

## **Topic: Multiculturalism and Tax Compliance of Business Entrepreneurs**

### **Abstract**

*Due to changes in immigration rules and globalisation, most developed countries including Australia, Canada, New Zealand, the United Kingdom and the United States of America are becoming more multi-cultural. The consequence of multiculturalism challenges the present assumption of culturally homogeneous resident taxpayers. With this, it warrants a re-examination of existing tax policies and tax administration which previously had not accounted for culturally diverse populations. With sparse research on tax compliance and multiculturalism, there is much to be gained from an in-depth qualitative study on actual ethnic taxpayers' compliance behaviours. This study examines the tax compliance practices and perceptions and the cultural values of the four largest ethnic business groups in a developed nation, New Zealand, using Hofstede's (1980, 2001) framework. It has been found that ethnic taxpayers do undertake varied tax compliance practices of which some have cultural underpinnings.*

### **Introduction**

Over the last three decades there were considerable relaxation of immigration rules and globalisation which led to greater human mobility and multi-cultural societies particularly amongst English speaking countries in the developed Organisation for Economic Co-operation and Development (OECD) nations. Multiculturalism brings various nations into one country (Singham, 2006) and consequently, policy makers and regulators face culturally diverse citizens with differing cultural beliefs and value systems. These changes create major challenges for government seeking to manage cultural diversity while aiming to maintain social harmony (Inglis, 1995).

Amongst the developed western nations that have publicly adopted the multiculturalism ideology in their government policies are Australia (Bowen & Lundy, 2011; Forrest & Dunn, 2007) and Canada (Ralston, 1998). Other countries such as Germany, New Zealand (NZ) and the United Kingdom (UK) have selectively incorporated multiculturalism in their systems such as introducing the mixed member proportional (MMP) representation voting/political system.<sup>1</sup>

Though social and political policies in these countries have embraced multiculturalism to some extent, the question remains as to whether tax policies and tax administration have evolved with the changing demographics of its taxpayers. In particular, Nerre (2008) identified the tax culture lag of most developed countries in which these countries have yet to address the issue of culture clash in their tax systems. The research question for this study is to understand the tax compliance behaviour of ethnic business taxpayers using Hofstede's (2001) cultural framework. This question is pertinent as the tax compliance behaviours of business taxpayers have anecdotally been shown to affect tax compliance (C. Coleman &

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<sup>1</sup> Under the MMP system, the voter casts two votes: one for a constituency representative and the other for a party. Due to this voting system, several minority parties have emerged. For example, the smaller parties in New Zealand such as the Greens Party and the United Future Party have formed alliances with the major parties to form the ruling governments in the last three elections.

Freeman, 1997). Tax compliance is of interest to tax authorities given that small and medium enterprises (SMEs) are renowned for their non-compliance statistics and their participation in the informal economy (Joulfaian & Rider, 1998; Morse, Karlinsky, & Bankman, 2009).

## **Economic and Tax Importance of SMEs**

SMEs are the economic backbones for both developed and developing countries (The World Bank, 2013a). They are important contributors to the economy in terms of employment and Gross Domestic Product (GDP) outputs (Ministry of Economic Development, 2011; OECD, 2009). SMEs constitute the majority of all businesses in most countries.<sup>2</sup> They operate in most industrial groups including supplying goods and services to customers (Azumah, Koh, & Maguire, 2007), providing specialised skills (Taylor & Murphy, 2004) and are involved with imports and exports (Ahmad, 2010). They service both the general and niche markets and are adaptable to the markets' needs due to their size (Hutchinson & Quinn, 2012; Tierlinck & Spithoven, 2013). However due to their size, they have limited resources for administrative and compliance tasks (Nelson, 2008). Most small businesses do not have expert personnel to undertake their accounting and tax functions (Massey, 2005; Smith, 2007). Resource constraints pose special challenges to small businesses in understanding and fulfilling their tax compliance obligations (Productivity Commission, 2013). Often, the voices of SMEs are not heard and therefore they are not well represented in the formulation of government policies (Sawyer, 1996; Small Business Advisory Group, 2012).<sup>3</sup>

