# THE ASSOCIATION BETWEEN CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE, TAX AGGRESSIVENESS AND SUSTAINABILITY REPORT ASSURANCE: EVIDENCE FROM INDONESIA

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## Abstract

There is a growing interest in Corporate Social Responsibility issues in developing countries such as Indonesia. Firms disclose their Corporate Social Responsibility activities and some of them provide assurance to gain recognition as socially responsible firms. However, several of those socially responsible firms involve in tax scandals and raise a question of whether Corporate Social Responsibility disclosure is used to disguise firm misconduct or as a reflection of a truly responsible firm. This study examines the association between Corporate Social Responsibility disclosure and tax aggressiveness and the role of sustainability reporting assurance to those association. This research develops a modified index according to Global Reporting Initiatives to measure Corporate Social Responsibility disclosure. Using a sample of Indonesian go public companies which issued Corporate Social Responsibility disclosure, the empirical result shows that there is a positive association between Corporate Social Responsibility disclosure and tax aggressiveness. Furthermore, results also indicate that sustainability reporting assurance mitigates those associations. The findings suggest that the stakeholders in developing countries should examine carefully firms with active Corporate Social Responsibility disclosure before labelling it as socially responsible firms.

**Keywords**: corporate social responsibility disclosure, tax aggressiveness, sustainability assurance, business ethics

## 1. INTRODUCTION

The issue of social responsibility in developing countries is an interesting issue to study because of the growing awareness of the importance of corporate social responsibility. Regulators began issuing rules that asked companies to actively carry out social responsibility activities. Other agencies outside the government have begun to actively give awards to companies that are classified as active in carrying out social responsibility activities. Data from globalreporting.org shows that there is an increasing trend of disclosure of social responsibility to companies in developing countries. Companies that actively carry out and disclose social responsibility get the title as companies that behave ethically in their business practices. The results of studies show that disclosure of social responsibility has a positive impact on company performance (Blazovich and Smith, 2010; Lev et al., 2010; Harjoto and Jo, 2011; Wang, 2011). This encourages companies to actively express their social responsibilities.

However, there is a paradox where companies active in corporate social responsibility are involved in

accounting scandals, especially taxation. In Indonesia, there are several companies that are active in social responsibility activities but are involved in taxation scandalous practices (e.g. PT. Asian Agri, PT. Asia Pulp and Paper, and PT. Kaltim Prima Coal). The paradox indicates that companies that actively carry out social responsibility disclosures are not always synonymous with companies that behave ethically in their business activities. Sikka (2010) stated that many companies provide information that contains promises and achievements of the company in terms of social responsibility but at the same time the company is involved in taxation scandals. This shows that disclosure of social responsibility can be used by opportunistic managers as a tool to trick and distract stakeholders from the unethical taxation practices of the company in the form of tax aggressiveness.

Research conducted in developed countries shows that companies with high social responsibility disclosure tend to reduce the practice of tax aggressiveness (Hoi et al., 2013; Lanis & Richardson 2012). However, different results can occur in the context of developing countries due to different situations. Developing countries have low investor protection so that the opportunistic behavior of managers becomes more difficult to control (Chih et al., 2008; Richardson, 2008). Managers can take advantage of the increasing trend of social responsibility disclosure by actively disclosing social responsibility to cover tax fraud committed. Managers can also take advantage of the naturalistic fallacy that exists in the community who assume that companies that actively carry out social responsibility means that companies also behave ethically in all their business practices. This makes the association between disclosure of social responsibility and tax aggressiveness interesting to study in the context of developing countries that still have lower awareness of social responsibility compared to developed countries. This study also looks at the role of assurance on the association of corporate social responsibility disclosures towards tax aggressiveness. The assurance shows the existence of external parties to verify the disclosure of social responsibility by the company. Assurance can mean that companies are really serious about disclosing social responsibility or it can also be a tool to make companies only look serious about disclosing social responsibility by utilizing the naturalistic fallacy that occurs in the community.

Specifically, this research was conducted in Indonesia because in addition to the fact that companies that actively carry out social responsibility are also involved in taxation scandals, Indonesia is a country with a high level of tax dependency. More than 80% of total state revenue comes from taxes. But with this high dependency, Indonesia's tax ratio is still low and even the lowest in ASEAN. This shows that there are high tax avoidance practices. Cobham & Jansky (2017) stated that Indonesia ranked highest among ASEAN countries with the greatest losses from tax avoidance. The loss value can potentially increase the tax ratio by 1%. In addition, the high participation of taxpayers in the tax amnesty program indicated the high activity of tax avoidance in Indonesia.

