requirement is simply a dissemination of information—a "name and shame" provision.

2. Disclosure Without Regulatory Sanction

Because the conflict mineral provision requires merely disclosure and not any change in corporate sourcing practices, the practical effect of the provision is that the market will provide the pressure to force corporate social responsibility on the issue of conflict minerals. Granted, companies will have to undertake extensive due diligence on their supply chains in order to comply with the provision, but the

of "manufacturing." *Id.* This exclusion includes the mining of lower grade gold ore, as well as the ancillary activities of mining, such as "transporting the mined ore to a processing facility; crushing and milling the ore; mixing crushed/milled ore with cyanide solution; floating cyanide mixture through a leaching circuit; extracting gold from a leached circuit; [s]melting leached gold . . . into ingots or bars . . . ; and transporting the [ingots or bars]" to a refinery for refining. *Id.*

49. Dodd–Frank Act, Pub. L. No. 111-203, § 1502(b)(1)(A), 124 Stat. 1376, 2213–14 (codified as amended at 15 U.S.C. § 78m(p)(1)(A)). "Adjoining countries" include Angola, Burundi, Central African Republic, Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda, and Zambia. *See* 15 U.S.C. § 78m(p)(5)).

50. *See* 15 U.S.C. § 78m(p)(1)(A), (2).

51. If the conflict minerals in use originated in the DRC or an adjoining country, the disclosing party must submit a report to the SEC that includes: (i) a description of the due diligence process undertaken by the disclosing party, which must be independently audited, with regard to the source and chain of custody of those conflict minerals; and (ii) a description of the products manufactured or contracted to be manufactured that are not "DRC conflict free," the identity of the independent auditor of the source and supply chain, the facilities that process the conflict minerals used by the disclosing party, the country from which the conflict minerals were obtained, and the efforts used to determine the origin (i.e., the specific mine) of the conflict mineral. *Id.* § 78m(p)(1)(A)(i)–(ii). For a product to be considered "DRC conflict free," the product must not contain minerals that finance, directly or indirectly, any armed groups in the DRC or adjoining countries. *Id.* § 78m(p)(1)(A)(ii).

52. *See* Jessica Holzer, *Retailers Fight to Escape 'Conflict Minerals' Law*, WALL ST. J., Dec. 2, 2010, at B1; Jessica Holzer, *SEC Proposes 'Conflict Mineral' Report*, WALL ST. J., Dec. 16, 2010, at B9.

ultimate presence of conflict minerals in their products does not warrant any legal sanction.[53] In other words, given the fact that the conflict minerals provision is a mere "name and shame" statute, the market, rather than the government, is the force asserting pressure on companies to responsibly source the four minerals listed in the conflict minerals provision of Dodd–Frank.

Thus, the efficacy of the provision and the potential impact on corporate social responsibility turns on the public consciousness and reaction to learning that certain corporations have products that contain conflict minerals. This, of course, assumes that not only investors but the public at large will review the companies' websites or SEC disclosures to learn whether a particular company has made a conflict mineral disclosure.[54]

In this way, the mandated corporate social responsibility structure related to conflict minerals is a hybrid model of both disclosure and market force. The consumer demand for conflict-free products, however, should not be underestimated and has already caused a number of multinational corporations to advertise their products as conflict-free.[55]

53. FIDEL BAFILEMBA, TIMO MUELLER & SASHA LEZHNEV, THE IMPACT OF DODD–FRANK AND CONFLICT MINERALS REFORMS ON EASTERN CONGO'S CONFLICT 1–2 (2014), http://www.enoughproject.org/reports/impact-dodd-frank-and-conflict-minerals-reforms-eastern-congo%E2%80%99s-war, *archived at* http://perma.cc/5KGY-NKYS. Ostensibly, a company can disclose the use of conflict minerals to the SEC, publish the disclosure on the company website, and cross its fingers hoping that there is no public backlash that affects its bottom line or its brand. In this situation, the corporate social responsibility initiative underlying the statutory provision ultimately falls flat. There remains, however, the risk of penalty for any misstatement made in the conflict minerals disclosure. 17 C.F.R. § 240.10b-5 (2014). The risk is a potential penalty from the regulatory agency, the SEC, as well as potential shareholder liability. *See id.* Because the conflict minerals disclosure is "filed" with the SEC, as opposed to merely "furnished," as it was originally proposed, shareholders are able to bring lawsuits based on any misstatement in a corporate filing. In addition, Rule 10b-5 provides a private right of action to shareholders injured in the sale or purchase of a security by false or misleading statements made by corporate insiders. *See id.* Rule 10b-5 is one of the strongest weapons in the SEC's arsenal because it applies to all corporate statements and not just filings. *Id.* The threat of 10b-5 liability alone is sufficient to pressure a company to comply with any statutorily required disclosures.

54. The SEC regulations require promulgation of the conflict mineral disclosure on the corporate website, as well as in a filing with the SEC. 15 U.S.C. § 78m(p)(1)(A), (E).

55. Intel, for example, had been specifically targeted for the way in which it has handled its stance on this legislation and was forced to analyze its supply chain. *See* Suzanna Fallender, *Intel's Statement on Conflict Minerals Issue*, INTEL (May 19, 2010), *available at* http://blogs.intel.com/csr/2010/05/intels_statement_on_conflict_m.php, *archived at* http://perma.cc/Z5TC-3DDY. Intel initially deleted critical comments on its Facebook page made by

Non-governmental organizations and other advocacy groups have been lobbying both regulators and consumers in order to create increased demand for products that do not contain conflict minerals.[56] As a result, the market is shifting in favor of both compliance with the statutory provision, and increased corporate social responsibility and transparency in supply chains.

