Charity and tax Planning in Socially Responsible Entrepreneurships in the Czech Republic

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Abstract: Today, more and more companies in the Czech Republic are committed to the concept of sustainable business or corporate social responsibility (CSR). Charity donations belong among the most common areas in which companies invest in terms of socially responsible behaviour. However, some critics point out that responsible companies should primarily behave in a way that does not endanger their core business. Regardless, CSR has become a global theme, both academically and in practice, and a broad concept that addresses economic, environmental, and social dimensions of entrepreneurship. The environmental and social issues were dominant in the concept of sustainable business and CSR practices but recently, a lot of the discussion has targeted the companies' responsibility to pay taxes. Indeed, taxation is not a new dimension and, instead, should be seen as part of economic responsibility, as paying taxes into public finances is inherently part of how businesses contribute to society. Thus, socially responsible companies will play an important role in the development of communities and as leaders of social innovations. To achieve its economic objectives, entrepreneurship, to be responsible, must always obey the law. That does not mean that socially responsible companies need to pay more in taxes than required by the law. CSR activities should not create obstacles to the normal and appropriate tax planning. Yet, CSR can be perceived as to set some limits to and requirements for the tax planning activities, such as aggressive tax planning; these are steps taken by taxpayers which are in line with the tax requirements, but do not correspond with reasonable expectations of the stakeholders. The first section of the article contains scientific work, with the introductory part focused on a survey of the current state of the issue and the level of knowledge. The following part of the research will use secondary data available, namely from the Ministry of Finance of the Czech Republic, concerning charitable donations and their effect on the overall tax base and income tax to prove or disprove whether Czech companies use charitable donations as a mean of aggressive tax planning. In conclusion, the findings will be formulated and presented.

Keywords: charity, tax planning, income tax, tax allowances, corporate social responsibility

1. Introduction

The obligation to be socially responsible is referred as being over and above minimum requirements imposed on companies by formal legal rules (Commission of the European Communities, 2002). Corporate social responsibility (CSR) is a business approach that contributes to sustainable development by delivering economic, social and environmental benefits for all stakeholders. It can be also viewed as a self-regulating business model that helps a company become socially accountable. Based on Buhmann, Roseberry and Morsing (2011), since mid-1990s, the world has experienced increasing public attention to CSR and the impact of corporations on global welfare. Since then the challenge of how best to ensure the strategic business potential for individual business in assuming social responsibility has been heavily debated. For many years, however, the opponents of the CSR such as Friedman (1962, 1970) argued that social issues are not the interests of business, that purpose of business is purely business, and the responsibility of business is to increase its profits. Nevertheless, the extent of issues involved in CSR is expanding, CSR is not regarded as only involving social and environmental issues but also aiming at business operations such as accounting and tax policies. Stanford (2014) claims that responsible business offers a new and strategic approach to all aspects of an organization, allowing for returns at every level.

CSR requires a change in the focus of corporate responsibility from profit maximisation for shareholders within the law to responsibility to a broader range of stakeholders, involving protection of environment, ethical and legal obligations, community development as well as human rights (McBarnet, 2009). Stakeholder engagement is a core element of corporate responsibility practice and triple-bottom-line thinking (Cohen, 2010). Elkington's Triple Bottom Line model (1998) is an influential model that has helped share the corporate social responsibility agenda. It is a concept that encourages the assessment of overall business performance based on three important areas: Profit, People and Planet. It refers to three kinds of impact of a company – social, environmental and economic. Business should measure all three kinds of performance and be responsible to all stakeholders, not just the ones interested in the financial bottom line, as the overall sustainability of the business depends on meeting needs of all stakeholders. Sustainable organizations recognize that "profit" isn't contradictory to "people" or "planet." In other words, organizations cannot operate sustainably by focusing only on the financial outcome they create, as that is not what most stakeholders desire. Shareholders may provide the funds, but stakeholders influence the ability of the business to become successful.

From the beginning the CSR has been viewed as a voluntary concept; a voluntary link between social, economic and environmental considerations in the organization's business to meet the expectations of all categories of stakeholders as well as ensuring long-term prosperity. As stated by McBarnet (2009), from the start, "voluntary" CSR has been socially and economically driven.