## 2. LITERATURE REVIEW

### 2.1. Corporate Social Responsibility Disclosure

The real concept of corporate social responsibility is about the ethical behavior of companies in conducting their business (Bowen, 1953; Carroll, 1997). Corporate social responsibility does not only talk about environmental and social issues, but it should be on all aspects of the company's business including financial aspects. This means the company runs its business by adhering to ethical values. Goel (2010) stated that one of the main characteristics in the triple bottom line concept is the financial transparency of the company. While Atkins (2006) stated that what is meant by the public as a company that has social responsibility is actually a company that carries out transparency in financial reporting and taxation. Companies that behave ethically in implementing social responsibility practices to meet the expectations of stakeholders should also behave ethically in financial and taxation aspects because corporate financial reporting itself is actually part of corporate social responsibility. Even though companies can obtain superior long-term financial performance by behaving ethically, economic motives are not the only ultimate goal of disclosure of corporate social responsibility. This perspective is in line with the ethical theory of putting corporate social responsibility as one manifestation of the ethical behavior of the company so that companies that conduct social responsibility disclosures also behave ethically on other aspects of the company, including in taxation aspects.

However, in its development, social responsibility has become part of the company's business strategy to gain profit from several points of view. The first point of view is that Resource-based view places social responsibility as part of the company's competitive advantage to win the competition (Barney, 1991). The competitive climate makes companies take various ways to excel compared to competitors and social responsibility is one tool to achieve this. This places disclosure of social responsibility as a tool for profit. The

company will actively carry out social responsibility activities and disclose them only if they contribute to the company's profit. There are no ethical considerations in disclosing social responsibility. Although research results show that disclosure of social responsibility contributes to performance, disclosure of social responsibility should be expressed as a manifestation of the company's ethical behavior in doing business and not just as a tool for profit.

The second viewpoint places social responsibility as part of the theory of legitimacy. The legitimacy theory indicates that there is a difference between a company's actions and community expectations. The manager then makes disclosures to bridge the gap by meeting community expectations or what the company considers community expectations (Gray et al., 1995). By doing this, the company will gain legitimacy to run its business in the community. This places social responsibility as a gap filler if there are company actions that are not in line with community expectations. As a consequence, companies can carry out unethical activities such as tax aggressiveness and use social responsibility to make up for these actions in order to retain legitimacy to conduct its business.

## 2.2. Tax Aggressiveness

Tax is a burden that has a large role in reducing the profits of a company. Businesses that make tax savings to be paid are normal and legal to do as long as the business does not violate any existing rules. On the other hand, the regulator also provides incentives and loopholes for companies as taxpayers to choose limited alternatives to minimize the amount of tax that must be paid without having to violate the rules. This is known as Tax Planning. However, this effort is classified as tax aggressiveness when companies try to exploit the weaknesses and gray areas in taxation rules and have the potential to disobey tax principles. Tax avoidance actions are categorized as tax aggressiveness if the legality of the action is questionable (Watson, 2015) and this is done by looking at the possibility of not being examined by the tax aggressiveness tax authority (Lietz, 2013). If the tax saving effort clearly violates applicable taxation rules, the action is classified as tax evasion.

Tax aggressiveness can be categorized as an unethical action because the action is opportunistic in which the company tries to exploit the contract between the company and the public. Tax planning actions are actions that are allowed by regulators based on the calculated risks on the decline in state revenue. However, tax aggressiveness is an action that has the potential to reduce state revenue that is not calculated. This causes the burden borne by the community to be higher because the distribution of company wealth to the public in the form of taxes is reduced.

## 2.3. Sustainability Report Assurance

Information contained in sustainability reports is vital because this can be fundamental for decision making. The assurance by an independent party aims to assess the credibility of the information from the company's sustainability report (Simnett et al., 2009). The assurance will provide sureness that the disclosure of corporate social responsibility information presented is reliable. The assurance against the sustainability report, in addition to giving confidence to the stakeholders, also shows that the company is serious in carrying out social responsibility activities, so much so that they are willing to be verified by independent parties. This means that the existence of assurance will limit the opportunistic behavior of managers who try to use social responsibility disclosure only as a tool to hide corporate misconduct behavior. However, it does not rule out the possibility that assurance is also used by companies to give the impression as if the company is serious about disclosing its social responsibility.

