# The Role of Corporate Social Responsibility in Mediating the Effects of Foreign Operation on Tax Aggressiveness

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***Abstract-*** This study aims to identify the role of corporate social responsibility in mediating the effects of foreign operation on tax aggressiveness. The sample used in this study was taken from Indonesian Stock Exchange during 2012-2016 period based on predetermined criteria set by the writer. The number of final samples was 33 corporations or 165 firm years. The analysis using Warp PLS 6 finds that CSR significantly mediates the effects of foreign operation on tax aggressiveness. Corporations with high foreign operation tends to have low CSR and low tax aggressiveness, meaning that these corporations are not performing tax aggressiveness. This finding indicates trade-off between CSR and tax. Mediation in this study is categorized as inconsistent mediation because although the mediated effect has different (opposite) sign from the direct effect, the mediated effect shows significant correlation. The contribution of this study is to provide empirical evidence on trade-off between CSR and tax. When CSR implementation is low, the corporation tends to have low tax aggressiveness indicating the corporation does not perform tax aggressiveness. The findings of this study are also expected to provide contribution for policy makers on CSR to explicitly state the sanctions for corporations that are not performing CSR activities and really implement the sanctions. The further researches in the future should be able to add some variables as the factors that strengthen the correlation between CSR and tax aggressiveness because the finding of this study still varies. Among these factors are culture and managerial characteristics of the nation where the research samples taken.

***Index Terms***- Corporate Social Responsibility, Foreign Operation, Tax Aggressiveness

## I. Introduction

Tax is one source of national income used to fund national expenditure. It contributes the highest proportion on national income in Indonesian State Budget (APBN). However, the realization of tax collection is always below the target. The Ministry of Finance states the realization of tax collection in 2016 was IDR 1.283,6 trillion or about 83.4% of tax collection target in Revised State Budget (APBNP) 2016 (ekonomi.akurat.co/id).

Indonesia includes in lower middle income country with average tax ratio 19%-26% of Gross Domestic Product (GDP). The Bureau of Budgetary Analysis and Implementation Secretary General of DPR-RI stated based on the data released by Government Procurement of Goods and Service Agency (LKPP), tax ratio in Indonesia increased during 2002-2012 period from 11.5% to 13.3% in 2009. The tax ratio plummeted to 11.1% in 2009 and consistently improved to 11.9% in 2011-2012 period. IMF explains that Indonesia's actual tax income relative to PDB is the lowest among G-20 countries and emerging market countries. Sri Mulyani, Minister of Finance Republic of Indonesia explains that Indonesian tax ratio is still below 11% in 2016, the lowest tax ratio in the world (http://wartaekonomi.co.id).

The unexplored tax potentiality becomes the opportunity for Indonesian Government because there are many problems concerning with poverty, education, health, national defense and security, environment, transportation, infrastructure and public facilities need to be solved by Indonesian Government. Tax income plays vital role in solving these social problems (Wahyudi, 2015).

Therefore, the participation of corporations in implementing its responsibility to pay taxes correctly is needed. One of the factors causing low actual tax income to ratio to GDP in Indonesia is probably caused by most of the taxpayers disobediently ignore their responsibility to pay taxes. One form of disobedience made by the taxpayers is there are corporations that avoid taxes and perform aggressive tax planning.

Rego (2003) defines tax avoidance as the utilization of tax planning method to legally reduce the amount of income tax that should be paid. Meanwhile, Desai and Dharmapala (2006) perceive tax avoidance as a form of abusing tax shelter facility. Tax avoidance is actually a legal action carried by a corporation because the provisions of tax avoidance itself have been regulated in laws. Tax avoidance is different from tax evasion, an illegal way to reduce the amount of taxes paid by a corporation.
Aggressive taxation is commonly carried out by domestic and multinational corporations. The definition of tax aggressiveness operated in this study refers to the definition proposed by Frank et al. (2009), namely an action to reduce taxable income by applying certain methods that are categorized (or not categorized) as tax evasion. Tax evasion is the obstacles in tax collection process that reduces national cash income. Hence, the term tax aggressiveness is a term that is widely defined and can be used in substitutive with tax avoidance/evasion and tax management.

Several tax avoidance and tax evasion cases in Indonesia were done by famous corporations. PT. Toyota Motor Manufacturing was accused of using transactions among its national and international affiliated companies known as transfer pricing. Transfer pricing is developed as tax planning carried out by corporations using a simple method, namely by transferring excessive income gained in a country to other countries with lower taxation rate. The transfer of taxable income is carried out through unreasonable price manipulation. The transfer pricing scandal was revealed when the Directorate General of Taxation assessed the Annual Tax Return (*Surat Pemberitahuan Pajak Tahunan/*SPT) of the corporation in 2005 with taxation rate IDR 1.07 trillion (https://investigasi.tempo.co). Other corporation performing tax evasion was Asian Agri Group. The Directorate General of Taxation investigated the scandal by assessing the financial report of 14 subsidiary companies of Asian Agri Group. The investigation revealed that tax evasion practice carried out by Asian Agri Group is conducted in sophisticated, systematic, and structured ways. They even employed a special unit to manage the tax evasion process (Kamaludin, 2014). Another case was PT. Bumi Resources Tbk. and its subsidiaries which were accused of conducting tax evasion. The investigation carried out by The Audit Board Republic of Indonesia revealed the deficit in Coal Sale Income (*Dana Hasil Penjualan Batubara/DHPB*) as much as US$ 143.189 million in 2003-2008. The amount had not been adjusted with financial statements of the company as much as US$ 608.178 million. The investigation also revealed deficit on royalty payment for 2003-2008 period as much as US$ 477.299 million.

