



## Are environmental responsibility companies socially responsible? Evidence from tax planning activities




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### ABSTRACT

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Malaysia's Income Tax Act of 1967 does not impose penalties on environmentally friendly companies engaged in tax planning. The primary objective of this study is to examine the relationship between a company's environmental activities and the tax planning of publicly listed companies in Malaysia. A sample of 158 publicly listed companies from various industries except for financial institutions in Bursa Malaysia will be used. The annual report included non-financial data such as the environmental responsibility variable. The annual report was also used to collect the remaining data including tax planning, profitability, size and debt ratio. The multiple regression analysis indicates that companies actively participating in environmental initiatives are more inclined to adopt socially responsible tax practices to uphold their credibility among stakeholders. These companies reinforce their reputation as responsible corporate citizens committed to sustainability by demonstrating consistency between their environmental and tax practices. This study additionally revealed a positive relationship between larger companies and tax planning due to their greater access to resources and experience which enabled them to employ more advanced tax planning tactics. The utilization of permanent and temporary book tax differences (BTDs) as factors for tax planning presents a more sophisticated approach to evaluating corporate tax strategies as suggested by future research.

**Contribution/ Originality:** This study uses proxy tax planning variables namely BTDs and TS variables to examine the precise contexts and approaches of tax planning tactics and their corresponding financial advantages. Additionally, it emphasizes environmental initiatives demonstrating how tax planning contributes to the long-term viability of companies and the protection of the environment.

### 1. INTRODUCTION

Corporate environmental initiatives have become increasingly important in Malaysia, a fast-rising nation with a flourishing business environment as corporations acknowledge the crucial significance of sustainability. In response to increasing worldwide apprehension regarding environmental matters such as climate change, biodiversity decline, pollution and resource exhaustion [1] numerous Malaysian companies are adopting environmentally friendly practices and incorporating sustainability into their fundamental strategies [2]. These activities encompass

a range of actions, including minimizing carbon footprints and enhancing energy efficiency as well as establishing environmentally friendly supply chains and advocating for responsible consumption. These companies are more recognised because of their dedication to sustainable practices as they manage the complex intersection of economic growth and environmental responsibility. It plays a substantial role in Malaysia's overarching endeavors to promote an environmentally friendly and sustainable future for both its populace and the Earth.

Tax planning plays a significant role in facilitating the advancement of environmental initiatives, thereby yielding advantages for shareholders. According to the perspective of shareholders, tax credits offer a variety of benefits that can have a positive influence on a company's financial performance and long-term sustainability. The study conducted by [Ma and Park \[3\]](#) sheds light on the potential advantages associated with the implementation of environmental tax planning strategies in company environmental endeavours. Tax planning credits have the potential to provide companies with incentives to engage in environmentally sustainable activities and technology, thereby resulting in a decrease in carbon emissions, the preservation of resources, and an overall enhancement of environmental performance. Tax planning enables companies to direct resources towards innovation, research and development strengthening their competitive edge in the long term by alleviating the financial burden of implementing sustainable projects. Moreover, the implementation of tax planning strategies possesses the capability to enhance an organization's reputation and brand image which is vital in attracting investors and customers who appreciate ecological sustainability.

[Ismail \[4\]](#) and [Majeed, et al. \[5\]](#) argue that tax planning incentivizes firms to embrace eco-friendly strategies and bolsters their reputation as socially responsible organisations (Ismail). Environmental tax planning incentivizes enterprises to mitigate their carbon emissions by offering financial incentives to companies that adopt sustainable practices. It promotes a positive perception of their commitment to environmentally responsible management. There is a greater emphasis on corporate sustainability activities across society as a result of the public's increasing awareness of and concern about environmental issues. Providing tax planning services to businesses that place a high priority on sustainability helps gain confidence and trust in their environmental efforts since it shows that these businesses are really focused on long-term environmental sustainability rather than merely making false environmental claims. People are inclined to support and engage with companies that value sustainability when they have a positive perception of corporate environmental responsibility which may enhance brand reputation and increase consumer loyalty.

