Corporate Social Responsibility, Tax Avoidance, and Evasion: Analysis of Dimensions and Components

Abstract

Tax avoidance is the perceived manipulation of legal loopholes in tax law to alleviate tax-related burdens, often implemented by deploying revenue in a low-tax, transition-priced area, also known as a tax haven. Tax is itself an expenditure imposed by the government on all for-profit organizations that generate any sort of revenue.

Taxation is one of the most predominant sources of government revenue that not only provides the financial resources that governments are looking after but also greatly contributes to a better distribution of income and wealth. The structure of tax revenues along with the share of taxes from total public revenues differs from one country to another, mainly owing to economic, cultural, and historical conditions. Tax avoidance and tax evasion render the countries' tax revenues always lower than expected. Therefore, all the issues contributing to and corresponding to the tax paradigm are highly concerning for society. Companies employ differing mathematical procedures to actively pursue tax evasion. Tax avoidance is nevertheless the exploitation of legal loopholes in tax law to mitigate taxes, which can be done by transferring revenue to a low-tax area or transfer pricing. Tax avoidance can be measured in several ways, including effective tax rates and tax differences. The results of this study indicate that managers highly regard strategies that reduce the company's tax and financial income (i.e., strategies to reduce tax expense in financial statements), as well as strategies that reduce cash taxes (i.e., strategies that make a difference in income tax payments).

The community is on a relentless quest to see whether or not companies and individuals pay their fair share of taxes against the social costs spared for them. As such, the purpose of this study was to examine the effects of selected dimensions of social responsibility on tax avoidance and tax evasion. The research tools employed in this research are questionnaires, documents, records, and financial information of companies listed on the Tehran Stock Exchange. The statistical sample also consists of 156 listed companies from the period 2006 to 2019. Findings indicate a significant effect of social responsibility on tax avoidance and evasion.

Keywords: *Social responsibility, Taxation, Tax avoidance, Evasion*

Rozita Roghani
PhD, Department of Economic Development, University of Tabriz, Tabriz, Iran.
Seyed Kamal Sadeghi*
Associate Professor of Economics, University of Tabriz, Tabriz, Iran.
E-mail: sadeghiseyedkamal@gmail.com

Introduction

Business entities and organizations are currently at the pinnacle of importance. They are expected to not only mull over increasing their profits, but also to be held accountable to the community and hence to be beneficial to society. That is, a well-established mutual relationship between the business entity and the community is the hallmark of prosperity. On the other hand, tax evasion and avoidance of companies is an academic and practical point of interest that has long been concerning for society. Thus, since taxation is one of the most predominant sources of government revenue that not only provides the financial resources that governments are looking after but also greatly contributes to a better distribution of income and wealth. Corporate shareholders are interested in knowing whether the company's management is successfully fulfilling its responsibility to increase shareholders' profits and wealth, whether the management of the company seeks deceitful practices in paying taxes to the government, and whether the executives in the guise of management policies have deceived them. As a result, corporate social responsibility is beneficial to both the company itself and the community. Examining the trend of the tax-to-GDP ratio in the country shows that although many efforts have been made to improve this ratio by simplifying laws, and reforming rates, among others, the country is still plagued with the devils of tax avoidance and evasion, clearly necessitating the subsequent analysis of its moral and social dimensions. This is the main reason why researchers have examined ethical aspects such as corporate social responsibility in a more global context. Social communities strive to influence and, as such, deploy corporate operations through a variety of means, including practicing rules of conduct and transparency. Companies also respond to these regulations and pressures by relentlessly modifying their mechanisms, and voluntarily following specific behavioral rules to limit various aspects of their operations. One of the practical mechanisms of companies for this purpose is corporate social responsibility (Hill, 2005). Overall, social responsibility emphasizes an organization's relationship with its productivity (Cadbury, 1992). That is, "social responsibility refers to the set of duties and responsibilities that an organization must perform to maintain, care for, and assist the community in which it operates." (Bozorg-Asl et al., 2013). This study examined various indicators, classified into various components, to study social responsibility, which was in turn classified into three dimensions as follows:

