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### RELATIONSHIP BETWEEN CSR AND TAX AVOIDANCE: CASE STUDY OF PAKISTAN

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#### **ABSTRACT**

To manage their business activities, business organizations are engaging in socially responsible practices through the lens of tax avoiding practices. The study examines that whether businesses in Pakistan are at the same time embarking on CSR and indulged in tax avoidance practices. There is non-availability of literature relating to the relationship between CSR and tax avoidance practices. The current situation of Pakistan demands the corporate sector to play its role in the development of the country. Firstly, the current study tried to accomplish whether business organizations which are engaged in tax avoidance practices consider themselves as socially responsible businesses. Secondly, the research analyzes those goals of stakeholders are attended in Pakistan. The study aims to identify the relations and the influences of the tax practices of corporations related to their undertaken social responsibility actions.

#### **INTRODUCTION**

In research, tax avoidance and corporate social responsibility are significant topics of both management and accounting literatures (Hoi, Wu, & Zhang, 2013). It has discussed that there has been a little attention paid to the relationship between CSR and tax avoidance. Similarly, the academicians and practitioners have come for in depth investigation about the relationship which enable the capacity of governments to provide security, healthcare, education, redistribute wealth to eradicate poverty, clean water, and provide an equitable and peaceful society (Action-Aid, 2009). Nevertheless, the payment of democratically agreed taxes has received a very little attention from academicians; despite the fact that payment of taxes is central to any notion of corporate social responsibility. Business organizations provide very little information regarding tax issues on a voluntary basis and it is rare for businesses to look at tax payment as social responsibility. Business organizations

nowadays are taking big about corporate social responsibility by producing brochures and reports, however the businesses are accompanying this with large scale tax evasions and tax avoidance. This leads to loss in revenues which can make a difference in quality of life of millions. According to study, in Pakistan CSR and its associated practices are relatively new to the socio-economic development scene (Majid et, al. 2013). However, individuals and businesses have been indulging in philanthropy and voluntary giving since long. In line with this, the most of the business organizations in Pakistan are contributing towards humanity, charity, religious purposes and community development.

From another point of view, business organizations can treat CSR as a risk minimization strategy a business can use to enhance its CSR reputation, which can protect the business from the risk of adverse regulatory, political and social penalties in case of negative corporate actions (Minor & Morgan 2011). The tax avoidance practices can lead to negative penalties such as increased political/media pressures, loss of firm reputation, consumers' boycotts and potential fines and penalties. The businesses can lessen the expected costs associated with tax avoidance practices by managing their CSR reputation. It has been discussing that if embarking on corporate social responsibility is a risk management strategy, then there should be a negative correlation between tax avoidance and irresponsible CSR activities (Hoi, Wu, & Zhang, 2013). While referring to corporate social responsibility, one of the most important elements is the notion of legitimacy of actions. Business organizations should pay taxes based on domestic or multi-national legislation, because it is a very important part of corporate activity. Therefore, in Pakistan the concept of tax avoidance is a very controversial issue in relation to corporate social responsibility. Furthermore, the relationship between corporate social responsibility and tax avoidance is the scope of this paper. In line with those of the decisions of managers were influencing the objectives of shareholders and stakeholders to be offshore and apply to various tax avoidance practices. Using a sample of Karachi Stock Exchange listed Textiles companies, it has been found that companies which are reporting more on CSR have a less probability of engaging in tax avoiding practices.

## LITERATURE REVIEW

Long before the development of any definition of corporate social responsibility, discussion regarding the impact business organization has on community, society and the environment were initiated. CSR has been meeting the merging needs of the society and it has a long history, which evolved with the development of businesses. CSR was in practice in developed countries in one way or another. The role of ethics in business, has historical surrounded by dominant ideology that the free-market economy is self-regulating by means of the "invisible hand", whereby an individual's self-interested goals will inevitably result in a democratic capitalist system. One of the strong proponents of Smith's argument and a stern critic of the emerging concept of CSR was Milton Friedman, who famously argued that "the only responsibility of the business is to maximize the profit" (Friedman, 1970). In line with this he argued that business organizations should not conduct CSR because of the reasons that only humans can have a moral responsibility for their actions, it was this reason that Milton Friedman hold that the only obligation of business is to drive profit