It has been shown that tax compliance costs are regressive for small businesses (Sandford, 1998; B. Tran-Nam, Evans, Walpole, & Ritchie, 2000) and they bear a disproportionate burden relative to the size of their business (J. Hasseldine, 1995; Inland Revenue, 2010). The regressivity of the compliance costs were brought about from diseconomies of scale, poor record-keeping practices, tax law complexity, and pace and volume of legislative changes and reforms (Binh Tran-Nam & Karlinsky, 2010). Some researchers have hinted that the regressive tax compliance costs may have led to retaliation from some small business taxpayers by under-stating their taxable liabilities (Bajada, 2002; Kirchler, 1999). SME taxpayers therefore have lower tax compliance statistics compared to wage and salary earners (Caragata, 1998) and that small business owner-managers are more likely to cheat on their taxes than other taxpayer groups (Kamleitner, Korunka, & Kirchler, 2012; Pope, 2008). Accordingly, small business owners are considered a high-risk group in terms of tax compliance (Organisation for Economic Co-operation and Development, 2004), and they are the major contributors of the income tax gap (Hite, Stock, & Cloyd, 1992; Nelson, 2008).

As personal and business affairs are closely intertwined, small business owners perceived taxpaying as a loss of economic freedom and wealth erosion (Ashby & Webley, 2008;

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<sup>2</sup>Australia and New Zealand have over 95% of businesses which are SMEs with the majority of self employed where the owner is the sole person operating the business. Canada, China, USA and UK have approximately 90% of businesses which are SMEs.

<sup>3</sup> At present, the Small Business Advisory Group (SBAG) in New Zealand provides the means for dialogue with SMEs and government departments. They provide assistance and advice to government departments on consultation with SMEs. However, their recommendations are not binding on the government.

Kirchler, 2007). A lack of withholding taxes paid during the year often result in taxes to be paid at year end for small businesses.<sup>4</sup> In addition, as they are collector of value added and employment taxes on behalf of the government (Joulfaian & Rider, 1998), many do not make a mental separation of these taxes (Prescott & Hooper, 2009). In other words, most small business owners perceived these taxes as belonging to them (Adams & Webley, 2001; Ashby & Webley, 2008), and therefore returning these taxes to the government was seen as a financial loss (Kamleitner et al., 2012).

Tax literature showed mixed results of the helpfulness of tax authorities towards SMEs (McKerchar, 1995; Noble, 2000). There was evidence of strong resentment towards the tax system by some SMEs (Australian Taxation Office, 1996), and SMEs in the United States of America (USA), UK, Australia, NZ and African countries unanimously are concerned with the broad range of taxes paid (Adebisi & Gbegi, 2013; Joulfaian & Rider, 1998; Webley, Adams, & Elffers, 2002; Yong & Cheng, 2011). Compared to the larger businesses, most SMEs view the tax system to be unfair to them (Murphy, 2003b), they feel more disassociated from the tax system and they admit to paying less than their fair share of taxes (Ahmed & Braithwaite, 2005).

SME taxpayers infrequently contact their tax authority and they do so only if they have a problem or wish to check on legislation changes (Cynthia Coleman & Freeman, 1994; Wallschutzky & Gibson, 1994). A significant number of them perceived tax authorities as unsympathetic, unaccommodating, judgmental and uninterested in their business (Adams & Webley, 2001; Murphy, 2003a). Consequently, SMEs employ tax practitioners to undertake some of the tax functions and to reduce the chances of tax audits (Marshall, Armstrong, & Smith, 1998; Tan, 1999). However there is also evidence that tax practitioners are employed to aggressively exploit ambiguous tax laws to reduce their tax liabilities (Tan, 2011).

Relatively little is known about the tax compliance behaviours of SMEs other than they operate in the cash economy; have inadequate tax knowledge to fulfil their tax obligations (Ahmed & Braithwaite, 2005; Kamleitner et al., 2012); have more opportunities to evade taxes (Cash Economy Task Force, 2003; McIntosh & Veal, 2001); and they perceive tax authorities to be able to elicit compliance from them (Ahmed & Braithwaite, 2005). This study aims to further our understanding of SME owners' tax compliance by examining the potential effects of cultural values on their compliance practices and perceptions.

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<sup>4</sup> Some countries such as New Zealand has addressed this problem by introducing provisional taxes which are taxes paid in advance and in instalments during the year in order to reduce the magnitude of the taxes owing at year end. For example, if the tax liability of small businesses reached the \$2500 residual income tax threshold of the previous year they will be required to pay three equal provisional taxes in advance for the following year's taxable liability (section 15B of the Tax Administration Act 1994 (TAA 1994)). Failing to pay provisional taxes would incur penalties and use of money interest as per sections 139B and 141AA to 141K of the TAA 1994.