Tax evasion phenomenon also occurs and is practiced by large international companies. In the last few years, world taxation is spiced up with stories of investigations carried out by taxation authorities on multinational companies such as Apple, Starbucks, Google, and Amazon. Taxation authorities doing investigations finds the taxation structure of multinational companies has made these companies pay unfair amount of taxes (Febriyanto, 2013). Based on these issues, tax evasion may be caused by taxation regulations applied in each country.

Corporations implementing aggressive taxation are considered as multinational companies practicing international business by opening branch offices/distributors and exporting their products. The development of information technology and international transaction enhances the ways of tax evasion practiced by multinational companies. Corporations with greater extensive international operational have a greater opportunity to evade income taxes than corporations with domestic business operation. For example, a multinational company has the opportunity to evade income taxes applied in one of its business locations with lower tax rate by transferring its income from locations with higher tax rate to locations with lower tax rate by exploiting different taxation regulations applied in different countries and taking advantages of tax subsidy agreement made with government of the country (U.S. Department of Treasury, 1999).

Tax avoidance activity has two effects on Effective Tax Rate (ETR). First, tax avoidance may cause Book-Tax Differences (BTD). BTD is temporary and permanent differences between accounting-based income and tax-based income. The transactions that may affect taxes are: overseas sales, tax-free income, tax credits, and deferring revenue admission for taxes. These transactions may reduce the ETR of a company. Second, multinational corporations often utilize foreign operation they practiced to avoid income taxes (Mills, 1998). In his research on tax avoidance practiced by multinational companies in the US, Rego (2003) found that multinational companies with extensive foreign operation have lower ETR, indicating that these companies minimized tax avoidance. This finding negates previous study carried out by Stickney and McGee (1982). In their study, Stickney and McGee (1982) showed that extent foreign operation variable has no significance in defining ETR, meaning that extent foreign operation does not affect ETR. Mills et al. (1998) utilized dummy variable to identify the effect of extent foreign operation. Their study found significant positive correlation between ETR and foreign operation variable. This finding indicates that companies with foreign (international) operation tend to avoid taxes.

Tax avoidance cases discussed in the previous paragraphs proves how poor these companies implement business ethics as indicated by their tendency in avoiding high amount of taxes. The obligation of these companies to implement its corporate social responsibility is merely written on tax regulations and laws, yet the implementation depends on the management of each corporation. The most common way done by the companies to avoid taxes is through aggressive tax planning.

One of the concepts that is closely related to business ethics is Corporate Social Responsibility (CSR). CSR is a sustainable commitment made by business companies to act ethically and contribute the economic development of local communities and society in general, alongside with improving the living quality of the employees and their family (World Business Council for Sustainable Development). Every corporation must commit on implementing ethics on all financial and operational activities because through business ethics, fair business practice, environmental effect, and Corporate Social Responsibility (CSR) play significant role in improving the legitimation of a corporation (Briefing, 1999). Carrol (1979) explains an organization with social responsibility must be profitable (economic responsibility), obeying the laws practiced by the society where the organization located (legal responsibility), conducting right actions and be fair (ethical responsibility), and becoming a good corporation (philanthropic responsibility). Hence, the implementation of CSR is the obligation of every corporation because it strongly correlates with reputation, social interests, economic interests, and environmental interests. Tax avoidance cases will never happen if all operational and financial activities are carried out based on the principles of business ethics. Previous studies carried out by Lanis and Richardson (2012, 2015) and Davis et al, (2013) find negative significant correlation between CSR and tax aggressiveness of a corporation, indicating the more social responsibility implemented by a corporation the less likely the corporation performs aggressive taxation. Meanwhile, Hoi et al. (2013) said that corporations with excessive irresponsible CSR activities have greater chances to avoid taxes and having greater difference on its discretionary/book-tax permanent. All of these previous studies took its sample in the US and Australia, countries with different cultural background and regulations applied from Indonesia.

