Do Audit Quality and Corporate Social Responsibility Influence Tax Avoidance?

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Abstract. Tax avoidance is a major concern for governments globally, as companies find ways to avoid paying their fair share of taxes, affecting government revenues and justice in the economy. But the biggest problem for governments is to ensure taxpayers' compliance. This study examines how audit quality and corporate social responsibility (CSR) influence firms' decisions regarding tax avoidance, viewed through the lens of agency theory. It utilizes a causal quantitative methodology with an explanatory research design to assess the causal effects of the independent variables (audit quality, CSR) on tax avoidance. This study's sample are Indonesian manufacturing firms. A significant negative relationship was observed between audit quality and tax avoidance. This result is consistent with prior empirical evidence suggesting that Big Four auditors are associated with lower levels of tax avoidance due to stronger monitoring functions that limit managerial opportunism. Conversely, CSR was not found to exert a significant influence on tax avoidance, supporting previous findings reported in the context of Indonesian listed food and beverage firms. Agency theory suggests high-quality audits reduce principal-agent problems and encourage tax compliance. The latter is constrained by poor enforcement and voluntary CSR reporting in emerging markets such as Indonesia. Policy makers need to focus on better audits for aggressive tax avoidance.

Keywords: Audit quality, Corporate Social Responsibility (CSR), Tax avoidance, Agency theory.

1 Introduction

Companies typically engage in complex tax avoidance strategies. Tax avoidance refers to companies' legal tax planning strategies to reduce their tax liabilities through financial reporting, which is often measured by the Effective Tax Rate (ETR) or Current ETR. Conversely, tax evasion is used to describe illegal tax planning. It is contrasted with tax avoidance (legal tax planning). In short, tax avoidance and evasion are legal and illegal tax planning, respectively. However, they can be easily mistaken, and technically it is hard to distinguish them. Tax avoidance is a concern for governments around the world, with companies engaging in legal tax planning strategies to reduce their tax burden, which affects public revenues and economic fairness.

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Audit quality is one factor that leads to tax avoidance. Audit quality is a quality auditor in audit procedures following the Professional Public Accountant Standard. The better the quality of the audit performed by auditors in serving the company, then the company's actions to manipulate the profit for tax purposes are not conducted. As well, there is also a strong interest in the business world and in academia when it comes to corporate social responsibility (CSR). In fact, there is a rapid increase in the interest of CSR in tax avoidance studies [1].

Empirical studies reveal mixed findings on the roles of audit quality and corporate social responsibility (CSR) in influencing such behaviour. For instance, higher audit quality by Big Four firms has been linked to increased tax avoidance in some contexts, while CSR often shows an ambiguous relationship, sometimes enabling avoidance as a risk management tool. Chouaibi et al., (2021) found that show that firms that do not engage in CSR activities tend to be more proactive in tax avoidance compared to others, supporting the notion that CSR can be viewed as an aspect of corporate culture influencing business tax avoidance strategies [2]. Putri et al., (2023) state that audit quality and CSR had a negative impact on tax avoidance [3]. Shafiq et al., (2024) find audit quality has a negative association with tax avoidance, suggesting that quality audits deter tax avoidance and enhance the credibility of financial reporting [4].

Greater tax expense disclosure was found to serve as a signal of corporate tax compliance, helping to alleviate stakeholders' concerns about potential tax avoidance activities undertaken by firms. Tax avoidance continues to occur, despite regulatory measures, and audit quality may not be able to slow down aggressive tax avoidance by companies due to auditor incentives. CSR practices, aimed at improving legitimacy, can simultaneously assist corporate tax avoidance (even providing a cover-up), prompting questions about the true motivations behind CSR theory with stakeholder pressures.