CSR can be described as behaviour by businesses 'going beyond legal requirements' but it could be as well viewed as going against the law, as the legal duty of managers to owners, still embedded in many national legislations, should not been forgotten. After all, any business that strives to be 'sustainably' socially responsible, needs to be able to maintain profitable on a long-term basis. Thus, if justification for adhering to CSR is to increase shareholders' value, it cannot be assumed in conflict of demands. However, this is not always enough. Hereby, modern shareholders realize that there is more to business than profit and that there out to be other elements involved in the way business is done. As appointed by Carroll (1979), the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time. Parker (2009) notes that ideally CSR includes compliance with business responsibilities but goes 'beyond compliance' in order to incorporate all dimensions of CSR. Campbell (2009) indicates that CSR activities are value-creating, because they strengthen a company's relationship with its key stakeholders, and thus CSR objectives are ultimately in a company's economic interests. Williams (2015) supports the idea by stating that addressing sustainability need not to be in conflict with delivering shareholder value, in fact sustainability and social good can drive it; sustainability is not where businesses spend their money but how they earn it, purpose of the business is beyond profit. Also (conversely), in the long term, environmentally unsustainable business practises have the potential to significantly damage the financial sustainability of business (Hopwood, Unerman and Fries, 2010).

When talking about giving and CSR, the role of institutional economics should not be forgotten. It is an economic perspective that attempts to extend economics by focusing on the institutions, i.e. social and legal norms and rules that underlie economic activity. Representatives of the theory, Marshal and Veblen, connected their work with the fundamental analysis of poverty in the late nineteenth century and the role of organized charity. Marshall (1961) saw charity as a necessity to solve the problems of the poor and suggested that the human spirit of helping others is based on an evolutionary-driven altruism gene. Veblen (1979) saw poverty as the necessary outcome of the market system of the capitalist economy and charity as a natural outgrowth of the system. Lately, there has been an increased interest in the role of shared values and in the sociological literatures surrounding such concepts as social capital, trust, community, and civil society (Knight, 1998). The role of government intervention is discussed as well; it understood that institutions matter, and that economists need to think hard about the ways in which institutions shape economic behaviour and outcomes (Rutheford, 2001).

2. Taxation as an element of CSR

Taxation is a means by which governments finance their expenditure by imposing charges on citizens and corporate entities. The main purpose of taxation is to accumulate funds for the functioning of the economy, provide public revenues to meet economic and social objectives, as well as distribute wealth. It is still discussed whether tax planning should be presented as a CSR element, even a separate dimension. Most agree that taxation should not be viewed as a new dimension, instead, should be part of economic responsibility. Factually, a call for transparency in tax reporting around the globe intensifies. Latterly, creative compliance, creative accounting and tax avoidance has become an issue regarding CSR. Companies are compelled to deal with the CSR pressure on the taxation issues. Information on amount of tax paid and tax planning policies have started to emerge in the CSR reports. To date, companies have largely advocated their right to minimize their tax, as long as it is within the limits of the law. And this opinion is still embedded in the minds of many managers and executives. However, the attention over legal compliance with the law has been shifting to compliance with the spirit of the law. The concept of CSR refers to the operations or actions of companies that are above or independent of the limits or minimum requirements set by legislation (Knuutinen, 2014). It is important that taxpayers recognize that their compliance with an acceptable and fair tax administration is fundamental to a stable economic system.

CFE Tax Advisers Europe stated in their report on CSR and taxation (CFE, 2016) that taxpayers should be free to adopt any tax planning strategy that is within the boundaries of the law. OECD Guidelines (Action Plan on Base Erosion and Profit Shifting, 2013) point out that complying with the spirit of law "does not require an enterprise to make payment in excess of the amount legally required". The study undertaken by Laguir et al (2015) indicates that companies enter tax avoiding activities based on the nature of the CSR activities it engages in, i.e. the higher the level of the social responsibility involvement, the lower the level of tax aggressiveness. That is supported by the idea that tax minimisation must be balanced against reputation risk minimisation and the maintenance of good relations with tax authorities (McBarnet, 2009). Tax planning often refers to the transactions of taxpayers which are not, per se, against the purpose of the tax law. Opposite, tax avoidance can be viewed and formulated as a global sustainability problem as it effectively dislocates social and environmental resources (Bird and Davis-Nozemack, 2018). However, where a line between acceptable behaviour and aggressive avoidance lies and who is going to set the standards, only remains to be seen.

