The Association Between Corporate Social Responsibility Disclosure and Tax Avoidance: Evidence from Malaysia

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Abstract

Social responsibility is an interesting topic because it is an important part of the company's strategy to increase its value in the eyes of investors. By increasing awareness of social responsibility, companies disclose activities to gain recognition as an ethically responsible company in their business practices. However, some research results in developing countries show that social responsibility disclosure can also be used as a tool to cover up corporate financial fraud. This study aims to examine whether companies that actively disclose their social responsibility also behave ethically in their financial aspects. More specifically, this study investigates whether companies with good social responsibility also behave responsibly in the aspect of taxation by reducing tax avoidance practices. This research uses a sample of publicly traded companies listed on the Malaysian stock exchange for the period 2014-2019 that published sustainability reports. The results of this study indicate that corporate social responsibility disclosure is negatively associated with tax avoidance.

Keywords: CSR disclosure, tax aggressiveness, business ethics

1. Introduction

The issue of social responsibility stems from the growing public awareness of the importance of the role of companies in society. This encourages the emergence of the triple bottom line concept (Elkington, 1998) which stated that companies in conducting their business do not only focus on one bottom line, namely profit (economics) but must also pay attention to other bottom lines, namely the planet (environmental) and the people (social impact). The regulator then issued a regulation for companies to be actively involved in social responsibility activities. The company began to be active not only in carrying out social responsibility activities but also in expressing it as a form of accountability to the public. Non-governmental organizations such as Global reporting initiatives issue guidelines and disclosure standards for social responsibility even though the disclosures are still voluntary.

The public then gives appreciation to companies that actively carry out corporate social responsibility and label the company as a company that behaves ethically in its business practices. The results of the study also show that companies that actively engage in and express social responsibility enjoy a positive impact in the form of increasing company performance through sales growth and increasing share price and corporate value because the company is considered to care about its social responsibility. (Orlitzky et al., 2003; Blazovich and Smith, 2010; Lev et al., 2010; Harjoto and Jo, 2011; Wang, 2011)

However, this showed that disclosure of social responsibility can be used as a tool to increase corporate profits which at some point will be contrary to ethical business principles. The results of other studies found that motivation in carrying out social responsibility disclosures is not always based on ethical corporate behavior (Ling & Sultana, 2015; Grougiou et al., 2016; Hemingway & Maclagan, 2004). Specifically, Sikka (2010) stated that the company provides information that contains the company's promises and achievements in terms of social responsibility, but then the company is proven to have manipulated their tax report. This means companies that are active in social responsibility cannot be categorized as companies that behave ethically in business activities. Opportunistic managers can use disclosure of social responsibility as a tool to trick or distract stakeholders from corporate tax avoidance. Company managers are often the target of tax avoidance. According to (Holland et al., 2016) managers are often inconsistent in responding to criticism regarding the legitimacy of tax avoidance. The character of company executives also affects tax avoidance, executives who have a risk taker character tend to do tax avoidance (Budiman & Sutiyono, 2012)

The results of the study on the relationship between social responsibility disclosure and tax avoidance are inconclusive. The study conducted by Hoi et al. (2013) and Lanis & Richardson (2012) gave negative correlation while another study conducted by Richardson (2008) gave positive correlation. These results indicate that there is a certain context that affects this relationship. Companies with excessive CSR activities tend to be more aggressive in tax avoidance (Hoi et al., 2013). Tax avoidance can be said to be legal by utilizing existing loopholes, but this affects support for the government and other social programs so that the company does not have social responsibility (Huseynov & Klamm, 2012) . This study uses assurance on disclosure of social responsibility as a moderating variable in the relationship between disclosure of social responsibility and tax avoidance. This research takes the context of the Philippines as a developing country which on the one hand has a high dependence on taxes but the state revenue from the taxation sector is still low. On the other hand, there is an increase in social responsibility disclosure. Developing countries are often dominated by opportunistic behavior of managers due to weak investor protection so that managers can use social responsibility disclosure as a tool to cover up their opportunistic behavior.

2. Literature Review

2.1 Disclosure of Social Responsibility

The basic idea of corporate social responsibility is an embodiment of the ethical business practices of the company (Bowen, 1953; Carroll, 1997). Companies that are active in social responsibility show that in their efforts to improve the welfare of shareholders, the company also pays attention to the environment and the society. This also means that the company is responsible for having ethical business practices on the three bottom lines so that transparency in financial reporting and taxation is part of corporate social responsibility (Atkins, 2006; Goel, 2010). Social responsibility should cover all areas of the company, including the financial side. This is in line with ethical theory which states that in fulfilling obligations to stakeholders, companies must still refer to moral values (Garriga & Mele, 2004). Companies that can do this will receive superior long-term performance.

