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Corporate Social Responsibility and Tax Aggressiveness: A Test of Legitimacy Theory

To me the idea that taxes are contributions to society is intuitively reasonable. It is a corporate social responsibility (CSR). Both tax behaviour and CSR reporting strategy are corporate decisions. Hence, otherwise identical companies might have different effective tax rates (ETRs) and CSR disclosures. Despite the large number of research studies on both tax aggressiveness and CSR reporting, only recently a few studies examining the relation between the two have been published. Lanis and Richardson are important contributors in this field.

Lanis and Richardson (2013) compare CSR disclosures of 20 'tax aggressive' companies with 20 matched, assumed non-tax aggressive entities (definitions discussed below). They find that tax aggressive companies disclose significantly more CSR information than others. The authors suggest that a high degree of tax aggressiveness is 'considered by the public to constitute socially irresponsible or illegitimate activity' (p. 79), that is, the companies are not paying a fair share of taxes. The authors argue that CSR disclosures are used strategically to repair corporate legitimacy.

Lanis and Richardson (2013) present the study as a test of legitimacy theory. It is noticeable that depending on which of Lindblom's (2010) four situations or strategies to secure legitimacy that are relevant to the companies in the study, the result of the study links opportunistic tax behaviour to opportunistic CSR disclosure. The study illustrates a link between legitimacy theory and agency theory. While agency theory is probably the most common theoretical framework in tax behaviour research, legitimacy theory definitely the most popular framework among CSR reporting researchers.

However, while Lanis and Richardson (2013) find a positive relation between tax aggressiveness and CSR disclosure, in an earlier paper, they come to the opposite result (Lanis and Richardson 2012). Both studies use sample sets of companies listed on the Australian Stock Exchange. These apparently contradictory findings (Ylönen and Laine, forthcoming) motivate further research on the topic and a closer look at the papers.

One important factor which might explain the different findings in these studies is the definition and operationalisation of tax aggressiveness. Tax aggressiveness concerns how much companies reduce current tax payments. This may be done through legal corporate tax planning, ethical questionable tax avoidance and/or illegal tax evasion. Lanis and Richardson (2012) measure tax aggressiveness by the use of ETRs. Without going into too many details here, the way ETRs are calculated means that this measure considers both tax planning, avoidance and evasion. Lanis and Richardson (2012, p. 91) even state that ETR is 'the proxy measure for tax aggressiveness most frequently used by academic researchers'. However, Lanis and Richardson (2013) implicitly define tax aggressiveness differently. Companies are separated into two groups, depending on whether the Australian Tax Office has accused them of tax aggressive behaviour or not. The Tax Office accepts legal tax planning, so tax aggressiveness includes only tax evasion and (partly?) tax avoidance in the 2013 study.1 The

importance of this difference in definition/operationalisation of tax aggressiveness between the two studies manifests itself when Lanis and Richardson (2013) report that there is no significant difference in ETRs between the two groups in the 2013 study.

Another crucial factor, relating to both studies, is the use of CSR disclosure as one homogenous concept. CSR is a diffuse and heterogeneous concept. Corporate reporting practices concerning community involvement, the natural environment, energy, work environment/ human resources, customers, products, social issues, corruption, etc. vary significantly (Branco and Rodrigues 2008; Deegan, Rankin, and Voght 2000; Gray, Kouhy, and Lavers 1995; Williams and Pei 1999; Zeghal and Ahmed 1990). It is not likely that the relation between tax aggressiveness and disclosure is the same for the different CSR issues. In the same way, a separation between voluntary and mandatory disclosure seems necessary (Fallan and Fallan 2009; Gray, Kouhy, and Lavers 1995). While the choices made by Lanis and Richardson (2012, 2013) is ok in such early papers, I think research designs should be modified by future studies.

Moreover, the question of the most appropriate proxies for CSR disclosure measurement could also consider other aspects. It might be difficult to compare results when Lanis and Richardson (2013) use number of sentences as a proxy for CSR disclosure, while the 2012 paper analyses the existence of different types of information content (a dichotomous variable). State-of-the-art research on CSR disclosure measurement might even suggest more valid proxies (Beck, Campbell, and Shrives 2010).

Lanis and Richardson (2012, 2013) have chosen not to cross reference these two papers. I think they should not be afraid of doing that. The contradictory findings provide important input for validity considerations that should be welcomed on a maturing research field.

Note

1Another issue is that this sampling technique means that a company is classified as non-tax aggressive as long as it is not caught in illegal activity by the Tax Office, irrespective of actual tax aggressive behaviour.

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