Reputation counts more than ever that is why companies out to incorporate responsibility to tax planning into their overall sustainable strategy. From the CSR point of view, we could formulate, that aggressive tax planning are actions taken by taxpayers which are in the line of requirements of tax law, but which do not meet the reasonable and justified expectations and requirements of the stakeholders. Thus, the discussion is mainly about the purpose and real substance of the actions.

2.1 CSR reporting on tax

Payment of taxes is a major way for companies to support the communities where they operate. Yet too many businesses are unwilling to disclose how much, and where, they pay taxes. Since 1997 Global Responsibility Initiative (GRI) has pioneered sustainability reporting and came up with GRI 207 Tax Standard that challenges this status quo by outlining clear best practice for disclosure.

In 2017, the Global Sustainability Standards Board (GSSB, 2019), initiated a project to develop new disclosures related to tax and payments to governments, which will be considered for incorporation into the GRI Standards. Its aim is to help promote greater transparency on a reporting organization's approach to taxes. Making tax data more widely accessible will help build stakeholder trust and contribute to better-informed policy and investment decisions. Companies will report and disclose their information in the three areas, i.e. how the approach to tax is linked to the business and sustainable development strategies of the organization, how tax governance, control, and risk management are identified, managed, and monitored, in the third area a description of the approach to stakeholder engagement and management of concerns related to tax, and country-by-country reporting is reported. Public reporting on tax increases transparency and promotes trust and credibility in the tax practices of organizations and in the tax systems. It enables stakeholders to make informed judgments about an organization's tax positions. Tax transparency also informs public and supports the development of socially desirable tax policy. However, the standard will only come to an effect in 2021.

3. Charity as an element of CSR

3.1 Charity as a social element of CSR

McBaret (2009) implies that CSR is not philanthropy[1], contributing charitable donations from profits, but involves exercise of social responsibility in how profits are made. CSR is too often about how companies spend (or donate) the money they have earned elsewhere in their business (Williams, 2015). The purpose of business is to be a driving force for social, environmental and economic benefit (World Economic Forum, 2019). Firms donating additional resources to CSR activities can construct a more ethical work climate that encourages executives to control tax risk while lowering tax expenses. For firms with unsatisfactory performance, the ethical benefits of CSR could disappear, thus suggesting a relationship with firm performance (Lin et al, 2019).

Often, relationship between CSR and philanthropy is barely distinguishable from each other, even in some cases used interchangeably. Both are positive concepts designed to deliver corporate resources to the community the corporation serves, and the giving may also be aimed toward specific causes. It is only true when companies' interests to be involved in CSR is beyond simply giving money, when a business engages in a more committed

[1] the authors are aware of the different definitions of philanthropy and charity, but believe that for the purpose of this article, their mutual confusion will not matter

form of giving with clear objectives. Philanthropy is most often seen in the form of financial contributions, but it can also include time and resources. The concept behind philanthropy involves making an effort to drive social change. It's not only the charitable donations that can go toward any number of direct-giving scenarios. Philanthropy involves finding a long-term solution.

Based on Caroll (2016) motivation of companies to strive to do the ethically right things is driven by philanthropic their responsibilities. Carroll's pyramid of CSR includes economic, legal, ethical, and philanthropic components. According to this pyramidal construct, one of the most popular constructs of the CSR that has been used in literature and practice since 1979, a firm should maximize its profit, obey the law, be ethical, and be a good corporate citizen, whereas the philanthropic responsibilities are at the top of the pyramid (Carroll, 1991). Most companies feel compelled to give to charity. Only few have figured out how to do it well. There must be a convergence of interests between philanthropy and business. It is when corporate expenditure produces simultaneous social and economic gains that this convergence will occur. Thinking about corporate philanthropy in this way, you have to use CSR activities as part of your business model (Enquist, Edvardsson and Sebhatu, 2008).

