

A study on Brazil corporate's CSR Activity and Propensity of Tax Avoidance

*Chae Chang Im¹, **Jeong Ho Kim, ***, Jury Ko

**Ph. D., College of Business Administration, Hankuk University of Foreign Studies, Seoul, Korea,*

imcee@naver.com

***Assistant Professor, Department of taxation and accounting, Silla University, Busan, Korea,*

taxskim@naver.com

****BA., College of Regional Studies in Brazil, Hankuk University of Foreign Studies, Yongin, Korea,*

kchick@naver.com

Abstract

This paper was intended to find Brazil corporate's correlation of between CSR activity and propensity of tax avoidance. Based on domestic (South Korea) empirical findings on relevance between corporate's CSR and propensity of tax avoidance, we analyzed Brazil corporate's behavior regarding two subjects which became topic recently. This paper discovered several facts regarding propensity of tax avoidance pivoting on Brazil corporate's CSR activeness.

Key words: CSR activity, Tax Avoidance, Korea, Brazil

1. Introduction

There is a trend that Corporate Social Responsibility (CSR) has been emphasizing as corporate's unethical management and environmental issues arisen recently. Economic and ethical responsibilities are demanded to corporate as well as social responsibility as a part of society. According to this movement, several international organizations established standards to evaluate corporate's CSR activity. International Organization for Standardization (ISO) established ISO 26000, Global Reporting Initiative (GRI) established a guideline that helps corporate understanding CSR standard and keep amending that guideline steadily since 1997. A corporate draws a report in compliance with this guideline and publicly announces to member of society as well as stakeholders. The number of corporate drawing and announcing their reports are growing continuously. As corporate's interest in CSR grows, so does on a study in relationship between CSR and taxation. Particularly a study in relationship between CSR activity and possibility of tax avoidance has been continued. Here, tax avoidance means not following regular transaction formality to reduce a tax burden.

Reducing a tax burden is beneficial to corporate in economic aspect since corporate's fundamental object is seeking a profit. Recently, however, corporate's unethical behaviors are

strongly criticized. Especially corporate being denounced by public outcry when it has exposed to public while in attempt to avoid tax. It further causes damages to corporate image and short or long term poor record of corporate performance. According to Kim (2012), however, Korean corporate entered into Brazil deploy a strategy utilizing CSR ahead. It means that CSR activity does play a positive role in corporate image. In this sense, we studied whether a corporate which actively participates CSR activity to improve corporate image thrive less to avoid taxes. In particular, we will study a relationship between Brazil corporate's CSR activity and propensity of tax avoidance.

This study is to increase understanding regarding Brazil corporate among Korean corporate by comparing difference of propensity of tax avoidance between two groups, which are divided into based on activeness of CSR activity.

2. Theoretical Backgrounds

2.1 Concept and Type of CSR activity

First, we will clarify the concept of CSR activity and how these types are appeared. Then, we have reviewed empirical findings to understand process of previous CSR activity studies.

2.1.1 The concept of CSR activity

Bowen initially defined the concept of CSR activity in 1953. "Obligation of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society¹," which is the earliest definition in the modern literature on CSR. Friedman(1970) defined as "there is one and only one social responsibility—to use its resources and engaging in activities designed to increase its profits as long as stays within the rules of the game, which is to say, engages in free and open competition without deception or fraud." Carroll (1979) labelled "economic, legal, ethical and discretionary responsibilities."

In 21st century, concept of CSR has been developed widely. Shin (2001) defined CSR as "corporate behavior's normative system that satisfies demand or expectation of corporate's stakeholder or general society by solving social, economic problems caused by corporate activity." Unlike Friedman, we may confirm that the concept includes corporate's stakeholder and general society, beyond the range of shareholders. Likewise, Porter (2006) and Kramer (2006) subdivided CSR into "moral obligation, reputation, sustainability and license to operation²" which suggested expanded concept that covers social, environmental aspect as

¹ Bowen. H. R.(1953). *Social Responsibilities of the Businessman*. New York: Haper & Row.

² Porter, M. E. & M. R. Kramer(2006), "Strategy & society: Link between competitive advantage and corporate

well as economic.

2.1.2 Types of CSR activity

In general, CSR has been studied in four categories as Carroll (1970) suggested, i.e., economic responsibility, legal responsibility, ethical responsibility and charitable activity. Carroll defined economic responsibility as "responsibility to produce goods and service as social standard unit," legal responsibility as "performing economic task within the boundary of legal requirement," ethical responsibility as "behavior and activity be performed as expected by a member of society though not regulated by law," and charitable activity as "spontaneous activity such as social donation, operation of social welfare facility as part of corporate's own discretion or decision."