and social issues are the responsibility of the state. It is argued that as a matter of fact the emphasize on the social and ethical business conduct was initially originated by the businessmen themselves, in the form of social give back policies, corporate philanthropy and codes of conduct that most of the business organizations established in 1920s (Frederick, (2006). In the present era , corporations like Carnegie, Lever and Cadbury were the pioneers companies to use their assets for the improvement of working conditions and also for improvement of society. In line with this business organizations begin to be recognized as “social enterprise” under the umbrella of social contract theory, if the business is serving the interest of the employees, customers, environment and society at large. There is a considerable increase in the volume and variety of literature regarding CSR in recent years (Banerjee, 2007). Mainly, the literature focused on theoretical perspectives and seeks to address issues about accountability, economics, governance, the future of capitalism, sustainability, ethics, and ultimately the survival of the planet and the human race. As a consequence, there is a wide range appreciation of the possibilities and limitations of addressing environmental, investment, employment, gender, ethics, politics, power and a variety of social problems. The scope of CSR is increasingly being broadened and is and is frequently associated with promises of ethical and socially responsible conduct. Experts argued that corporate social responsibility denotes the obligation of business organization to use its resources in a way that can benefit the society and all other stakeholders (Snider and colleagues, 2003). According to European Commission (2002) corporate social responsibility is a concept whereby business organizations incorporate social and environmental concerns in operations of their business and their fundamental interaction with all the constituencies on a voluntary basis. It has been defined corporate social responsibility as it the commitment by businesses to improve well-being of community through contribution of corporate resources and through voluntary business practices (Kotler and Lee, 2005). This is why CSR is considered as a strong discretionary component beyond what is required by law and beyond the interest of the business.

In developing countries like Pakistan CSR is increasingly recognized to have some peculiarities and distinctive features. According recent study, in developing countries corporate social responsibility is more extensive than commonly believed, less politically rooted and less embedded in corporate strategy than in most of the developed countries (Visser, 2008). It is argued that research on corporate social responsibility on SMEs of developing countries have shown a mixture of religious and personal motivation CSR initiatives which result in altruistic, philanthropic CSR orientation. This is the reason why discussions of CSR at an international level often involve consideration of environment, society and sustainability issues. CSR has become much more prominent in today’s age of globalization. Business organizations seek to minimize cost have strong opportunities and incentives to look for legal obligation that which is less stringently regulate, for example, environmental abuses and human rights. There have been numerous attempts by non-government organizations (NGOs) to fill the void where an international legally binding framework did not exist, whereby business organizations are encouraged by civil regulation to address human rights and environmental violations. There have been guidelines and other forms of soft law by

intergovernmental an international organization such as World Bank and United Nations to minimize various types of business organization's abuses. However, there is a lack of enforcement mechanism of external regulation. Still there are a lot of business organizations which have voluntarily started to embark on CSR mainly targeting the traditional CSR issues of environmental sustainability and human rights. Therefore, a self-regulatory approach to corporate social responsibility could reduce the harms caused by tax avoidance practices, if notions of socially responsible behavior expand beyond environmental and human rights issues. The taxation systems itself offers an easy way to escape so that affluent evade taxes whereas governments suffer that why NAB (National Accountability Bureau) reported tax evasion is almost Rs 7 billion per day. Another reason may be people's perception as they feel that taxpayer money is being used for reasons other than social welfare and uplift (Business Recorder, 2013).

### **RATIONALE OF THE STUDY**

The current study examines the corporate social responsibility and business domains in Pakistan by probing their tax practices. It has been found that CSR activities are comprised of all the actions taken by business organizations and all the stakeholders of the business, such as employees, environment, community, suppliers, customers, government etc. in line with this, activities which are damaging, employees, corporate governance, human rights, communities, employees' relations, diversity, environment and public health etc. are considered as irresponsible CSR activities. The disparities between corporate claims of corporate social responsibility and their practice of avoiding tax are increasingly highlighted by pressure groups and non-governmental organizations.

#### ***Relationship between CSR and Tax Avoidance***

It is argued that tax avoidance harms not only to shareholders but also to government and companies should feel fear from the public than from governments. Consumers' perceptions of corporate performance are more sensitive to news of socially irresponsible activity than to news of socially responsible activity (Fisher, 2014). Thus, as corporate tax avoidance becomes increasingly publicized and stigmatized, news of a corporation's engagement in tax avoidance practices likely will have an increasingly detrimental effect on its reputation. Some corporations are more susceptible to reputational harm than others. Tax avoidance practices cost the U.S. government up to \$100 billion in lost revenue each year, in addition to causing financial harm to the government of the offshore locale, the corporation itself, and the corporation's shareholders (International Revenue Service, 2013). It has been reported that international businesses can synthetically transfer profits from high-tax to low-tax jurisdictions using a variety of techniques, such as shifting debt to high-tax jurisdictions or shifting profits from a high-tax jurisdiction to a low tax one is to borrow more in the high-tax jurisdiction and less in the low-tax one (Gravelle 2013). This shifting of debt can be achieved without changing the overall debt exposure of the firm. Transfer pricing can shift profits from high-tax to low-tax jurisdictions i.e. pricing of products or services sold between affiliates. To show exact income, price of products sold by related companies must be the equal to