2 Literature Review

Audit quality, measured by auditor size (Big Four), audit fees and auditor tenure, is an external watchdog that can curb tax avoidance through improved financial reporting quality. CSR is seen as both an ethical obligation that curbs avoidance, and a veil to conceal avoidance through tax-deductible disclosure costs. Agency theory describes audit quality and CSR as governance mechanisms reducing agency issues in tax avoidance. Audit quality improves external governance, and CSR internally signals management, curbing tax avoidance. Existing literature presents conflicting results: some conclude audit quality decreases tax avoidance, others show it has a positive impact. Likewise, CSR can be multidimensional and differ across countries. This is especially true in the moderating or direct effect of CSR as a business strategy on audit quality and tax avoidance in Indonesia.

Agency theory predicts that quality audits (such as by Big Four firms) increase scrutiny of managers' actions and, thereby, the costs of tax avoidance, which in turn restrains opportunistic behaviour that may benefit managers at the expense of shareholders.

H1: Audit quality has a negative effect on tax avoidance.

An agency perspective suggests that CSR investments serve as a bonding mechanism as managers signal a pursuit of principals' long-term interests, reducing the motivation for tax avoidance since this could potentially be viewed as an act of self-serving and attract undue attention.

H2: Corporate social responsibility negatively influences tax avoidance.

3 Methodology

This research employs a causal quantitative approach with an explanatory framework to investigate the causal link between the independent variables (audit quality, CSR) and the dependent variable (tax avoidance). The study's population consists of all taxpayer companies in Indonesia, while the sample focuses on manufacturing firms. Secondary data were gathered from IDX annual reports, company websites, and databases like the IDX, organized in a time series for panel data analysis. Variables were measured as: tax avoidance via ETR = (Income Tax Expense - Deferred Tax)/Pre-tax Income; audit quality via a Big 4 dummy and CSR via the GRI disclosure index or total CSR expenditure. Multiple linear regression or panel data regression (fixed/random effects) to test direct influence, with classical tests (normality, heteroscedasticity, multicollinearity) and Chow/Hausman test.

4 Results

The following table explains the results of statistical tests in this study.

Table 1. Coefficients[a].

		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
Model		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	.128	.030		4.322	.000		
	AQ	.119	.028	.560	4.228	.000	.406	2.464
	CSR	.001	.001	.173	1.307	.196	.406	2.464

a. Dependent Variable: Taxavoid

The calculation of tolerance values indicates that none of the independent variables have a tolerance value below 0.10, signifying that there is no correlation exceeding 95%

among them. Similarly, the VIF value assessment reveals that no independent variable possesses a VIF value greater than 10. Therefore, it can be inferred that multicollinearity is absent among the independent variables in the regression model [5]. From the SPSS calculation results in the table above, Hypothesis 1 is accepted, with a sig value of 0.000 ($p < 0.05$), demonstrating that audit quality exerts a significant negative effect on tax avoidance. This finding corroborates Rizqia and Lastiati (2021), who reported a similar significant negative impact of Big Four auditors on tax avoidance (measured via ABTD) among manufacturing firms listed on the IDX and Malaysia Stock Exchange in 2018, attributing it to enhanced monitoring that curbs managerial opportunism [6]. H2 is rejected since the sig value is 0.196 ($p > 0.05$) and suggests that corporate social responsibility (CSR) does not influence tax avoidance. This finding is in line with that of Irawan et al. (2023), who investigated IDX-listed companies from the food and beverage industry and found CSR not a significant factor in tax avoidance [7].

5 Conclusion and Recommendation

To agency theory, better audit quality reduces principal-agent problems through better monitoring, increased alignment with shareholder interests and tax compliance. This finding helps regulators of emerging markets to prioritise audit quality in order to support tax compliance. In emerging markets (Indonesia), this is tempered by ineffective law enforcement and voluntary CSR reporting, consistent with mixed international evidence that CSR's effect on tax avoidance is often insignificant due to varied forms of CSR or other company-specific factors.

This research suggests that regulators in emerging markets (such as Indonesia) should emphasise quality (independence, expertise, enforcement and transparency) rather than audits. This finding is consistent with research that better audit quality leads to better tax compliance and lower tax avoidance. Also, Emerging-market firms could combine high quality audits with CSR reporting (related to stakeholder accountability and third-party verification) to demonstrate transparency, which could improve their tax compliance images.

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