2.2 International Standard of CSR activity

International standard of CSR has been studied continuously. There was Global Treaty, proposed in Dabo's Forum in 1999 which officially launched in 2000. Later, multinational corporate guideline emerged in 2000 which OECD had suggested and amended to minimize negative effect of multinational corporate. In 2001, a green paper of EU appeared and GRI Guideline that suggested guideline on the notion of economic, environmental and social aspect been newly amended in 2006. The most recent international standard of CSR is 'ISO 26000' established by International Organization for Standardization in 2010. This paper will briefly describe GRI Guideline utilized in this study.

2.2.1 GRI Guideline

Global Reporting Initiative is an international organization established in 1997 with purpose to 'activate corporate's sustainable management and protection of environment. 'According to GRI (2006), GRI Guideline was designed to arouse importance of sustainable development to meet the demand of the times, and to contribute to sustainable development and emphasize corporate's role at the same time.

A development of global network is considered as another background that caused to establish GRI Guideline. As range of corporate activity expanded to global-wide, so does to information network between corporate in all countries of the world. Therefore, an universal standard for sustainable development and common evaluation standard for corporate are required. Corporate began to announce report in compliance with GRI Guideline since 1999 when GRI Guideline was established, then voluntarily compared and analyzed sustainable

social responsibility," Harvard Business Review, 1-16.

management performances for its development.

2.3 Concept of Tax Avoidance

Hanlon and Heitzman (2010) defined tax avoidance as “reduction of explicit taxes.” Executives in general try to avoid taxes to reduce costs of taxation, then follows increase of shareholders’ profit and manager’s private profit³. Executives attempts two methods ① reduce costs of taxation and maintain account benefit or ②maintain costs of taxation and increase account benefit⁴.

According to Park et. al (2013), both tax saving and tax evasion are included in reducing costs of costs of taxation legitimately. Legitimacy may distinguish reducing costs of taxation from tax evasion, but there is difficulty to distinguish legitimacy only appraising financial statements. Thus, this paper estimates propensity of tax avoidance utilizing simple numerical value in financial statements of Brazil corporate.

2.4 A study between CSR and tax avoidance.

Grant and Roman (2011), Watson (2011), announced studies regarding tax avoidance and CSR. Grant and Roman (2011) announced empirical finding that ‘corporate performing more active CSR records lower level of tax avoidance.’ Watson (2011), in his study, based on level of CSR, divided corporate into three groups and surveyed propensity of tax avoidance. Watson found a result that ‘group performing passive CSR records higher propensity of tax avoidance.’ Lastly, Gye (2012) drew a result that ‘between CSR and estimated amount of tax avoidance has significant relationship.’ Further, based on significant relationship between estimated amount of tax avoidance and market response⁵, it was discovered that CSR alleviates corporate’s negative aspect.

3. Discussion

3.1 Methodology

3.1.1 Corporate categorizing in conformity with GRI Guideline

³ Desai, M. A. and D. Dharmapala (2009), “Earnings Management, Corporate Tax Shelter, and Book - Tax Alignment,”*National Tax Journal*, 62, 169 - 186.

⁴ Tang, T. and M. Firth (2011). Can Book - Tax Differences Capture Earnings Management and Tax Management? Empirical Evidence from China. *The International Journal of Accounting*, 46, 175 - 204.

⁵ Gye, E. (2012). The Effects of Corporate Social Responsibility on Market Response to Tax Avoidance and Tax Avoidance. *Tax Accounting Research* 29 (2): 107-136.

Sustainability report is a voluntary report which does not requires a third-party verification in general but may verify for the credibility and transparency. G3 guideline rates report 'A, B or C' upon number of items applied by guideline. When an evaluation was made by third-party verification, '+' mark was affixed right after each rating for distinction. G4 guideline amended in 2012, however, evaluates report only expressing 'in accordance with G4' instead of previous 'A+, A, B+, B, C+, C.' 'In accordance with G4' implies the report verified by GRI standard.

This paper, first, researched corporate's sustainability report issued in 2014. Then we marked each report 1 with mark confirmed with 'picture 2' mark or 'in accordance' verification, 0 with not confirmed with mark or G4 verification. Groups are categorized into 1 as 'active CSR corporate' and 2 as 'passive CSR corporate.'