the prices that would be paid by unrelated parties. By decreasing the price of products sold by parents and affiliates in high-tax jurisdictions and increasing the price of purchases, income can be shifted. It is analyzed that policy measures are required to redress the distortions that have arisen as globalizing companies have left nationally based tax regimes floundering.

Furthermore, the corporate citizenship debate needs urgently to address the issue of how company directors should act on tax avoidance in the context of their CSR agendas. It has been discussed that businesses must view tax planning via corporate responsibility lens (Richard Miller et al,2011). The major factors include the increase in public analysis [or] scrutiny of corporate tax evasions [&] tax avoidance, and a rehabilitated attempt to tackle tax avoidance [&] tax evasions by dominant revenue authorities in developed and developing countries. The Oxford Centre for Business Taxation conducted survey in 2007 and reported that a mainstream of respondents thought that, “corporate taxations give the impression to be too multifarious or complex for both public and media to understand. Thus, the tax issues are not enclosed by the media [or] overlooked by public.” Researcher reported that participants suggested, if public and media concentrate on tax planning and taxpaying as important social issues, tax would be the part of CSR. The emergent debate about corporate social responsibility on the domain of tax planning presents businesses with an opportunity to showcase their commitment to corporate responsibility, and their approaches to risk management. The challenge now is to translate this commitment into concrete steps that contribute to a positive vision of tax responsibility. It has been found that CSR performance is highly influenced by tax havens or Offshore Finance Centers (OFCs) (Hines and Rice,1994). OFCs catch the attention of bank deposits and described business activities through small or zero tax rates and often do not require extensive corporate actions within the terrain It has been concluded that companies enjoying tax havens also claims that they are socially responsible and practicing under the shelter of CSR norms (Preuss ,2010). Furthermore, it is found that Offshore Finance Centers based companies have made significant efforts to design codes of conduct. it is particularly surprising to find that 38 per cent of the OFC sample firms claimed to obey both the letter and the spirit of legislation

### *Nature of Taxation in Pakistan as to the Number and Rate of Taxes*

There is no comprehensive study available. But it is generally believed that everything is taxed and is taxed at a far higher rate. In 1990, Karachi Chamber of Commerce and Industry had established that the industry was subjected to 50 direct and indirect taxes but the President PFCCI (Pakistan Federation of Chambers of Commerce and Industry) at the Businessmen Conference in Islamabad on March 25, 1997, that 37 government departments and agencies were collecting taxes gives a measure of the proliferation of taxes that has taken place in Pakistan (Rehman, 1997). There are 70 major taxes to which consumers and producers are subjected. In addition, there are host of specific taxes like a Research and Development Levy, Drug Manufacturing License and Drug Registration Fee. It can be said safely that there are at least 100 taxes in vogue in Pakistan.

## CONCLUSION

The study shows the relationship between CSR and tax avoidance in the context of Pakistan. The results are based on examination of tax avoidance and CSR practices by business community in Pakistan. It was found that businesses which are not conducting CSR activities are more likely to avoid tax, lending credence to the idea that CSR could be viewed as a facet of corporate culture that affects corporate tax avoidance. Secondly, current study examines the businesses which are avoiding tax and still consider not socially responsible. There are a lot of businesses in Pakistan which are indulge in tax avoiding practices but still consider to have a well-known CSR approach. Thirdly, it was also examined in the paper the influence of stakeholder's goals for those companies which are involved in tax avoidance practices. There are socially responsible companies in Pakistan, but their actions have the result of moving capital outside the domestic countries and resultantly there is lack of the taxes which each company pays to the country in. In addition, the research provides a review of CSR practices of businesses in Pakistan. CSR is at its initial stages in Pakistan and companies started to align their policy based on this criterion. Pakistan is considered as a tax burden country as a result a lot of companies moved their capital using tax avoidance practices. These types of companies are continuing to publish in their annual report the part of the CSR, without mentioning anything about the tax avoidance practices. Therefore, there is a dire need for companies in Pakistan to review their activities from a social point of view.

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