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Responsible Tax as Corporate Social Responsibility: The Case of Multinational Enterprises and Effective Tax in India

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Abstract

Anecdotal evidence often suggests that multinational enterprises (MNEs) operating in developing countries "exploit their multinationality" to avoid paying taxes to host governments. This article explores the concept of "responsible tax" as a corporate social responsibility (CSR) issue for MNEs, based on the notion that MNEs face considerable variation in the extent, monitoring, and application of tax laws internationally. This variation creates a "moral free space" as to which tax payments to make. Using firm-level data from three important sectors in India, the authors explore whether foreign MNE subsidiaries pay higher taxes than local firms, and whether, in the case of MNEs, there are differences between subsidiaries of MNEs with and without a reputation for CSR. The results show that MNEs pay considerably higher effective tax rates than do local firms, and MNE subsidiaries known for CSR pay more tax than do MNE subsidiaries less known for CSR. This set of findings suggests that MNEs operating in India see taxation in developing countries in relation to CSR.

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Keywords

corporate social responsibility, taxation, developing countries, multinational enterprises, local companies, India

One of the prominent issues facing multinational enterprises (MNEs) in developing countries is their impact on the local (i.e., host) economy. In this article, "developing" is a broad category in distinction to "developed" (or advanced), and thus includes newly industrialized countries or emerging economies. As MNEs establish value-adding activities in developing countries through foreign direct investment (FDI), they create the potential for contributions to economic development through, for example, the transfer of technology, skills and knowledge, and increasing employment (Fortanier & Kolk, 2007a; UNCTAD, 2000). This potential developmental contribution has been framed by some in terms of the MNE's corporate social responsibility (CSR) toward the host country (Fortanier & Kolk, 2007a; Meyer, 2004). By stressing awareness of the specific social setting and the obligation of responsiveness to local concerns (Bird & Smucker, 2007), this CSR framing takes a moral, ethical approach to MNEs and development.

Tax payments have begun to figure more prominently in the discussion on MNEs' responsibilities towards development (Christensen & Murphy, 2004; Oxfam, 2000). Concern for "responsible business and tax" has emerged in the past few years in part as a consequence of scandals surrounding Enron and KPMG's tax advisory services in the US, but also due to generally increasing pressure on companies to be transparent in their tax management, in particular with respect to taxes paid in developing countries (Christensen et al., 2007; Christensen & Murphy, 2004; SustainAbility, 2006). Bird and Smucker (2007, p. 5), while paying more attention to other dimensions of MNEs' CSR in developing countries such as building up local social services, welfare and infrastructure, also mention that CSR in developing countries involves "contributing fairly to taxes."

If CSR refers to actions for the public good "beyond the interests of the firm and that which is required by law" (McWilliams & Siegel, 2001, p. 117; see also Rodriguez et al., 2006; Portney, 2008), MNE taxation in the developing country context can be seen as a CSR issue due to the considerable discretion MNEs enjoy with respect to taxation, particularly in weaker enforcement settings, in combination with the importance of tax for developing country governments' ability to provide public goods. Firstly, fiscal competition among developing countries to attract FDI constrains their governments' ability to make taxation claims on MNEs (Morisset, 2003; Zee et al., 2002).

Moreover, developing countries face challenges in enforcement of tax legislation and monitoring, which creates opportunities for tax avoidance (or even tax evasion) by MNEs (Cravens, 1997; Eden & Yu, 2001). Lastly, different norms and different regulations across countries create uncertainty as to which laws to comply with under which circumstances. What remains is a "moral free space" (Donaldson, 1996) in which, economically and legally, no wrong may be done; but in terms of responsiveness to local needs, MNEs minimizing their local tax burden may be tantamount to "shirking" their moral obligations to the host country.

Despite the Tax Justice Network's (2011) assertion that "tax is the forgotten element in the corporate social responsibility debate—and probably the most important," extant research framing tax contributions as a moral issue is relatively limited. Studies have taken a moral perspective to responsible tax at the individual level, by looking for example at tax accounting practitioners (Cruz et al., 2000; Doyle et al., 2009; Hume et al., 1999), managers (Godar et al., 2005), or taxpayers (Chung & Trivedi, 2003; McGee et al., 2008; Trivedi et al., 2003). Some studies have considered the morality of tax avoidance with specific attention to MNEs (Hansen et al., 1992), but this research has typically approached the issue more in terms of individual ethics than as a social responsibility of the corporation.

This lack of attention may also be due to the fact that empirical evidence on the issue of MNE taxation in developing countries is limited. Several studies and activist campaigns point to incidences of MNEs shirking their tax responsibilities to developing countries, but most evidence is anecdotal (Christensen & Murphy, 2004; Oxfam, 2000; Roberts, 2004) or based on a small number of high-profile cases (Oman, 2000; Riesgo et al., 2005). Recent work using a large sample from many countries over a 20-year period (Markle & Shackleford, 2010) suggests that multinationality may in some cases be associated with lower effective tax rates (ETRs), but developing countries encompassed only a small part of the sample and no consistent patterns were identified. As a result, it remains unclear whether MNEs typically pay higher or lower ETRs than local firms, and whether there are systematic patterns in taxation that can be linked to firms' level of CSR.

This article aims to shed light on the debate on responsible tax through a firm-level approach, concentrating on MNEs and their tax contributions in developing countries. Using data from three prominent and FDI-intensive sectors in India, the authors investigate two questions. First, do MNE subsidiaries in India pay significantly higher ETRs than local firms? If so, they may *not* be "exploiting their multinationality" to shirk on tax. Secondly, do MNEs known for CSR pay higher ETRs in India than MNEs less known for CSR?