In sum, regulations aim to give effect to government goals, including in the area of corporate social responsibility. The alternative to regulation in advancing these goals is incentivization, considered next.

III. INCENTIVIZING CORPORATE BEHAVIOR

Incentivizing behavior has much precedence, particularly in the tax law.[57] There are several methods by which to use tax law to achieve

activists over its stance on the conflict mineral legislation. Jonathan Hutson, *Intel Freaks Out, Shuts Off Human Rights Protest on Facebook*, ENOUGH PROJECT (May 19, 2010), http://www.enoughproject.org/blogs/intel-freaks-out-shuts-human-rights-protest-facebook, *archived at* http://perma.cc/F3WQ-TN24. After reinstating the deleted comments, Intel released a statement that said, "For well over a year, we have been engaged in both conversations with NGOs and our own industry focused on creating workable solutions. We have shared with our suppliers our current position on the issue. . . . We also support the objective of US legislation to address this problem." Fallender, *supra* (citation omitted). Intel now is heralded by NGOs for being fully onboard with using only conflict-free minerals in its products.

56. *See, e.g.*, *Conflict Minerals*, ENOUGH PROJECT, http://www.enoughproject.org/conflicts/eastern_congo/conflict-minerals#Our_Initiatives (last visited June 6, 2015), *archived at* http://perma.cc/E9KZ-6GSW. One of the most vocal non-governmental organizations has been The Enough Project, which regularly promulgates information regarding which companies have taken steps to ensure their products do not contain conflict minerals. *See, e.g.*, *2012 Conflict Minerals Company Rankings*, RAISE HOPE FOR CONGO, http://www.raisehopeforcongo.org/content/conflict-minerals-company-rankings-0 (last visited June 6, 2015), *archived at* http://perma.cc/VD9M-N3SR. In other words, The Enough Project is expanding the reach of the disclosure information in hopes of affecting the market and pressuring companies into compliance.

57. For example, the Reagan administration developed tax incentives for corporate giving. The purpose was to shift the burden of providing certain social services to the charitable sector. Nancy J. Knauer, *Reinventing Government: The Promise of Institutional Choice and Government Created Charitable Organizations*, 41 N.Y.L. SCH. L. REV. 945, 959 (1997). *But see* Peter Dobkin Hall, *Business Giving and Social Investment in the United States, 1790–1995*, 41 N.Y.L. SCH. L. REV. 789, 816–17 (1997) ("The decline of corporate social responsibility policies and practices after the mid-1980s can be attributed not only to the failure of political liberalism, but to the inability of the proponents of business giving and social investment to articulate persuasive rationales for such activities. Tax incentives proved insufficient to fuel large-scale corporate commitments (as Hayden Smith's 1983 study shows, companies with deep commitments to social responsibility often contributed at levels greater than could be justified by tax savings, while companies lacking such commitments did not bother to take advantage of potential savings).").

certain congressional goals. It is true that tax law may be used to collect and redistribute the revenues to address corporate social responsibility concerns, which does not amount to an incentive because the result will be the same no matter how the corporation behaves: the corporation will be taxed and the taxation revenue will be redistributed.[58] However, tax law can also be used to penalize certain actions, which incentivizes actors to avoid the penalties.[59] Alternatively, tax law may be used to incentivize desirable corporate behavior through credits and deductions that allow corporations to minimize their tax liability, which will be the focus of this Part. Such tax incentives may be necessary to supplement the inherent incentives that exist in the corporate structure, which are considered first.

A. Incentives Inherent to Corporate Structure

There are certain incentives inherent to the corporate framework, many of which result from the corporate duty to maximize profits. Profits may be maximized by adding value to the company's brand, appealing to consumers, avoiding regulation, remaining in good standing with the local community, and developing a particular corporate culture to attract employees.[60] Many of these methods for profit maximization are advanced by engaging in corporate social responsibility.

58. For a discussion on this topic, see Williams, *supra* note 35, at 740–50.

59. For example, the Affordable Care Act contains a tax penalty for applicable large employers who fail to offer full-time employees enrollment in qualifying employer-sponsored health coverage, and individuals face a mandate that requires that most Americans obtain health insurance or pay a tax penalty. 26 U.S.C. §§ 480H, 5000A; *see, e.g.*, JESSICA BANTHIN, ALEXANDRA MINICOZZI, HOLLY HARVEY & SARAH ANDERS, CONG. BUDGET OFFICE, PAYMENTS OF PENALTIES FOR BEING UNINSURED UNDER THE AFFORDABLE CARE ACT (2012), *available at* https://www.cbo.gov/sites/default/files/09-19-12-Indiv_Mandate_Penalty.pdf, *archived at* https://perma.cc/FK36-EQ2V; HINDA CHAIKIND & CHRIS L. PETERSON, CONG. RESEARCH SERV., R41159, SUMMARY OF POTENTIAL EMPLOYER PENALTIES UNDER THE PATIENT PROTECTION AND AFFORDABLE CARE ACT (PPACA) (2010), *available at* http://www.ncsl.org/documents/health/employerpenalties.pdf, *archived at* http://perma.cc/33CT-8C2Y; David Gamage, *Perverse Incentives Arising from the Tax Provisions of Healthcare Reform: Why Further Reforms Are Needed to Prevent Avoidable Costs to Low- and Moderate-Income Workers*, 65 TAX L. REV. 669, 692–700 (2012). In the child labor context, Congress had attempted to penalize employers using child labor with a 10% tax, but the United States Supreme Court invalidated this tax, holding it to be an invalid exercise of the taxing power, which the Court suspected to be a penalty. Bailey v. Drexel Furniture Co., 259 U.S. 20 (1922).

60. *See* Chatterji & Richman, *supra* note 2, at 33; Ribstein, *supra* note 10, at 1433–34.