However, in its development, problems occur when the bottom line is not seen as a complete unit. Social responsibility is only considered as the company's concern for environmental issues and social impacts without seeing that corporate financial management is also a part of that social responsibility. With the existence of empirical evidence that disclosure of social responsibility affects company performance, companies can use issues of concern for the environmental and social impacts to improve the welfare of company owners. Social responsibility activities can become a legitimation for a company to continue its business regardless of whether the business operations include financial management based on ethical principles or not. This is also supported by the naturalistic fallacy that occurs in society, which states that something good is also the correct thing to do. When a company actively discloses its social responsibility activities (good), it means that the company has behaved ethically in all of its business practices (correct). This condition can be exploited by opportunistic managers by disclosing social responsibility with the aim of tricking stakeholders from finding out about the tax avoidance in the company.

Disclosure of social responsibility has also shifted from its original purpose as a reflection of the company's ethical behavior to a company strategy to gain profit. Companies use social responsibility disclosure to shape the company's image as an institution that is responsible for its business practices. Social responsibility is seen as one competitive advantage in facing business competition. The company will finally make social responsibility disclosures based on the consideration that the disclosures will contribute to the company's profits and not based on ethical considerations. Disclosure of social responsibility is a tool to meet stakeholder expectations so that companies can continue to run their business. In the case of opportunistic managers, disclosure of social responsibility is carried out to meet expectations as a company that cares for society. The manager can thus continue his opportunistic behavior. By leveraging the naturalistic fallacy, companies can gain superior short-term benefits but can be counterproductive in the long run. GRI (Global Reporting Innitiative) Sustainability reporting Guidelines are the most widely used reporting standards for sustainability reporting. The GRI was created with the aim that reporting organizations can reveal the most important impacts, both positive and negative, on the environment, the society, and the economy. In the G4 Guidelines, there are two types of disclosures, namely age standard disclosures and special standard disclosures. General standard disclosures consist of 7 aspects, namely: strategy and analysis regarding organizational sustainability, organizational profile, material and boundary aspects, relationships with stakeholders, profile reports on the overview of basic information, governance and ethics and integrity. (Wulolo, 2017). Specific disclosures consist of management disclosures and indicators of categories and aspects.

2.2 Tax avoidance

Tax expense is an expense that significantly affects the profits to be enjoyed by the company. Therefore, the company will always have a tendency to be able to reduce this burden. Regulators can also understand this by providing incentives and loopholes in tax regulations to provide options in their efforts to minimize the amount of tax to be paid. Efforts to minimize taxes are allowed as long as they are within the legal corridor. However, an action is classified as tax evasion when it enters the gray area and has the potential to violate taxation rules (Watson, 2015; Lietz, 2013).

In this study, tax avoidance is an unethical act because it is opportunistic and has the potential to violate applicable regulations. Tax avoidance is a deliberate action by taxpayers who, in an effort to minimize the amount of tax to be paid, intend not to comply with tax rules. For the state, tax avoidance causes the state to suffer losses that are not taken into account because of its tendency to violate regulations. For companies, tax avoidance may put the company at risk of being subject to tax sanctions and may also damage the company's reputation. Tax avoidance practices tend to flourish in developing countries because they have low investor protection and weak tax infrastructure so that the opportunistic behavior of managers becomes more towards tax aggressiveness. Measuring the performance of a company in the efficient use of company assets can be proxied by using the return on asset ratio. (Fahmi, 2012). Fixed assets of companies can provide opportunities for companies to reduce taxes as a result of depreciation of fixed assets each year (Rofriguez & Arias, 2012). The bigger the depreciation expense, the smaller the tax. Apart from manager characteristics, company characteristics also influence the company's actions in tax avoidance, in this case the company's investment in fixed assets. The company's investment in fixed assets can be seen using the capital intensity ratio (Ambarita et al., 2017). In carrying out operations, the company needs third party funds such as debt, proxied by the debt ratio. The higher the company's debt ratio, the higher the CSR disclosure (Roberts, 1992) because companies with high levels of debt will convince investors and creditors with more detailed CSR disclosures.

2.3 Hypothesis Development

The results of previous studies found that company motivation to make social responsibility disclosures is not always based on ethical considerations. Disclosure of social responsibility that can lead to naturalistic fallacy in society can be used by companies to act as a tool to trick people into unethical corporate actions. Companies can make social responsibility disclosures to be categorized as companies that act ethically even though this is done to cover up tax avoidance actions which are a reflection of inethical company actions. This condition can grow in developing countries due to the weak legal system and low protection of investors (Ling & Sultana, 2015). The results of Preuss (2010) study found that companies that practice aggressive tax avoidance are active in disclosing social responsibility. These results are also supported by research by Davis et al., (2015) which found that there is a positive relationship between social responsibility disclosure and tax aggressiveness. Based on this, the following hypothesis is compiled:

H1 : Disclosure of social responsibility is positively associated with tax aggressiveness