If so, MNEs may see taxation as an extension of their overall approach to CSR. The study uses India as an empirical setting because India is an important developing country with a high dependence on income-based tax revenue and considerable FDI participation in certain sectors. India also has a tax structure that does not systematically favor either foreign firms or locally-owned firms (Kelkar, 2002; Van Tulder et al., 2004).

The rest of this article comprises four sections. In the next section, the authors discuss MNE taxation as a CSR issue in more depth and develop hypotheses. In the subsequent section, they move to an explanation of the empirical setting and presentation of the data. The next section thereafter presents results of the analysis. The article concludes with a discussion of findings and implications for theory and practice.

Toward a CSR Perspective on MNEs and Taxation in Developing Countries

Research on MNEs and developing countries has paid much attention to the economic implications of FDI in terms of crowding in versus crowding out (Agosin & Mayer, 2000; Alfaro et al., 2003), concentration ratios (Blomström, 1986), productivity growth (Sjöholm, 1997), or price-fixing and market sharing (Levenstein & Suslow, 2001). In contrast, a social responsibility perspective on MNEs and development focuses on the moral obligation to make a positive contribution to the host economy, or at the least to offset potential negative externalities stemming from MNEs' operations. Research in this vein aims more broadly at establishing a link between MNEs' economic impact and their corporate social responsibility (CSR) (Fortanier & Kolk, 2007a), or even their social irresponsibility (Strike et al., 2006) should MNEs actively avoid making a substantive contribution to development.

The Economic Perspective on Taxation in Developing Host-Country Contexts

With respect to taxation, economically-defined research on FDI in developing countries has typically framed the issue as a purely economic one. Such research has argued that firms, much like individuals, can and should use all legally available means to minimize their tax burdens. In light of potential fiscal incentives, income shifting, bargaining, and general institutional weakness (Eden, 2001; Ramamurti, 2001; Rugman & Eden, 1985), one might assume *ex ante* that MNEs pay less tax in developing countries than they would under different circumstances—if the assumption is that MNEs respond to economic considerations alone. Extant research has attended to this economic framing of taxation by investigating the use of fiscal incentives as an attractor of FDI (Graham, 2001; Oman, 2000; Wells & Allen, 2001) and on international tax regimes and incentives, accounting rules, and the specifics of acceptable and unacceptable pricing methods and practices, including transfer price manipulation (Cravens, 1997; Eden & Yu, 2001; Horst, 1971). However, research relies mostly on developed countries' trade statistics, yielding little insight into firms' actual tax contributions in developing countries. Thus it remains an empirical question whether MNEs exploit opportunities to avoid taxation in developing countries, or whether MNEs are sensitive to a potential moral obligation to behave "responsibly" with respect to taxation.

The fact that an issue such as taxation is subject to law does not, in and of itself, preclude it from being a CSR issue. In this sense there is a certain parallel with corruption, which is also regulated (e.g., through the U.S. Foreign Corrupt Practices Act), but still commonly discussed as a CSR issue (Wiig & Kolstad, 2010; Windsor, 2007) and included in the voluntary UN Global Compact principles. Tax is similarly an issue that shows differences across countries, not only in terms of societal expectations and norms, but also regarding the degree of legalization, compliance, and "avoidance" opportunities. Thus, the "above and beyond the law" criterion for what is assumed to constitute CSR may not adequately reflect the realities of international business for three main reasons: cross country variation in legal frameworks, variation in implementation and enforcement, and variation in application.

As to the first reason, many MNEs operate in a large number of different contexts with widely varying legal rules and norms, and often divergent views of the role of business in society (Devinney, 2009; Kolk & Van Tulder, 2010; Windsor, 2006). These differences suggest that there may be no universal definition of compliance, and in such a void managers have some discretion in how they comply. As to the second reason, within the variation in legal frameworks there is also variation in the degree of implementation and enforcement, with developing economies having larger problems than developed countries due to weaker institutional structures and administrative capabilities. Thus the formal existence of law does not ensure enforcement or compliance. And finally, with respect to the third reason, the application of laws within any country context (and particularly in countries with weaker institutions) may be arbitrary, such that firms may face sanctions even though they are compliant, or conversely be shielded from sanctions despite clear violation of the law.

Despite its high degree of "legalization," tax is therefore a matter that exhibits differences across countries, not only in terms of societal expectations and norms, but also regarding degrees of compliance and opportunities to avoid payment. Faced with these different norms, expectations, levels of legalization, and avoidance opportunities, MNEs can be said to face a "moral free space" when it comes to MNE taxation, or a "grey zone" in which managers must "chart their own course" (Donaldson, 1996, p. 56). While taxation thus far has not been addressed in this fashion, similar dilemmas have been identified in terms of for example to what degree MNEs can standardize policies and operations across countries, given the pressures that exist to accommodate local tendencies (Buller & McEvoy, 1999; Kolk & Van Tulder, 2004). Moral free space thus forms a void in which managers face a certain amount of discretion to base their actions on alternate signals.

MNE Subsidiaries and Responsible Tax in Developing Host-Country Contexts

With respect to CSR in particular, recent research has shown that when MNEs are exposed to multiple and potentially conflicting signals, the resulting uncertainty drives managers to defer to a broader set of principles for guidance, rooted for instance in their intrinsic motivation structures and values (Muller & Kolk, 2010), or rooted in the home country context from which the MNE originates (Levy & Kolk, 2002). The home country has been shown to be a key driver of approaches to and understandings of CSR (Chapple & Moon, 2005; Katz et al., 2001), and in general MNEs are exposed to greater institutionalized pressures to be socially responsible than local firms in developing markets (Kolk, 2010). Firms internalize these perceptions and expectations into their organizational routines and behaviors and extend them into their overseas operations (Kostova & Roth, 2002).