This inherent incentive to engage in corporate social responsibility stems from the reality that, while corporations are not human, their customers are—the recognition of which has driven many corporations to cater to people's desires and preferences as a method of recruiting their business and avoiding boycotts.[61] In this way, incentives act as the converse of the threat of negative market reaction, as discussed in Part II.C.

For example, corporations seek to increase their bottom lines through public perception of responsibility.[62] The availability of external markers of their corporate social responsibility, such as *Fortune* magazine's "Corporate Social Responsibility" rankings, incentivizes them to perform well on such rankings.[63] These corporate rankings, however, have their shortcomings: companies may misrepresent the extent of their social contributions and it is difficult to establish useful metrics of social responsibility.[64] Nonetheless, they have the ability to influence public perception and, therefore, the demand for the corporation's products.

Thus, businesses and corporations have begun to pursue corporate social responsibility under the theory that corporate social responsibility

61. *See* Chatterji & Richman, *supra* note 2, at 33, 48. "All successful companies aim to meet the demands of consumers, and to some degree enjoy a capability to detect and respond to market preferences." *Id.* at 48. For example, "In the face of actual and threatened boycotts and consumer activism, Nike improved its labor practices and Pepsi withdrew from Burma." Diane L. Fahey, *Can Tax Policy Stop Human Trafficking?*, 40 GEO. J. INT'L L. 345, 381 (2009); *see also* Jonathan Todres, *Moving Upstream: The Merits of a Public Health Law Approach to Human Trafficking*, 89 N.C. L. REV. 447, 505 n.265 (2011). For a review of the Nike litigation, see Vicki McIntyre, Note, Nike v. Kasky*: Leaving Corporate America Speechless*, 30 WM. MITCHELL L. REV. 1531 (2004).

62. *See* Chatterji & Richman, *supra* note 2, at 48–49; Fahey, *supra* note 61, at 381.

63. Metcalf, *supra* note 3, at 196 (suggesting that *Fortune* magazine's "Corporate Social Responsibility" rankings may encourage large global companies to engage in corporate social responsibility). *But see id.* at 191 ("Walmart, as a laggard in the 2004–2006 sample, may not be 'disciplined' by the market if improvements in its ranking would require it to abandon its business model based on highly competitive labor conditions, and instead involve labor as a stakeholder and promote collective bargaining."). The author concedes that "Walmart has moved from its 'laggard' position at the bottom of the ranking in more recent surveys." *Id.* at 191 n.144.

64. Chatterji & Richman, *supra* note 2, at 34. For example, *Working Mother* magazine listed Morgan Stanley in its "100 Best Employers for Working Moms" shortly before Morgan Stanley paid $54 million to settle a sex discrimination lawsuit. *Id.* at 34 n.7.

is good for business.[65] It has even become a strategy taught in business schools.[66]

However, it is unclear whether and to what exact extent these inherent incentives exist because it remains unclear whether corporate social responsibility metrics predict financial performance.[67] To the extent that they do not, additional incentives, such as tax incentives, are useful.

B. Tax Incentives

One of the most effective ways to incentivize behavior is through the tax law.[68] Although most states have a state corporate tax as well,[69] this Article limits itself to federal taxation.[70]

There is a strong case that tax law can incentivize individuals to act in a particular way,[71] but the case is particularly strong in the corporate

65. *See* Ronen Shamir, *Corporate Social Responsibility: Towards a New Market-Embedded Morality?*, 9 THEORETICAL INQUIRIES L. 371 (2008).

66. *Id.* at 392 ("[B]usiness schools around the world are now offering programs and classes that are based on the business-case approach to social responsibility, encourage research and theoretical models which explore the economic incentives for moral performance, and measure the business value of being 'morally right.'").

67. "More than 100 studies have examined whether corporate social responsibility (CSR) metrics predict financial performance, with a variety of results . . . ." Aaron K. Chatterji, David I. Levine & Michael W. Toffel, *How Well Do Social Ratings Actually Measure Corporate Social Responsibility?*, 18 J. ECON. & MGMT. STRATEGY 125, 128 (2009); *see also* Hall, supra note 57, at 794 ("All CEOs understand the public relations value of giving. Most also appreciate the tax savings that can come from the deductibility of contributions. However, few regard giving to be in any way related to profitmaking . . . .").

68. "Tax avoidance is as American as apple pie. Each year, individuals, families, and businesses alter their behavior in ways meant to decrease their federal, state, or local tax liabilities." Jeremy M. Wilson, Recent Development, *Statutory Interpretation in* Wal-Mart Stores East, Inc. v. Hinton *and Why North Carolina Courts Should Apply Anti-Tax Avoidance Judicial Doctrines in Future Cases*, 88 N.C. L. REV. 1471, 1471 (2010) (footnote omitted).

69. Rick Geisenberger, *The Delaware Corporation Franchise Tax*, DEL. LAW., Fall 2012, at 18, 20. For a history of corporate taxation, see Philip T. Hackney, *What We Talk About When We Talk About Tax Exemption*, 33 VA. TAX REV. 115 (2013).

70. *But see* Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267, 1269 (2013) (arguing that "federal tax incentives also affect the states because most states incorporate federal definitions of income into their own tax laws").

71. For the argument that economic incentives drive women's behavior, see Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983, 1033, 1040–41 (1993) (arguing that Congress should lower married women's tax rates to encourage both marriage and married women's participation in the labor force); see also EDWARD J. MCCAFFERY, TAXING WOMEN 19–23 (1997) (noting that, because married couples often view the wife's income as supplemental, which is taxed at

context given the sophistication of corporations, which benefit from extensive legal advice in order to minimize taxes.[72] Incentivizing corporate behavior through the taxation system is therefore an area of significant opportunity for legislators.