1. Corporate governance: The methods and managerial styles employed by company executives are aimed at determining strategies that lead the company to

achieve pre-devised goals, risk control, and optimal allocation of resources. Cadbury (1992) defines corporate governance as a system that directs and controls companies, the focus which is the performance of senior organizational managers in observing the principles of transparency, integrity, and accountability. The ultimate purpose of corporate governance is to balance the setting of economic and social goals as well as individual and public goals. It ensures the effective allocation of resources and hence the obligation to be held accountable, rendering the interests of the company, individuals (stakeholders), and society as close as possible in the aftermath. It is perceived to consist of independence of the board of directors, knowledge of the board of directors, and ownership percentage of controlling shareholders, among others (Hassas, 2006).

2. Community (addressing community concerns, community expectations): The second dimension of social responsibility pertains to the concerns of the community on elements such as the environment, human rights, labor rights, education and development of local workers, and assistance to a community program, among others (Hassas, 2006).
3. Diversity (in applying methods and processes): Another dimension of social responsibility is diversity, which includes components such as target market diversification, beneficiary diversification, and diversity in management policies, among others (Hassas, 2006).

Although numerous studies have pursued tax evasion and social responsibility, examining the relationship therebetween is a research gap in the relevant literature (Carroll and Joulfaian, 2005; Hanlon and Heitzman, 2010). As such, the purpose of the current study was to fill in this academic gap. The main contribution of this study is the simultaneous examination of the effect of social responsibility on tax avoidance and evasion, while separately exploring the effects of strengths and concerns of three levels of corporate social responsibility.

Theoretical foundations and research background

Taxes are the main source of government funding in the budget revenue sector and cover a significant portion of public expenditures in the economies of most countries, especially those of developed countries. In some countries, 90 to 95 percent of public spending is generated through tax revenues. Owing to the lack of transparency of revenues and the incapability of the tax system to specify the accurate income of the people, the amount of tax recognition is insignificant. Moreover, a significant portion of the very same recognized tax is not collected and if it is collected, the benefit-cost principle is not observed, that is, the cost of collection is higher than the tax collected.

The tax-to-GDP ratio changes with fluctuations in tax revenues, which is in turn influenced by factors affecting tax collection, among which are tax avoidance and evasion. According to government financial reports from 1978 to 2008, the tax-to-GDP ratio decreased from about 9% in 1978 to 7.1% in 2008. That is, despite the increase in collected taxes and GDP in this period, the tax-to-GDP ratio has not only remained stagnant during the aforementioned period but has also decreased. The GDP and collected tax levels may experience fluctuations to varying degrees, which is in some cases, influenced by tax avoidance and evasion (Arab-Mazar et al., 2011; Musavi Jahromi et al., 2009). Ines (2018) studied financial crime, corruption, and tax evasion and reported that there is a positive relationship between tax evasion and financial crimes and that countries with higher levels of corruption are more likely to report tax evasion. Prem (2018) studied the social effects of avoidance and concluded that tax avoidance prevents strengthening public accountability and fair competition. Watson (2015) examined the effect of revenue performance on the relationship between corporate social responsibility and tax avoidance and showed that when current (future) income performance is low, it positively mediates the relationship between tax avoidance and social responsibility, and when current (future) income performance is high, this effect decreases. In a study of corporate ownership structure and tax avoidance, Hairul et al. (2014) reported that tax avoidance methods are as old as taxation and that tax-giving companies have recently further complicated their schemes. Their research suggests that a strong government mechanism can reduce tax avoidance. Hoi et al. (2013) whether corporate social responsibility is associated with tax avoidance, the findings to which revealed that companies with responsible operations are more likely to seek tax avoidance. Huseynov and Klamm (2012) studied the relationship between tax avoidance, tax management, and corporate social responsibility, reporting the interaction of community concerns with tax management fees positively affects both generally accepted accounting principles (GAAP), and cash effective tax rate (ETR), while the interaction of corporate governance strengths and diversity concerns with tax management fees negatively affects Cash ETR. On the other hand, Babajani and Abdi (2010) evaluated the relationship between corporate governance and taxable profits. The results of this study show that there was no significant difference between the mean percentages of difference declared a definite profit in the group of companies, which has corporate governance mechanisms with the group of companies that do not have corporate governance mechanisms. However, in each group of companies, the percentage difference between