Although there are "no tight prescriptions" (Donaldson, 1996, p. 56) and firm-level disclosure of tax payments is still relatively rare (Fortanier & Kolk, 2007a; Sakakibara & Yamawaki, 2008; SustainAbility, 2006), there is increasing evidence that MNEs see taxation as a CSR issue. There has been growing pressure from MNEs' home countries on MNEs to behave "responsibly" when it comes to tax. MNEs are increasingly called on to be more transparent on tax management, on their unresolved dilemmas in the tax field, and on the specific amounts and rates paid in their countries of operation (Christensen et al., 2007; SustainAbility, 2006). Supported by hundreds of NGOs, the "Publish What You Pay" (PWYP) campaign (see http://www.publishwhatyoupay.org/) emphasizes that it is also in the interest of shareholders and investors to be informed fully of MNE tax remittances to governments in view of credit and reputational risks.

As awareness of the importance of transparency has grown, MNEs have started to give information on the distribution of their "value added" (which includes shares that went to governments in the form of tax) over the past decade (Fortanier & Kolk, 2007a; Kolk, 2004). Similarly, accounting firms have been subjected to increased public and judicial scrutiny in relation to tax advisory services, particularly concerning tax havens. This level of scrutiny does not typically apply to developing country firms, due to the lower levels of societal pressure in their respective home countries to act responsibly. In contrast, the higher pressure developed-country MNEs face to behave responsibly on a global scale forces them to develop policies in this regard that they can extend into their overseas operations. This scrutiny leads to the following hypothesis:

> Hypothesis 1: Subsidiaries of foreign MNEs pay higher effective tax rates than do locally-owned firms.

Additionally, some MNEs have started to include this information in their voluntary CSR reports, which suggests an increasing tendency to see tax payment accountability as part of their CSR. If MNEs see taxation as a CSR issue, they can also be assumed to defer to their higher-CSR foundations as a normative guide for their approach to "responsible tax" in developing countries. Additionally, if responsible tax truly is a CSR issue, then firms known for CSR—and thus familiar with these expectations and pressures—should also be more responsive to pressures of moral obligation with respect to taxation and development. Given stakeholder pressure on MNEs for transparency in relation to tax payments and attention for the potential to reduce tax burdens in developing countries in particular (Christensen et al., 2007; Christensen & Murphy, 2004; SustainAbility, 2006), firms known for their strong CSR are also more cognizant of the debate on the contributions of FDI to host economies, particularly in developing countries. Such international dimensions, including issues related to development and other social impacts, are explicitly recognized by large and highly-visible MNEs, for example in their CSR reporting (Fortanier & Kolk, 2007b).

Social responsibility—and the risk of irresponsibility—is an important aspect of firm reputation (Fombrun, 2001). A reputation as a socially responsible firm is an asset that has been shown to have significant value for firms as a form of insurance against future crises (Godfrey et al., 2009; Muller & Kräussl, 2011a; Peloza, 2006). Reputation, as an asset that is hard to acquire but easily lost, requires continuous monitoring and investment in order to maintain its value (Roberts & Dowling, 2002). If MNEs see tax as a CSR issue, then MNEs face CSR-reputation risk from their tax management strategy and, in light of media and NGO attention, in particular regarding tax remittances in developing countries. From this line of reasoning, it is plausible to expect MNEs with a strong reputation for CSR to pay higher taxes (Riesgo et al., 2005) than other firms, in order to reduce this reputational risk. This leads to the following hypothesis:

Hypothesis 2: Subsidiaries of MNEs with reputations for CSR pay higher effective tax rates than do subsidiaries of MNEs without reputations for CSR.

Data and Method

To investigate tax as an international CSR issue, the authors explore the relationship among foreign ownership, MNE reputation for CSR, and effective tax rates (ETRs) in India. The first subsection below proceeds with an elaboration of India as a research setting for exploring empirically the aforementioned hypotheses. In the second subsection, the data set used to conduct the analysis and the supporting methodologies are discussed. Subsequent subsections describe separately the variables used to operationalize the dependent, independent, and control variables used in the analysis.

Research Setting

As a large developing country with a high dependence on income-based tax revenue, India faces considerable development challenges. India has a tax structure that in general treats foreign investors and locally-owned firms equally—that is, it has no systematic incentive structure aimed specifically at FDI. The tax system, however, has also been subject to considerable reform (particularly during the 1990s), necessitated by the transition from an import-substituting industrialization strategy to a more market-based system (Kelkar, 2002; Van Tulder et al., 2004).

The first major reforms were initiated in 1991 when the Rao government took office and established the Chelliah Committee to reform India's tax system. At the time the problems of evasion and intrusiveness of the tax system were increasing, and the basic principles of the Chelliah Committee's recommendations were to "broaden the base, lower marginal tax rates, reduce rate differentiation, and undertake measures to make the administration and enforcement of the tax system more effective" (Rao, 2000, p. 66). To attract foreign investment, the taxation of foreign companies was to be simplified and made transparent. In 1993, the corporate tax rate for domestic companies was reduced from 50% to 35% and for foreign companies from 65% to 40%. Domestic companies pay an additional surcharge, which has varied over time from 15% in 1995/96 to no surcharge in 1997/1999, and then to 10% in 2000. (This surcharge was fixed at 2.5% and extended to foreign companies as well in 2002/03). As a result, the overall contribution of tax revenue to the Indian economy has declined over the decade, while the average globally has increased slightly (International Monetary Fund [IMF], 2002, p. 30). In the meantime, the role of trade and FDI in India's GDP increased.