3.2 Charity as an economic element of CSR

Companies are also encouraged to foster CSR indirectly for example through tax incentives or government procurement policies. The major tax policy instrument affecting giving is the charitable deduction allowed in the calculation of taxable income for taxpayers who itemize their deductions. As a result of this tax treatment, there are two major tax effects on giving: the tax liability affects the after-tax income from which taxpayers can make contributions and the deduction reduces the net price per dollar of contribution made. The econometric analysis of individual giving implies that the income tax has a strong effect on giving (Clotfelter, 1985).

Andrews (1972) argues that contributions are properly excluded from the income tax base because they constitute neither accumulation nor consumption. An alternative justification for the current charitable deduction is to view the deduction as an incentive by which the tax law encourages desirable behaviour. According to this view charitable giving is an item of discretionary spending that warrants an incentive. A deduction is only one of several forms such an incentive might take; a tax credit or some matching arrangements might be as good or better.

Attitudes towards taxes are often contradictory. On the one hand, taxes are like any other costs for a company, but on the other hand, they are an economic contribution to the society in which the business is conducted. It is in nature of the business to lower the cost as much as possible. Lin et al (2019) suggest that the influence of CSR on tax risk tends to disappear in the presence of firm profitability, unsatisfactory performance and financial constraints. A possible explanation is that good firm performance provides the economic resources for the development of CSR corporate culture that is manifested in activities such as job creation and community donations; further a lower tax burden does not necessarily create high tax risk; thus, increased tax savings and lower tax risk can coexist

4. Methods and data

In 2018, the Ministry of Industry and Trade of the Czech Republic (Ministry of Industry and Trade of the Czech Republic, 2018) published the results of the CSR on-line survey. In the spring 2019, the survey was followed by a study concerning relations between CSR and taxation in small companies in the Czech Republic (Jarolimova, Tuckova, 2019). Results of the study were in line with those of the survey. Both revealed, among other results, that undoubtfully tax issues are important part of a decision-making process in connection to CSR, that CSR activities should be enhanced by the government in some form of tax incentives, such as possibility to reduce tax or a tax base in case of charity giving or other philanthropy oriented activities, and lastly that regardless the social aspects of responsible behaviour, tax savings are on the list of reasons why companies take part in CSR. That raises questions whether motivation to CSR is necessarily a genuine concern and whether the primary purpose of charity giving aspiration in the Czech Republic is to reduce corporate income taxes or socially responsible behaviour that serves to the community and society?

Most Czech companies actively supporting a concept of CSR do not currently report on CSR in the field of taxation. However, previous researches revealed that companies in the Czech Republic, regardless the size, know and support an idea of CSR. Therefore, the research is based on publicly available secondary data retrieved from the materials of the Ministry of Finance of the Czech Republic, comprising all corporations reporting income tax. The ministry publishes annually, on its website, information summarizing data from all tax returns submitted by legal and natural persons. Figures from the years 2005 to 2018 presented in various divisions are available. Also, aggregate data comprising gift deductions are available for a period starting in the year of 2000. Data set was also acquired from the publication by Via Foundation in the Czech Republic (Nadace Via, 2018).

The research wants to build on the above-mentioned survey and the study and aims to explore whether Czech companies view charitable donations as a way to significantly reduce their taxes.

5. Result and discussion

Previous research has shown that Czech corporations, whether small or large, see socially responsible behaviour as their contribution the society and something they deserve to be rewarded for, for example by possibility to reduce their tax. Such thinking may be contributed to the fact that in the Czech Republic, the income tax act allows certain items to be deducted from a tax base and deduction of charitable donations is among them. This nevertheless is not the common practice only in the Czech Republic. In 1938 U.S. Congress gave the justification for deduction in its Congressional Report: "The exemption from taxation on money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare" (U.S. Congress, House of Representatives 1938).

Most EU countries also motivate taxpayers to charitable giving by using various tax-advantaged approaches in the form of various deductions from the tax base, tax credit or other compensations mainly in order to strive for longevity and sustainability of altruistic behaviour of taxpayers.

Carroll and Joulfaian (2005) analysed tax return data to determine whether firms make charitable contributions for the purpose of receiving a tax deduction. The results showed that corporate philanthropy declines with the tax price and rises with income and advertising. However, results from the data retrieved from the Ministry of Finance of the Czech Republic prove otherwise.