Nevertheless, the implementation of tax planning strategies may potentially clash with the tenets of social responsibility which promote the notion that companies should take into account the wider socioeconomic and environmental consequences of their activities. The conflict stems from a tax planning approach that prioritizes cost reduction and profit maximization often disregarding environmental sustainability and social welfare. Excessive tax planning can have detrimental effects on society as it diminishes government money allocated toward public services including healthcare, education and infrastructure. The conflict is intensified by the legal duty of enterprises to optimize shareholder value which may occasionally clash with the concerns of other stakeholders including local communities and environmental organisations. Consequently, a conflict arises between the immediate economic benefits attained through tax planning and the potential long-term societal and ecological ramifications that may ensue from these strategies. Therefore, it is imperative for businesses to effectively manage their tax planning tactics while also considering their social responsibility requirements to avoid sacrificing their overall welfare in their pursuit of financial profits.

This research paper introduces two noteworthy additions. In this study, proxy tax planning variables, namely Book Tax Differences (BTDs) and Tax Savings (TS) are used as opposed to the typically employed Effective Tax Rate (ETR) as observed in prior research. The inclusion of BTD and tax savings variables enables a more thorough examination of the particular locations and approaches to implementing tax planning tactics as well as the

corresponding financial benefits or savings. Although ETR offers a broad assessment of tax performance, it does not reveal specific tax planning strategies or their corresponding results.

Furthermore, this study deviates from previous studies by focusing more on environmental responsibility than taking a more all-encompassing approach to corporate social responsibility (CSR). Environmental activities may not always be precisely understood by CSR due to their varied range of responsibilities despite being a core component of corporate social responsibility (CSR). The choice to prioritize environmental stewardship above corporate social responsibility (CSR) presents notable benefits. This study aims to enhance comprehension of the direct impact of tax planning on the conservation and sustainability of the natural environment by corporations by prioritizing environmental responsibility. Furthermore, businesses may gain long-term financial rewards and qualify for tax credits by promoting environmental measures such as adopting sustainable and energy-efficient systems.

### *1.1. Problem Statement*

The self-assessment tax system has been implemented by the Malaysian government wherein corporations are required to submit tax calculations to the Inland Revenue Board Malaysia (IRBM). This system enables enterprises to engage in tax planning while ensuring compliance with tax regulations. According to Razali, et al. [6] Malaysia's Income Tax Act of 1967 does not penalize businesses that use environmentally friendly techniques. Companies that are awarded green building certificates have the opportunity to derive advantages from the deduction of industrial building allowances from their adjusted income. In addition, companies that engage in activities aimed at preserving the environment such as the utilization of biomass for the production of value-added goods or the generation of renewable energy are eligible to seek pioneer status or investment tax allowances as outlined in the Promotional of Investment (Amendment) Act of 2007. These allowances have the potential to provide them with a complete exemption from statutory income potentially reaching up to 100%.

The Malaysian government implemented Green Technology Tax Incentives to encourage the procurement and use of environmentally friendly technology, such as solar energy and power during the period of the 2013 assessment to December 31, 2020 [7]. The government also announced the extension of the Green Technology Tax Incentives until 2023 and introduced income tax exemption of up to seventy percent for up to ten years for companies undertaking solar leasing activities. Furthermore, producers of electric vehicles (EVs) will be considered for a variety of tax exemptions including sales, excise and import taxes from January 1, 2022 [8]. Consumers can claim tax relief for owning an EV as part of the government's efforts to lower the cost of adopting zero-emission vehicles [8].

## **2. LITERATURE REVIEW**

### *2.1. Stakeholder Theory*

The theory of stakeholders offers a conceptual framework that elucidates the dynamics between a company and its diverse stakeholders encompassing entities such as the environment and tax enforcement bodies. Companies are expected by various stakeholders including local communities, consumers, employees and regulators to embrace sustainable practices and mitigate their adverse environmental effects from environmental activities. The concept of stakeholders suggests that companies should consider the concerns and interests of different stakeholders when making decisions about their environmental initiatives.