The guideline used in conducting assurance for sustainability reports is AA1000AS, which is issued by AccountAbility, an independent non-profit organization engaged in accountability, sustainable business practices, and corporate responsibility. Assurance services are carried out by independent parties both from public accounting firms and other independent parties who have a license to carry out assurance based on AA1000AS standards.

## 2.4. Hypothesis Development

Researches that have been conducted to examine the relationship between disclosure of social responsibility and tax aggressiveness provided inconclusive results. Research conducted by Preus (2010) found that companies actively engaged in aggressive tax avoidance by moving the location of their headquarters to tax haven countries claiming that they were actively involved in social responsibility activities. This shows that companies that actively carry out social responsibility disclosures will also be in tax avoidance activities. This is in line with the study of Davis et al., (2016) who found a positive association between disclosure of social responsibility and tax avoidance. The opposite results were obtained from the

research of Hoi et al (2013) who examined the relationship between social responsibility and tax avoidance, which found that companies categorized as bad companies in carrying out social responsibility turned out to be performing aggressive tax avoidance. Lanis and Richardson (2012) found that companies that actively carry out social responsibility tend to minimize their tax avoidance activities. These results indicate that corporate culture influences tax avoidance. Ling & Sultana (2015) stated that a country's economic growth rate influences corporate social responsibility practices and developing countries tend to have weak legal systems, standards, and stakeholder pressures in the application of social responsibility. This can make managers' opportunistic behavior difficult to control. Managers can use social responsibility disclosures as a tool to hide opportunistic acts of tax aggressiveness committed. Based on this, the following hypothesis was formulated:

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

Research conducted by Watson (2015) found that companies with low social responsibility disclosure performance were positively related to tax avoidance when companies had low current and future financial performance. However, this effect disappears when the company has high financial performance now and in the future. This shows that the association between disclosure of social responsibility and tax aggressiveness depends on a specific context. This study uses assurance variables for sustainability reports as a contextual factor that can affect the association between disclosure of social responsibility and tax agresiveness.

H2 : The association of corporate social responsibility disclosure and tax aggressiveness is moderated by the assurance of sustainability report

## 3. RESEARCH METHODS

This research was conducted on companies going public in Indonesia which are listed in the Indonesia Stock Exchange. The research sample is a company that issues a standalone sustainability report based on the rules published by the Global Reporting Initiative (GRI) for the 2013-2018 period. During this period, GRI issued G4 guidelines (2013) and GRI standards (2016) which became the benchmark for preparing sustainability reports. Based on these two rules, the authors then create a disclosure index (CSRI) that is used to measure the social responsibility disclosure variable. Disclosure of social responsibility is measured by comparing the number of disclosure items reported by the company and the disclosure index.

The tax aggressiveness (TAG) variable is proxied by GAAP ETR (Dhaliwaal et al, 2004), which is measured by dividing the total income tax expense by profit before tax. The author does not use Cash ETR because in the study period there is a tax amnesty policy that effected the amount of tax payments reported, including the amount of payment for ransom of assets participating in the program. While the Assurance of social responsibility disclosure variable is measured using a dummy variable, namely 1 if the company has an assurance report on the sustainability report that has been published and 0 if the company does not have an assurance report on the sustainability report that has been published. This study uses control variables namely company size, debt level, profitability, company growth, and dummy industry.

The research model used to test the hypothesis is as follows:

1. Model to test H1

$$TAG_{it} = \alpha 0 + \alpha_1 CSRI_{it} + \alpha_2 SIZE_{it} + \alpha_3 LEV_{it} + \alpha_4 ROA_{it} + \alpha_5 PPE_{it} + \alpha_6 IND_Dummy_{it} + \varepsilon_{it} \quad (1)$$

2. Model to test H2

$$TAG_{it} = \alpha 0 + \alpha_1 CSRI_{it} + \alpha_2 SRA_{it} + \alpha_3 CSRI*SRA_{it} + \alpha_4 SIZE_{it} + \alpha_5 LEV_{it} + \alpha_6 ROA_{it} + \alpha_7 PPE_{it} + \alpha_8 IND_Dummy_{it} + \varepsilon_{it} \quad (2)$$

## 4. RESULT AND DISCUSSION

Based on the research period and the availability of data needed to measure the variables in this study, the research obtained a final sample of 274 observations from 69 companies. The following are descriptive statistics from the sample:

**Table 1. Descriptive statistics**

| | N | Mean | Median | Std. Dev. |
|---|---|---|---|---|
| *Continuous Variables* | | | | |
| TAG | 274 | 0.287 | 0.243 | 0.889 |
| CSRI | 274 | 0.332 | 0.286 | 0.174 |
| SIZE | 274 | 24.341 | 24.133 | 1.474 |
| LEV | 274 | 0.626 | 0.627 | 0.260 |
| ROA | 274 | 0.066 | 0.042 | 0.111 |
| PPE | 274 | 22.757 | 22.896 | 1.474 |
| | | | | |
| *Dummy variable* | | 1 (%) | 0 (%) | |
| SRA | 274 | 77 (28%) | 197 (72%) | |

Based on table 1, it can be seen that TAG has a mean (median) of 0.287 (0.243) on a scale of 0-1. The CSRI variable the observations show that the mean (median) is 0.332 (0.286) on a scale of 0-1. The level of corporate social responsibility disclosure is low because the disclosure is still not mandatory and there are no standard reporting standards required by regulators. The SIZE control variable has a mean (median) of 24,341 (24,133), LEV has a mean (median) of 0.626 (0.627), ROA has a mean (median) of 0.066 (0.042), PPE has a mean (median) of 22,757 (22,896). Whereas for the SRA dummy variable, only 28% of the total sample did the assurance for the sustainability report which was a disclosure of corporate social responsibility.

Next, table 2 reported the correlation of variables used in research using the Pearson correlation. The correlation results show that CSRI is positively associated with TAG. These results indicate that the higher the level of disclosure of social responsibility, the higher the level of tax aggressiveness. In addition, Table 2 also shows the correlation between explanatory variables. The correlation is at a low level with the highest correlation between ROA and LEV of -0.388 ($p < 0.01$). Researchers also calculated Variance Inflation Factor (VIF) in the regression model to test the multicollinearity between explanatory variables. Test results (not reported) indicate that the VIF value for each variable is <10. This shows that there is no multicollinearity problem in the regression model (Hair et al., 2014).

**Table 2. Results of the Pearson Correlation test**

| | TAG | | CSRI | | SIZE | | LEV | | ROA | | PPE | | SRA | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| TAG | 1.000 | | | | | | | | | | | | | |
| CSRI | 0.114 | ** | 1.000 | | | | | | | | | | | |
| SIZE | 0.003 | | -0.139 | ** | 1.000 | | | | | | | | | |
| LEV | 0.241 | *** | -0.169 | *** | 0.343 | *** | 1.000 | | | | | | | |
| ROA | -0.014 | | 0.077 | | -0.168 | *** | -0.388 | *** | 1.000 | | | | | |
| PPE | 0.059 | | 0.175 | *** | 0.361 | *** | -0.279 | *** | 0.058 | | 1.000 | | | |
| SRA | -0.022 | | 0.057 | | 0.227 | *** | -0.016 | | 0.155 | *** | 0.258 | *** | 1.000 | |

*, **, *** indicate sig. at the 0.10, 0.05, 0.01 levels, respectively.

The results of hypothesis testing are presented in table 3. In equation 1, the results of the hypothesis test show that the CSRI variable is positively associated with TAG ($\beta = 0.532$, $p < 0.05$), which supports Hypothesis 1. This shows that the higher the disclosure of social responsibility, the greater the company's tax aggressiveness. Managers actively disclose corporate social responsibility to the public but at the same time take tax aggressiveness. This result is contrary to the results of research by Hoi et al., (2013) and Lanis & Richardson (2012) who used a sample of companies in developed countries. This difference can be caused by differences in the context of disclosure of social responsibility in developed and developing countries. In developed countries, good investor protection and strong stakeholder pressure constrained

opportunistic managers to take opportunistic actions that will benefit themselves and harm others. Whereas developing countries have low investor protection characteristics so that opportunistic behavior of managers becomes more difficult to control. In developing countries, stakeholder pressure comes only from foreign investors or buyers with strong bargaining positions (Ali et al, 2017). In addition, there is a naturalistic fallacy due to a still limited understanding of social responsibility and in conducting a comprehensive analysis of company conditions resulting in managers becoming more at liberty to do unethical actions. The existence of disclosure of social responsibility in developing countries is used by managers to conceal tax aggressiveness. In addition, disclosure of social responsibility can also be used to neutralize and legitimize tax aggressiveness by companies.