In the Czech Republic, the support is implemented through the deduction of the value of the charitable donation or contribution from the tax base with the fixed minimum and maximum limits[2]. Since 2014 the maximum limit is determined by 10% of the tax base when it doubled compare to 2013.

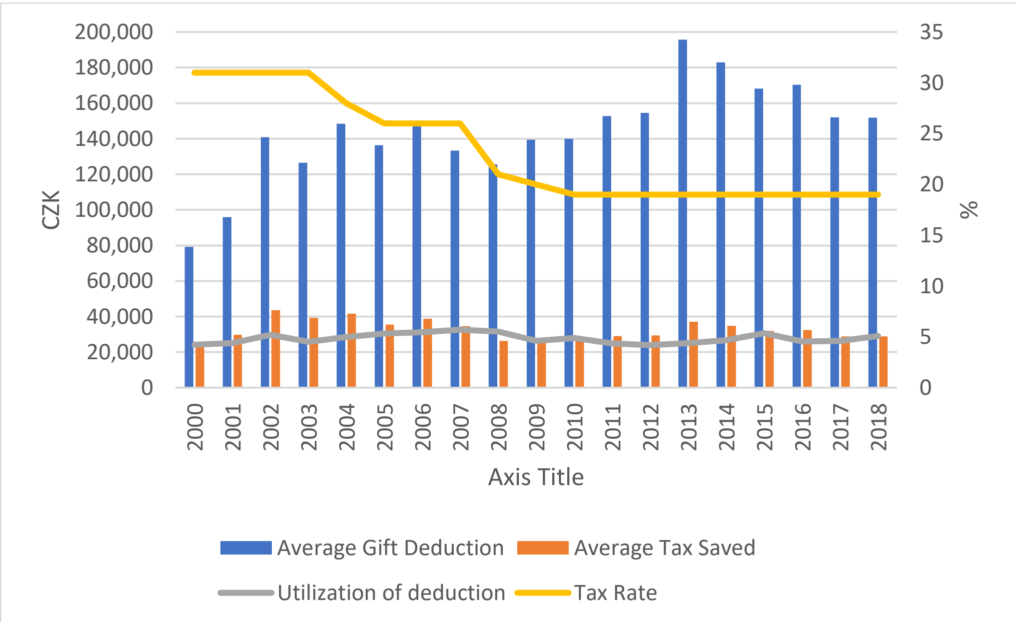

Figure 1: Development of the use of deduction of charity donations (MFCR and Nadace Via, 2019)

[2] §20 of Income Tax Act

If tax deductions on charitable donations and contributions should be an important factor considered in the company's decision-making process to provide a donation in order to reduce its own tax liability, should it be assumed that donations will reflect the level of tax rates. However, as shown in Figure 1, in the years when the corporate tax rate was above 30%, the average amount of deductions was the lowest, and conversely, in the period of the lowest 19% tax rate since 2010, the average amount of deductions gradually increased until 2013 and then started decreasing again regardless the fact the tax rate remained unchanged. Thus, it cannot be confirmed that the reduction of tax rate also reduces willingness of taxpayers to donate.

Donations were also not affected by the fact that the maximum limit for the deduction was doubled in 2014, exactly the opposite, average amount of donations show descending level and gradually returns to its original level. Studying macroeconomic conditions of the Czech Republic, it is more likely to attribute the increase in the volume of donations to the wave of solidarity due to the natural disaster of 2013 than to the willingness to donate more generally, irrespective the period of economic growth. Surprisingly, willingness to donate did not dramatically drop during the worldwide economic crisis in 2008 and 2009, from which it can be concluded that in the Czech Republic donors are mostly not influenced by economic or political aspects and donate regardless of these influences.

Although the average amount of donations has not been positively influenced by the increased limit for deduction, it is positive that number of companies reporting charitable donating increases as shown in Figure 2. Based on the assumptions of Knauer (1994) that legal entities always itemize the deduction of charitable donation in their tax returns, the deductions reflect the real situation. Therefore, if the deduction was reported by 5.1 % of legal entities in 2018 (Figure 1), there are only 5.1% of donors among corporations.