This study aims to examine the role of CSR in mediating the effects of foreign operation on tax aggressiveness. In this study CSR plays as mediating variable because of its positive effects on the corporation itself, community, and the environment. CSR also brings negative effects to the government in term of income taxes. In this study, the writer attempts to view CSR from different perspective taken by previous researchers. in previous studies, the researchers viewed CSR as a part of business ethics that must be implemented in order to avoid taxes. CSR in Indonesia is a mandatory activity rather than voluntary activity. CSR may bring negative effect to the government related to tax aggressiveness. The cost of CSR may reduce the gross income of a company. This regulation may be used to develop a new strategy to lower gross income through CSR. Corporations will avoid taxes by allocating higher amount of CSR implementation cost from its gross income (Sibarani et al. 2014). As stated on agency theory, there is conflict of interest between the management and the shareholders. The management are hesitant to avoid taxes (although tax avoidance may increase investment value provided by the investors) unless the management gains some profits from tax avoidance. The theory of agency stated that every individual has a tendency to be selfish and act rationally to maximize his/her economic profit (Jensen, 2005; Donaldson dan Davis, 1991; Crutchley dan Hansen, 1989). The study conducted by Carroll and Joulfaian (2005) found that charity events carried out by corporations aimed to reduce the amount of taxes to be paid. Corporations also face two options that bring consequences to the reputation. The options whether to spend greater amount of CSR cost or to pay taxes depends on the policies made by the management after considering the advantages of both options. Preuss (2010) found that some corporations with high CSR activities has avoided taxes. This phenomenon also occur in Indonesia. The corporation winning CSR Award in 2014 has been found performing aggressive tax evasion (Nugroho, 2016). Sikka (2010) illustrates an example how a company claims itself having social responsibility yet at the same time the company has performed tax evasion.

This study uses corporations registered in Indonesian Stock Exchange during observation period 2012-2016 as its sample. This study finds that the higher foreign operation of a corporation the higher its tax aggressiveness indicating that the corporation has conducted tax evasion. The result of mediation test indicated that corporations with high foreign operation have low CSR rate resulting in low tax aggressiveness rate.

The contribution of this study is providing empirical evidence on trade-off between CSR and taxes. When CSR rate is low, the corporation has low tax aggressiveness indicating that the corporation does not performing aggressive taxation. This study also contributes a recommendation for policy makers concerning CSR to explicitly state the sanctions for companies that does not implement CSR and really enforce the sanctions.

This study is organized into several parts. In the second part, the writer discusses the relevant theories and hypothesis development. In the third part, the writer describes research design applied in this study and presenting empirical findings on the fourth part. The fifth part will be conclusion.

## II. Theories and Hypothesis Development

### 2.1 Theory of Agency and Theory of Reasoned Action

This study is based on theory of agency and theory of reasoned action. Talking about CSR and tax aggressiveness is closely related to behavior of the company management as the agent authorized to organize the company by the investors or principals. Basically, CSR activity is closely related to business ethics, yet the activity may become unethical if the implementation violates the existing regulations, especially related to tax aggressiveness. In Indonesia, CSR activity may reduce gross income which in turns lower the amount of taxes to be paid. This regulation may bring positive effect if the company conducts CSR activities correctly as provisioned by the law, in which CSR activities function to subtract gross income. Yet, CSR activities may also bring negative effect if in implementing CSR activities the company is avoiding taxes by allocating greater amount of fund subtracted from gross income (Sibarani et al. 2014). The findings of a study carried out by Carroll and Joulfaian (2005) found that charity events carried out by corporations aimed to reduce the amount of taxes to be paid. Here the theory of agency applies. The management are hesitant to avoid taxes (although tax avoidance may increase investment value provided by the investors) unless the management gains some profits from tax avoidance. The theory of agency stated that every individual has a tendency to be selfish and act rationally to maximize his/her economic profit (Jensen, 2005; Donaldson dan Davis, 1991; Crutchley dan Hansen, 1989).

Meanwhile, according to theory of reasoned action tax aggressiveness behavior is affected by positive individual belief and negative individual belief owned by a taxpayer towards the taxes he/she should pay. If the taxpayer has stronger positive individual belief, he/she will pay taxes obediently. On the other hand, if the taxpayer has stronger negative individual belief, he/she tends to ignore his/her obligation in paying taxes.(Fishbein and Ajsen (1975) as cited in Vallerand et al. 1992).

### 2.2 Foreign Operation and Tax Aggressiveness

A company involves in international business through several ways, namely international sales (export-import), license, franchising, joint venture, acquisition of existing operations, and establishing new branches/affiliated companies overseas (Madura 2012, p.10).Companies with extensive foreign operation has greater chance to avoid income taxes compared to companies with domestic operations. Multinational corporations with foreign operations are likely to avoid taxes through tax planning. Mills et al. (1998), Mills (1998) and U.S. Department of Treasury (1999) revealed positive correlation between foreign operation and tax avoidance practice. Corporations with extensive foreign operations tend to perform tax planning to avoid taxes. Meanwhile, Rego (2003) found negative between foreign operations and tax avoidance, indicating that multinational corporations with extensive foreign operations do not have tendency to avoid taxes because these corporations have applied effective tax planning while Stickney and McGee (1982) did not find correlation between foreign operation and ETR as indicator in measuring tax avoidance. Based on explanation above, the first hypothesis proposed in this study is:

**H1: Foreign operation has significant effect on tax aggressiveness**

### 2.3 Foreign Operation and CSR

World Business Council for Sustainable Development defines CSR as a sustainable commitment made by business companies to act ethically and contribute the economic development of local communities and society in general, alongside with improving the living quality of the employees and their family. Carrol (1979) mentions the aim of corporate social responsibility is to implement the responsibilities of a company to its society, consisting of economic responsibility, legal responsibility, ethical responsibility, and discretionary responsibility. Economic responsibility is the obligation that must be implemented by the company related to profit making. This is the main obligation of a company. Legal responsibility is company's obligation to obey laws and implement regulations in its operation. Ethical responsibility refers to behavior and activities that need to be done by the company as part of society although these actions not regulated or provisioned in the laws or regulations. Discretionary responsibility is additional obligations usually implemented through charity events or philanthropic activities.