In the light of declining tax income, a major debate arose in India concerning the use of tax incentives. Supporters argued that the exemptions were necessary for continued growth of their industry, while many studies point to their ineffectiveness (Oman, 2000; Wells & Allen, 2001). This debate came on the heels of a report by a new government body, the Kelkar Committee, which called for a reduction in income tax rates, excise taxes and custom duties in exchange for the reduction of exemptions and rebates, considered by the committee to have become a "source of abuse" (Kelkar, 2002, p. 128). The Kelkar Committee report (2002, p. 128) showed that for a sample of 3,777 companies with a statutory tax rate of 38.5%, the ETR over book year 2000 (December 1999 through November 2000) was only 21.7%. Within the context of that observation, the question is whether systematic patterns in ETRs exist that can be attributed to foreign versus local ownership, and levels of social responsibility.

Sample and Method

Against this backdrop, the authors target three sectors in India that not only have well-developed, competitive, domestically-owned businesses but also high levels of FDI: (a) automotive, (b) financial and information technology (IT) services, and (c) chemicals and pharmaceuticals (McKinsey Global Institute, 2003). To obtain firm-level data in these sectors in India, the authors enlisted the services of FirstSource, a financial service firm in India. FirstSource collects firm-level financial data as part of its internal market research and in exchange for a commitment to non-disclosure, the authors were able to purchase financial records (profit and loss statements and balance sheet) for 82 different firms, in nearly all cases for two years (book years, 2000, 2001 and/or 2002), leading to a pooled sample of 154 observations. An example of these data is included in the Appendix. The authors note that these data were not collected first-hand, nor are they directly publicly available, but may be purchased by subsequent researchers or, possibly, obtained through the Indian tax authority. Therefore, the data are not subject to direct validation and are not available by researchers without purchase or government provision. The findings of this study are thus limited by this circumstance. However, there is also very little empirical research published on this research topic, which is one of considerable importance in CSR theory and practice.

The analysis begins with ordinary least squares (OLS) regression to identify the power of the independent variables in explaining variance in ETRs. However, one risk with statistical techniques that compare an effect across two groups is that the two groups may differ systematically, since for each firm, only one possible group membership can be observed: foreign or local ownership. Thus it is impossible to know what a given foreign firm's ETR would be if it were domestic, or vice versa. Since assignment into one group (foreign ownership) or the other (local ownership) is not random, there may be systematic (and unobserved) factors associated with group assignment that lead to biased coefficients and thus an inflated or deflated measurement of the effect of interest (Heckman, 1979).

Tax research has regularly used treatment and control methods to identify the effect of policy instruments on income shifting (Dhaliwal & Wang, 1992; Gramlich, 1991) and marginal tax rates (Shackleford & Shevlin, 2001). Matching is a technique commonly used in labor economics to estimate the "treatment effect" of a particular variable, such as the effect of participation in a job-training program on future wages (Lechner, 1999). Matching techniques compare observations in the two groups along the control variables in order to identify possible sources of bias in the identified treatment effect (Heckman et al., 1998). This article uses "nearest neighbor" matching (cf. Muller & Kräussl, 2011b for a recent example), which has a number of advantages over other matching algorithms in that it allows for the identification of multiple matching observations between "treated" and "untreated" groups (Abadie et al., 2004). In this case, foreign ownership is considered the "treatment," and the treatment effects the analysis attempts to capture are significant differences in ETRs.

Dependent Variable

The measurement of ETRs has long been a thorny matter in tax research (Plesko, 2003; Shevlin & Porter, 1992). In general ETR captures tax liability divided by income (Gupta & Newberry, 1997), but measurement of both the numerator and the denominator involve issues. The authors draw the basis for their ETR measure from the data provided, which contains total revenue as well as total expenses (including specification of wage costs, rent and royalty, and interest). Profit before taxes is reported as total revenue minus the aforementioned expenses, and profit after tax is also reported.

On the basis of the available data, the numerator of the ETR measure (i.e., taxes paid) consists of the difference between pre-tax profit and after-tax profit. The denominator uses the gross profit measure (revenue minus expenses; Harris et al., 1991). While these measures, as any, are subject to certain limitations, data on actual tax paid are of greatest interest because tax paid reflects the firm's actual contribution to India, as opposed to a "liability" measure that may or may not be realized. Additionally, using a gross profit measure, in contrast to alternatives such as taxable income, captures income before any exemptions or incentives are applied (Gupta & Newberry, 1997).

Independent Variables

This study uses two independent variables, one concerning foreign ownership and the second concerning CSR reputation. Each independent variable is described further below in sequence.

Foreign ownership. The first independent variable is foreign ownership. Hypothesis 1 concerns whether foreign ownership is related to higher taxation levels. To identify foreign ownership (irrespective of participation level) the authors consulted Dun and Bradstreet's Who Owns Whom database, annual reports, and company websites of the 82 companies in the sample. The authors allowed for minority foreign ownership to qualify as "foreign," with 18% foreign ownership as the minimum threshold in accordance with consolidation requirements. It should be noted however that MNEs in the dataset typically hold majority stakes. For example, even Hindustan Lever, the quintessentially "Indian" subsidiary of Unilever, is a majority-owned foreign subsidiary (52%).

Reputation for CSR. Hypothesis 2 explores whether the Indian subsidiaries of MNEs known for CSR pay higher ETRs than the Indian subsidiaries of MNEs less known for CSR. Therefore one must account for the CSR reputation of the corporate parents of foreign-owned firms in India. To capture this expectation of greater CSR performance, the authors use a dummy variable representing inclusion in the Dow Jones Sustainability Index (DJSI), whereby inclusion is coded 1 and non-inclusion is coded 0. The DJSI consists of companies that were evaluated by SAM Research, an independent agency in Zürich, as being in the top 10% of their respective industries in terms of overall sustainability, measured across economic, environmental and social dimensions. The DJSI is comprehensive in scope and independently audited, and can therefore be considered a good indicator of overall international CSR performance (Ricart et al., 2005). While the inclusion of CSR data for locally-owned Indian firms would be desirable for comparison, such data are not readily available in India.