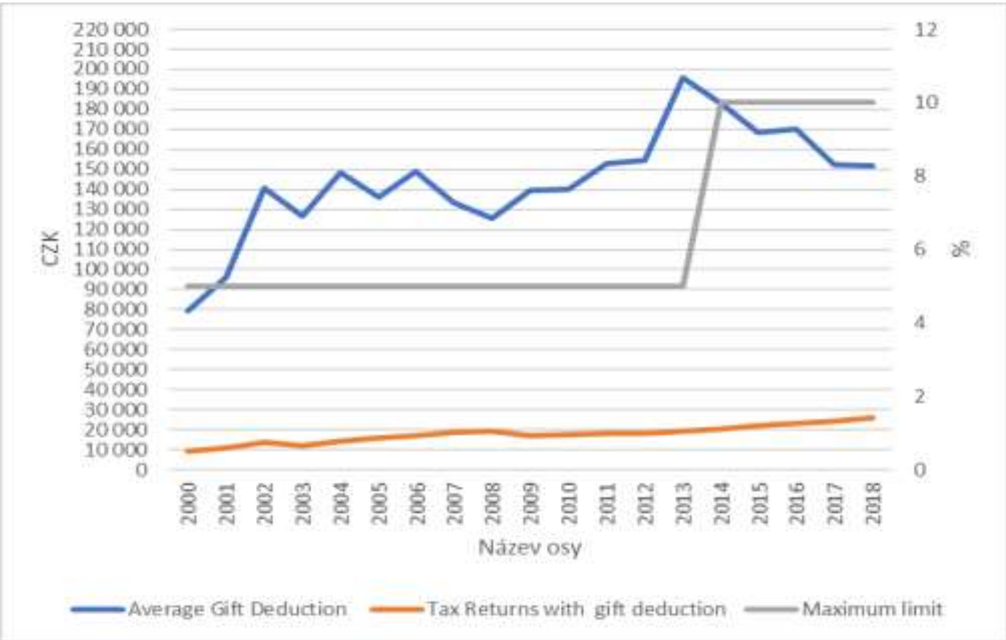

Figure 2: Development of gift deductions in relation to maximum limit (MFCR and Nadace Via, 2019)

The research showed that the set maximum deduction limit is enough. Though, the limitation of maximum can be counterproductive, as it basically tells the taxpayer to make sure not to contribute above the limit, because it will not be beneficial for him if he exceeds the upper limit. Despite responsible behaviour, approaches to altruistic behaviour are still influenced by the economic aspects of individual companies.

6. Conclusion

One of the triggers for the increased attention to tax and tax planning matters within CSR has been the financial and debt crisis in 2008 due to which public finances of many countries suffered. It is going to be interesting to see how the situation evolves with, yet another ongoing crisis caused by Covid-19. The process of social responsibility has been implemented in the mind set of many companies and their stakeholders. However, with less resources, it can be only guessed whether companies will be able to sustain their CSR activities, such as philanthropy and charity giving.

Even though taxation for long time stayed aside the interests of CSR, it is not seen as a completely new dimension and, instead, we can see it as part of economic responsibility. It is often said that philanthropy is charity with other people's money. Attacking CSR by attacking philanthropy could be seen as inappropriate as, as resulted from data, corporate donations and gifts currently amount to less than 1% per annum of pre-tax profits. The data also show that the average amount of the gift in relation to the size of the profit does not change with the size of the company.

Donation is always associated with expense, and a donor is faced with a decision to donate and lose funds that might be otherwise at his disposal. In return, the company gains tax savings that equal usual tax rate on the donated amount. In the current situation in the Czech Republic, deduction loses its effectiveness. If the state is to play an active role in supporting CSR activities, it should choose another form of support.

The data of the Ministry of Finance reveal that the reduction in taxes is not the primary purpose of Czech companies to donate, but rather the result of it. In the Czech environment, tax deductions resulting from charitable donations are not used to the maximum and thus it cannot be addressed as aggressive tax planning. This also corresponds with the results of the last year's survey that tax deductions are viewed rather as a reward for responsible behaviour.

In order to understand some other contexts, further research will need to examine the behaviour of entities in terms of their motivation, so that the conclusions that have been drawn from the data from tax returns can be verified.

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