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Does Corporate Social Responsibility and Audit Committee affect Tax Avoidance: Some Indonesian Evidence

Siti Rochmah Ika[1], Dewi Puspitasari[2], Andreas Ronald Setianan[3], Henry Sarnowo[4] and Ari Kuncara Widagdo[5]
[1,2,3]Department of Accounting, Janabadra University
Email: ika@janabadra.ac.id, dewi@janabadra.ac.id, andre@janabadra.ac.id
[4]Department of Economic Development, Janabadra University,
Email: henrysarnowo@janabadra.ac.id
[5]Department of Accounting, Sebelas Maret University
Email: widagdo1998@staff.uns.ac.id

***Abstract*— This article aims to examine whether corporate social responsibility (CSR) and the number of audit committees have an association with corporate tax avoidance. After analyzing 428 firms' years of observation of the manufacturing industry from 2017 to 2019, the results of the linear regression suggest that CSR activities reported in the corporate report have no association with tax avoidance. Profitability and leverage, which serve as control variables, have an influence on tax avoidance. The study's findings suggest that companies do not use CSR activities as a tax avoidance tool, and conversely, high CSR activities do not correlate with increased tax payments or reduced tax avoidance. The number of audit committee members negatively affects the effective tax rate score (ETR), suggesting it encourages more tax avoidance. Our findings inform the tax authority agency and financial authority service that, to ensure tax compliance, the company should enhance the effectiveness of its audit committee.**

***Index Terms*— corporate social responsibility, CSR disclosure, tax avoidance, audit committee.**

I. INTRODUCTION

Corporate social responsibility (CSR) is the practice of incorporating economic, legal, ethical, and charitable duties into the decision-making process of a company. This concept, introduced by (Carroll, 1979; Kumar and Lata; 2022), encourages corporations to take into account the concerns of stakeholders other than just their shareholders. Taxing jurisdictions are important stakeholders in a corporation because they collect revenues that are used to fund public goods. Tax avoidance refers to the actions taken by companies to minimize the amount of taxes they owe to the government. These actions can include both legal strategies as well as potentially problematic practices, known as tax aggressiveness (Watson, 2015). Due to the fact that both taxes and CSR involve allocating resources to parties other than shareholders, there has been significant attention given to the connection between CSR and the avoidance of taxes. Hanlon and Heitzman (2010) requested further research in this field, prompting this attention.

Current anecdotal data indicates that certain individuals involved in public corporations view corporate fiscal

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obligations as socially responsible, whereas many others perceive them to be irrelevant within the framework of CSR (Davis et al., 2016). Previous studies have attempted to establish a link between CSR and avoidance of taxation, but their findings have been contradictory. The results presented by Chouaibi et al. (2022), Hoi et al. (2013); Kim & Im (2017), and Rahman & Leqi (2021) are in line with the hypothesis that CSR is negatively correlated with tax avoidance. According to their interpretation of the results, fiscal obligations as socially responsible (Lata & Kumar, 2022). Hence, socially responsible firms tend to comply their tax obligation. On the other hand, corporations do not consider avoiding taxation as a component of CSR, according to Alsaadi, (2020), Davis et al. (2016), and Mao (2019). These studies found evidence that supports a favorable association between CSR and avoiding taxes.

In Asian countries and developing countries, the existing literature that investigates the relationship between CSR and tax avoidance also documents mixed results. China's publicly listed companies with high CSR performance tend to avoid taxes (Gulzar et al., 2018; Mao, 2019), just as in Egypt (Abdelfattah & Aboud, 2020), while in Korea, participation in CSR initiatives deters tax avoidance (Kim & Im, 2017). In Indonesia, using the mining industry as a sample, Karundeng et al. (2020) find that CSR initiatives encourage companies to conduct less tax avoidance, while in Malaysia, according to Mohanadas et al. (2020), there is no correlation between tax aggressiveness and CSR performance among Malaysian corporations.

The objective of this article is to examine whether CSR activities and audit committees influence the tax avoidance behavior of manufacturing companies in Indonesia. Previous studies in the country have observed the effect of CSR activities on tax payments in some industries, such as mining (Karundeng et al., 2020) and all industries (Winarno et al., 2021). The results of these studies demonstrate that across all proxies, corporations with larger CSR investments exhibited less tax avoidance activity. On the other hand, Aryatama and Raharja (2021) find contradictory results, stating that CSR engagement is more likely to improve tax avoidance in the food and beverage industry. The food and beverage industry is one of the manufacturing industry's subsectors. Hence, in general, previous research in the country is similar to those in the international arena in that the influence of CSR investment on tax payments delivers mixed results.