Control Variables

The analysis makes use of a number of controls to try to isolate the effects of ownership and CSR reputation as well as possible. The first is *profitability,* since a firm's tax burden is to a large extent determined by its income. Profitability was defined as pre-tax profit as a percentage of total sales (Eden et al., 2005). A second is *industry* effects, using dummies for the three sectors: services (n = 19 observations), chemicals & pharmaceuticals (n = 106 observations) and automotive (n = 29 observations). *Leverage*, measured as the ratio of debts to total assets, was controlled for given the negative impact of debt on profitability. A fourth involves *size*, using the currency value of total sales (in rupees), because large firms may have greater bargaining power and be more likely to secure exemptions, but also are more visible and thus subject to greater external pressures for CSR. Additionally, some firms had deferred tax liabilities, which would reduce their taxable income, or reported accumulated losses, defined as a loss (or losses) from previous years carried forward in order to offset future earnings, which reduces the tax burden as deductions from the taxable profit. To account for these relationships, the analysis included dummy variables for firms reporting *deferred tax liabilities* as well as *accumulated losses*.

Results

Table 1 reports descriptive statistics and bivariate correlations. The table shows that the average ETR in the sample was 21.7% (median value 22.8%), a result virtually identical to the figure reported by Kelkar (2002) and well below the nominal rates for India of 35% to 40% (Markle & Shackleford, 2010). Table 1 reports median values, but for statistical purposes the authors log-transformed the size and leverage variables to correct for non-normality due to skewness. Table 1 reveals a number of expected relationships. For instance size and accumulated losses are negatively related to ETR, while profitability is positively related to ETR. The positive relationship between deferred tax liabilities and ETR, on the other hand, is unexpected. The

Table 1. Descriptive Statistics and Correlations ($n = 154$).

		Mean	*SD*	1	2	3	4	5	6	7	8
1	Effective Tax Rate (ETR)	21.7%	15.2%	1							
2	Size (Rs billions)[a]	6,201	90,251	–.255**	1						
3	Profitability[a]	9.0%	14.4%	.369**	–.241**	1					
4	Deferred tax liabilities	0.23	0.43	.172*	.182*	0.019	1				
5	Leverage[a]	34.0%	227.1%	0.13	0.036	–.172*	–0.1	1			
6	Accumulated losses	0.08	0.28	–.398**	–0.13	–.361**	–.171*	.268**	1		
7	MNE subsidiary	0.42	0.49	.229**	–0.04	–0.11	–0.01	0.022	0.099	1	
8	Reputation for CSR[b]	0.48	0.50	0.045	.286*	0.07	0.214	–0.16	0.023	n.a.[c]	1

*and **signify $p<.05$ and $p<.01$, respectively (two-tailed tests).
[a]Median value.
[b]Foreign-owned firms only.
[c]Cannot be computed as the multinational enterprise (MNE) subsidiary variable is constant (=1).
Correlations are based on transformed variables, where relevant.

Table 2. OLS Regression Results for ETRs[a] Among MNE Subsidiaries and Locally Owned Firms in India.

	Model 1		Model 2		Model 3		Model 4	
	β	*SE* Sig.	β	*SE* Sig.	β	*SE* Sig.	β	*SE* Sig.
Constant	0.15	0.04***	0.09	0.04**	0.22	0.04***	0.20	0.04**
Automotive	–0.02	0.04	–0.03	0.04	–	–	–	–
Chemicals & pharmaceuticals	0.05	0.04	0.06	0.03*	0.00	0.04	–0.01	0.04
yr2001	–0.02	0.03	0.00	0.02	0.03	0.03	0.04	0.03
yr2002	–0.02	0.03	0.02	0.03	0.01	0.04	0.01	0.04
Size (standardized)	–0.03	0.01***	–0.03	0.01***	–0.04	0.02**	–0.06	0.02***
Profit	0.19	0.09**	0.19	0.08**	0.23	0.14	0.21	0.14
Deferred tax liability	0.07	0.03**	0.05	0.03**	0.06	0.04	0.04	0.04
Leverage	0.06	0.02***	0.07	0.02***	0.07	0.02***	0.07	0.02***
Accumulated losses	–0.19	0.04***	–0.22	0.04***	–0.25	0.06***	–0.26	0.06***
MNE subsidiary			0.11	0.02***				
Reputation for CSR							0.06	0.03**
Model *F*-statistic		9.58***		13.79***		10.32***		10.31***
R^2 (adj)		0.36		0.46		0.54		0.57
R^2 change		0.37***		0.12***		0.60***		0.03***
n		154		154		64		64

Note. The reference sector is services and the reference year is 2000.
[a]ETRs = Effective Tax Rates.
*$p < .10$. **$p < .05$. ***$p<.01$, two-tailed tests).

bivariate relationship between ETR and foreign ownership suggests foreign firms pay higher ETRs than locally-owned firms. OLS regression and nearest-neighbor matching techniques are used to explore this relationship.

Table 2 reports the results of the OLS regression analyses. Model 1 is a control model. Model 2 includes the dummy predictor for foreign ownership to test Hypothesis 1. The results show that foreign ownership is associated with significantly higher ETRs (β = .11, $p < .01$). A coefficient of 0.11 means that when controlling for other factors, the foreign-owned firms in the sample have ETRs that are 11 percentage points higher than those of locally-owned firms. This finding lends support to Hypothesis 1. Additionally, the model confirms some of the relationships identified in Table 1; namely, that larger firms and firms with accumulated losses pay lower ETRs, while profitability, leverage and deferred tax liabilities are related to higher ETRs.