Companies with overseas sales are multinational corporations that must consider its CSR activities so that its products can be recognized internationally. Islam and Deegan (2008) found that since 1990 the stakeholders had pushed garment industries in Bangladesh to improve its social performance. This pressure directly correlates with expectations of global society which in turn encourages the social policies of the industry and closely relates to practice of disclosure. This finding indicates that concerning international (overseas) sales, the corporations must also consider the ethics and regulations applied in the destination country. The government and the consumers in the destination country do pay much attention on social and environmental performance of the corporation. Bennett (2002) explains the correlation among multinational corporations, social responsibility, and conflicts that may occur if a corporation fails to comply the social responsibility. International business community plays an important role in improving economic and social justice through its business operation or to be blamed for contributing a condition where conflicts easily occur. Multinational corporations have a power and responsibility to the community where the business operation locates. Branco and Rodrigues (2008) examined the social responsibility disclosure by comparing the company website and company's annual financial website through several variables, namely international experience, company size, industry affiliation, consumer proximity, environmental sensitivity, and media exposure. The result of examination indicates that international experience does not significantly affect social responsibility disclosure on the website and the financial statements. Based on this discussion, the second hypothesis proposed in this study is:

**H2: Foreign operation has significant effect on CSR**

### 2.4 Foreign Operation, CSR, and Tax Aggressiveness

Foreign operation is one form of business activities that surpasses national borders. Foreign operation can be applied by establishing overseas branches, export sales, and many other ways. A company doing international trade must implement CSR (Islam and Deegan, 2008). International business community is very important in improving economic and social justice or to be blamed for contributing a condition where conflicts easily occur (Bennett, 2002). Carrol (1979) explains an organization with social responsibility must be profitable (economic responsibility), obeying the laws practiced by the society where the organization located (legal responsibility), conducting right actions and be fair (ethical responsibility), and becoming a good corporation (philanthropic responsibility). Hence, the implementation of CSR is the obligation of every corporation because it strongly correlates with reputation, social interests, economic interests, and environmental interests. CSR activity is expected to benefit both the company and the society however it is not impossible that CSR activity also provides negative effect for the government related to the amount of taxes should be paid by a company. Carroll and Joulfaian (2005) found that charity events carried out by corporations aimed to reduce the amount of taxes to be paid. The cost of CSR may reduce the gross income of a company. This regulation may be used to develop a new strategy to lower gross income through CSR. Corporations will avoid taxes by allocating higher amount of CSR implementation cost from its gross income (Sibarani et al. 2014). Therefore, it can be said that the company has done aggressive taxation considered in legal area or illegal. Taxes paid by a corporation may be related to CSR if the payment does imply the society. In this sense, the corporation must realize that paying taxes is a responsibility of the corporation towards its society, not a burden. If a company perceives tax payment merely as a part of business transaction and operational cost, the company will try to minimize the amount of tax owed as much as possible (Avi-Yonah, 2008). Hence the third hypothesis proposed in this study is:

**H3: CSR activities mediate the effects of foreign operation on tax aggressiveness**

## III. Research Design

### 3.1 Sample Description

The population of this study consists of all corporations registered in Indonesian Stock Exchange. The sample of this study was chosen based on following criteria:

Corporations registered in Indonesian Stock Exchange in 2012-2016 and not categorized as service companies

Corporations that have been continuously registered in Indonesian Stock Exchange with complete report during 2012-2016 period in order to see its consistency and not to disrupt the observation

Corporations that have exported its products consistently during 2012-2016 period.

Corporations with positive profits (not experiencing loss in 2012-2016 period).

Based on criteria above, the number of corporations taken as sample of this study was 33 corporations with the total number of samples meeting the criteria was 165 corporations.

### 3.2 Operational Definitions of the Variables and its Measurement

The dependent variable examined in this study is tax aggressiveness measured based on Effective Tax Ratio (ETR). ETR is used by the writer because of several considerations. First, previous empirical studies on taxation has found that ETR summarizes tax aggressiveness (Slemrod, 2004; Dyreng et al. 2008; Robinson et al. 2010). Second, ETR indicates tax aggressiveness proxy that is commonly used by the academicians (such as Mills et al. 1998; Phillips, 2003; Rego, 2003; Dyreng et al. 2008). In this study, the ETR uses cash ETR proxy defined as the ratio of tax paid on total accounting profits before taxation (Dyreng et al. 2010).