Different from previous research, the current study will examine the manufacturing industry as a whole using the most recent data from the pre-COVID-19 period. The manufacturing industry was used as a sample for several reasons: First, the manufacturing industry has the highest number of companies listed on the Indonesia Stock Exchange (IDX). Second, preliminary data for 2022 indicated that the manufacturing sector was the most important economic driver in Indonesia, accounting for about 18.34% of Gross Domestic Product (Siahaan, 2023). Third, the manufacturing industry's growth, which has been high since 1995, goes beyond Indonesia's economic growth for the next decade (Verico, 2021).

A recent study in Indonesia Manihuruk et al. (2021) investigated factors influencing tax avoidance in the manufacturing industry. However, the factors examined did not include CSR or the audit committee. Hence, the current study aims to address the existing gap. Indonesia presents several advantages for conducting research on tax payment or tax avoidance. First, the country implements a self-assessment system, allowing taxpayers to evaluate and determine the amount of tax they owe based on their earned or accrued income, and then make the payment accordingly (Fitdra & Inayati, 2022). The system provides increased freedom for tax calculation and reporting. However, it also incentivizes taxpayers to employ their ingenuity in exploiting loopholes within the tax legislation in order to minimize their tax obligations. Second, research indicates that Indonesians refrain from fulfilling their tax obligations or placing their earnings in tax havens due to the country's intricate tax structure and inadequate tax management (Alm, 2019; Lata & Kumar; 2021). And third, Indonesia holds the second position among the ASEAN-5 nations in terms of tax evasion, with a staggering amount of USD 17.8 billion. This indicates a significant degree of tax avoidance that poses a threat to tax regulations, following Thailand (Safuan et al., 2022).

The structure of this article comprises five distinct sections. The second section presents the underlying theories related to the variables involved and develops hypotheses. This article then discuss the research methodology, proceed to the results, and conclude with our findings.

II. Theory and Hypotheses Development

According to stakeholder theory, managers should fairly weigh the interests of all parties involved and act accordingly (Freeman, 1984). According to the theory, managers should answer to those who have a stake in their success or failure. Anyone or anything that benefits or suffers as a result of a business's choices or activities is considered a stakeholder (Freeman, 1984; Jensen, 2001). Along with shareholders, stakeholder theory considers a wider range of interested parties. Financial backers, vendors, workers, consumers, local and state governments, political parties, and trade groups are the eight broad types of stakeholders (Chouaibi et al., 2022). In addition, taxation and CSR both aim to benefit society through various social and environmental initiatives, which are consistent with legitimacy and stakeholder theory (Tasnia et al., 2020). It is important to note that taxation plays a crucial role in influencing the nature and operation of the government, economy, and society. The main purpose of collecting taxes is to facilitate the government in delivering various public goods and services to the general public (Olawole, 2023).

A. The Association between CSR and Tax Avoidance

CSR reporting is becoming increasingly important in terms of promoting transparency inside companies. CSR disclosure not only provides information to various stakeholders but also allows managers to showcase their company's contributions to economic and social growth (Formigoni et al., 2021). Greater openness in CSR operations will lessen the public's knowledge gap, which in turn will boost investor trust and decrease risk (Abdelfattah & Aboud, 2020). As stated earlier, although both CSR and taxes have a shared attribute, namely the promotion of societal well-being through engagement in social and environmental initiatives, results examining the influence of CSR activities on tax avoidance are mixed.

There are two different views regarding the association between CSR and tax payments. The first view argues that for businesses, contributing to society through taxation is a critical social responsibility (Zeng, 2019). Any company serious about doing the right thing by society would do the right thing by paying their fair amount in taxes. It is a fundamental principle of responsible citizenship to pay one's fair share of taxes; engaging in tax avoidance goes against the spirit of good corporate citizenship and CSR.

Numerous studies have linked CSR to corporations' tax avoidance strategies. Businesses are less likely to be tax-aggressive if they provide more information about their CSR (Lanis & Richardson, 2012, 2015). The study discovered an inverse relationship between CSR disclosure and tax aggression among publicly traded corporations in Australia. In the United States (US), tax-sheltering, low-effective tax rate (ETR), and larger book-tax discrepancies are some of the aggressive tax practices that Watson (2015) identifies among companies with poor CSR scores. Furthermore, Watson, (2015) finds that socially responsible businesses discourage tax aggressiveness because they attract customers and investors who share their ideals. Researchers in Canada (Zeng, 2016) and South Korea (Kim & Im, 2017) found similar results.