Models 3 and 4 test the relationship between reputation for CSR and ETRs for the sub-sample of foreign-owned firms ($n = 64$) to test Hypothesis 2 concerning whether subsidiaries of MNEs known for CSR would pay higher ETRs than subsidiaries of MNEs less known for CSR. Model 3 reports the model with the control variables, and Model 4 the full specification including reputation for CSR. Initially, the regression was run using the same palette of control variables as in Model 1, but it emerged that the sector dummies were associated with abnormally high variance inflation factors (VIFs; automotive = 5.0 and chemicals & pharmaceuticals = 6.6). These high VIFs appear to be a function of small subsample sizes (automotive and services had only 14 and 7 observations, respectively).

The authors subsequently specified their model to include only a single sector dummy (chemicals & pharmaceuticals = 1; all other = 0), which brought the VIFs back within acceptable bounds (maximum VIF = 2.1). The coefficient for DJSI inclusion, the predictor for reputation for CSR in Model 4, is positive and significant ($\beta = .06$, $p < .05$), indicating that subsidiaries of MNEs with reputations for CSR pay ETRs in India that are 6 percentage points higher than subsidiaries of MNEs without such reputations (Hypothesis 2), when controlling for other factors. Visual examination of scatter plots of the residuals suggested no heteroskedasticity and the low VIFs (Model 2 max = 2.1; Model 4 max = 1.9) and condition numbers (Model 2 = 11.2; Model 4 = 5.1) do not indicate any evidence of multicollinearity.

Sensitivity Tests

The OLS regressions provide evidence that MNE subsidiaries in India pay considerably higher ETRs than do local Indian firms, and that subsidiaries of MNEs known for CSR pay higher ETRs than do subsidiaries of MNEs less known for CSR. However, given the possibility for sample selection bias—that is, that MNE subsidiaries differ systematically from local firms—nearest-neighbor matching analysis (Abadie et al., 2004) is applied to investigate the possibility of over- or under-inflated OLS coefficient estimates. Tables 3a and 3b report matching results for Hypothesis 1 and Hypothesis 2 respectively. As a sensitivity analysis, Tables 3a and 3b report a number of permutations of the matching specification. Each table considers the range of reported parameter estimates as a general indication of the effect in question.

Considering all six permutations together, Table 3a shows that the sample average treatment effect (SATE) of foreign ownership is slightly lower than

Table 3a. Effect of MNE Ownership on ETRs[a] Among Firms in India.

Model	β[b]	*SE*	z-stat.(sig.)	No. of matches	exact match on:
1	8.4%	0.022	3.87***	4	
2	9.6%	0.023	4.19***	4	size (1.3% exact)
3	10.4%	0.021	4.96***	4	profitability (36% exact)
4	10.9%	0.021	5.16***	4	leverage (15% exact)
5	9.0%	0.021	4.24***	6	
6	8.3%	0.023	3.61***	2	

[a]ETRs = Effective Tax Rates.
[b]Standard average treatment effect (SATE).

Table 3b. Effect of a Reputation for CSR on ETRs[a] Among MNE Subsidiaries in India.

Model	β[b]	*SE*	z-stat.(sig.)	No. of matches	exact match on:
1	8.1%	0.028	2.86***	4	
2	11.6%	0.031	3.71***	4	size (0.8% exact)
3	8.9%	0.029	3.10***	4	profitability (23% exact)
4	6.6%	0.027	2.48**	4	leverage (13% exact)
5	8.5%	0.028	2.97***	6	
6	9.4%	0.029	3.28***	2	

[a]ETRs=Effective Tax Rates.
[b]Standard average treatment effect (SATE).

the 11 percentage points reported in Table 2, hovering between 8.4% and 10.9%. The results in Table 3a are robust to changes in the number of matches (Abadie et al., 2004) specify four matches as the optimum; the analysis in this article uses bias-adjusted estimators to counter the increase in bias that comes from using multiple matches), and to different specifications of exact matches on individual covariates. For instance, Models 2, 3, and 4 in Table 3a show that the difference in ETR between foreign- and locally-owned firms holds when cases are matched on size (where only 1.3% of cases could be matched on exact values), profitability (36% of cases were exact matches), or leverage (15%). Models 5 and 6 show that the SATE coefficient remains significant, irrespective of the number of matches.

In contrast, the results in Table 3b suggest the CSR coefficient estimates in Table 2 are conservative. The SATE coefficients in Models 1 through 6 range from 6.6% to 11.6%, with an average value of 8.8%. This range of coefficients suggests that the Indian subsidiaries of MNEs with reputations for CSR paid ETRs on average nearly 9 percentage points higher than the Indian subsidiaries of MNEs without reputations for CSR. These findings are similarly robust to the constraint of exact matches on specific covariates and changes in the number of matches per observation (Table 3b, Models 2 through 6). Matching analysis lends strong additional support to the core finding of this article, namely 1) that MNE subsidiaries in India pay higher ETRs than do local Indian firms, and 2) that subsidiaries of MNEs known for CSR pay higher ETRs than do subsidiaries of MNEs less known for CSR.

Additional Robustness Checks

The authors have pooled multiple years in the analysis to increase the number of observations available. While they recognize the possibility of endogenous firm-specific idiosyncrasies, limiting the pooling to only three years (with no more than two observations per firm) and including year dummies keeps the potential for serial autocorrelation limited. To check the robustness of these findings, the authors also ran regressions on each year in isolation. Those results (not reported here) support the findings reported in Tables 2 and 3. For instance, running the model specifications from Table 2 on the 72 observations from 2001 yields a positive and significant coefficient for foreign ownership ($\beta = .16$, $p < .01$) in a significant model (F-statistic = 11.07) with strong explanatory power (adjusted $R^2 = .53$). The same procedure run on the 45 observations from 2002 alone generates a positive and weakly significant coefficient for foreign ownership ($\beta = .07$, $p < .10$) in a significant model (F-statistic = 5.20) with strong explanatory power (adjusted $R^2 = .43$).

