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Corporate Social Responsibility (CSR) Disclosure and Its Impacts towards Corporate Tax Aggressiveness

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ABSTRACT

To create greater sustainability, businesses are urged to be more socially responsible. The corporations are required to disclose the Corporate Social Responsibilities (CSR) behavior through the establishment of regulatory frameworks set by the governments all over the world. However, for some corporations despite flaunting their responsible behavior in public, discreetly they can be practicing tax aggressiveness behavior. This unethical behavior arises as a result of the tax incentives provided by government in encouraging the corporations to indulge in CSR activities. Corporations had wrongly used the incentives provided by aggressively managing their tax affairs since they want to show higher profit. Therefore, the main objective of this study is to examine whether the different dimensions of CSR disclosure namely environment, social and governance would give significant effect on corporate tax aggressiveness or otherwise. This study is confined to the Public Listed Companies in Malaysia and content analysis on CSR report and other discrete reporting documents for financial year end 2014 were analyzed to gather all relevant information relating to the disclosure. The computation of Effective Tax Rate (ETR) had been conducted to measure corporate tax aggressiveness since it is the most effective tool as compared to the others. The result is consistent with most of the prior studies where the authors found disclosure items related to the corporate mission, code of ethics/business conduct, board composition and corporate governance statement give positive significant effect on corporate tax aggressiveness. Hence, this study could be benchmark for future study in examining the relationship between CSR disclosure and corporate tax aggressiveness especially in Malaysia context.

KEYWORDS: CSR Disclosure, Effective Tax Rate, Corporate Tax Aggressiveness, Public Listed Companies, Organizational Legitimacy

INTRODUCTION

Organizations seek for initiatives to operate within the bounds and norm of society which involve what is known as corporate social responsibility (CSR) [25]. Through an annual report disclosure, organizations usually disclose their responsible behavior to provide a clear representation of their image as a community conscious organization and they strive to meet the society's expectation. Traditionally, CSR reporting has been recognized as voluntary action by companies, but as its essentiality arises, many governments and stock exchange have made it a mandatory requirement [26]. In Malaysia, Bursa Malaysia has made it mandatory for the Public Listed Companies (PLCs) to disclose their social activities through CSR reporting.

It is a current trend nowadays that many companies are genuinely involved with social responsibility activities although some have shown irresponsible behavior such as aggressive tax avoidance which intended to reduce their tax liabilities legitimately. They claim to be a public concern organization and increasingly devoting into social and environmental needs. In year 2009, US Treasury had estimated that more than \$345 billion loss for each year as a result of various tax avoidance schemes. US government also reported that about 66% of the domestic corporation and 68% of foreign corporations did not pay any federal corporate taxes during the period 1998–2005[27]. Most of them had given excuses by disclosing their social responsibility behavior, which they deemed as though they had been paying a fair share of corporate taxes. However, in reality, many of these corporations have abusively used CSR as a tool to cover up their tax aggressive behavior in their attempt to gain public confidence and trust. These corporations attitude has raised the question of their sincerity towards the public and society needs when they are actually engaged in large scale tax avoidance and evasion. Thus, this paper investigates the extent of CSR disclosures and how it will impact on corporate tax aggressiveness behavior among Public Listed Companies in Malaysia.

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LITERATURE REVIEW

There are various definitions of CSR adhered by every organizations. According to [1], CSR is defined as ‘‘how business takes account of its social and environmental impacts in the way it operates, maximizing the benefits and minimizing the downsides’’. Previously, [2] have stated that CSR is a business approach where the corporations are involved in activities for the betterment and welfare of the society comprising three key dimensions in the environment, social and governance.