The second view believes that managers' opportunistic and discretionary actions in pursuit of rent seeking are the main causes of tax avoidance (López-González et al., 2019). In order to hide their tax avoidance and striving toward personal gain, managers may use CSR to their advantage. In these situations, managers participate in CSR initiatives to protect themselves. Furthermore, businesses incur significant costs—such as public and governmental scrutiny—and risk public and private perception when they engage in tax avoidance. CSR can mitigate risks associated with unfavorable company occurrences. A company's CSR statement, code of ethics, and pledge to act responsibly are all tools it can use to weather environmental storms and protect its reputation. A US based study revealed a negative correlation between CSR and the ETR, but a positive correlation with tax-lobbying expenditures (Davis et al., 2016). The study, examining whether public corporations in the country view paying corporate tax as socially responsible, reveals that socially responsible businesses not only pay lower taxes but also engage in more tax lobbying than their counterparts.

Preuss, (2010) investigates US companies that have overseas financial centers and discovers that businesses that assert involvement in socially conscious actions actually operate in tax-haven countries. The study contends that when companies disregard their fundamental obligations to society, such as paying taxes, while asserting their commitment to social responsibility, CSR becomes little more than a cosmetic purpose. In general, the second view supports the belief that CSR is a tool to control or manipulate financial reporting quality in relation to earnings management (Hanlon & Heitzman, 2010; Ika et al., 2022) or tax avoidance (Gavious et al., 2022; Watson, 2015).

Given the conflicting findings regarding the impact of CSR activities on tax avoidance, this study formulates the hypothesis in a non-directional manner.

H1: Companies that have a greater level of CSR reporting are more or less likely to participate in tax avoidance compared to other companies.

B. Audit Committee and Tax Avoidance

The agency dilemma arises from the agency theory, which states that managers will prioritize their own interests over those of shareholders (Jensen & Meckling, 1976). Corporate governance serves as a tool to address agency concerns, such as the audit committee's responsibility for supervision. The audit committee is a component of the corporate governance structure whose role includes assisting the board of commissioners in ensuring the accuracy and integrity of financial reporting (Ika & Mohd Ghazali, 2012). The audit committee is also responsible for ensuring adherence to norms and regulations by the company and the submitted reports (Ika et al., 2017). Therefore, it is essential for the audit committee to possess appropriate resources, specifically a suitable number of members, in order to effectively carry out its responsibilities. An adequate number of members have a superior understanding of tax legislation, ensuring the production of high-quality financial reports and decreasing the probability of tax evasion. However, as tax avoidance is a legal activity, this study posits that the number of audit committee members encourages more tax avoidance.

A study in Indonesia observing the effect of audit committees on tax avoidance in the banking industry shows that the number of audit committee members has a favorable effect on the probability of tax avoidance (Idzniah & Bernawati, 2020). In the mining industry, the number of audit committees had no relationship with tax payment behavior (Gunawan et al., 2021; Sulistiyanti & Saputra, 2020). Similar to those in the banking industry, the increased number of audit committees in the manufacturing sector relates to a lower ETR, which indicates that the higher the number of audit committees, the higher the probability of avoiding taxes (Damayanty & Putri, 2021).

Based on the above explanation, this study formulates the following hypothesis:

H2: Companies that have a higher number of audit committee members are more likely to participate in tax avoidance compared to other companies.

C. Financial Indicators and Tax Avoidance

The present research's control variables are the financial characteristics of a company, namely profitability, level of debt, and firm size. Kim and Im (2017) found that highly profitable enterprises have the opportunity to utilize tax deductions in order to decrease their tax expenses. Managers in these organizations typically utilize tax benefits to decrease their taxable income. Hence, in a company with higher profitability, the management tends to minimize tax payments through tax avoidance. The leverage ratio is a reflection of a company's capital structure and an indication of its capacity to convert its long-term liabilities. There are two ways for a business to get capital: its owners' investments or debt financing (Rahman & Leqi, 2021). Companies with a lot of debt generally have a larger information risk, which might make them more compliant with their tax obligations. In a similar vein, larger corporations face more scrutiny from the general public and may opt to comply with tax bills in order to preserve their reputation. So, this study predicts that larger firms and those with more leverage are less likely to avoid paying taxes.