There are several ways to incentivize behavior through the taxation system: by providing (1) a tax deduction that reduces taxable income[73] or (2) a tax credit that reduces tax liability dollar-for-dollar.[74] Congress has employed both methods to incentivize certain corporate behavior, in addition to exemptions such as the payroll tax exemption.[75]

For example, Congress has used tax credits to encourage companies to hire certain groups of people in order to boost their employment rates. Specifically, the Work Opportunity Tax Credit provides a tax credit for hiring people from certain target groups that have consistently

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higher marginal rates, the tax code provides a disincentive for married women to work), and Jennifer L. Venghaus, Comment, *Tax Incentives: A Means of Encouraging Research and Development for Homeland Security?*, 37 U. RICH. L. REV. 1213, 1220 (2003) (suggesting that the tax code can change society's behavior). However, other scholars have suggested that the tax code does not influence people's behavior but that people's behavior influences the tax code. *See, e.g.*, Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1392 (1975) (suggesting that the tax code codifies social mores); Erik M. Jensen, *Jonathan Barry Forman, Making America Work*, 5 PITT. TAX REV. 165, 170 n.16 (2008) (book review) (suggesting that the tax code is indifferent to whether the husband or wife is the primary wage-earner but that social expectations may be more sexist).

72. *See* Mark J. Cowan, *A GAAP Critic's Guide to Corporate Income Taxes*, 66 TAX LAW. 209, 232 (2012) ("Policymakers also understand the motivation of corporate managers to minimize taxes and rely on corporate managers to respond to incentives to engage in certain activities—such as investing in new equipment or research and development—put in the tax law.").

73. "An example [on tax deductions] may be helpful here. Assume . . . A . . . [has] paid $1000 under [a] local property tax. Taxpayer A is an itemizer whose income places him in a 15% marginal rate bracket . . . . Because A is able to take the [$1000] deduction, A will not have to pay $150 in income tax. A's property tax expense has been subsidized by the federal treasury . . . ." Mildred Wigfall Robinson, *It Takes A Federalist Village: A Revitalized Property Tax as the Linchpin for Stable, Effective K-12 Public Education Funding*, 17 RICH. J.L. & PUB. INT. 549, 582 (2014).

74. "Unlike an income tax deduction, a credit is taken after tentative federal income tax liability has been determined. It is a dollar-for-dollar reduction of federal tax liability that would otherwise be borne." *Id.* at 583.

75. For an excellent review of international tax incentives for corporate social responsibility, see Jeyapalan Kasipillai & Shanthy Rachagan, Tax Incentives and Corporate Social Responsibility (presented at the International Congress on Innovation and Regional Economic Development at the University of Science and Technology of China, Dec. 2–4, 2012), *available at* http://congress.ustc.edu.cn/pro/2_.pdf, *archived at* http://perma.cc/3JJR-SQ3U (reviewing tax incentives for corporate social responsibility in Australia, Canada, China, New Zealand, Singapore, and the United Kingdom).

faced significant barriers to employment, such as Temporary Assistance for Needy Families (TANF) recipients and food stamp recipients.[76]

The Indian Employment Tax Credit, meanwhile, incentivizes businesses to spur employment on Native American reservations by providing a credit if a qualified employee, such as someone who is an enrolled member of a Native American tribe or the spouse of such a member, is hired and performs substantially all of her services within a Native American reservation. The person also must have her main home on or near that reservation.[77]

In the wake of the 2007 recession that produced an unemployment rate that hovered at 9%,[78] the Hiring Incentives to Restore Employment (HIRE) Act of 2010 included a payroll tax exemption for hiring unemployed people, as well as an increased business tax credit, totaling billions of dollars in tax breaks.[79] This group of tax incentives aims to help secure employment for potentially disadvantaged categories of Americans.

Many tax credits also aim to support the hiring of former members of the military. For example, the Activated Military Reservist Tax Credit rewards employers with fifty or fewer employees with a maximum credit of $4,000 for every employee who is a National Guard member or Reservist and whose wages are paid while away on active duty for more than thirty days.[80] The Wounded Warrior Tax Credit

76. 26 U.S.C. § 51(a), (d) (2012); *see also Work Opportunity Tax Credit*, U.S. DEP'T OF LAB. EMP. & TRAINING ADMIN., http://www.doleta.gov/business/incentives/opptax/ (last updated Apr. 30, 2015), *archived at* http://perma.cc/3ENZ-W7QX.

77. 26 U.S.C. § 45A; *see also* DEP'T OF THE TREASURY INTERNAL REVENUE SERV., PUBLICATION 954: TAX INCENTIVES FOR DISTRESSED COMMUNITIES 26 (2004)*, available at* http://www.irs.gov/pub/irs-prior/p954--2004.pdf, *archived at* http://perma.cc/K56W-P92H. For an overview of taxation and Native American issues, see Mark J. Cowan, *Double Taxation in Indian Country: Unpacking the Problem and Analyzing the Role of the Federal Government in Protecting Tribal Government Revenues*, 2 PITT. TAX REV. 93 (2005).

78. *See, e.g.*, Andrew J. Kazakes, Developments in the Law, *Protecting Absent Stakeholders in Foreclosure Litigation: The Foreclosure Crisis, Mortgage Modification, and State Court Responses*, 43 LOY. L.A. L. REV. 1383, 1393 & n.42 (2010); *Labor Force Statistics from the Current Population Survey*, U.S. DEP'T OF LAB. BUREAU OF LAB. STAT., http://data.bls.gov/timeseries/LNS14000000 (last visited June 7, 2013), *archived at* http://perma.cc/Z3YN-XJAT.