declared and definite taxable profits were significant. Pourheidari and Sarvestani (2013) examined the factors affecting tax management and hence showed that there is no significant and direct relationship between the growth opportunities and the experience of the company with the effective tax rate. The type of industry has a significant effect on the effective tax rate. In addition, the results show that institutional ownership negatively and effectively affects corporate tax. This result indicates that institutions can prove to be pivotal in tax management.

Research Hypotheses

Considering the theoretical foundations and research background, the following hypotheses are proposed for the study:

- Main Hypothesis 1: The dimensions of corporate social responsibility have a significant and positive effect on tax avoidance.
    - Sub-hypothesis 1.1: The dimension of corporate governance has a significant and positive effect on tax avoidance.
    - Sub-hypothesis 1.2: The dimension of society has a significant and positive effect on tax avoidance
    - Sub-hypothesis 1.3: The dimension of diversity has a significant effect on tax avoidance.
- Main Hypothesis 2: The dimensions of corporate social responsibility have a significant effect on tax evasion.
    - Sub-hypothesis 2.1: The dimension of corporate governance has a significant effect on tax evasion
    - Sub-hypothesis 2.2: The dimension of society has a significant effect on tax evasion.
    - Sub-hypothesis 2.3: The dimension of diversity has a significant effect on tax evasion.

The research employs descriptive methods for its purposes. Given the purpose of this study, this study was conducted using a mixed approach, that is, one that includes quantitative and qualitative methods, in which the dimensions of social responsibility (governance dimension, society dimension, and diversity dimension) and the effect of social responsibility dimensions on tax avoidance and evasion are studied.

Statistical sample of the research

The statistical population of the first stage of the research includes university professors, managers of stock exchange companies, executives of the stock exchange organization, and some academic and professional experts in the field of corporate social responsibility. The purpose of the second stage of this study was to examine the dimensions of social responsibility on tax evasion and avoidance of companies. Considering that the necessary condition for any research is to obtain the required information, the information regarding companies listed on the stock exchange was searched and hence made available. Also, according to the criteria set by the Securities Exchange Organization for admission, a continuation of activities and reporting methods of companies, information about listed companies were of higher quality and were thus far more coherent and homogeneous, and, as such, companies listed on Tehran Stock Exchange were selected as the research population of the present study. Moreover, the statistical population of the second stage of the research consists of all companies that were listed on the Tehran Stock Exchange between 2004 and 2016 and have remained listed in this period. In the present study, the companies with the following inclusion criteria were selected for the statistical population and other companies were excluded from the study:

1. The company has been listed on the Tehran Stock Exchange since the beginning of 2004;
2. The fiscal period of the company should be one year ending on March 20;
3. The company has not changed its fiscal year and has left the stock exchange during the study period;
4. The company should be active in sectors other than investments, financial intermediation, holdings, and leasing;
5. The information needed to calculate the research variables in the years of review should be available;
6. The company should not have an operational hiatus of more than 3 months and be active at the time of inspection.

Considering the aforementioned inclusion criteria, 164 companies were selected as the statistical sample.

Data collection methods

The tools used to collect data in this research are questionnaires, interviews, and documents.

In order to determine the indicators of social responsibility in companies, first, the relevant literature was analyzed for extraction of contents, which were hence scored by academic experts and professionals of the capital market. Then the authors established the theoretical framework of the subject and the related sources. A questionnaire was designed to identify the importance of each of the indicators and components of corporate governance and society, and to identify barriers, problems, and limitations of disclosure and reporting. After designing the initial research framework, the Delphi method was used to validate the framework and

determine its dimensions and classes and determine whether the predicted checklist corresponds to the current situation, that is, the reality of the Iranian capital market. To conduct the first stage of the research, a preliminary questionnaire was prepared by carefully reviewing the processes and results of previous research.