According to Beekun and Badawi [9] companies are legally bound to make tax payments while simultaneously being accountable to their stakeholders for optimizing their financial gains. Tax planning entails making deliberate choices to reduce tax obligations while adhering to legal regulations. According to Firmansyah and Estutik [10] and Onuma and Shimada [11] stakeholder theory posits that corporations ought to take into account the concerns and welfare of their various stakeholders such as shareholders, employees and customers when undertaking tax planning endeavors. Nevertheless, there is ongoing debate regarding the ethical implications of tax planning.

There is a contention that engaging in excessive tax planning which entails taking advantage of loopholes and participating in intricate schemes to decrease tax obligations is morally wrong [6]. This is due to the perception that it involves evading social accountability and transferring the task of financing public services to private parties. Conversely, an alternative perspective posits that companies bear a fiduciary obligation towards their shareholders to optimize financial gains within the confines of the established legal structure. According to Stainer, et al. [12] there is a contention that tax planning can be considered ethically acceptable as long as it adheres to legal parameters.

## 2.2. Environmental Responsibility and Tax Planning

Additional study on tax planning and environmental responsibility is necessary. A study by Firmansyah and Estutik [10] found that aggressive tax planning is less prevalent in companies with strong environmental responsibility performance which may drastically impact corporate tax aggression. Companies may prioritize their reputation and stakeholder support over cost-saving measures viewed as non-ethical or incompatible with corporate social responsibility activities. Therefore, businesses that perform highly on environmental responsibility may be more inclined to perform properly when it comes to taxes in order to keep stakeholders from abandoning confidence in them.

Onuma and Shimada [11] found that firms that aggressively engage in environmental protection responsibilities can enjoy a lower Effective Tax Rate (ETR) under the benefit of green investment tax incentives. The higher the ETR will indicate, the lower the tax planning because of the high tax expenditure burden charged to the company. The government of Japan introduced a tax incentive system for promoting investment in environmental protection responsibilities (i.e., its green investment tax incentive) to encourage corporate environmental responsibility. This green investment tax incentive permits management to claim a special depreciation or tax deduction when acquiring an asset that promotes a reduction in energy environmental loading from June 30, 2011, to March 31, 2018. Applying this tax incentive can reduce corporate income tax payments by spending more on environmental protection responsibilities.

The impact of environmental uncertainty on tax planning is examined by Purnomo and Eriandani [13]. Environmental uncertainty encompasses the endeavors undertaken by an organisation to comprehend, forecast and address uncertainties present in its external environment. This encompasses several sources of uncertainty including suppliers, consumers, competitors and policymakers. Environmental uncertainty can be defined as the level of unpredictability or ambiguity present in the external environment within which a corporation conducts its operations. Manufacturing companies listed on the Indonesia Stock Exchange were used from 2016 to 2020. The findings of the research demonstrate a positive correlation between environmental unpredictability and tax planning. Tax planning is influenced by environmental uncertainty due to the fact that taxes are a crucial component of cost planning. In an environment characterized by uncertainty, firms exhibit a heightened level of caution when formulating plans, particularly in the realm of tax planning owing to the substantial financial burden imposed by tax obligations on these entities. Managers face challenges in mitigating the risks associated with environmental unpredictability which might result in heightened tax planning.

## 3. METHODOLOGY

### 3.1. Sample Description and Data Collection

The final sample of this study consists of 158 listed Malaysian companies in 2021. However, the financial services companies in Malaysia will be excluded because they might have different natures of taxation and regulation. This study uses the period of data because the latest data can be collected when this research is done in 2022. A minimum sample size of 30 is sufficient for statistical analysis [14]. All the data were collected from the company's annual report which includes all industries.

### 3.2. Regression Model

Regression analysis is a powerful tool used to explore the relationship between variables. It helps us understand how one variable changes in response to the fluctuations in another. The model used to test the hypotheses is as follows:

Functional form

Tax planning = f (environmental activities, profitability, debt ratio and size).