79. Hiring Incentives to Restore Employment Act, Pub. L. No.111-147, §§ 101, 102, 124 Stat. 71, 72–76 (2010).

80. 26 U.S.C. § 45P; *see also* CTR. FOR AM., 2013 FEDERAL TAX BENEFITS FOR HIRING AND EMPLOYING QUALIFIED VETERANS, NATIONAL GUARD MEMBERS AND RESERVISTS 12–13 (2013), *available at* http://www.centerforamerica.org/pledge/ng/AJAH_2013_Federal_Tax_Benefits_for_Hiring_Veterans.pdf, *archived at* http://perma.cc/5YU6-UTN8.

provides a tax credit of several thousand dollars to businesses that hire veterans with service-related disabilities.[81] Additionally, "the Returning Heroes Tax Credit encourages the hiring of unemployed Gulf War-era II veterans."[82]

In addition to these tax incentives for hiring certain groups of people, there are tax credits to encourage investment in certain underperforming communities.[83] For example, the New Markets Tax Credit provides a tax credit to individual and corporate investors for making equity investments in Community Development Entities (CDEs), which are specialized financial institutions.[84] In providing the tax credit in 2000, Congress aimed to increase investments into businesses and real estate projects located in low-income communities, determining that a qualified CDE is any U.S. corporation or partnership that meets the following criteria: Its "primary mission" is to serve or provide investment capital for low-income communities or people; it "maintains accountability to residents of low-income communities through . . . representation on any" governing or advisory boards of the entity; and it is certified by the CDFI Fund of the Department of the Treasury.[85]

Similarly, the Empowerment Zone and Renewal Community Employment Tax Credit encourages employers to hire individuals who work and live in an empowerment zone or a renewal community, both of which are federal designations for highly distressed areas with high

81. 26 U.S.C. § 51; *see also* CTR. FOR AM., *supra* note 80, at 8–11.

82. Marcy L. Karin & Katie Onachila, *The Military's Workplace Flexibility Framework*, 3 AM. U. LAB. & EMP. L.F. 153, 178 (2013) (providing a discussion of the legal framework on hiring former members of the military).

83. Commentators have urged the federal government to focus on this issue. *See, e.g.*, Jesse J. Norris, *State Efforts to Reduce Racial Disparities in Criminal Justice: Empirical Analysis and Recommendations for Action*, 47 GONZ. L. REV. 493, 500 (2011) ("The need for greater investment in poor communities . . . is a complex policy question that, despite its urgency, could be addressed in a number of different ways. Even so, if state-level anti-disparities processes are earnestly committed to reducing disparities, they must address this issue. Unfortunately, this article shows that most of these processes are, in fact, neglecting the need for more services."); Jasmin Sethi, *Lessons for Social Scientists and Politicians: An Analysis of Welfare Reform*, 17 GEO. J. ON POVERTY L. & POL'Y 5, 31 (2010) ("[William Julius Wilson's] work implied that a substantive change in outcomes required improved social organization in poor neighborhoods and significant investment in poor communities by the federal government.").

84. 26 U.S.C. § 45D.

85. *See id.*; *see also* DEP'T OF THE TREASURY INTERNAL REVENUE SERV., *supra* note 77, at 18; INTERNAL REVENUE SERV., NEW MARKETS TAX CREDIT 5–6 (2010), *available at* http://www.irs.gov/pub/irs-utl/atgnmtc.pdf, *archived at* http://perma.cc/2YUY-VNZS.

levels of poverty and emigration.[86] Empowerment zones include Tucson, Arizona; Cleveland, Ohio; Knoxville, Tennessee; Fresno, California; and Detroit, Michigan; while renewal communities include Chicago, Illinois; Atlanta, Georgia; New Orleans, Louisiana; Flint, Michigan; and Youngstown, Ohio.[87]

Finally, the Disabled Access Tax Credit provides a non-refundable credit for small businesses that incur expenditures for providing access to people with disabilities.[88] Eligible expenses include readers for customers or employees who have trouble with sight, sign language interpreters for those who are hard of hearing, adaptive equipment, removal of architectural barriers in facilities or vehicles, and certain fees for consulting services.[89]

These are several examples of tax credits being used to incentivize businesses to act in desirable ways toward certain groups of people and communities. The other major category of incentives takes the form of tax deductions. Credits are more favorable to a taxpayer than deductions because they reduce tax liability dollar for dollar,[90] but deductions also reduce liability.

There have been several deductions offered to corporate taxpayers to encourage certain behavior.[91] For example, the Charitable Contribution Tax Deduction allows businesses to deduct their charitable contributions to qualified organizations.[92] This deduction allows businesses to reduce their taxable income by donating funds or property

86. 26 U.S.C. §§ 1396, 1400H; *see also* DEP'T OF THE TREASURY INTERNAL REVENUE SERV., *supra* note 77, at 3, 8.

87. DEP'T OF THE TREASURY INTERNAL REVENUE SERV., *supra* note 77, at 3–4.

88. 26 U.S.C. § 44; *Tax Benefits for Businesses Who Have Employees with Disabilities*, INTERNAL REVENUE SERVICE, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Tax-Benefits-for-Businesses-Who-Have-Employees-with-Disabilities (last updated Jan. 13, 2015), *archived at* http://perma.cc/A4H4-G4SK.

89. 26 U.S.C. § 44(c)(2); *Tax Incentives for Businesses*, MID-ATLANTIC ADA CENTER, http://www.adainfo.org/content/tax-incentives-businesses (last visited June 7, 2015), *archived at* http://perma.cc/9WUA-TWWE.

90. Roberton Williams, *Income Tax Issues: What is the Difference Between Tax Deductions and Tax Credits?*, TAX POL'Y CENTER (Sept. 26, 2011), http://www.taxpolicycenter.org/briefing-book/background/issues/credits.cfm, *archived at* http://perma.cc/M9GA-FRJ3.