The mediating variable examined in this study is CSR activities measured through CSRI based on GRI 3. This study still applied GRI 3 because the data collection began in 2012 and Indonesia has not applied GRI 4. Indonesia started adopting GRI 4 in 2013 implemented in few corporations.

The independent variable examined in this study is foreign operation defined as corporations operating international trading by exporting its products overseas. Hence, this variable is measured by dividing total export rate with total sales operation in one period.

### 3.3 Technique of Data Analysis

In this study, the writer applied path analysis to analyze the data. Path analysis was chosen because this technique can examine the variables simultaneously and identify the direct effect and indirect effect. The data was processed using Warp PLS 6.0.

The procedure in examining the hypothesis assuming the role of CSR variable in mediating the effects of foreign operation on tax aggressiveness consists of two steps, namely:

1. Estimating the direct effects of foreign operation on tax aggressiveness

Estimating the indirect effects of foreign operation on tax aggressiveness simultaneously based on the following path: foreign operation → CSR → tax aggressiveness.

The conclusion about mediating variable are:

1. If the effect of foreign operation on tax aggressiveness remains significant and unchanged when CSR variable is inputted as additional predictor variable, the function of CSR variable as mediating variable is rejected.
2. If the effect of foreign operation on tax aggressiveness decreases yet remains significant after CSR variable is inputted as additional predictor variable, the function of CSR variable as partial mediator is accepted.
3. If the effect of foreign operation on tax aggressiveness decreases at some point insignificant statistically when CSR variable is inputted as additional predictor variable, the function of the variable as full mediator is accepted.

## IV. Empirical Results

### 4.1 Statistical Description

The statistical description of research variables examined in this study is presented on Table 1 below. Foreign operation variable is the ratio between export sales to total sales operated by the corporations. The average foreign operation rate is 27.12 % with the lowest rate 0.07% operated by PT. Lion Metal Work, which markets almost all of its products domestically and the highest rate 100% found on PT. Vale Indonesia Tbk because all products of this nickel mining company are sold overseas according to long-term contract.

The CSR variable examined in this study is measured based on items stated by the companies on its annual financial statement divided by the number of items that should be stated. CSR in this study is measured based on social dimension, environmental dimension, and economic dimension. The average CSR variable statement is 34.34% with the lowest rate 6.41% by PT Tunas Baru Lampung Tbk. During observation period, the company always showed low CSR index. Meanwhile, the highest rate is 56.38% by PT Indocement Tunggal Perkasa Tbk. this company has won many environmental awards and achieved environmental certifications.

Tax aggressiveness variable proxied by Cashetr is the ratio between tax payment in cash and net profit. The average cashetr ratio is 52.72% with the lowest ratio 0.02% by PT Vale Indonesia Tbk and the highest rate 177.50% by PT Vale Indonesia Tbk in 2016 because in previous years PT Vale Indonesia involved in tax dispute that must be solved in 2016.

**Table 1**
**Description statistic**

| | N | Min | Max | Mean | Std.Dev |
|---|---|---|---|---|---|
| *Foreig Operation* | 165 | 0,0007 | 1,0000 | 0,2712 | 0,3006 |
| *CSR* | 165 | 0,0641 | 0,6538 | 0,3434 | 0,1403 |
| *Cash ETR* | 165 | 0,0002 | 17,7503 | 0,5272 | 1,5889 |

### 4.2 Results of Hypothesis Examination

After conducting examination on research hypotheses proposed in this study through several steps of examination because of the existence of mediating variable, the writer generates the following examination model:

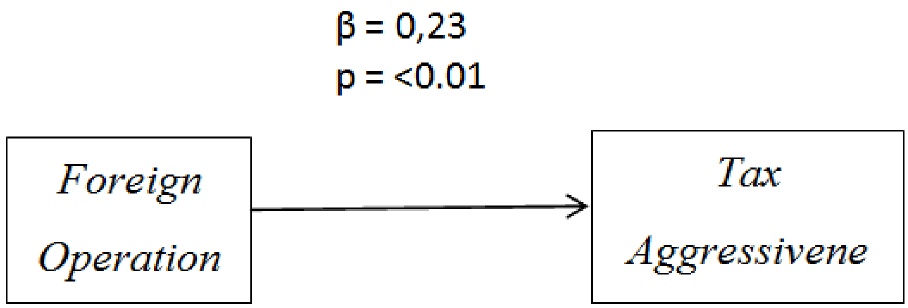


Figure 1
Direct effects

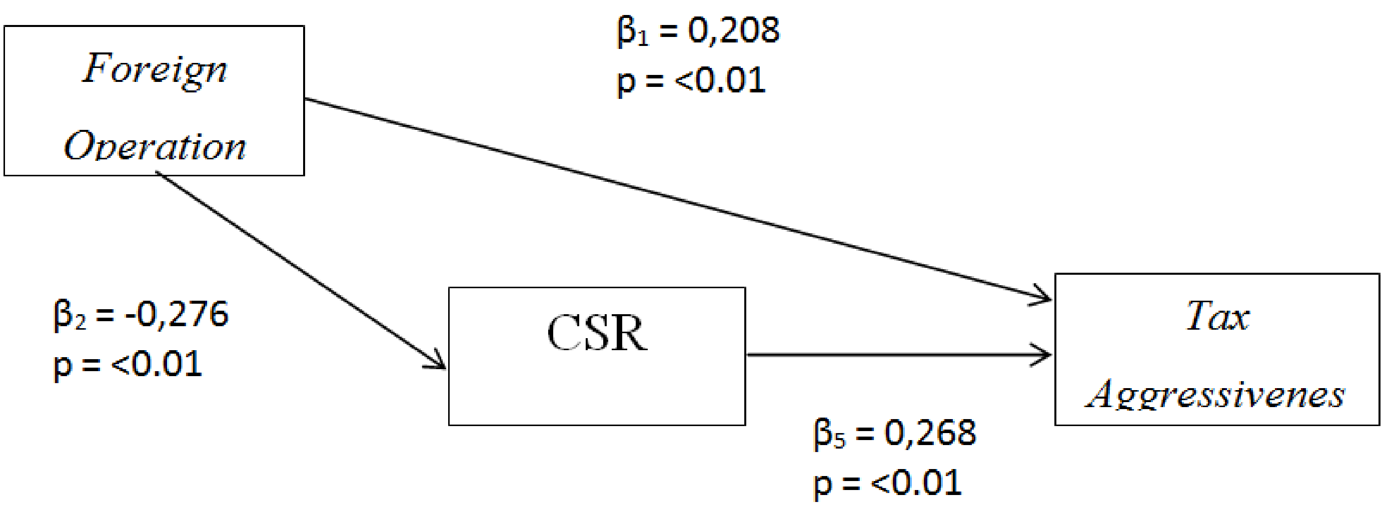


Figure 2
Indirect effects

Figure 1 above describes the direct effect of foreign operation variable on tax aggressiveness (indicated by path coefficient 0.23 and p-value < 0.01). This finding indicates $H_1$ stating foreign operation positively affects tax aggressiveness is accepted. The following step is examining the indirect effect/mediating effect. Figure 2 indicates the mediating effect of CSR on the effect of foreign operation on tax aggressiveness. $H_1$ stating foreign operation has significant effect on tax aggressiveness is accepted while $H_2$ stating that foreign operation has significant effect on CSR is accepted (indicated by path coefficient -0.28, p-value < 0.01) and CSR significantly affects tax aggressiveness (indicated by path coefficient = 0.27 and p-value $\leq$ 0.01). The examination results the path coefficients of foreign operation and tax aggressiveness on the second-phase examination are lower than their path coefficients on the first-phase examination (0.23 decreases to 0.21) yet remains significant ($p < 0.01$). Based on this finding, $H_3$ stating that CSR activities mediate the effect of foreign operation on tax aggressiveness is accepted. Based on the p-value that remains significant, the characteristic of existing mediation is partial mediation.

### 4.3 Discussion

#### 4.3.1 Foreign operation provides positive effect on tax aggressiveness

The findings of this study indicated that foreign operation variable has positive and significant effect on tax aggressiveness. Therefore, the first hypothesis proposed in this study stating that foreign operation has significant effect on tax aggressiveness is accepted.

The rationality of this finding is that companies with more extensive foreign operation have greater chance to avoid income taxes compared to companies that only operates domestically. Multinational corporations with foreign operation often avoid income taxes through tax planning. This finding is consistent with the result of previous studies carried out by Mills (1998), Mills et al (1998) and U.S. Department of Treasury showing positive correlation between foreign operation and tax avoidance practice. According to U.S. Department of Treasury companies with more extensive foreign operation have greater chance to avoid income taxes compared to companies that only operates domestically. By utilizing the data collected through survey carried out by Slemrod and Blumenthal (1993) on 365 corporations in the U.S., Mills et al. (1998) conducted an examination on company investment on tax planning. They applied planning, company size, foreign operation, leverage, capital, inventory and entity as the research variables. They found that burden planning decreased as the increasing company size. Corporations with foreign investment tend to perform tax planning. Capital intensity and entity positively correlates with tax planning while inventory intensity and leverage do not correlate with tax planning. Mills (1998) explains tax avoidance activity may affect Effective Tax Rate (ETR) in two ways. First, tax avoidance creates Book-Tax Differences (BTD). BTD refers to temporary and permanent difference between accounting profit and taxation profit. The transactions that may affect taxation are foreign sales, tax-free income, tax credits, deferring profit admission. These transactions lower ETR rate of the corporations. Second, multinational corporations tend to use its foreign operation activities to avoid income taxes.

The findings of this study are inconsistent with the result of a study conducted by Stickney and McGee (1982). In their study, they examined empirically the correlation between Effective corporate Tax Rates of the companies based on indicators of company size, capital intensity rate, foreign operation, natural resources, and leverage rate. Corporations with lower Effective Tax Rates (ETR) tend to have high leverage rate, intense capital, and involve in natural resource industry while foreign operation and company size do not provide dominant effect in defining ETR (not correlated with ETR).