Hence, our function can be estimated under the following model:

$$TP_{it} = \alpha + \beta_1 EA_{it} + \beta_2 ROA_{it} + \beta_3 Debts_{it} + \beta_4 SIZE_{it} + \epsilon_{it}$$

Variables definition

Dependent variable

TP = Tax planning

Independent variable

EA<sub>it</sub> = Environmental activities (EA)

Control variable

ROA<sub>it</sub> = Return on assets

DEBTS<sub>it</sub> = Debts ratio

SIZE<sub>it</sub> = Company size

I = Company

T = Time

E = Error

### 3.3. Measurement Variable

#### 3.3.1. Dependent Variable

Tax planning is the dependent variable in this study. It can be in the form of book-tax differences (BTDs) or tax savings. The formula is as follows:

- i. Book tax differences (BTDs)

Book-tax differences refer to variations between a company's financial accounting records (often called "book" records) and its taxable income as reported to tax authorities. These differences arise due to variations in accounting principles and tax regulations. The variable will be measured as follows:

$$BTDs = \log_{10}(\text{accounting book income} - \text{taxable income})$$

- ii. Tax savings (TS)

TS, sometimes referred to as tax planning or optimization is the process by which people and companies legally lower their tax liability and save money on taxes. Tax-saving strategies can help companies minimize the income subject to taxation, take advantage of tax deductions and credits and structure their financial affairs tax-efficiently. The variable will be measured as follows:

$$TS = \text{Statutory tax rate} - \text{Effective tax rate (ETR)}$$

### 3.4. Independent Variable

#### 3.4.1. Environmental Activities (EA)

The EA data were collected by counting the percentage of unweighted environmental disclosure by companies stated in Table 1. The formula is as follows:

$$ED_j = \frac{\sum X_{ij}}{n_j} \times 100\%$$

Where

ED<sub>j</sub> = Environmental disclosure of j company.

ΣX<sub>ij</sub> = Total disclosure item of j company.

n<sub>j</sub> = Total required disclosure item of j company.

Table 1. Environmental items.

No.	Environmental item
1	Statement, existence and disclosure of environmental concern.
2	Steps were taken to monitor compliance with a policy statement.
3	Environmental targets and standards.
4	Performance against environmental targets.
5	Structural and responsibility changes are undertaken in the organization to develop environmental sensitivity.
6	Environmental awareness training.
7	Recognition of government regulations.
8	Presence of the environmental department and personnel.
9	Acknowledgement of the impact of activities.
10	Presence of environmental management system (EMS).
11	Environmental program, restoration and rehabilitation.
12	Involvement with community projects.
13	Environmental audit compliance.
14	Environmental audit EMS.
15	Environmental programs (Response to environmental audits).
16	Environmental accounting policy.
17	Amount spent on environmental protection.
18	Anticipated pattern of future environmental spending.
19	Assessment of actual and contingent liabilities.
20	Physical unit analysis of materials, energy and waste.

Source: Nor, et al. [15].

### 3.5. Measurement of the Control Variable

This study uses several control variables: profitability, size and debt ratio.

#### 3.5.1. Profitability

Profitability is a key financial metric that assesses a company's ability to generate earnings or profits relative to its expenses and investments. It is a fundamental measure of a company's financial health and efficiency in using its resources. The variable will be measured as follows:

$$\text{Return on assets (ROA)} = \frac{\text{Net income}}{\text{Total assets}}$$

