



National culture and firm-level tax evasion[☆]

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ABSTRACT

A significant research stream provides evidence that institutional, demographic, and attitudinal factors influence the likelihood of tax evasion. Assessments of culture's role in tax evasion are far more scarce and limited. Absent are investigations of how theoretically derived culture variables predict tax evasion likelihood. Institutional anomie theory (IAT) informs this research gap, suggesting cultural values that likely influence deviant firm behaviors. Accordingly, a cross-cultural perspective examines the influence of important cultural forces (individualism, achievement orientation, assertiveness, humane orientation) on tax evasion, simultaneously controlling for institutional, demographic, and attitudinal factors. Multilevel analysis, with both country- and firm-level data, examines actual reports of firm tax illegal evasion from over 3000 companies in 31 countries using hierarchical generalized linear modeling. After controlling for the above-mentioned factors, a subset of influential cultural values stipulated by IAT surfaces to predict tax evasion. Findings suggest a number of theoretical and practical cross-cultural research implications.

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1. Introduction

Tax evasion generally involves economic activities hidden from revenue agents. The [United States Internal Revenue Service \(2005\)](#) reports tax evasion numbers, also referred to as the tax gap (difference between what taxpayers should pay and what they actually pay), in excess of \$300 billion per year, representing 2.7% of Gross Domestic Product (GDP). Other countries experience hidden economies between 6% of GDP (Switzerland) and 27% of GDP (Italy) ([Giles, 1998](#)). In both developed and developing countries, income taxation is necessary for the country's investment in social services and economic infrastructure. Accordingly, income tax evasion, both

personal and business, potentially hurts the poorest within that taxing jurisdiction.

Research examining cross-national differences in tax evasion considers an array of factors including institutional (e.g., rule of law, corporate tax rates), demographic (e.g., firm size, ownership, audit likelihood), and attitudinal (e.g., tax fairness, perceived burden) ([Richardson, 2006](#)). Cross-national research on tax morale and stated willingness to pay taxes uses similar predictors ([Alm and Torgler, 2006](#)). Although some research considers how certain aspects of cultural values relate to tax evasion or morale ([Richardson, 2006](#)), only two previous studies ([Richardson, 2008](#); [Tsakumis, Curatola, and Porcano, 2007](#)) use any of the major national culture models (such as [Hofstede, 1980](#)). However, no study examines the influence of culture while controlling for institutional, demographic, and attitudinal predictors of tax evasion.

This paper examines whether cultural values continue to influence tax evasion after controlling for institutional country-level factors, demographic factors, and attitudes toward taxes. Controlling for these factors is important because some of these previously identified variables may be proxies for cultural values held. In omitting institutional, demographic, and attitudinal information when examining the impact of culture on tax evasion, researchers may misidentify cultural influences where none exist, or fail to see more nuanced cultural effects on tax evasion.

In addition to the above, this work contributes to knowledge on other fronts. First, rather than focusing on all possible dimensions of culture, the institutional anomie theory (IAT) of deviance provides a

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rigorous framework for selecting relevant variables. Second, the analysis employs hierarchical linear modeling (HLM), which is a statistical technique appropriate for cross-level, cross-national data (Bryk and Raudenbush, 1992). Finally, while other studies operationalize tax evasion using either individual taxpayer reports or broad estimates of national tax evasion rates, this study uses self-reports from firms about tax evasion practices as the dependent variable.

Most tax evasion theories focus on the individual decision to avoid tax payments. For instance, economists question why people or firms pay taxes when the probability of an audit or penalty is so low (Dhami and al-Nowaihi, 2007). Often referred to as the “Yitzhaki puzzle” (Yitzhaki, 1974), this failure of expected utility theory encouraged investigation of more psychological, ethical, and social predictors of evasion and compliance (Hanno and Violette, 1996). Still lacking, however, is the application of a macro sociological theory explaining how context can affect rates of deviant behavior: in this case tax evasion. This study suggests that national culture creates a context that encourages or discourages different rates of tax evasion by firms regardless of other influential individual firm characteristics or other national institutional components.

The classic sociological theory of anomie provides the basic insights and theoretical foundations for this investigation of the cultural influences on tax evasion. Specifically, the most recent rendition of anomie theory, institutional anomie theory (IAT) (Messner and Rosenfeld, 2001), identifies specific cultural values that might influence tax evasion. IAT suggests conditions where the willingness, through any means, legitimate or not, to achieve pecuniary benefits like monetary rewards displaces normative behavior or, in this case, tax compliance (e.g., Cullen, Parboteeah, and Höegl, 2004).

The remainder of the paper describes the conceptual background and hypotheses development, explains the research approach and methodology, reports the results and concludes with a discussion of the findings and implications.