### 4.3.2 Foreign Operation Has Significant Effect on CSR

The result of examination indicates that foreign operation provides significant negative effect on CSR therefore the second hypothesis proposed in this study stating foreign operation has significant effect on CSR is accepted. This finding can be interpreted as the higher foreign operation (in this study proxied as the division between total export rate with total sales) the lower CSR practice.

This finding contradicts the legitimation theory proposed by Gray et al. (1995) stating that multinational companies must operate based on social values practiced by international society in order to legitimate its products and its existence internationally. Gutrie and Parker (1989) also failed to confirm the legitimation theory in defining CSR activities implemented by corporations in Australia from time to time.

Gunawan et al. (2009) perceived that CSR understanding of companies in Indonesia is still considered low as indicated by low disclosure of CSR activities made by companies in Indonesia. The low disclosure indicates that companies' concern on CSR activities in Indonesia is still low. Retnaningsih (2015) explains that CSR activities in Indonesia has good concept yet only few companies are able to implement the good concept well.

The low CSR implementation may be caused by the characteristics of the management. Thomas and Simerly (1995) defined the role of top management and social performance. There is significant correlation between the characteristics of top management and social performance of chemicals and electronics companies. Characteristics of top management correlates with organizational strategies and systemic changes of economic performance affecting CSR performance. Rashid and Ibrahim (2002) examined the attitude of Malaysian managers and executives towards social responsibility and the range of activities categorized as social responsibility, company disclosure, and several factors affecting the attitude towards social responsibility. They found significant difference in attitude showed by the managers working in banking sector, telecommunication sector, manufacturing sector, and construction sector towards social responsibility. The most determining factor affecting the attitude towards social responsibility is family education while other important factors are belief and habits and general practices of industry. Diez et al (2011) examined the importance of CEO role on CSR, particularly the correlation between managerial profile and CSR practice mediated by ethics and social responsibility based on agency and stewardship approach. Based on stewardship approach, the CEOs tend to emphasize on ethics and social responsibility to implement CSR activities in their companies. Fernandez et al. (2006) defined the main characteristics of a manager with environmental responsibility and examined whether his/her proficiency and critical attitude towards environmental success through literary review. Behavioral characteristics, especially orientation, attitude, and competence of a manager do directly affect his/her role in CSR and the performance of his/her corporation because these characteristics serve as input of the system and generate performance.

Another fact indicating poor CSR implementation in Indonesia is low disclosure of labor on CSR disclosure. Cahaya et al. (2012) find that corporations in Indonesia do not perceive its responsibility towards the employees as the key performance and CSR disclosure as proven by low labor disclosure practice and by focusing on certain items and thus omitting other important items. Indonesian corporations may hide some information to protect its image and reputation. These practices indicate institutional pressure causing low labor disclosure in Indonesia.

The rationality of this finding is that the increasing foreign operation does not necessarily improve the implementation of CSR activities as idealized by theory of legitimation because the implementation of CSR activities is still strongly affected by the characteristics of Indonesian corporation managements and most of these corporations do not implement their CSR activities well. Indonesian corporations only focus on certain items of CSR practice and disclosure. The implementation of CSR in Indonesia is only as a formality to follow regulation, not as morality (Aditya and Juniarti, 2016).

The finding of this study confirms the result of previous study conducted by Sikka (2010). Sikka (2010) attempts to examine the taxation practice carried out by international corporations claiming that they have implemented their social responsibility. From the examined cases, Sikka found differences in terms of topic discussed by the corporations, decisions made, and actions taken that led to organized hypocrisy (smoke and mirror). The corporations develop two practices, namely assuring ethical behavior towards external community and separating organizational practices aimed to gain profit and avoiding taxation. In principle, these corporations have developed a complicated practice towards the society through social capital investment, transfer pricing, royalty programs, offshore tax havens, and careful transaction organization through tax avoidance techniques.

The findings of this study are not consistent with the result of study carried out by Islam and Deegan (2008). In their study, Islam and Deegan informed that since 1990, stakeholder groups have encouraged the garment industries in Bangladesh to improve its social performance. The encouragement is directly correlated with the expectation of global society which in turn inspires the development of social policies of the industry related to disclosure practice. This process indicates that in international sales, a company must also consider ethics and regulations applied in destination countries where the government and consumers in the destination country pay much attention on social and environmental performance. Bennett (2002) explained the correlation between social responsibility of a multinational company and potential conflicts may occur if the company fails to implement its social responsibility. International business community plays important role in promoting economic and social justice improvement through its operation or to be blamed for contributing a condition vulnerable to conflicts. A multinational company has the authority and responsibility to the community living in the area where the company operates. Meanwhile, Branco and Rodrigues (2008) found that international experience variable provided insignificant effect on social responsibility disclosure presented on company website or annual financial statement.