This questionnaire was distributed among 50 experts of social responsibility, including university professors, researchers, active social responsibility writers, and officials of the stock exchange companies active in the field of social responsibility, from which, 40 questionnaires were completed and returned. LISREL was then used to combine the scores and rank the final criteria. Criteria with a factor load greater than 5.0 were included in the analysis, while the few criteria with a factor load of less than 5.0 were excluded therefrom. The components agreed upon by the experts are the 28 components plotted in Figure 1. Also, a total of 186 indicators (56 indicators for the corporate governance dimension, 105 indicators for the social dimension, and 25 indicators for the diversity dimension) were extracted from the contents (Table 1).

Table 1: Dimensions and components of social responsibility

Dimension	Component
Corporate governance	Concentration of ownership
	Transparency of Ownership
	Institutional shareholders
	Voting procedures and sessions
	Dividend and equity rights
	Equal treatment of shareholders
	Adequacy and quality of information disclosure
	Disclosures related to bonuses and shares of board members
	Structure and composition of the board of directors
	Board meetings
	Evaluating the performance of the board
Society	human rights
	Responsible investment
	Business ethics / fair operating procedures
	Corruption, bribery, and money laundering
	Employment and work procedures and staff
	Observance and compliance with relevant laws and regulations
	Paying taxes
	Environmental measures and solutions
	Observance of laws and regulations related to the environment
Diversity	Target market diversification
	Product diversification
	Workforce diversification
	Diversity in the supply chain, customers, and consumers of products/services
	Diversity in management policies

After this process, the second questionnaire was prepared using the agreed indicators, copies of which were sent to each of the studied companies. Where possible, the MSCI KLD 400 Social Index was employed to collect specialized data. The required data for the second stage of the research were as follows: market value of the company, book value of equity, total assets and liabilities, and advertising costs, among others. This data was collected from various sources, namely statistics and information from the Tehran Stock Exchange Organization and published financial statements and explanatory notes, reports of the board of directors, and financial information software applications such as Rahvard Novin, Tadbir-Pardaz, and Internet websites.

Data analysis methods

The research employed a two-stage approach for data analysis. In the first part, content analysis and confirmatory factor analysis methods have been used to identify the elements and dimensions of social responsibility (corporate governance dimension, society dimension, and diversity dimension). In the second part of the research, multivariate regression was used

to test research hypotheses. Also in the descriptive statistics section, the mean and median indices and the standard deviation index were used, while in the inferential statistics section, multivariate regression using pooled data was employed. Hausman test was used to determine the type of effect for the pooled data (i.e., fixed effects vs random effects), while F and T statistics were utilized to determine the significance of regression pattern and indices obtained from regression pattern estimation, respectively. Moreover, Excel, Eviews8, and Lisrel were used for data extraction and content analysis. After conducting exploratory studies and reviewing the research, the basic conceptual model of the research is drawn as follows:

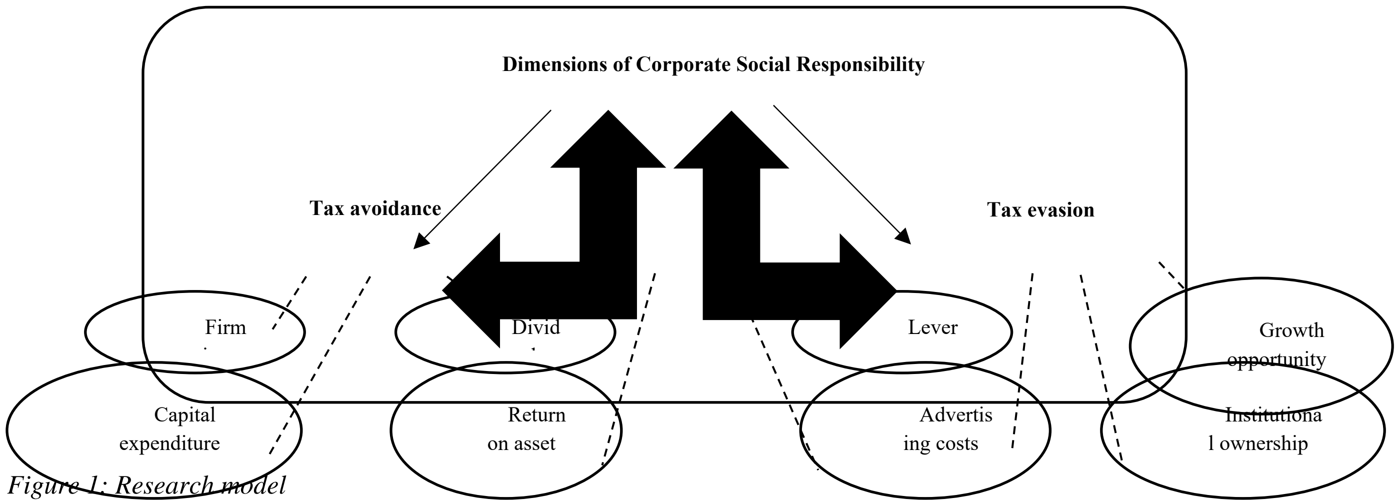

Figure 1: Research model

Research variables

In this study, the dimensions of corporate social responsibility are independent variables, and tax avoidance and evasion are considered dependent variables. Furthermore, the following variables were used as control variables: firm size, financial leverage, dividend, book-to-market value, percentage of institutional ownership, capital expenditure, profitability, and advertising cost.

Tax avoidance (represented by effective tax rate or ETR): In the accounting literature, there is no globally accepted measure for representing tax avoidance. Nevertheless, the authors employed ETR to determine tax avoidance (Gupta and Newberry, 1997; Rego, 2003). A reduced ETR may indicate a high level of tax evasion. The ETR of the company i in period t is calculated as follows:

$$ETR_{it} = TAX_{it} / PBT_{it}$$

Where PBT is Profit before tax of company i in period t and TAX is the tax declared by company i in period t.

Tax evasion (represented by book-tax differences or BTD): the variable is used to measure the ratio of the difference between the final taxable income and the declared taxable profit to the total assets. BTD can be defined as follows:

$$BTD_{jt} = (ACCINC_{jt} - TAXINC_{jt}) / ASS_{jt}$$

Where BTD is book-tax differences of company j at the end of fiscal year t; ACCINC is the accounting taxable income of company j at the end of fiscal year t, TAXINC is the taxable profit of company j at the end of fiscal year t, and ASS is the total assets of company j at the end of financial year t.

Firm size (SIZE): One of the control variables of the research is the size of the company, represented by the natural logarithm of the sum of assets of a company. The larger the company's assets, the larger the company. Considering the theoretical principles on the relationship between firm size and assets and sales, most studies have used the logarithm operation for firm size. Given the exclusion of financial intermediation companies in this study, employing assets instead of sales seemed more reasonable. Therefore, to measure with other variables of the research model, the natural logarithm of the company's assets was used:

SIZE = Ln (Total assets)

Financial leverage (LEV): another control variable of the research denoting the percentage of assets secured from debt. Financial leverage is calculated as the ratio of the company's total debt to its total assets at the end of the financial year.

Dividend (DIV): Another control variable, which is a dummy variable, that is, if the company has distributed cash dividend, the variable is assigned a value of one, otherwise zero.

Book to market ratio (MTB): A control variable calculated by dividing the book value of equity by the market value of the company's stock.

Conclusion

Having in mind the agency dilemma, risk-neutral shareholders expect that executives, acting on their behalf, would focus on profit maximization, which includes seizing opportunities to reduce tax debt such that the benefits outweigh the costs. Therefore, managers highly regard strategies that reduce the company's tax and financial income (i.e., strategies to reduce

tax expense in financial statements), as well as strategies that reduce cash taxes (i.e., strategies that make a difference in income tax payments). Most companies actively seek more tax avoidance within tax laws by transferring revenue to a low-tax area and transfer pricing.

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