Hypothesis 2 test results show that the CSRI*SRA variable affects TAG ($\beta = -0.854$, $p < 0.10$). A negative sign means that the interaction of social responsibility disclosures and assurance against sustainability reports decreases tax aggressiveness. This means that companies that make assurance disclosures as reflected in the sustainability report will also reduce tax aggressiveness. Disclosure of social responsibility is still voluntary, so companies that do more business by reporting and making assurances from independent parties on reports that are still voluntary means showing the seriousness of the company in social responsibility. The results showed that such companies were less likely to perform tax aggressiveness. The existence of assurance does not only indicate the extra costs incurred by the company but also the company's willingness for the report to be verified by external parties. The seriousness indicates that social responsibility is an important value held by the company. The company is not only trying to show how it cares about social responsibility but also how it provides space for outsiders to audit the disclosure of social responsibility by the company. The company maintains this reputation by limiting tax aggressiveness because the conflicts with ethical values is reflected in social responsibility. The assurance from external parties will provide confirmation of the company's claim as a company that cares about social responsibility. Without assurance, the company is considered to only provide one-sided claims, hence the truth can be questioned.

**Table 3. Hypothesis Test Results**

| **Variable** | **Equation 1** | | | **Equation 2** | |
|---|---|---|---|---|---|
| | **Coeff.** | | | **Coeff.** | |
| | ***(t-stat)*** | | | ***(t-stat)*** | |
| CSRI | 0.532 | ** | | 0.848 | ** |
| | *(1.689)* | | | *(3.361)* | |
| SRA | -0.143 | | | 0.150 | |
| | *(-1.195)* | | | *(0.617)* | |
| CSRI*SRA | | | | -0.854 | * |
| | | | | *(-1.382)* | |
| SIZE | -0.185 | | | -0.201 | * |
| | *(-1.283)* | | | *(-1.080)* | |
| LEV | 1.807 | *** | | 1.815 | *** |
| | *(6.718)* | | | *(-1.060)* | |
| ROA | 0.886 | * | | 0.790 | * |
| | *(1.625)* | | | *(2.241)* | |
| PPE | 0.197 | | | 0.203 | * |
| | *(1.555)* | | | *(1.020)* | |
| *Industry Dummy* | *included* | | | *included* | |
| F | 4.022 | *** | | 3.903 | *** |
| Adj $R^2$ | 0.142 | | | 0.145 | |

*, **, *** indicate sig. at the 0.10, 0.05, 0.01 levels, respectively.

The implication of the results of the research is that stakeholders need to be careful in interpreting companies that are actively carrying out social responsibility as companies that act ethically in their business activities. Because in developing countries where investor protection is low, managers can act opportunistically, such as by utilizing corporate social responsibility disclosures to obtain the title 'as if' the company has good social responsibility. Stakeholders cannot only use sustainability reports to assess that the company has acted ethically in its business activities. Disclosure of social responsibility cannot automatically be generalized to show that a company is a company that holds ethical principles if the claim is unilaterally carried out by the company. In addition, this study shows the importance of external verification of the claims made by the company. The verification is carried out through an assurance process from a competent independent party. Regulators need to issue rules that require companies to disclose social responsibility. The regulation also needs to provide guidelines and reporting standards so that the social responsibility disclosure model becomes more homogeneous. Regulators also need to encourage the development of professional organizations that provide assurance services for disclosure of social responsibility to help provide confidence to stakeholders regarding the company's disclosure.

## 5. CONCLUSION

This study examines the association of social responsibility disclosure and tax aggressiveness and the role of assurance in the association. The results showed that the disclosure of social responsibility was positively associated with tax aggressiveness, but the positive association was weakened by the presence of assurance against sustainability reports. This research has limitations because it only focuses on companies that express their social responsibility through sustainability reports based on guidelines issued by GRI. In practice, the company can express its social responsibility through various media such as through the company's website or as a part of the annual report. Companies can also publish sustainability reports that are not GRI based. Future researches can develop more comprehensive measures of social responsibility disclosure that accommodate a variety of social responsibility reporting media. Research on social responsibility in developing countries is still interesting to study because of the different characteristics of developed countries, where it can provide new insights. Further researches can also be in other developing countries and use other measurements to relate to opportunistic behavior of managers such as earnings management and political connections.

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