## Cross cultural and intra cultural research on tax compliance

The study of culture on tax compliance had been undertaken cross-culturally and intra-culturally to examine the tax behavioural differences between nations and between ethnic groups within a country respectively. Generally, research has shown that cultural differences between nations and ethnic groups do affect the tax compliance/evasion attitudes of the taxpayers to some extent (C. Coleman & Freeman, 1997; McGee, Ho, & Li, 2008; Richardson, 2008).

## Cross-cultural tax compliance research

The survey study undertaken by Alm and Torgler (2006) shows that the USA had higher tax morale than Spain, and that Switzerland also had higher tax morale relative to other European countries. The differences in the tax morale of these countries were attributable to institutional and political differences, trust in government, and the fiscal exchange between the taxpayers and government. Similarly, Cummings et al., (2009) found that tax compliance behavioural differences between the USA, Botswana and South Africa were largely due to cultural differences in the perceived fairness of tax administration, the perceived fiscal exchange between the taxpayers and government, and the taxpayers' overall attitudes towards government.

Frey and Weck-Hannemann (1984) compared survey results from 1960 to 1978 to identify a country's level of "tax immorality" (tax evasion) index. They attribute a median rank to the USA, Canada, Japan and Ireland, which lie between Scandinavian countries, Britain, the Netherlands, and the German speaking countries. They also found Romanic countries such as France, Italy, and Spain had higher tax immorality indices than most other countries.

Cross-cultural research using Hofstede's (2001) cultural values of power distance, uncertainty avoidance, individualism/collectivism and masculinity/femininity have found to affect the tax compliance/evasion attitudes of its citizens.<sup>5</sup> For example, Tsakumis et al., (2007) differentiated between compliant and non-compliant countries. They profiled non-compliant countries as those with high uncertainty avoidance, low individualism, low masculinity and high power distance. Richardson (2008) examined the legal, political, religious and cultural factors on the tax evasion attitudes across 47 countries. His regression results indicate that the higher the level of uncertainty avoidance and the lower level of individualism, legal enforcement, trust in government, and religiosity, the higher is the level of tax evasion across countries.

The importance of culture in tax compliance research is further reinforced by survey studies undertaken on tertiary students. Richardson suggested that "it might be that cultural setting is an important factor that should be taken into account" (Richardson, 2005, p. 22) as he

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<sup>5</sup> For further discussion see George Tsakumis, Anthony Curatola and Thomas Porcano, 'The Relation Between National Cultural Dimensions and Tax Evasion' (2007) 16 *Journal of International Accounting, Auditing & Taxation* 131; and Grant Richardson, 'The Relationship Between Culture and Tax Evasion Across Countries: Additional Evidence and Extensions' (2008) 17 *Journal of International Accounting, Auditing & Taxation* 67.

discovered differences between Australian and Hong Kong (HK) students' tax attitudes towards tax fairness, tax rate structure and self-interest. McGee et al., (2008) surveyed students from HK and the USA and found the former to be more conditional in their perceptions on tax evasion than the latter, who viewed tax evasion as morally wrong. HK students tend to justify their tax evasion perceptions based on the government's performance and are willing to compromise towards tax evasions if their expectations of their government are not met. Similarly, Chan et al., (2000) observed that collectivistic HK students are less compliant and have less favourable attitudes toward the tax system compared to the individualistic USA students.

The above cross cultural research had shed some light into how cultural values affect tax compliance behaviour and perceptions. Intra-cultural research on New Zealand tertiary business students also revealed that 51 percent of European and 28 percent of Chinese students admitted to understating their taxable incomes in the five years preceding the study and that Europeans and Maori are more likely to know others who had evaded taxes (Birch, Peters, & Sawyer, 2003). Further simulation results on New Zealand students also found a lower propensity to pay tax among male Maori and Chinese, while tax honesty is most evident among Pacific Islanders and female Chinese and Indians (Marriott, Randal, & Holmes, 2010).