3. Research Method

This research was conducted on go public companies listed on Bursa Efek Malaysia. The research samples are companies that publish sustainability reports based on the Global Reporting Initiative (GRI) in the 2014-2019 period. Social responsibility disclosure is measured based on a disclosure index that was created based on a combination of the GRI G4 index and GRI Standard index. During the research period, GRI published the G4 guidelines (2013) and the GRI standards (2016). Based on these two rules, the writer then creates a disclosure index that is used to measure the social responsibility disclosure variable. Social responsibility disclosure is measured by comparing the number of disclosure items reported by the company and the disclosure index. Tax avoidance variable is proxied by GAAP ETR (Dhaliwaal et al, 2004), which is measured by dividing total income tax expense by profit before tax. The higher the GAAP ETR value, the lower the tax avoidance measures. This study uses control variables, namely company size (Prior et al., 2008), profitability (Desai and Dharmapala, 2006), and level of debt (Lanis and Richardson, 2015). The research model used to test the hypothesis is as follows:

$$GAAP_{ETR_{it}} = \alpha_0 + \alpha_1 CSRI_{it} + \alpha_2 SIZE_{it} + \alpha_3 ROE_{it} + \alpha_4 PBV_{it} + \alpha_5 LEV_{it} + \varepsilon_{it} \qquad (1)$$

4. Result and Discussion

Based on the research period and the availability of data needed to measure the variables in this study, a final sample of 174 observations from 68 companies was obtained. The following are descriptive statistics of the sample:

Table 1. Descriptive statistics

Variables	Mean	Median	StandarDeviation
GAAP_ETR	0.245	0.253	0.198
CSRI	0.380	0.299	0.224
SIZE	16.240	16.119	1.806
ROE	0.197	0.076	0.518
LEV	5.149	1.230	12.820
CIR	2.672	1.303	3.200

Based on table 1, it can be seen that GAAP_ETR has a mean (median) of 0.245 (0.253) with a scale of 0-1. This shows that the average effective tax rate in Malaysia is still low, namely in the range of 25%, in line with the prevailing standard tax rate of 24%. In the CSRI variable, the observation results showed that the mean (median) was 0.380 (0.299) on a scale of 0-1. This is because the level of disclosure of corporate social responsibility is low because the disclosure is still voluntary. The control variable SIZE has a mean (median) of 16,240 (16,119), ROE has a mean (median) of 0.197 (0.076), and LEV has a mean (median) of 5,149 (1,230).

Table 2. Hypothesis Test Results

Variable	**Equation 1**	
	Coeff. *(t-stat)*	**Coeff. *(t-stat)***
CSRI	0.152 ** *(1.99)*	0.149 * *(1.85)*
SIZE	0.017 *(1.55)*	0.022 * *(1.81)*
ROE	0.216 *** *(2.49)*	0.223 *** *(2.49)*
PBV	-0.009 *** *(-2.47)*	-0.009 ** *(-2.31)*
LEV	-0.001 *(-0.04)*	-0.000 *(-0.01)*
Year Dummy		*included*
Industry Dummy		*included*
Adj R^2	0.039	0.040

p-values in parentheses: * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

The results of hypothesis 2 testing show that the CSRI variable is positively associated with GAAP_ETR ($\beta = 0.152$, $p < 0.05$). A positive sign means that disclosure of social responsibility is positively related to tax effectiveness, thereby reducing tax avoidance practices. These results are consistent after including year and industry dummy variables. This result means that the hypothesis that disclosure of social responsibility is positively associated with tax avoidance is not accepted. The results of this study contradict the results of research by Preuss (2010) and David et al., (2015), which stated that disclosure of corporate social responsibility is positively associated with tax avoidance. This shows that companies that actively disclose social responsibility have a high effective tax rate, which means they have low tax avoidance. The smaller the effective tax rate, the greater the company's tax avoidance practices. This condition indicates that the disclosure of social responsibility is substantial, which means that disclosure of social responsibility is a manifestation of the ethical values adopted by the company. Ethical values adopted by companies in social responsibility are adopted by in all other aspects of its business, including financial aspects. So, the same behavior will occur in both the social responsibility and taxation aspects. If the disclosure of social responsibility is only symbolic, the disclosure is merely an impression that the company is seen as a responsible company in its business practices but it is not a corporate value

The implication of the research results is that stakeholders can use corporate social responsibility disclosure as a source of information in making decisions. Information on social responsibility disclosures can be considered information in addition to financial information. The results showed that the non-financial disclosure of information on social responsibility is associated with the financial information produced by the company, especially in the taxation aspect

5. Conclusion

This study examines the association of social responsibility disclosure and tax avoidance in go public companies in Malaysia. The results showed that the disclosure of social responsibility was negatively associated with tax avoidance, which means that companies that are active in disclosing social responsibility are companies that have low tax avoidance. This study has limitations because it only focuses on companies that disclose their social responsibility through sustainability reports based on the guidelines issued by GRI. Subsequent researches can compare the association of social responsibility disclosures with different media disclosures of companies using other variables to describe ethical behavior or corporate fraud. The scope of this research also needs to be expanded by doing it to cmpanies in other developing countries so that it can provide a more comprehensive picture of the practice of disclosing social responsibility and corporate ethical behavior. Research in developing countries can provide different research results due to different contexts with developed countries so that it can enrich the study of disclosure of corporate social responsibility. In addition, subsequent researches can also add new variables to moderate the relationship between social responsibility disclosure and corporate ethical behavior.

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