2. Background, related research and hypotheses

2.1. Taxation, ethics and norms

Businesses typically arrange operations and financial transactions to minimize taxes, which is commonly accepted practice. Defining appropriate arrangements or management of tax positions characterizes the primary debate between taxpayers and tax collectors. Tax accountants often push the envelope with legitimate means to reduce tax liabilities, sometimes breaching ethical and legal standards. The concern of this study is illegal tax evasion behaviors (i.e., not reporting sales revenue to taxing authorities) rather than the possible legal approaches to avoiding tax payments.

Research examining efficient and effective methodologies to improve tax compliance includes communicating legal sanctions to taxpayers for non-compliance with tax laws, as well as appeals to taxpayers' morals and other social norms regarding compliance (Wenzel, 2004, 2005). Other work probes taxpayers' ethical, moral, and social attitudes and considers the relationship between these attitudes and compliance (e.g., Hanno and Violette, 1996). Broadly, these research streams find that culture envelops attitudes toward tax compliance and evasion. Culture shapes these attitudes through social learning and environmental influences (Wenzel, 2004). As a result, taxpayer values reflect values generally held by others within the social environment (social norms) (Wenzel, 2005).

2.2. National culture

Hofstede (1984, p. 25) defines national culture as a “collective programming of the mind which distinguishes the member of one human group from another”. National culture informs societal

members on what is or is not acceptable with regard to values, beliefs, and actions (Schwartz, 1992). In the work environment, values regarding organizational operations are congruent with broader cultural values (Newman and Nollen, 1996).

Although a number of major culture models appear in business research (e.g., Hofstede, 1980; House, Hanges, Javidan, Dorfman, and Gupta, 2004; Schwartz, 1992; Trompenaars, 1994), this study employs the most recent perspectives from the Global Leadership and Organizational Behavior Effectiveness (GLOBE) study (House et al., 2004). The GLOBE study is a long-term multi-phase program involving scholars from around the world, and provides the most comprehensive model in terms of country coverage ($n = 62$) and the most recent data on measures of national culture. This examination of national culture's influence on tax evasion uses dimensions of national culture from the GLOBE study consistent with IAT.

2.3. Institutional anomie theory

Anomie refers to instability in society caused by the erosion or abandonment of moral and social codes. Changes within a society (e.g., modernization of commerce) contribute to the decline of traditional social controls and a weakening of pro-social norms (Durkheim, 1897/1966; Merton, 1968). As pro-social norms deteriorate, the potential occurrence of deviant behavior, such as tax evasion, can increase. This deterioration of pro-social norms is especially prevalent when existing cultural values emphasize gaining materialistic and economic rewards and set aside ethical considerations within the society or organization (Martin, Johnson, and Cullen, 2009). Examples of fraudulent financial statements generated by Enron, Worldcom, Tyco, and Adelphia and the allegedly abusive tax shelter products sold by international CPA firms provide powerful evidence of firms' deliberate acquisition of material wealth using any available means.

Appealing to anomie theory, these examples indicate normlessness permeating the social structure of the firm. They tell of the pressures that exist for firms to engage in non-conforming behavior to achieve various goals. Anomic state firms may deviate from generally accepted standards and procedures in favor of activities that promote material achievement even if they violate social norms. As a result, anomie may limit legitimate firm achievement of organizational goals (Martin et al., 2009).

IAT specifies the cultural values that generate deviant behavior, suggesting that detachment from social rules and norms can flourish under the influence of certain cultural systems (Messner and Rosenfeld, 1997, 2001). A predominant outcome of social rule detachment is the willingness of individuals to “have no moral qualms” (Rosenfeld and Messner, 1997, p. 214) about choosing paths to goal fulfillment irrespective of the ethical norms prescribed within that society. Indeed, scholars argue that IAT appears readily adaptable for examining the relationship between cultural values and tax evasion behaviors (Riahi-Belkaoui and Picur, 2000). Although IAT also suggests that social institutions affect rates of deviant behavior, the focus of this paper involves using IAT to provide a theoretical rationale for selecting a set of cultural dimensions that may lead to differences in rates of firm-level tax evasion among countries.

2.4. Tax evasion and national culture

IAT highlights four specific culture dimensions likely to promote or suppress illegal tax evasion. These parsimonious and theoretically derived sets of national cultural dimensions include individualism, achievement orientation, assertiveness, and humane orientation.

First, evidence shows that in more individualistic cultures, calculative decision-making based on goal achievement prevails (Robertson and Fadil, 1999). Individualistic cultural values set the stage for firm behaviors that emphasize the pursuit of firm self-interest, largely neglecting concern for ethical consequences (Cullen

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