Despite the convenience of having student samples, there are certain limitations when using findings from student's research. First, students are not perfect representatives for actual taxpayers due to age, working and taxpaying experiences differences from actual taxpayers (Cuccia, 1994; Yong, 2006). Majority of the students are younger and have higher education than average citizen (Fehr, Fischbacher, von Rosenblatt, Schupp, & Wagner, 2003). Second, even though there are claims that students do not behave differently from non-students in experimental research (Alm, 2012; Alm & Jacobson, 2007), the findings suffered from low external validity. This is because real factors such as social stigma of jail time and loss of reputation cannot be modelled in experimental research (Kirchler, 2007; Levitt & List, 2007), and that the "absence of social pressures could inhibit the same psychological processes as actual taxpayers which are important in the real world" (Torgler, 2007, p. 11). Further, students were found to game-play in experimental research (Cuccia, 1994) and they are comparatively less compliant and they take more risks than non-students (Gerxhani & Schram, 2006; Starmer, 1999). Given the limitation of student samples, this present study sampled actual taxpayers to achieve high external validity (McKinnon, 1988). Using actual taxpayers help to overcome the limitations of research that lack generalisability to real taxpayers and to address the shortages of tax studies that use actual taxpayer data.<sup>6</sup>

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<sup>6</sup> For more information on the critique for not having enough actual taxpayer data and the lack of generalisability of actual taxpayer data in tax research, see John Hasseldine, Peggy Hite, Simon James and Marika Toumi, 'Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors' (2007) 24 *Contemporary Accounting Research* 171,171.

## **Ethnicity and intra-cultural tax compliance research**

Ethnicity not only affects tax evasion decisions but also the taxpayers' willingness to contribute to taxes. Due to "intergroup bias" (Li, 2010, p. 149), ethnic groups are more willing to pay taxes to finance public spending that benefitted their own group but are reluctant to bear the economic cost for other groups (Alesina, Baqir, & Easterly, 1999; Alesina & Ferrara, 2005). Further, Luttmer (2001) finds that individuals increase their support for welfare spending when the recipients are from their own ethnic group. In addition, the greater the ethnic fractionalisation, the greater is the probability of non-compliance (Li, 2010).

Recognising the cultural diversity of countries, there have been several studies undertaken which links cultural values and tax compliance of its citizens. Frey (2003) found that southern Italians have lower levels of civic virtue than northern Italians, and that former East Germans are less cooperative than former West Germans in public goods contribution (Ockenfels & Weimann, 1999). However, more recent research shows that former East Germans demonstrate higher tax morale than former West Germans and "the cultural background seems to have an effect on tax morale" (Torgler, 2007, p. 232).

However, two intra-cultural Malaysian survey studies have found "no significant differences among ethnic groups (Malays, Chinese and Indians) on the overall non-compliance attitude" (Kasipillai & Abdul-Jabbar, 2006, p. 85) and that "a direct relationship was not found between ethnicity and tax compliance" (Loo & McKerchar, 2011, p. 16). Though the Malaysian studies did not find any direct relationship between ethnicity and tax (non) compliance, other intra-cultural research showed greater variations in tax attitudes between ethnic groups. For example, an Australian focus group study on ethnic SME taxpayers reveals tax attitude differences between the Asians, Greeks, Lebanese (collectivistic groups) and local born Australians, with the Asians undertaking extensive tax planning to minimise taxes (Rothengatter, 2005). In addition, not declaring cash jobs is not considered unethical by the collectivistic SME groups, though local born Australians perceived the practice as morally wrong. SME operators who identify themselves as Australians are also more willing to contribute towards taxes than those who do not (C. Coleman & Freeman, 1997; Rothengatter, 2005).

Further studies which linked the cultural backgrounds of SME taxpayers to tax attitudes were undertaken by Dornstein (1976) and Coleman and Freeman (1997). Dornstein found that self-employed migrants from the least developed countries, with a non-democratic socio-political background, have relatively negative tax attitudes and are least conforming to tax regulation compared to migrants from western European countries or native Israelis. Similar results were also found in the interview study by Coleman and Freeman. Taxpayers who have been in Australia longer and are born in Australia were found to be more compliant than those who are not (C. Coleman & Freeman, 1997). For example, they observed a South African business taxpayer practicing income smoothing to avoid the attention from the Australian Tax Office.