[3]stated that environmental dimension reflects the economic growth of a nation but without contaminating the environment. It is the responsibility of the company’s management to consistently preserve the environment, such as by; reducing the waste of resources, practicing the prescribed ethical code of conduct, publishing a transparent annual environmental report, protecting the scarce natural resources and biodiversity, carrying out a sustainable use of natural resources, reducing the emissions of toxic and contaminating products, promoting an efficient energy use and promoting recycling [4]. From the perspective of social dimension, [5] have acknowledged various CSR contributions by some organizations towards employees, women, community, and minorities. The latest study by [4] emphasizes that the enhancement in the definition of social elements encompasses the capability of organization in creating more job opportunities, respecting and protecting human right, helping developing countries, developing staff skills, enhancing quality of life of host countries, practicing non-discrimination behavior, making contributions to the needy as well as ensuring the quality and safety of their products. On the other hand, governance dimension usually reports on the transparency of board members, adherence to the code of conduct and anti-corruption index within the organization which serve as the basis of the relationship between board and shareholders and management.

Although organizations have the right to reduce their tax liabilities [6], this behavior will become illegal if they deliberately engage themselves in avoiding taxes. [7]defined tax aggressiveness as a behavior that includes all tax planning activities, regardless if it is legal or illegal or those that fall into the gray area. In order to make all tax planning activities not only legitimate but also an avenue for organization to enjoy the advantage of paying minimal level of tax, organization should adhere to the rules and regulations which had been established by the authorities which are considered to be within the spirit of law [8-10]. In Australia for instance, engaging in tax planning with the intention to reduce tax liabilities is not considered as behaving within the spirit of law [11]. Organizations are also considered to be tax avoidant organizations, if they do not pay their ‘‘fair share’’ of the corporate income tax to the government which is the sole provider and financier public goods in society [12, 13].

Currently, studies on the relationship of CSR and the level of tax aggressiveness are increasing. [14] found that corporations with excessive irresponsible CSR activities becomes more tax aggressive in nature, thus, the immoral firm’s culture gives negative impact on firms’ tax behavior. In addition, [15] also derived the same conclusion as they found higher level of CSR performance would lower the likelihood of tax avoidance. For this study, the CSR disclosure will be separated into three dimensions and by doing that the CSR disclosure is thought to give different effect on corporate tax aggressiveness compared to the overall CSR disclosure. This study perceives that the level of different dimensions of CSR disclosure will influence the level of tax aggressiveness behavior. Hence, the research hypotheses are as follows:

H1: The level of CSR environmental dimension of a corporation has significant effect on corporate tax aggressiveness.

H2: The level of CSR social dimension of a corporation has significant effect on corporate tax aggressiveness.

H3: The level of CSR governance dimension of a corporation has significant effect on corporate tax aggressiveness

The theoretical model shown in Figure 1 summarizes these hypotheses.

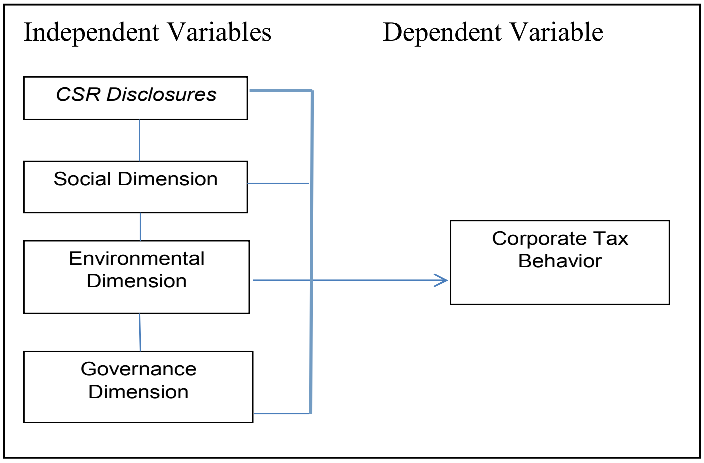

Figure 1: Conceptual framework

RESEARCH METHODOLOGY

The population for this study are all Public Listed Companies (PLC) in Malaysia. This study has selected year 2014 as the sample for disclosure analysis as well as for the financial statement analysis. However, all corporations that have been categorized under financial corporation's sector consisting of 34 companies are excluded from the initial samples since government regulations are likely to affect their ETR [16]. After excluding the entire financial corporation, the remaining samples of 167 corporations are further scrutinized where corporations with negative net income or tax refunds (20 companies) were excluded since their ETRs are likely to be distorted [17]. The final samples of 147 corporations which consisting of various industries such as accommodation, civil engineering, construction and etc.