### 4.3.3 CSR Activities Mediate the Effects of Foreign Operation on Tax Aggressiveness

The findings of this study indicates that CSR activities significantly mediate the effects of foreign operation on tax aggressiveness, therefore, the third hypothesis proposed in this study stating CSR activities mediate the effects of foreign operation on tax aggressiveness is accepted. The rationality of this finding is when the foreign operation of a company is high, the CSR activity implementation is low. An observation on a sample of multinational corporations in Indonesia performing export trade indicates that a company with higher export rate does necessarily mean the company has high CSR activities. The sample companies perform low CSR implementation because of the characteristics of the management and there are many companies in Indonesia have implemented CSR well (Thomas dan Simerly, 1995 ; Rashid dan Ibrahim, 2002 ; Diez dkk., 2011 ; Fernandez dkk., 2006; Retnaningsih, 2015). Most companies in Indonesia only focus on certain items of CSR practice and disclosure. CSR implementation in Indonesia is only to follow regulations, not as part of morality (Aditya and Juniarti, 2016). The result of statistical analysis shows positive correlation between CSR and tax aggressiveness. This condition indicates that although these companies have poor CSR implementation these companies have less tax aggressiveness meaning that these companies obediently pay taxes. This situation suggests there is a trade-off between taxation and CSR implementation. The companies chose paying taxes rather than diversifying its CSR activities in a larger scale. CSR activities performed by these companies are merely as a formality to comply with regulations stipulated by the government rather than a part of morality (Aditya dan Juniarti, 2016). Disobeying tax obligation may be risky for these companies. They consider aggressive taxation as a risky illegal action that my bring sanction from taxation authorities and may reduce the reputation of the company. Rego and Wilson (2012) define tax avoidance as a risky action the managers won't dare to take by minimizing the investment. Tax avoidance may increase additional operational and managerial costs of a company including paying tax consultant, spending more time for tax audit, reputation fines, and other fines paid to tax authority while the sanction given to companies not doing CSR is not clear and not realized (Irawan, 2016).

The finding of this study is consistent with agency theory describing the relationship between company management as an agent with the shareholders. There is a conflict of interest between the management and the shareholders. The management are hesitant to avoid taxes (although tax avoidance may increase investment value provided by the investors) unless the management gains some profits from tax avoidance. The theory of agency stated that every individual has a tendency to be selfish and act rationally to maximize his/her economic profit (Jensen, 2005; Donaldson dan Davis, 1991; Crutchley dan Hansen, 1989). The finding of his study is consistent with the result of previous study conducted by Carroll and Joulfaian 2005. In their study, Carroll and Joulfaian found that the number of charity events held by the company was low, the company paid higher tax rate. Consequently, when the number of charity event was high, the company tend to decrease its tax rate because the charity events held were intended to lower tax rate. Another study illustrated positive correlation between CSR activity and tax avoidance is a study conducted by Preuss (2010). In his study, Preuss compared a sample of companies located in tax haven countries and companies located in the US. He found that companies located in tax haven countries tend to carry out more CSR activities than compared to companies located in the US. This finding indicates companies with high CSR activities tend to be more aggressive in taxation. Davis et al. (2013) also confirmed positive correlation between CSR activities and tax avoidance through tax lobbying activity. Their finding indicates that companies with high CSR activity also have high tax avoidance. Sikka (2010) proves that multinational companies claiming that they had done CSR yet they also performed tax evasion. Siswianti and Kiswanto (2016) examined the effect of CSR activities on tax aggressiveness of multinational companies in Indonesia. Their findings indicated positive and significant correlation between CSR and tax aggressiveness. Companies with aggressive taxation tend to reveal much information on CSR activities in order to transfer the allocated fund for taxation to CSR activities.

## V. Conclusion

This study examines the mediating effect of CSR activities in the correlation between foreign operation and tax aggressiveness. Based on the results of empirical examination, this study finds that CSR activities significantly mediates the effects of foreign operation on tax aggressiveness. The rationality of this study is when the CSR activities carried out by a company is low the tax aggressiveness of the company will also be low meaning that the company does not perform aggressive taxation. This finding also signifies a trade-off between CSR activities and tax payment. The companies consider tax aggressiveness as a high-risk action due to its legal consequences and sanctions given by tax authority and the potentiality of reducing the reputation of the company. Tax avoidance may significantly increase operational and managerial costs including to hire tax consultant and spend much time on tax auditing, reputation fines, and other fines paid to tax authority (Rego and Wilson, 2008) while the sanction given to the companies not doing CSR is still unclear and not realized (Irawan, 2016).

The contribution of this study is providing empirical evidence on trade-off between CSR and taxes. When CSR rate is low, the corporation has low tax aggressiveness indicating that the corporation does not performing aggressive taxation. This study also contributes a recommendation for policy makers concerning CSR to explicitly state the sanctions for companies that does not implement CSR and really enforce the sanctions. The further researches in the future should be able to add some variables as the factors that strengthen the correlation between CSR and tax aggressiveness because the finding of this study still varies. Among these factors are culture and managerial characteristics of the nation where the research samples taken.

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