Earlier studies in the United States found that whites were more tax compliant and had greater commitment towards paying taxes than non-whites (Roth, Scholz, & Witte, 1989; Song & Yarbrough, 1978). Research also shows a positive correlation between lower compliance rates and the proportion of non-whites in the United States communities (Li, 2010). Given the data limitations of whites and non-whites, ethnicity needs to be broken down further to gain a better understanding of how different ethnic groups comply with the tax requirements. This is important for culturally diverse countries such as Australia, Canada, NZ, UK, and the USA. This present study examines the tax compliance behaviours of the four largest ethnic SME taxpayer groups in NZ given that NZ is culturally diverse.<sup>7</sup>

### **Rationale for choosing New Zealand as the sample study**

The income tax system of NZ was inherited from the “English (British) system” (Goldsmith, 2008, p. 17), and NZ tax law closely followed English law (Holmes, 2008). Given that, one would expect taxpayers of the English descent to be more familiar with the tax requirements and that tax regulations are more compatible with their cultural values. Given the immigration influx and cultural mix of the NZ population,<sup>8</sup> how does that affect the tax compliance practices of the non-English ethnic groups? In addition, it has been projected that the European (Anglo) population shows declining trends with a greater significance of the Asian and Pacific ethnic groups and the Maori staying proportionately the same (Statistics New Zealand, 2010). The declining trend of the Anglo population is common in other English speaking OECD countries.<sup>9</sup>

NZ is an interesting case to study SMEs due to several reasons. First, according to the OECD reports, NZ has consistently been ranked number 2 and 3 amongst 183 countries in the world, in terms of ease of setting up a business indicator from 2008 to 2012 inclusively (The World Bank, 2012, 2013b). Despite the ease in which owner-manager could set up a SME in NZ, it does however suffer from a poorer ranking in terms of the paying taxes indicator as determined by the OECD Committee. New Zealand was ranked 12, 9, 26, 36 and 21 in the world in terms of the paying taxes indicator for 2008, 2009, 2010, 2011 and 2012 respectively (The World Bank, 2012, 2013a, 2013b). The paying taxes indicator “records the taxes and mandatory contributions that a medium-size company must pay in a given year, as well as measures of the administrative burden of paying taxes and contributions” (The World

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<sup>7</sup> New Zealand has more than 200 ethnicities according to Edwina Pio, *Longing and Belonging: Asian, Middle Eastern, Latin American and African Peoples in New Zealand* (2010, Dunmore Publishing).

<sup>8</sup> New Zealand is predominantly populated by European (Anglo descent), indigenous Maori, Asians and Pacific Peoples and other minor ethnic groups such as Middle Eastern and Africans. For detailed statistics of the demographic mix, see Statistics New Zealand *2006 census data – QuickStats-about-culture-and-identity-tables.xls* (2010a) <<http://www.stats.govt.nz/Census/2006CensusHomePage/QuickStats/quickstats-about-culture-and-identity-tables>>

<sup>9</sup> There is an increasing non Anglo population in the United Kingdom, United States, Australia and Canada. See [http://en.wikipedia.org/wiki/Race\\_and\\_ethnicity\\_in\\_the\\_United\\_States](http://en.wikipedia.org/wiki/Race_and_ethnicity_in_the_United_States); [http://en.wikipedia.org/wiki/Ethnic\\_groups\\_in\\_the\\_United\\_Kingdom](http://en.wikipedia.org/wiki/Ethnic_groups_in_the_United_Kingdom); [http://en.wikipedia.org/wiki/Demographics\\_of\\_Australia](http://en.wikipedia.org/wiki/Demographics_of_Australia); [http://en.wikipedia.org/wiki/Ethnic\\_origins\\_of\\_people\\_in\\_Canada](http://en.wikipedia.org/wiki/Ethnic_origins_of_people_in_Canada)

Bank, 2009, p. 89). It measures all taxes and contributions that are government mandated, apply to the standardised business and have an impact in its income statements.

This study aims to get an in-depth insight as to why there was a dichotomy in terms of ease of doing business and paying taxes in New Zealand according to the OECD reports. In order to answer a “why” research question, literature has suggested that a qualitative approach is more suited to answer this type of question as quantitative approach is more suited to answer the “what” and “how” questions (Denzin & Lincoln, 2005).

This study is important as it provides some insights as to how ethnic groups within a multicultural society comply with the tax requirements of a developed English speaking OECD country. The knowledge gained has wide implications for other English speaking countries with culturally diverse taxpayer groups in terms of tax regulations, tax administration, tax assistance (support), tax practices, tax education and the formulation of tax policies. Furthermore, the contribution of this study is to build on the currently sparse tax literature of culture and SMEs (Kamleitner et al., 2012; Nkwe, 2013). This study adopts the qualitative research methodology and uses Hofstede’s cultural framework as the theoretical lens to analyse the data.