91. *See supra* Part III.B.

92. 26 U.S.C. § 170. Individual taxpayers also benefit from this charitable deduction. *Id.*

to charities.[93] Charitable giving is incentivized through tax deductions on both the business and individual levels.[94]

Meanwhile, the Architectural Barrier Removal Tax Deduction incentivizes businesses to remove architectural and transportation barriers for the elderly and people with disabilities.[95] Businesses may use this deduction in addition to the Disabled Access Credit in the same tax year if both are applicable.[96] If a business avails itself of both the deduction and the credit, "the deduction is equal to the difference between the total expenditures and the amount of the credit claimed."[97] Examples of deductible expenditures include those incurred to widen doors, install ramps, restripe parking lots, and modify vehicles.[98]

Therefore, many tax incentives exist to encourage certain corporate behavior that benefits the community. Some of these incentivized behaviors fall strictly in the corporate social responsibility rubric, others do so more loosely.[99] Either way, they achieve Congressional goals of directing and shaping certain corporate behavior.

C. Theoretical Justifications

Tax incentives are effective because corporate management has the responsibility to shareholders to minimize tax liability.[100] Scholars have

93. DEP'T OF THE TREASURY INTERNAL REVENUE SERV., CHARITABLE CONTRIBUTIONS 2 (2013), *available at* http://www.irs.gov/pub/irs-pdf/p526.pdf, *archived at* http://perma.cc/JWQ2-57X5.

94. For both individuals and businesses, the tax-expenditure estimate for charitable deductions in 2009 totaled over $40 billion. OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2010, at 301 tbl.19-1 (2009), *available at* https://www.whitehouse.gov/sites/default/files/omb/budget/fy2010/assets/spec.pdf, *archived at* https://perma.cc/WV65-Y7VB. Furthermore, certain non-profit organizations are exempt from tax. *See* Brian Galle, *Charities in Politics: A Reappraisal*, 54 WM. & MARY L. REV. 1561, 1568 (2013).

95. 26 U.S.C. § 190.

96. *Tax Benefits for Businesses Who Have Employees with Disabilities*, *supra* note 88.

97. *Id.*

98. *Tax Incentives for Businesses*, *supra* note 89.

99. See *supra* Part I for examples of corporate social responsibility.

100. *See* Cowan, *supra* note 72, at 231–32 ("Any residual tax burden that cannot be passed on to workers, suppliers, and customers—or other 'outsiders'—presumably falls on the shareholders. To keep the shareholders happy, corporate managers must engage in tax planning to minimize this cost and enhance shareholder value. Indeed, shareholders have been known to litigate if they perceive that managers have not minimized corporate taxes."). *But see* Linda Sugin, *Theories of the Corporation and the Tax Treatment of Corporate Philanthropy*, 41 N.Y.L. SCH. L. REV. 835, 836 (1997) ("The Internal Revenue Code has fossilized a conception of the corporation as a 'real entity.' It generally treats that entity like

pointed out that this method of encouraging the private sector to engage in charitable activities the state cannot handle is no less legitimate than taxing corporations and then regulating corporate social responsibility.[101]

To every tax incentive, there is a corresponding cost resulting from the foregone tax revenue.[102] However, unless obtained through lobbying,[103] the cost is borne because of the value placed on the incentivized behavior.[104] For example, the charitable giving tax incentive has been criticized for its cost, but its continued existence has been justified by the value placed on charitable giving.[105]

any other taxable person, but it presumes that the entity is 'the classic profit maximizer in collective form.' According to the tax law, a corporation earns its own income and pays its own tax. Treating the corporation as a real entity serves important practical goals: it eases administration and allows form to control the tax consequences of many corporate transactions, thereby improving predictability for taxpayers. Developments in corporate theory, however, challenge this conception of the corporation." (footnotes omitted) (quoting William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1490 (1989))).

101. Reuven Avi-Yonah, *Taxation, Corporate Social Responsibility, and the Business Enterprise* (Comparative Research in Law & Political Econ., Research Paper 19/2009). Avi-Yonah investigates tax incentives for corporate social responsibility under three different views of corporations: as an artificial entity, as a real entity, and as a nexus of contracts. *Id.*

102. "We suspect that few people really oppose all efforts by corporations to minimize their tax liability or improve their financial appearance—the problem is when they go too far." Claire Hill & Richard Painter, *Of the Conditional Fee as a Response to Lawyers, Bankers and Loopholes*, 1 AM. U. BUS. L. REV. 42, 47, n.17 (2011) (emphasis omitted).

103. Businesses and industries spend many resources lobbying for tax incentives. *See, e.g.*, Nancy A. McLaughlin, *The Role of Land Trusts in Biodiversity Conservation on Private Lands*, 38 IDAHO L. REV. 453, 458 (2002) ("[L]and trusts have been increasingly active in lobbying for even greater tax incentives to encourage both the donation and sale of conservation easements, and lawmakers appear to be increasingly receptive to their pleas."); Eric Homsi, Comment, *Financing Films One State at a Time: A Survey of Successful Film Incentive Programs*, 21 SETON HALL J. SPORTS & ENT. L. 149, 151 (2011) (reviewing the American film and television production industries' lobbying efforts for "incentives to prevent further runaway productions and to maintain the industry's beneficial impact on the American economy").

104. One commentator proposed the following framework for evaluating tax incentives: "If, however, lobbyist-legislator-advocates claim that tax breaks provide a tax incentive, the tax break must be held to a higher standard: Does the tax incentive help the economy? . . . [It does] if its economic benefits outweigh its economic costs." Martin A. Sullivan, *Tax Incentives and Economists*, 111 ST. TAX NOTES 20, 26 (2006).

