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# Corporate social responsibility and tax avoidance: A comment and reflection

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### ABSTRACT

This paper is a response to Sikka's 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance'. We believe that 'Smoke and Mirrors' (hereafter S&M) identifies an area of considerable importance but that it is misleading and problematic for several reasons. First, it glosses over the important distinction between tax avoidance and tax evasion. Despite using the term 'tax avoidance' in the title, to establish its conclusion, the paper relies predominantly on a handful of examples involving fraud, deceit and corruption, which are behaviors usually associated with 'tax evasion'. In the context of corporate social responsibility, we explain why this distinction is crucial and offer directions for future research in this area. Second, Sikka's paper ignores voluminous extant research on tax compliance, corporate tax avoidance and its relationship with CSR. Third, the paper mis-reports key statistics on the tax gap in the UK and US, and finally, it omits a robust discussion of the considerable policy response to corporate tax avoidance, which has been promoted by numerous tax agencies and international organizations such as the OECD. In the current paper, while recognizing the merits of S&M, we highlight the problems listed above, seek to remedy them, identify additional areas of concern and encourage further research attention in this area.

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## 1. Introduction and motivation

This paper responds to Sikka's recent article, 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance' (Sikka, 2010; hereafter S&M), which was published in this journal. In Section 4 of S&M, it is stated that the purpose of the paper is to 'encourage research into corporate claims of socially responsible conduct by examining their tax practices' (p. 165) and that the 'payment of democratically agreed taxes represents a litmus test for claims of social responsibility' (p. 166). In Section 1 of S&M, there is a claim, which we dispute, that 'comparatively little scholarly attention is paid to the payment of democratically agreed taxes' (p. 154).

In the course of establishing what many might consider an important conclusion, that is, 'in essence, companies have developed elaborate practices to appropriate returns due to society on its investment of social capital' (p. 165), S&M describes a number of instances in which corporations and advisors have engaged in activity that falls short of the standard of behavior that society might reasonably expect of such entities. The examples adduced in S&M, including Enron, WorldCom and Deutsche Bank, are acknowledged (at p. 157) as examples of deceit, fraud and/or corruption. Many of the examples provided in S&M demonstrate various types and aspects of fraud, deceit and/or corruption that were not voluntarily disclosed by the

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companies or organization identified. Very few of the examples in S&M represent tax-related behavior that is not an instance of fraud, deceit or corruption. We suggest that these examples provide very little information or insight concerning the tax-related behavior of the majority of companies and organizations and are therefore insufficient to justify the conclusion reached on p. 165 (see above). In addition, these examples say little about the relationship between tax-related behavior and the corporate social responsibility (CSR hereafter) practices of the majority of companies and organizations and why disclosure and transparency may be important for substantiating the CSR claims of corporations. It is a great pity that S&M takes this approach. We agree with S&M that the tax-related behavior of corporations and other organizations might, in certain circumstances, act as a litmus test both when considering the CSR claims of particular companies and when addressing various scholarly debates (see Avi-Yonah, 2008; Desai & Dharmapala, 2006b; Freedman, 2008a).

However, the content and tenor of S&M, as well as the methods of reasoning and unstated assumptions that appear to us to be present in S&M, the lack of inclusion of citations to established prior theoretical and empirical scholarly literature, the use of non-peer-reviewed reports,<sup>1</sup> the incorrect interpretation of existing tax gap statistics and the absence of any discussion of policy response by governments and tax agencies all are severe shortcomings.

In this response, we address several aspects of S&M that, when taken together, call into question the reliability of the conclusion that is offered and suggest that the research approach employed fails to identify a number of important issues that are relevant to the discussion of these topics.

This response is organized as follows. In the next section, we highlight the importance of distinguishing between the concepts of 'tax avoidance' and 'tax evasion' as well as discuss how such a distinction might be made and the relevance of the distinction when assessing the CSR behavior of corporations. In so doing, we acknowledge the difficulties that might be associated with such a distinction. We believe that a major failure of S&M is that by occasionally eliding the two concepts of tax avoidance and tax evasion, S&M fails to establish, however tentatively, any conclusion that is generally applicable to corporate activity.

In our view, S&M also fails to identify, let alone discuss, important issues concerning the nature of certain categories of corporate behavior for which the distinction between tax avoidance and tax evasion is relevant and useful. A major reason for our view is that, while S&M identifies a handful of companies and other organizations that did not disclose their deceitful, fraudulent and/or corrupt activity, this information is of little interest. To then use these examples to draw conclusions about the tax-related behavior of companies in general is, in our opinion, unconvincing.

What S&M does not consider are the merits of tax-related behavior that is *not* considered to be deceitful, fraudulent or corrupt by democratically elected governments and tax authorities. It is in this area of behavior that the relationship between tax-related behavior and CSR, whether considered on a national basis or with respect to the cross-border activity of multinational enterprises, raises important questions and may be of most interest. Given the number of headline corporate scandals in the past few decades, it is reasonably easy to identify what can be recognized as appropriate responses to deceit, fraud and/or corruption and these responses are accepted as appropriate by many of the parties contributing to the discussions taking place on these topics.<sup>2</sup>

It is more difficult to identify an appropriate and justified response or set of responses to tax-related behavior that is not deceitful, fraudulent and/or corrupt behavior, including behavior that some have characterized as creative compliance (Farber, 1999; McBarnet, 2005; Shah, 1996). We suggest that the academy should be focusing on the identification of such a response or set of responses and how they should be reflected in CSR behavior and disclosure. As the actual title of S&M suggests, it is the relationship between CSR and tax avoidance that is interesting, not the relationship between CSR and deceitful, corrupt or fraudulent behavior that, we suggest, is commonly identified as tax evasion.

Having argued that there is a useful and important distinction between tax evasion and other types of tax-related behavior,<sup>3</sup> we then consider S&M's approach to the distinction in Section 3, arguing that even though the distinction between tax evasion and tax avoidance is not pursued, it is pertinent to S&M's argument.

Section 4 considers, in summary form, the considerable scholarly attention paid to tax-related behavior, the payment of democratically agreed taxes and extant research (uncited in S&M) on the link between CSR and taxation. This research is wide-ranging and originates in many different parts of the academy. We believe that the omission of this literature is unfortunate and undermines claims made in S&M that imply a paucity of existing tax research, which is incorrect.

In Section 5, we consider the use that S&M makes of some of its 'evidence', particularly the relevance of the examples cited, the selective and/or incorrect citation of reports on the tax gap and the dependence of S&M on statements that appear to be without foundation. We also briefly outline the policy approach to large business compliance currently undertaken by many tax authorities around the world and the regulation of tax accountants, which are topics clearly relevant to CSR and tax avoidance yet entirely omitted in S&M. In particular, we refer to the approach adopted by Her Majesty's Revenue and Customs (HMRC) to the behavior of large UK businesses with respect to their tax planning and tax positions and to the 'Working with Tax Agents' initiative (HMRC, 2009a, 2009b).

<sup>1</sup> See Fuest and Riedel (2009) for an interesting review of the literature on tax avoidance and tax evasion in developing countries, including a criticism of the methodology used in arriving at such estimates by a number of non-peer-reviewed reports.

<sup>2</sup> The websites of tax administrators (e.g., IRS, HMRC and the Australian Tax Office) regularly report instances of the consequences of deceit, fraud and/or corruption in the area of taxation. The consequences often involve a prison sentence.

<sup>3</sup> That is, other types of tax-related behavior being referred to in this paper as tax avoidance.

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