#### 3.5.2. Size

Company size refers to a business entity's scale, magnitude or extent and it can be measured in various ways. It is a fundamental characteristic of a company that helps provide insights into its operations, financial structure and overall presence in the market. The variable will be measured as follows:

$$\text{Size} = \log_{10}(\text{Total assets})$$

#### 3.5.3. Debt Ratio

The debt-to-assets ratio is a financial metric used to assess a company's financial leverage and risk by measuring the proportion of its total debt to its assets. This ratio helps evaluate how much of a company's assets are financed through debt. The variable will be measured as follows:

$$\text{Debts ratio} = \frac{\text{Total liabilities}}{\text{Total assets}}$$

Table 2. Descriptive statistics

Variable	N	Minimum	Maximum	Mean	Std. deviation
ED	158	0.04	0.68	0.376	0.142
BTDs	158	0.06	3774661.21	162125.622	496417.585
TS	158	0.00	0.55	0.167	0.106
ROA	158	-0.78	0.36	-0.004	0.133
DEBTS	158	0.00	1.0	0.205	0.170
Total assets	158	11804250.00	33432906000.00	2241480801.698	5401844601.027

## 4. RESULTS AND DISCUSSION

### 4.1. Descriptive Statistics

The dataset in Table 2 consists of 158 observations and various descriptive statistics were calculated for six different variables. The independent variable which is ED represents environmental disclosure. The data ranged from a minimum value of 0.04 to a maximum of 0.68 with a mean of approximately 0.376 and a standard deviation of about 0.142. The dependent variables in this study are Book tax differences (BTDs) and tax saving (TS). Book tax differences (BTDs) before log10 displayed a wide range from a minimum of RM0.06 to an exceptionally high maximum of RM3,774,661.21. The mean value for BTDs before log10 was approximately RM162,125.622, accompanied by a substantial standard deviation of roughly 496,417.585. TS data varied from a minimum of 0% to a maximum of 55% with a mean of approximately 16.78% and a standard deviation of about 0.106.

The variable return on assets (ROA) ranged from a minimum of -0.78 to a maximum of 0.36 with a mean of approximately -0.004 and a standard deviation of about 0.133. The debt ratio (DEBTS) varied from a minimum of 0.00 to a maximum of 1.00 with a mean of approximately 0.205 and a standard deviation of roughly 0.170. Total assets showed a considerable range with a minimum value of RM11,804,250.00 and a maximum of RM33,432,906,000.00. The mean for total assets was approximately RM2,241,480,801.698 and the standard deviation was notably high at approximately RM5,401,844,601.027.

Table 3. Pearson correlation.

Pearson correlation							
Variable		BTDs	TS	ED	ROA	DEBTS	SIZE
BTDs	Pearson correlation	1					
	Sig.						
	N	159					
TS	Pearson correlation	0.098	1				
	Sig.	0.219					
	N	159	159				
EA	Pearson correlation	-0.117	-0.185*	1			
	Sig.	0.143	0.020				
	N	159	159	159			
ROA	Pearson correlation	0.040	-0.075	0.120	1		
	Sig.	0.614	0.350	0.130			
	N	159	159	159	159		
DEBTS	Pearson correlation	0.017	-0.030	-0.127	-0.289**	1	
	Sig.	0.832	0.708	0.111	<0.001		
	N	159	159	159	159	159	
SIZE	Pearson correlation	0.315**	0.084	0.031	0.237**	0.294**	1
	Sig.	<0.001	0.293	0.702	0.003	<0.001	
	N	159	159	159	159	159	159

Note: \*\*. The correlation is significant at the 0.01 level (2-tailed).

\*. The correlation is significant at the 0.05 level (2-tailed).

Table 3 shows a significant negative relationship between the EA and TS variables with a Pearson correlation coefficient of approximately -0.185. Second, a significant positive relationship is observed between the ROA and DEBTS variables with a Pearson correlation coefficient of approximately 0.289. This indicates that as the return on assets (ROA) increases, the debt ratio (DEBTS) tends to decrease. Finally, there is a significant positive relationship between the size variable (company size) and several other variables, including BTDs, EA, ROA and DEBTS with correlation coefficients ranging from approximately 0.237 to 0.315. This suggests that larger companies (SIZE) exhibit stronger positive correlations with these variables.

Table 4. Summary of multiple regression analysis.