III. RESEARCH METHOD

A. Variables Identification

Following previous research Abdelfattah & Aboud, (2020); Gavious et al., (2022); Mohanadas et al., (2020), this study quantifies corporate tax avoidance by utilizing the current effective tax rate (CETR). We calculate the CETR by dividing the proportion of current income tax expense by pre-tax profit. A high CETR indicates that a company has paid or incurred a significant amount of tax on its income, suggesting that it is not aggressively minimizing its corporate tax obligations (Dyreng et al., 2010; Hanlon & Heitzman, 2010). The CETR is stated in percentages. This study assesses the performance of CSR or CSR activities by analyzing the CSR disclosures included in annual reports or sustainability reports. This study utilizes a CSR disclosure index based on Global Reporting Initiatives (GRI) G4 (Firmansyah et al., 2022; Ika et al., 2017). To assess the index, this study assigns a score of 1 for each disclosed instance of the CSR statement and a score of 0 otherwise. This article quantifies the CSR reporting level by calculating the ratio of CSR performance disclosures to the total number of disclosure items, which stands at 79. This study also expresses the score of CSR disclosure (CSRD) in percentage.

This article utilizes the number of audit committee members (ACM) to assess the audit committee variable. According to Indonesia’s capital market regulation on corporate governance, a company shall have an audit committee with at least three members, including at least one person with financial accounting expertise (Ika & Mohd Ghazali, 2012). The ACM score indicates how many audit committee members a company has.

For financial indicators, which serve as the control variables, this study uses company size (SIZE), profitability (PROF), and debt structure (LEVER). This study calculates SIZE using the natural logarithm of total assets. PROF refers to return on assets, i.e., the division of net income by total assets. LEVER reflects the leverage ratio, i.e., total debt divided by total assets. Data relating to ACM, PROF, LEVER, and SIZE are available in the annual report.

B. Data Analysis Model

To investigate the influence of CSR and the audit committee on corporate tax avoidance, this study applies ordinally least squares (OLS) regression. The use of OLS instead of panel data regression is due to the fact that the final sample arriving from the sample selection procedures is the unbalanced firm-year observation (see Table 1. for details). In this study, the regression model is presented as follows:

$$CETR = \alpha + \beta 1CSRD + \beta 2ACM + \beta 3PROF + \beta 4LEVER + \beta 5SIZE + \varepsilon \quad (1)$$

Where:
CETR = current ETR (current income tax expense/pre-tax profit) x 100%
CSRD = CSR disclosure (total CSRD disclosure score /79) x 100%
ACM = the number of audit committee member
PROF = profitability (net income/total assets) x 100%
LEVER= leverage (total debt/total assets) x 100%
SIZE = the natural logarithm of total assets

C. Sample

This study examines manufacturing industry companies listed on the IDX between 2017 and 2019. Over the course of three years, the Stock Exchange listed 204 consecutive companies. This study then selects the sample using the following criteria: (1) the availability and completeness of the data variables during the window period; and (2) the exclusion of companies whose ETR is negative or whose net income is negative. The final sample is made up of 428 firm observations. Table 1 displays the details of the final sample selection process.

TABLE I. SAMPLE SELECTION PROCEDURES

Criteria	2017	2018	2019	Total
Manufacturing companies that were consecutively listed in 2017-2019	204	204	204	612
(-) Incomplete data	(18)	(22)	(15)	(75)
(-) Companies whose ETR is negative or net income is negative	(20)	(25)	(23)	(68)
(-) Outlyers	(21)	(20)	(20)	(61)
Total number of samples	145	137	146	428

IV. RESULTS AND DISCUSSIONS

A. Descriptive Statistics

Table 2 depicts the statistical descriptions of the variables observed in this study. The sample company's CETR ranged from 4.5% to 29.8%, with a mean score of 24.2%. The CETR is slightly below Indonesia's 25% tax rate. The average score of CSRD is around 35%, the smallest CSR disclosure is only 3.8%, and the maximum disclosure is full disclosure in accordance with GRI G4, at 100%. The mean CSRD score below 50% indicates that CSR reporting in the manufacturing industry is relatively low. The minimum number of ACM is three, which means they comply with the corporate governance rule on the stock exchange.

The sample company has an average of 3.25 ACMs, indicating the appointment of three individuals to the manufacturing industry audit committee in Indonesia. On average, the manufacturing industry's profitability is around 24%, with the highest ROA score of approximately 407%.

A company in the automotive industry achieves the highest level of profitability. The sample company's debt level ranges from 0.12% to 26.9%, with an average LEVER score of around 3%. The size that reflects how large a company's total assets are ranges from 4.16 to 8.33, with an average value of 6.35.