Picture 1 G4 Guideline Mark

There were reports marked according to G3 guideline, I.e. 'A+~C' mark, not following amended G4 guideline occasionally. We marked 1 as we determined that it was verified by GRI standard regardless of ratings. We marked 0 for Corporate which did not announce sustainability report because we determined those corporates are not verified by GRI standard.

3.1.2 Estimation of tax avoidance

For the estimation of tax avoidance, we utilized method from empirical finding. We decided $\frac{\text{Accounting Income} - \text{taxable Income}}{\text{Basic Gross Asset}}$ as value of tax avoidance. That is BTD, the difference between accounting income and taxable income, divided by basic gross asset. The relationship between BTD and tax avoidance is based on study of Mills (1998) and Wilson (2009). Mills (1998) found "as BTD increases the probability of being investigated for taxable income increases and taxable modified amount increases as well." Wilson (2009) announced "corporate indicted for tax avoidance records increase of BTD." Based on two empirical findings, we found Brazil corporate's financial statements (as of 2014) and applied to tax avoidance estimating formula mentioned above.

3.2 Results

In compliance with GRI Guideline, we researched total sixty (60) Brazil corporate, then divided into two groups. First, like Table 1, corporate performing passive CSR activity (30). Second, like Table 2, corporate performing active CSR activity (30). We picked out net income, earning after tax, basic gross asset from financial statements of each corporate and calculated propensity of tax avoidance from tax avoidance estimating formula. T-test results are as follows in Table 1.

Table 1. t-test: Two groups with equal variance hypothesis

	Corporate performing passive CSR activity	Corporate performing active CSR activity
Average	-0.0009	-0.0047
Number of Observation	30	30
t-value	1.6715	

3.3 Analysis

The tax avoidance average of Brazil Corporate performing active and passive CSR activity each records ‘-0.0009’ and ‘-0.0047’, which does not show significant difference. It implies that Brazil corporate’s activeness on CSR activity and propensity of tax avoidance does not have correlation. What gives our attention is that, regardless of activeness on CSR activity, the level of tax avoidance does not have significant difference. We may interpret this result that Brazil corporate has duplex behavior, which means that CSR has legal and ethical responsibility, and tax avoidance implies avoidance of this legal and ethical responsibility as well. According to the result of this paper, however, we may interpret a corporate with higher propensity of tax avoidance performs active CSR activity to create positive corporate image.

There are many studies showing result that corporate’s CSR activity influences positive effect to corporate image and performance. Corporate may reduce indirect cost by CSR activity and increase profit at the same time, and also affect positively in image of corporate product and consumer purchase (Beckwit & Lehman, 1975).

Variance value of two groups shows, first, a group of passive CSR records ‘0.0006’ which is bigger than the record of active CSR group, ‘0.0006.’ In other words, corporate performing passive CSR activity shows different behaviors in propensity of tax avoidance, corporate with active CSR relatively shows consistency in propensity of tax avoidance. Thus, corporate performing active CSR activity has much higher probability to show lower propensity of tax avoidance.

4. Conclusions

This paper was intended to find Brazil corporate's correlation of between CSR activity and propensity of tax avoidance. Based on domestic (South Korea) empirical findings on relevance between corporate's CSR and propensity of tax avoidance, we analyzed Brazil corporate's behavior regarding two subjects which became topic recently. This paper discovered several facts regarding propensity of tax avoidance pivoting on Brazil corporate's CSR activeness.

First, there is not much difference in propensity of tax avoidance between active and passive CSR activity among Brazil corporates. Unlike previous empirical findings, Brazil corporates shows similar propensity of tax avoidance regardless of CSR activity. Second, corporate performing active CSR activity shows relatively consistent behavior in propensity of tax avoidance compared to passive one. The level of tax avoidance for passive one has records various spectrums, but active one converges close to 0 in propensity of tax avoidance. Brazil corporates, regardless of activeness, shows similar propensity of tax avoidance, but active CSR activity may lower probability of tax avoidance.

This paper has limit that plenty of samples are not gathered due to a short period of data collection. Moreover, we simply digitized CSR activeness into 0 and 1, which cause very narrow spectrum to determine activeness. Also this paper did not include other variables such as cash retention, corporate value which affect tax avoidance. Finally, it will verify more clearly the relevance between CSR activity and propensity of tax avoidance, if there is further study on how much does Brazil corporate place emphasis on CSR activity, what kinds of CSR activity are made or Brazil corporates' regular propensity of tax avoidance.