105. *See, e.g.*, Eric M. Zolt, *Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above*, 63 HASTINGS L.J. 361, 404 (2012) ("[T]he current regime for charitable deductions creates value, but perhaps not enough value for its costs, broadly defined."); Grace Soyon Lee, *Mitigating the Effects of an Economic Downturn on Charitable Contributions: Facing the Problem and Contemplating Solutions*, 22 CORNELL J.L. & PUB. POL'Y 589, 609–612 (2013) (outlining the criticisms of the charitable deduction).

Similarly, corporate social responsibility is valued and subsidized. For example, the hiring of certain groups of people is valued to the extent that its costs are subsidized through the tax code. In other words, advancing these public policy goals has been deemed worth the foregone tax revenue. In this way, the government has been characterized as a partner in the business by foregoing certain tax revenues.[106]

Of course, the effectiveness of the tax incentives requires that corporations have tax liability that they seek to minimize. This requires making the important distinction between minimizing tax liability and tax avoidance. As corporations endeavor to avoid taxation by geography or the structure of their transactions, the tax base decreases and tax incentives become less effective because no tax liability needs to be minimized.[107] However, to the extent that income exists, corporations will seek to minimize their tax liability and the government can take advantage of this known goal through tax incentives for certain corporate behavior.

IV. THE FRAMEWORK ON WHETHER TO LEGISLATE OR INCENTIVIZE

Observers have called for tax incentives and for corporate regulations for certain corporate behaviors.[108] But what is the framework that should govern whether Congress legislates or incentivizes behavior?[109] Regulation and incentives have different levels

But see Patrick E. Tolan, Jr., *Compromising the Safety Net: How Limiting Tax Deductions for High-Income Donors Could Undermine Charitable Organizations*, 46 SUFFOLK U. L. REV. 329 (2013) (noting the importance of the charitable deduction to giving).

106. Cowan, *supra* note 72, at 237 (reviewing the literature likening the government to a shareholder by virtue of its right to a share of corporate revenue through taxation). "But the government's position is different from that of private shareholders in at least seven ways." *Id.*

107. For a history of corporate taxation and the ways in which corporations seek to avoid it, see John T. VanDenburgh, Note, *Closing International Loopholes: Changing the Corporate Tax Base to Effectively Combat Tax Avoidance*, 47 VAL. U. L. REV. 313 (2012); see also Joann M. Weiner, *An Economist's View of Income Allocation Under the Arm's Length Standard and Under Formulary Appointment*, *in* THE STATE AND LOCAL TAX LAWYER—2009/10 SYMPOSIUM EDITION, at 25, 29 (2013) ("To minimize their overall tax liability, multinational corporations have an incentive to attribute income to low-tax jurisdictions and to attribute expenses to high-tax jurisdictions.").

108. *E.g.*, Arthur Acevedo, *Responsible Profitability? Not On My Balance Sheet!*, 61 CATH. U. L. REV. 651, 693–95 (2012).

109. *Id.* at 693 (arguing that Congress should use tax law to encourage corporations to engage in socially responsible behavior, specifically related to products liability).

of effectiveness depending on the desired behavior. Also, the nature of the desired corporate behavior may preclude regulation, leaving incentives as the best method of achieving such behavior. These issues are considered next.

A. Legality

There are certain corporate behaviors not amenable to regulation. These areas are the easiest candidates for tax incentives, which are the only way to achieve desired corporate behavior if regulation is not possible.

For example, while corporations may not discriminate, they cannot be told whom to hire.[110] This is clear territory where tax incentives may fill the legislative gap necessarily in existence. Accordingly, several tax incentives exist to hire from certain groups of people.[111]

Similarly, government cannot legislate in which geographical areas a corporation must hire. In fact, there arises competition among jurisdictions to attract business through their tax law.[112] Again, this is where tax incentives fill the legislative void,[113] and tax incentives have arisen to encourage hiring from certain communities.[114]

Government also cannot legislate where businesses invest their money, short of taxing them and redistributing the tax revenues. On the other hand, government can incentivize companies through tax law to invest in certain underperforming geographical areas. This is the reason for tax incentives that encourage businesses to invest in certain areas,

110. *See Employers and the ADA: Myth and Facts*, U.S. DEP'T OF LAB. OFFICE OF DISABILITY EMP. POL'Y, http://www.dol.gov/odep/pubs/fact/ada.htm (last visited June 7, 2015), *archived at* http://perma.cc/966F-X3GD. There is a network of federal laws preventing discrimination in hiring, including the Title VII of the Civil Rights Act of 1964 that prohibits discrimination on the basis of race, color, religion, national origin, or sex, as well as The Age Discrimination in Employment Act of 1967 (ADEA) that prohibits discrimination against people over 40 years old. For further information on these laws and others enforced by the federal government, see *Laws Enforced by EEOC*, U.S. EQUAL EMP. OPPORTUNITY COMMISSION, *available at* http://www.eeoc.gov/laws/statutes/ (last visited June 7, 2015), *archived at* http://perma.cc/F3QA-95GJ.

111. *See supra* Part III.B.

112. The competition among the states for filmmaking business is an example. *See, e.g.*, Schuyler M. Moore, *The Future of Money*, L.A. LAW., May 2013, at 20, 26 ("The most important development in film financing over the last decade is the drastic expansion of state tax credits for film production. Revelations used this approach to obtain New York tax credits for *The Magic of Belle Isle*.").

113. *See supra* Part III.B.

114. *See supra* Part III.B.

such as the Empowerment Zone and Renewal Community Employment Tax Credit.[115]

Increasing accessibility to people with disabilities is an area where Congress has chosen to both legislate and incentivize behavior. Specifically, while Congress has legislated certain minimal standards of accessibility for people with disabilities, further accommodations are incentivized through the tax law, such as the Disabled Access Tax Credit.[116] This increases the response to the issue.

