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The relation between national cultural dimensions and tax evasion

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Abstract

Although penalties and audits exist, tax evasion is a widespread phenomenon and continues to be a problem for many countries. National culture may contribute to a further understanding of intentional noncompliance across countries. In this study, we investigate the influence of national culture on tax compliance levels across 50 countries. Using Hofstede's (1980) cultural framework as a basis for our hypotheses, we find that a noncompliant country's profile is characterized by high uncertainty avoidance, low individualism, low masculinity, and high power distance. Our results have implications for both research and practice. This is the first study to employ Hofstede's cultural framework as an explanator of international tax compliance diversity and serves as the starting point for the development of an international tax compliance framework. Tax policy implications also are addressed.
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1. Introduction

Tax evasion[3] is a widespread phenomenon and continues to be a problem for many countries. For example, Greece's underground economy is estimated to equal approximately 40% of

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[3] As noted by Sandmo (2005), tax evasion is a violation of tax law whereby the taxpayer refrains from reporting income which is, in principle, taxable. Tax avoidance is within the legal framework whereby the taxpayer takes advantage of tax

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GDP—the largest in the European Union (Athens, 1997). Italian tax authorities estimate that 15% of all economic activity goes unreported (Rome, 1997). In the United States, estimates of lost tax revenues for 2001 were as high as $353 billion.[4] Of this $353 billion, intentional underreporting of income represented anywhere from $250 to $292 billion (IRS, 2005).

Some form of penalty usually is used as a means to control tax evasion within countries. The penalties most commonly used in the United States include fines and imprisonment. Even though penalties and audits exist, tax evasion continues to pose a significant threat to countries' economies by placing a strain on a country's budget through lost revenues. Many studies have examined the effects of varying penalties, audit rates, and other variables on tax evasion (e.g., Porcano, 1988; Porcano & Price, 1993; White, Harrison, & Harrell, 1993); fewer empirical studies have examined tax compliance levels from an international perspective (e.g., Alm, Bahl, & Murray, 1990; Alm & Torgler, 2006; Picur & Riahi-Belkaoui, 2006; Riahi-Belkaoui, 2004; Richardson, 2006). Only Alm and Torgler (2006) investigates the relation of culture to tax morale for a "large" number (16) of countries.

This study further explores the role that national culture might play in explaining countries' tax evasion behavior. Culture is a multivariate concept, and this is the first study to use Hofstede's (1980) cultural framework as an explanator of international tax compliance diversity; that is, it uses Hofstede's four cultural dimensions as measures of culture and analyzes their relation to tax evasion for 50 countries in various geographic areas.

Therefore, the purpose of this study is to explore the extent to which international differences in tax evasion can be explained by differences in national culture, as proposed by Hofstede (1980). Hofstede identifies four cultural dimensions, which identify core values that attempt to explain general similarities and differences in cultures around the world. These four cultural dimensions are uncertainty avoidance, individualism, masculinity, and power distance.[5] This paper links Hofstede's (1980, 2001) notion of culture with tax compliance levels across countries.

The results suggest that Hofstede's cultural dimensions appear to be relevant in explaining international tax evasion levels. Specifically, higher (lower) uncertainty avoidance and power distance are associated with higher (lower) tax evasion levels across countries. We also find support for higher (lower) individualism being associated with lower (higher) tax evasion across countries. We also find that higher masculinity is associated with lower tax evasion levels across countries.

Our results have implications for both research and practice. By using Hofstede's cultural framework to investigate international tax compliance diversity, this study adds to the development

provisions to minimize the tax liability. Also, it is important to distinguish between tax evasion and corruption, which are very different concepts. Tax evasion involves hiding the real value of a legal transaction to avoid fiscal (i.e., tax) liability, while corruption involves a transaction in which one agent typically pays a sum of money or performs a service in exchange for an illicit act by a public official (Andreoni, Erard, & Feinstein, 1998).

[4] The IRS (2005) updated its estimates of the tax gap for 2001 to $343 billion as the difference between what taxpayers should have paid and what they actually paid on a timely basis. This revised figure falls at the high end of the range of $312 to $353 billion per year. (IR, 2006–28).

[5] These dimensions are: *uncertainty avoidance* (*UA*), the degree to which individuals in a society feel uncomfortable with uncertainty and ambiguity; *individualism* (*IND*), relates to people's self-concept of "I" or "we," or a society's preference for a loosely knit social fabric or a more interdependent, tightly knit social fabric; *masculinity* (*MASC*), the extent to which gender roles are differentiated within a society and the extent to which traditional masculine values of performance and visible achievement are emphasized relative to traditional feminine values of relationships, caring, and nurturing; and *power distance* (*PD*), the extent to which hierarchy and unequal power distribution in institutions and organizations are accepted. They are discussed further in Section 2.2.

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