TABLE II. DESCRIPTIVE STATISTICS

Variables	N	Mean	Min	Max	Std. Deviation
CETR	428	24.2	4.47	29.78	0.47
CSRD	428	34.69	3.80	100	20.55
ACM	428	3.25	3	5	0.45
PROF	428	24.24	0.67	407.16	45.34
LEVER	428	3.01	0.12	26.86	3.04
SIZE	428	6.35	4.16	8.33	0.75

B. Testing the Hypotheses

Table 3 displays the multivariate regression output results. The table clearly shows that there is no correlation between CSRD and CETR. The CSRD variable's sig value is much higher than 0.05. Hence, CSR reporting does not influence tax avoidance. To put it another way, the sample companies do not use CSR activities as a tool to manipulate their financial reports and avoid tax obligations. The results that CSR activities do not affect tax avoidance are consistent with prior studies in Indonesia that took the manufacturing industry as a sample (Susanti, 2017). However, it contradicts the research's result using the food and beverage industry, which documents that CSR has a negative relationship with ETR (Aryatama & Raharja, 2021). The findings of our study align closely with the results reported in Malaysia.(Mohanadas et al., 2020).

Table 3 shows that ACM has a significant negative effect on ETR at the 5% level, with a *p* value of 0.046. The results suggest that the increased number of audit committee members is more likely to encourage the management to do tax avoidance since a lower ETR indicates higher tax avoidance. The results indicate that the members of the audit committee will use sufficient resources to minimize tax payments in a lawful manner. The findings that the number of audit committees has a favorable effect on tax avoidance are consistent with previous researches (Damayanty & Putri, 2021; Idzniah & Bernawati, 2020), but opposite with the work of Sulistiyanti and Saputra (2020), which found that audit committees do not affect tax avoidance in the mining industry.

TABLE III. OUPUT OF OLS REGRESSION

Variables	B	t	Sig	TOLERANCE	VIF
Constant	1.781	2.574	0.012		
CSRD	-0.140	-1.335	0.738	0.676	1.479
ACM	-0.396	-1.851	0.046**	0.792	1.262
PROF	-0.336	-6.134	0.000***	0.893	1.228
LEVER	0.215	3.163	0.002***	0.964	1.037
SIZE	0.061	1.666	0.098*	0.814	1.228
F value		11.633			
F *p value (sig)*		0.000			
Adjusted R^2		0.283			
Durbin Watson		1.809			
Normality sig		0.077			

*, **, and *** indicate the significant results in 10%, 5%, and 1%, respectively.

Table 3 also shows that PROF significantly affects ETR in the opposite direction, with a p value of 0.000. The results suggest that profitability has a negative association with ETR, indicating that the higher the profitability, the higher a company's tendency to avoid taxes. The result is in line with previous research on Malaysian (Mohanadas et al., 2020), in Korea (Kim & Im, 2017) and China (Gulzar et al., 2018; Rahman & Leqi, 2021). The table also demonstrates that length and size positively affect ETR significance at the 1% and 10% levels, respectively. The findings are consistent with the expectation that the higher the debt level and the larger the company, the less likely it is to engage in tax avoidance. Credit providers' monitoring activities and public scrutiny encourage a company not to avoid tax in order to maintain its reputation. Our results, however, are different from those in Malaysia (Mohanadas et al., 2020) and in international comparisons (Zeng, 2019), which find that leverage and size negatively affect ETR.

As exhibited in the table, the F *p* value is 0.000, indicating the regression model is fit and suitable to use. The adjusted R square is 0.283, indicating that the regression model is able to explain 28% of the factors that influence ETR. Other factors not included in the regression model determine the remaining 72%. In terms of the classical assumption, the regression model has passed the normality assessment, as shown by the normality sig. of 0.077, which is above 0.05. The Durbin Watson value and the Tolerance VIF value indicate the regression model is free from autocorrelation and multicollinearity issues, respectively.

V. CONCLUSION

This article seeks to investigate the potential correlation between CSR and the involvement of audit committees with corporate tax avoidance. The findings of the linear regression analysis, based on a comprehensive examination of 428 organizations over a three-year period (2017-2019), indicate that there is no correlation between the CSR activities disclosed in the corporate report and the avoidance of taxes. Profitability and leverage, acting as control variables, exert an impact on tax evasion. The study's results indicate that firms do not employ CSR activities as a means of minimizing taxes, and vice versa, a high level of CSR activities does not correspond to higher tax payments or a decrease in avoiding taxes. The size of the audit committee has a detrimental impact on the ETR, indicating that it promotes greater tax avoidance. The results of our study inform the tax authority and the financial authority agency that in order to ensure tax compliance, it is recommended that the company improves the efficiency of its audit committee. This research has some limitations. Firstly, we cannot generalize the results to other industries within or outside the country, as the results are based on tax regulation and country context. Secondly, the relatively low adjusted R square necessitates the examination of other factors, including share ownership involvement and board of commissioners characteristics such as board independence. In addition, the examination of other audit committee components of effectiveness, such as expertise and number of meetings, may also be applied.

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