There are also plenty of areas where Congress may legislate, but such legislation may be out of place. This may be the case of conflict minerals. Specifically, a sole humanitarian provision in the context of financial reform such as Dodd–Frank seems inconsistent. Moreover, the stated aim of the conflict minerals provision is a reduction in violence in the Democratic Republic of Congo,[117] yet Congress requires only mere disclosure by companies with reporting requirements to the SEC and no actual penalty for use of conflict minerals.[118] In other words, the conflict mineral legislation, while ambitious in shaping corporate social responsibility, likely will not be able to produce a measurable effect on its underlying goal of reducing violence in the DRC. While market forces could pressure companies into acting responsibly, it is possible that Congress would have gotten more buy-in and participation from both public and private corporations if it had offered tax incentives rather than regulations tied to SEC reporting requirements.

B. Effectiveness

No doubt, there are frequent breaches of corporate social responsibility, especially when corporate social responsibility is neither regulated nor incentivized.[119] Many of these breaches result from the

115. *See supra* Part III.B.

116. *See supra* notes 88–89 and accompanying text. For example, the 1973 Rehabilitation Act, section 504, requires a recipient of federal funds to "make reasonable accommodation to the known physical or mental limitations of an otherwise qualified handicapped applicant or employee unless the . . . accommodation would impose an undue hardship on the operation of [the employer's] program or activity." 34 C.F.R. § 104.12(b) (2011).

117. Dodd–Frank Act, Pub. L. No. 111-203, § 1502(a), 124 Stat. 1376, 2213 (2010).

118. *Id.* § 1502(b)(1)(A) (codified as amended at 15 U.S.C. § 78m(p)(1)(A) (2012).

119. *See* Craig Mackenzie, *Boards, Incentives and Corporate Social Responsibility: The Case for a Change of Emphasis*, 15 CORP. GOVERNANCE: INT'L REV. 935 (2007) (drawing

nature of the corporate framework, which pursues maximization of profits. This has certain lessons for the effectiveness of regulation versus incentives.

Corporations seek to circumvent regulations if the regulations conflict with profit maximization, as they often do.[120] When corporations are effective in dodging regulations, they are able to undermine the intent of the regulations. One way to avoid this effect is to incentivize particular behavior instead of regulating it.

Corporations also seek to circumvent taxes,[121] which is why opportunities to lower tax burdens through tax incentives are effective. Whereas it is difficult to harness corporate avoidance of regulations into productive results, it is easy to harness corporate avoidance of taxes by offering tax incentives.

A major exception to the corporation's primary duty to maximize profits for shareholders[122] is the case wherein the shareholders value corporate social responsibility in itself.[123] There has been some movement toward socially responsible investing, where investors buy stock based in part on the company's record in the social, ethical,

upon economic theories to analyze the primary causes of breaches of corporate social responsibility).

120. "[C]orporations have a strong inclination to resist, co-opt, or preempt government directives, and . . . the spread of economic globalization has made it even easier for corporations to avoid governments altogether." Chatterji & Richman, *supra* note 2, at 41; *see also* Hill & Painter, *supra* note 102, at 42 (noting that "loophole lawyering" makes regulating corporations difficult).

121. *See, e.g.*, Gulf Oil Corp. v. Clayton, 147 S.E.2d 522, 529 (N.C. 1966) ("[E]xploring ways [for the corporation] to minimize taxes is as much a part of its business as exploring for new sources of oil."); *see also* Cowan, *supra* note 72, at 235 ("Given the high stakes and high profile of tax planning—especially effective tax rate planning—corporations spend billions on in-house tax departments and tax consulting advice.").

122. *See* Chatterji & Richman, *supra* note 2, at 34 (arguing that advocates of corporate social responsibilities need to remember the function of the corporation). *But see* Susan S. Kuo & Benjamin Means, *Corporate Social Responsibility After Disaster*, 89 WASH. U. L. REV. 973, 977 (2012) (arguing that the "standard story concerning corporate social responsibility is incomplete because it features only the largest, publicly traded corporations" and not "closely held, locally owned businesses, whether corporations, LLCs, or even franchise establishments with owners who reside in the community").

123. "Managers can promote shareholders' interests without maximizing profits to the extent the shareholders have some objective other than profit maximization." Ribstein, *supra* note 10, at 1433. The question also is to what extent is society's interests consistent with those of shareholders? *Id.*

environmental, or political realms.[124] Nonetheless, the significant number, turnover, and anonymity of shareholders of public corporations, whose stock trades on an exchange, result in the operation of the assumption that shareholders want maximum profit. This has prompted debate over whether corporate social responsibility is even possible. Indeed, "[f]or centuries legal, political, social, and economic commentators have debated corporate social responsibility ad nauseam."[125]

V. CONCLUSION

With the choice of whether to incentivize or regulate corporate behavior, legislators must decide how to achieve certain desirable behavior. This question arises often in the context of corporate social responsibility. This Article has proposed a framework in which to make these types of decisions, evaluating examples of both approaches.

Ultimately, the decision whether to legislate certain corporate behavior or incentivize it depends on whether regulation is even possible and, if it is, whether it would be effective. The subject of the regulation or incentive helps determine which method would be possible and effective. For example, certain subjects are beyond the scope of regulation—such as where or whom a corporation may hire—and certain subjects are unusual for regulation. These are ideal areas for incentivizing corporate behavior to achieve desired corporate behavior.

124. Siebecker, *supra* note 18, at 623. Siebecker cites the public's willingness to pay a premium for "socially sound business practices" as a monetary incentive for corporations to engage in corporate social responsibility. *Id.* at 624.

125. Butler & McChesney, *supra* note 1, at 1195 (emphasis omitted).