Additionally, examination of the data reveals that 19 of the 154 observations report zero or negative profits. Since tax cannot be paid on non-existent profits, this fact suggests that the relationship between profit and tax cannot be fully linear. To check for potential bias associated with this non-linearity, the authors reran analyses excluding these 19 cases. They note for completeness that Heckman's two-step model (Heckman, 1979) would also be an appropriate empirical tool to account for potential selection bias, in this case caused by non-random likelihood of being profitable (if, for example, zero profitability occurs only among foreign-owned firms). However, the Heckman technique presents a specification problem because it requires an instrumental variable in the first stage (probit) equation that predicts the likelihood of positive profitability and which is not a predictor of ETRs in the second stage. All the continuous variables in this study are significant predictors of ETR and thus no such instrumental variable is available in the data set. The

Table 4. OLS Regression Results of ETRs[a] on Firms With Positive Profit Only.

	Model 1		Model 2	
	β	*SE* Sig.	β	*SE* Sig.
Constant	0.16	0.05***	0.11	0.04**
Automotive	0.05	0.04	0.05	0.03
Chemicals & pharmaceuticals	–0.01	0.05	–0.02	0.04
yr2001	0.00	0.03	0.01	0.03
yr2002	0.00	0.03	0.04	0.03
Size (standardized)	–0.04	0.01***	–0.04	0.01***
Profit	0.06	0.11	0.08	0.10
Deferred tax liability	0.07	0.03**	0.05	0.03*
Leverage	0.07	0.02***	0.07	0.02***
Accumulated losses	–0.31	0.10***	–0.31	0.09***
MNE subsidiary			0.10	0.02***
Model *F*-statistic		4.51***		7.33***
R^2 (adj)		0.19		0.32
R^2 change		0.25***		0.13***
n		135		135

Note. The reference sector is services and the reference year is 2000.
[a]ETRs=Effective Tax Rates.
*$p < .10$. **$p < .05$. ***$p < .01$, two-tailed tests.

results of the restricted-sample regressions, reported in Table 4, suggest that while nonlinearity in the profitability measure had some inflationary impact on the coefficients in the full sample (Table 2), the main results continue to hold.

Discussion and Conclusion

This article aimed to shed light on responsible tax, a topic that has received increasing attention in recent years. The debate centers on MNEs and their tax contributions in developing countries, as it is in this setting that issues like potential tax avoidance are most problematic. While governments in developing countries rely heavily on income-based taxation for revenue (Grunberg, 1998; Tanzi & Zee, 2000), they face the "squeeze" of pressures to offer fiscal incentives on the one hand, and the potential for MNEs to shift income away on the other, thereby reducing their potential tax base. Research on MNEs' actual tax contributions in developing countries has been very scarce, however. Cases in which MNEs supposedly avoid their tax responsibilities to developing countries have been noted, but evidence has been largely anecdotal or based on a small number of high-profile examples. Problems of data availability, especially at the firm level, have seriously complicated research on this topic. No known research has compared tax payments by MNE subsidiaries to those of locally-owned companies in the same developing-country setting.

This article contributes to the debate by exploring "responsible tax" as a CSR issue, and examining data on both MNE subsidiaries and local firms in India. The authors argue that taxation is more than a matter of compliance because MNEs not only face a varied palette of rules and norms in the countries in which they operate, but also variation in compliance, enforcement and application of laws, especially in developing countries. As such the mere existence of legal frameworks does not eliminate uncertainty, leaving a "moral free space" in which managers must "chart their own course" (Donaldson, 1996, p. 56). This article argues that MNEs, as large and highly visible organizations exposed to considerable scrutiny from numerous stakeholders, internalize and extend their responsiveness to such pressures even when they enter lower-CSR, weaker-enforcement contexts because of a heightened awareness of the reputational risks associated with "irresponsibility."

Building on this line of reasoning, it can be expected that if MNEs see tax as a component of their CSR—and there is evidence to suggest that they do—then MNEs will make more (socially) responsible decisions within the moral free space that they face with regards to taxation. Empirically, the article uses firm-level data on ETRs among both MNE subsidiaries and locally owned firms in India to address two questions. First, all else being equal, do the Indian subsidiaries of foreign MNEs pay higher ETRs than locally owned firms? Second, do the subsidiaries of MNEs known for CSR pay significantly higher ETRs than the subsidiaries of MNEs less known for CSR? Positive support for both questions can be interpreted as evidence that MNEs see taxation as a CSR issue and that they adjust their tax management strategies accordingly.

The article used OLS regression and nearest-neighbor matching techniques to analyze ETRs for 82 firms during the period 2000-2002 (154 firm-year observations). The data reveals that on average, the firms in the sample paid ETRs that are significantly lower than nominal tax rates (21.7%, versus 35%-40%). When comparing foreign subsidiaries to locally-owned firms, the article finds that the former pay ETRs around 10 percentage points higher than local firms when controlling for other factors (Hypothesis 1). When considering only foreign-owned firms, the subsidiaries of MNEs known for CSR pay ETRs six to nine percentage points higher than the subsidiaries of MNEs less known for CSR (Hypothesis 2). The findings are robust to alternate specifications and across both OLS and nearest-neighbor techniques. Hence, this study did not find evidence that MNEs "shirk" their tax responsibilities compared to local firms, and those MNEs with a reputation for CSR even pay more than those without such a reputation.