Secondary data are used in this study since it represents the most prominent procedure on CSR disclosure in Malaysia [18-20]. Company discrete reporting such as the sustainability report, management commentary report, environmental disclosure report as well as CSR report are usually used as supplementary documents to support the financial information of the companies. Content analysis is employed in determining the level of CSR disclosures for each dimension.

Corporate tax aggressiveness is the dependent variable in this study. There are several methods used in calculating the level of corporate tax aggressiveness, but for this study, the ETRs calculation is used as it has been the widely used method in determining corporate tax aggressiveness [7, 16, 21]. ETRs measure the efficiency of a corporation in mitigating its current tax liability related to its pre-tax accounting income. Hence, ETRs stipulate the relative tax burden across corporations [22]. The low ETRs usually indicate a sign of tax aggressiveness for an organization, while the high ETRs indicate lower tax planning or a detection of tax avoidance within an organization. The independent variables in this study are the three dimensions of CSR which are; social, environmental and governance dimension.

FINDINGS AND DISCUSSION

Descriptive Statistics

The descriptive statistics was performed to provide brief summary and detail explanation on the characteristics of the variables used in this study. Table 3.1 below presents the descriptive statistic for individual dimensions of CSR disclosure.

Table 1:Descriptive statistics for individual dimension of CSR disclosure

Variables	N	Mean	Minimum	Maximum	Median	Std. Deviation
Environment (%)	147	43	0	100	43	30
Social (%)	147	62	29	96	62	13
Governance (%)	147	77	44	100	78	13

The environmental dimension presented in Table 1 above scored a mean value of 43% with a standard deviation of 30%. Based on the 14 items listed in the environmental dimension, the mean score reveals that all PLCs companies in this study only disclose about 43%. Next, the social dimension scored a mean of 62 % and the standard deviation of 13% which indicate that the 17 items of disclosure index within the social dimension, on average, the PLCs companies disclose about 62%. As for the governance dimension, the mean and standard deviation are 77% and 13% respectively. This means that, on average, all PLCs in Malaysia disclose about 77% from total of 13 items in modified disclosure index. This value surpasses over the other dimensions. Thus, according to the descriptive statistic, environmental dimension shows the lowest mean among all the dimensions. The result strongly implied that, PLCs in Malaysia have a low-level of information on environmental dimension. They do not initiate any effort or investment on environment and they are reluctant to provide adequate information regarding their environmental responsibility behavior. On the other hand, governance dimension shows the highest mean. Thus, there is no ambiguity on Malaysia which had been ranked at 4^{th} place among 142 countries allocate with good investor protection by its legislator, since companies in Malaysia have extensive information on governance dimension [23].

Regression

The Kolmogorov-Smirnov statistic has been the prominent practice and similarly this study has used it to assess the normality of the data distribution. The data were found to be normally distributed for the three dimensions; environment, social and governance since the Kolmogorov-Smirnov value is more than 0.05. However, for the dependent variables, the data for ETR 1 and ETR 2 were not normally distributed. As regression analysis requires the data to be normally distributed, the observation values of ETR1 and ETR2 were converted into its natural logarithmic equivalents and additionally, subjected to the Kolmogorov-Smirnov (K-S) Test of Normality. Then, the multiple regression statistical analysis was conducted to serve the main objective of this study which was to determine the relationship between environmental, social and governance dimension of CSR disclosure towards corporate tax aggressiveness. Two equations were developed since there were two dependent variables applicable. The first analysis is to determine whether environmental, social and governance dimensions of CSR disclosure will affect corporate's ETR1 or vice versa, while the second analysis is to determine whether the three dimensions also will affect corporate's ETR2 or opposite. Hence, the following equations are formulated in order to test hypothesis 1, 2 and 3:

Equation 1:

$$\left(ETR1 = \beta_0 + \beta_1(ENV) + \beta_2(SOC) + \beta_3(GOV) + \varepsilon\right)$$

Where,

ETR 1= ETR 1; ratio of current tax expense divided by income before interest and tax

ENV = Total Environmental Dimension for CSR disclosure

SOC = Total Social Dimension for CSR disclosure

GOV = Total Governance Dimension for CSR disclosure

ε = Error term of the regression

Equation 2

$$\left(ETR2 = \beta_0 + \beta_1(ENV) + \beta_2(SOC) + \beta_3(GOV) + \varepsilon\right)$$

Where,

ETR 2= ETR 2; ratio of current tax expenses divided with operating cash flow

ENV = Total Environmental Dimension for CSR disclosure

SOC = Total Social Dimension for CSR disclosure

GOV = Total Governance Dimension for CSR disclosure

ε = Error term of the regression

For regression equation 1, there is no significant association between all or any independent variables and ETR1 since the p-value is at 0.480 which is greater than 0.05. Hence, based on the findings, for ETR1 measurement, hypotheses 1, 2 and 3 are rejected since there are no significant associations between all or any of the independent variables and ETR1.

Table 2 below shows the results of the regression which is statistically significant since p-value is 0.042 ($p<0.05$), implying that there is an association between ETR and any or all of the independent variables. R-square value with 0.168, indicates that the thorough of three independent variables, accounts for 16.8 per cent of the variation in the dependent variable (ETR2).

Table 2:Regression results between environmental, social and governance dimension and ETR2

	Coefficients	t-statistics	p-value
(Constant)	4.872	3.410	0.001
Total Environment	0.038	0.328	0.744
Total Social	0.042	2.999	0.766
Total Governance	0.037	2.074	0.042
R^2	0.168		
Adjusted R^2	0.152		
F-value	4.300		
p-value	0.042		

Looking at the individual regression coefficient, the result reports that only coefficient of total governance is statistically significant since p-value is 0.042 ($p < 0.05$) whereas those total environment and total social are non-significant coefficients. The coefficient of total governance is positive (0.037) by showing a pattern of increment in governance disclosure within CSR report would affect and increase the ETR2. Whereas, any changes in the other two variables would reflect to zero impact at all on ETR2. This result indicates that, corporations tend to lower their tax aggressiveness behavior when they are practicing a good corporate governance. Overall, as reported by the regression result above, only hypothesis 3 is accepted, while the hypotheses 1 and 2 are rejected.

CONCLUSION AND RECOMMENDATIONS

This study has investigated whether different dimensions will give any effect on corporate tax aggressiveness or otherwise. The result indicates that corporate governance structure in Malaysia has given a positive effect towards corporate tax aggressiveness. It can be interpreted that, when proper and sound governance structure is imbedded in the organizations, they would become less aggressive in managing their tax payments. This result is parallel with the outcome of previous empirical literature [16], where the authors found several disclosure items related to the corporate mission, code of ethics/business conduct, CSR strategy statement and corporate governance statement which have positive significant impact on corporate ETR. Previously, [24] had investigated the impact of board of director composition on corporate tax aggressiveness and they declared the presence of positive relationship between the two variables involved. The result proved that the higher level of independent directors within organization would determine the likelihood of tax aggressiveness behavior through better governance and control. Meanwhile, another study conducted by [13] also expressed similar opinion by stating that when corporations practice unethical business conduct, they would engage in tax reducing activities. Such activities have considerable impact on the society at large as it reduces the capability of government in providing public goods.

Data used in this study is only for one particular year and this poses some limitations which future studies can pick upon. The availability of more years of data and more samples will increase the depth and breathe of the study to give better understanding and generalizability of the study.

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