References

- [1] Gye, E. (2012). The Effects of Corporate Social Responsibility on Market Response to Tax Avoidance and Tax Avoidance. *Tax Accounting Research* 29 (2): 107-136.
- [2] Kim, J. (2012), "A great response to CSR activities of Brazilian companies in Hyundai", *Yonhap News*.
- [3] Park, H, Lee, J., and Chung, G. (2013). Audit efforts and corporate tax avoidance. *Accounting Research*, 18 (1), 227-249.
- [4] Shin, Y. (2001). *Social - oriented management: business and society*. Kyeongmunsa
- [5] Beckwit, N., & Lehman, D. (1975). The Importance of halo effects in multi-attribute attitude models. *Journal of Marketing Research*, 12.
- [6] Bowen. H. R. (1953). *Social Responsibilities of the Businessman*. New York: Haper & Row.

- [7] Desai, M. A. and D. Dharmapala (2009). Earnings Management, Corporate Tax Shelter, and Book - Tax Alignment. *National Tax Journal*, 62, 169 - 186.
- [8] Friedman, M. (1970). The social responsibility of business is to increase its profits. *New York Times Magazine*, vol. 9, 32-33.
- [9] GRI (2007). A Brief History of GRI Guideline: Sustainability Reporting 10 Years On.
- [10] Hanlon, M. and S. Heitzman (2010), " Review of Tax Research," *Journal of Accounting and Economics*, 50, 127 - 178.
- [11] Porter, M. E. & M. R. Kramer (2006). "Strategy & society: Link between competitive advantage and corporate social responsibility," *Harvard Business Review*, 1-16.
- [12] Tang, T. and M. Firth (2011). Can Book - Tax Differences Capture Earnings Management and Tax Management? Empirical Evidence from China. *The International Journal of Accounting*, 46, 175 - 204.

*1st author: Chaechang Im, Ph.D.

Ph. D., College of Business Administration, Hankuk University of Foreign Studies, Seoul, Korea

E-mail: *imcee@naver.com*

*Corresponding author: Jeong Ho Kim, Ph.D.

Assistant Professor, Department of taxation and accounting, Silla University, Busan, Korea

E-mail: *taxskim@naver.com*

Appendix 1. Corporates performing passive CSR activity

Corporate	CSR Activity	Tax Avoidance(As of 2014, R\$)
Bradesco	0	-0.0001
Petrobras	0	0.0004
Cremer	0	-0.0002
Pão de Açúcar	0	0.0119
Usiminas	0	0.0161
Itaúsa	0	-0.0022
Brasil Foods	0	0.0031
Raia Drogasil	0	0.0000
Tractebel	0	-0.0091
Hypermarcas	0	0.0135
JHSF	0	-0.0017
Cosan	0	-0.0099
Multiplan	0	0.0000
Equatorial	0	-0.0120
BR Malls	0	-0.0029
SLC Agrícola	0	-0.0005
Cemig	0	-0.0000
Odontoprev	0	-0.0002
CCR	0	0.0040
AmBev	0	-0.0050
Ultrapar	0	-0.0004
Prumo	0	0.0005
CSN	0	0.0001
Tereos	0	0.0028
São Carlos	0	-0.0000
Eztec	0	0.0000
Rede Energia	0	-0.0123
Ouro Fino	0	-0.0018
Marcopolo	0	-0.0000
Par Corretora	0	-0.0215

Appendix 2. Corporates performing active CSR activity

Corporate	CSR Activity	Tax Avoidance(As of 2014, R\$)
Vale	1	0.0052
Itaú Unibanco	1	-0.0003
JBS	1	-0.0040
Oi	1	-0.1218
Braskem	1	0.0040
Embraer	1	-0.0008
Natura	1	-0.0010
Duratex	1	-0.0009
Tecnisa	1	-0.0117
Triunfo	1	0.0324
Cielo	1	-0.0016
Santander	1	-0.0000
Tractebel	1	-0.0006
Dasa	1	-0.0013
Lojas Americanas	1	0.00904
CPFL	1	-0.0003
Fibria	1	-0.0005
Biosev	1	-0.0001
CTEEP	1	-0.0017
Porto Seguro	1	0.0002
WEG	1	-0.0007
MRV	1	-0.0028
EDP	1	-0.0072
Allianz	1	-0.0000
Even	1	-0.0044
Copel	1	-0.0050
JSL	1	0.0000
Sonae Sierra	1	-0.0248
Whirlpool	1	-0.0008
EcoRodovias	1	-0.0004

Reproduced with permission of copyright owner. Further reproduction prohibited without permission.