Implications

The findings of this study suggest that MNEs see international tax as a CSR issue (Houlder, 2004; SustainAbility, 2006) and that they respond to the institutional uncertainty they face by assuming a greater responsibility for tax in developing countries. This behavior is beneficial to the MNE because it helps reduce the reputational risk associated with (perceptions of) irresponsible behavior. The findings also appear to provide indirect evidence that MNE operations in low-CSR, weaker-enforcement contexts are affected by the greater CSR pressures to which they are exposed (particularly at home), and thus that MNEs can potentially serve as mechanisms for "upward harmonization" (Muller & Kolk, 2010; OECD, 1999). Ultimately MNEs may address the tax-based "moral free space" by affording tax a more prominent place in future corporate codes of ethics than has thus far been the case (Kaptein, 2004; Kolk & Van Tulder, 2005).

This tentative and emergent approach to the taxation issue led the director of the Organization for Economic Co-operation and Development (OECD) tax policy center to observe that "tax is where the environment was 10 years ago" (Houlder, 2004). This statement highlights not only the changing perceptions of CSR-relevant issues over time, but also the difficulties of distinguishing between the "discretionary activities" and "legal responsibilities" of firms. If CSR entails the management of a firm such that it is "economically profitable, law abiding, ethical and socially supportive" (Carroll, 1999, p. 286), it is not fully clear by which laws MNEs should abide, given that they may be subject to multiple jurisdictions with different levels of regulation and enforcement. As such, the definition of CSR as actions "beyond the interests of the firm and that which is required by law" (McWilliams & Siegel, 2001, p. 117; see also Portney, 2008; Rodriguez et al., 2006) should be extended to take into account the "grey zones" that exist between different legal frameworks, in terms of their content, their implementation, and their enforcement.

In general, the low overall ETRs do indicate that all firms exploit opportunities to reduce their tax burden below the nominal rate to some degree. If this is a general response to the institutional avenues afforded them to optimize their tax burden, it suggests that the perception of low tax contributions by

MNE subsidiaries reflects a much broader structural problem that spans industries and economies more generally, and not just fiscal advantages that MNEs are purported to exploit (Fauvelle-Aymar, 1999). It may be that poor tax revenue development in developing countries has more to do with local contextual issues—including capacity-building and collection problems. In the words of Bird et al. (2004), it may be that "institutions rule" in the area of developing country taxation. However, this is obviously something that requires further investigation. As such, the results of this study imply that developing-country policymakers should focus their efforts more on bolstering their tax collection efforts and being more stringent with regards to both foreign and local firms.

Limitations and Future Research

This study focused on India, a developing country that is an important emerging economy with a well-developed tax system and relatively high levels of foreign participation in key sectors. The authors note however that while India is an important and relevant case, it may not be a "typical" developing country due to for example its size, institutional development, and relative skill levels. (There may or may not be a "typical" developing country except by groups of countries.) Such factors may need to be considered when extending this research to other contexts. Additionally, more in-depth studies at the subsidiary level and the sector level seem necessary to parse out the effects under investigation more deeply, and explore possible other explanations for the findings. A comprehensive, multi-country study like that of Markle and Shackleford (2010), but focused on systematic differences in ownership (foreign vs. domestic) as opposed to multinationality, would be desirable. At present, however, such datasets are not available.

Finally, while the focus of this article is on the potential link between MNEs, CSR and ETRs, additional investigation of intra-firm transactions that could potentially reveal profit shifting, or data on tax incentive packages, would shed additional light on this relationship. However, the firm-level data used here remains a useful first step in addressing the overarching question of whether tax can be seen as a CSR issue, and more data may become available in view of ongoing pressure for transparency in the context of CSR and tax.

It should be reemphasized that the data used by the authors were not directly collected and are not readily available to other researchers without purchase or government provision. The circumstance naturally limits the reliability of the findings. This study should be viewed as exploratory. The reader should bear in mind, however, that relatively little empirical research is available—in any form—concerning responsible tax management in relationship to CSR.

Appendix

Sample File of Data Obtained From FirstSource[a]

Financial Indicators and Products Manufactured/Traded

(Unit: Rs.thousands)[b]

Year ended	December 2000	November 2001	Year ended	Dec-2000	Nov-2001
Accounting Period	12 months	11 months			
Profit and Loss Account			Balance Sheet		
Total income	4,375,700	3,906,200	Net Worth	953,200	1,291,700
			Paid-up capital	162,000	162,000
Total expenses	3,529,100	3,237,200	Reserves & surplus	791,200	1,129,700
of which			Revaluation reserves	0	0
Salaries & Wages	199,100	185,700			
Rent & Royalty	48,800	11,900	Total borrowings	40,300	23,800
Interest	14,500	1200	Secured Loans	0	0
			Unsecured Loans	40,300	23,800
Profit before tax	846,600	669,000	Fixed Deposits	0	0
Profit after tax	714,600	490,000			
Dividend	837,400	178,500	Gross fixed assets	710,400	729,400
Dividend rate (%)	450	100	Net fixed assets	434,500	417,000
			Investments	892,000	931,600
PAT/Total income (%)	16.33	12.54	Investments in cos.	0	0
PAT/Total assets (%)	71.93	37.25	Net current assets	–218,000	58,600
Generic Names of Principal Products/ Services			Current assets	951,800	1,002,200
			Current liabilities	1,169,800	943,600
			Net deferred tax assets	–115,000	-91,700
			Deferred tax assets	0	12,000
			Deferred tax liabilities	115,000	103,700
			Misc. expenses	0	0
			Accumulated losses	0	0
			Total Assets/ Liabilities	993,500	1,315,500

[a]Firm-identifying information omitted for confidentiality.
[b]As of January 2000, the exchange rate was 0.021395 Rupees per $US. Based on this rate, total income referred to above for the year ending in December 2000 (4,375,700,000 Rupees) equates to just above $US 90 million.

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