Multiple regression analysis		
Variable	BTDs model	TS model
Constant	-2.828	0.022
	-1.643	0.190
EA	-1.574*	-0.142**
	-1.789	-2.424
ROA	-0.856	-0.103
	-0.827	-1.491
DEBTS	-1.259	-0.087
	-1.518	-1.565
SIZE	0.890***	0.025*
	4.440	1.851
R <sup>2</sup>	0.129	0.063
Adjusted R <sup>2</sup>	0.106	0.038
Anova statistic p-value	0.000***	0.040

Note: \*\*\*. The correlation is significant at the 0.01 level (1-tailed), \*\*. Correlation is significant at the 0.05 level (1-tailed), and \*. The correlation is significant at the 0.10 level (1-tailed).

Table 4 shows that the TS model's R-squared value is 0.063 and the BTDs model's R-squared value is 0.129 indicating the percentage of the dependent variable's variance related to the independent variables. The adjusted R-squared values which adjust for the number of predictors in the model are 0.106 and 0.038, respectively. These values suggest that the BTDs model explains more of the variance than the TS model. The Anova statistic p-value indicates the significance of the overall regression model. The BTDs model's p-value is very low (0.000\*\*\*) indicating that the model is statistically significant. The TS model's p-value is 0.040 which is still significant but less so than the BTDs model.

The relationship between the independent and dependent variables indicates that there is a negative correlation between EA, BTDs and TS. This result consistent with [Firmansyah and Estutik \[10\]](#) and [Onuma and Shimada \[11\]](#) who found a negative correlation between environmental activities and tax planning. Therefore, companies with high environmental activities may be more likely to engage in socially responsible tax behavior to maintain their legitimacy in the eyes of stakeholders.

The only variable that strongly correlates with both TS and BTDs is size. This result is consistent with [Razali, et al. \[6\]](#). [Akintoye, et al. \[16\]](#) state that the advantages of size in tax planning methods are diverse. Initially, it is important to keep in mind that larger businesses usually have easier access to resources and knowledge which allows them to use more sophisticated tax preparation strategies. The strategies encompassed in this category may involve the utilization of tax credits and deductions, the restructuring of business activities or the engagement in tax-efficient investments. In addition, larger companies may benefit from economies of scale which allow them to distribute fixed expenses across a larger income stream and potentially decrease their total tax liability. In both models, the other control variables, ROA and DEBTS are not significant.

## 5. CONCLUSION

This study demonstrates that companies that prioritize environmental responsibility tend to exhibit a reduced propensity for engaging in tax planning strategies. The observed phenomenon can be attributed to the underlying principles of environmental stewardship that these companies uphold, frequently encompassing a dedication to ethical norms and open financial procedures. These companies acknowledge the significance of making contributions towards environmental welfare, perceiving tax payments as both a legal requirement and an integral component of their social accountability. Their adherence to ethical principles is evident in their financial decision-making which reduces their inclination towards pursuing aggressive tax planning tactics. The findings of the study



indicate a negative relationship between engagement in rigorous environmental activities and the adoption of tax planning strategies. This shows that companies that prioritize environmental responsibility are more inclined to adhere to equitable and responsible tax policies.

In addition, environmental companies consistently strive to align their behavior with societal norms and values. Companies operating in the environmental sector which frequently prioritize social ideals such as sustainability and environmental stewardship may perceive assertive tax planning as a potential threat to their public perception. Participating in these activities may be in conflict with their ethical and environmental obligations which might potentially erode their credibility among their stakeholders.

Subsequent studies suggesting the utilization of permanent and temporary book-tax disparities as factors for tax planning provide a more sophisticated perspective for evaluating company tax strategies. Permanent disparities arising from variations in financial and tax reporting that have an indefinite impact on taxation are indicative of deliberate decisions and may suggest a more assertive approach to tax planning. The presence of temporary disparities arising from variations in the time of recognizing certain items in tax and financial accounts serves to underscore the utilization of short-term tax deferral strategies and adherence to tax regulations. The aforementioned dual analysis assists explain the intricacies of a business's tax planning and strategic approach, offering important insights into its long-term financial policies and risk management strategies.

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