## **Hofstede’s Theoretical Framework**

According to Hofstede, a person’s behaviour is partially determined by his or her culture which is defined as the “collective programming of the mind that distinguishes the members of one group or category of people from others” (Hofstede & Hofstede, 2005, p. 4). Culture affects one’s behaviour and it “forms the roots of action”(Trompenaars, Hampden-Turner, & Trompenaars, 1994, p. 24). Hofstede’s (2001) framework has been used to analyse human tendencies from different countries (de Mooij, 2001; Hoppe, 1990) and ethnic groups within a country (Cohen, 2007; Popper & Sleman, 2001).

Even though Hofstede’s work has been widely cited in various disciplines including accounting, international taxation, management, entrepreneurship etc (Gray, 1988; Newman & Nollen, 1996; Sivakumar & Nakata, 2001; Tsakumis et al., 2007), there are several criticisms of his work.<sup>10</sup> Despite these criticisms, business researchers have applied Hofstede’s work in dramatically increasing numbers (Taras, Kirkham, & Steel, 2010) making it “the dominant culture paradigm” (Sivakumar & Nakata, 2001, p. 557). Some have labelled Hofstede’s model as “a watershed conceptual foundation for many subsequent cross-national research endeavours” (Fernandez, Carlson, Stepina, & Nicholson, 1997, p. 44).

Hofstede (2001) used five cultural dimensions to explain the differences in people’s behaviours which are: high and low power distance, individualism-collectivism, long term-short term orientations, high and low uncertainty avoidance and masculinity-femininity. For the purpose of this study, the masculinity-femininity dimension has been specifically

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<sup>10</sup> For further discussion see Rachel Baskerville, ‘Hofstede Never Studied Culture’ (2003) 28 *Accounting, Organizations and Society* 1; and Brendan McSweeney, Hofstede’s Model of National Culture Differences and Their Consequences: A Triumph of Faith - a Failure of Analysis’ (2002) 55 *Human Relations* 89.

excluded due to the confusion of this dimension with gender related roles and stereotypes (Eddleston & Powell, 2008).

### **Cultural Dimensions and the Ethnic Groups**

High power distance (PD) indicates the less powerful members of institutions within a society expect and accept that power is distributed unequally and that authority figures ought to be respected and obeyed. A low PD culture is where people tend to relate to one another as equals, regardless of actual power distinctions. Hofstede's cultural index for a country was based on the dominant cultural group which for New Zealand is the European. The Europeans exhibit low PD compared to Asians, Maori and Pacific Peoples (Begley & Tan, 2001; Hofstede, 2001; Lucas, 2009; Pfeifer, 2005).

Individualism is used to describe the degree to which members of a culture place a greater emphasis on the group versus the individual himself/herself. In those cultures where individualism is dominant, every person is expected to focus on what is best for him/herself. In the collectivist cultures, the individuals are, from birth, integrated into strong, cohesive groups which continue to protect them throughout their lives in exchange for unquestioning loyalty. Their allegiance is towards meeting group's needs at the individual's expense (Hofstede & Hofstede, 2005). NZ, as a country (i.e. European) is highly individualistic (Hofstede, 2001) whereas Asians, Maori and the Pacific Peoples are collectivistic (Podsiadlowski & Fox, 2011; Tiatia, 1998; Warriner, 2007).

Long term (LT) orientation relates to the fostering of virtues oriented toward future rewards [such as] long term planning, perseverance, and thrift, whereas short term (ST) orientation relates to the fostering of virtues related to the past and present [such as] respect for tradition, living for the day, preserving "face", and fulfilling social obligations. Asians are high scorers for LT orientation whereas NZ overall has medium term orientation (Hofstede, 2001; Hofstede & Bond, 1988). Pacific Peoples are ST oriented with little future planning (Crocombe, 2008) and they generally undertake tasks only when they are needed (Crocombe, 1976). To the Maori, "decisions require much contemplation and consideration from every angle" (Mataira, 2000, p. 25) with little emphasis on future planning. The emphasis is largely on present living and nurturing relationships to preserve one's *mana* (aura, status or face) (Clydesdale, 2007; De Bruin & Mataira, 2003).

Uncertainty avoidance (UA) is defined as "the extent to which the members of a culture feel threatened by ambiguous or unknown situations" (Hofstede & Hofstede, 2005, p. 167). Low UA cultures accept rather easily the notion of ambiguity and unfamiliar risk, whereas high UA cultures attempt to counter ambiguity and unfamiliar risks by having rules, regulations and structured events to give some form of predictability. Asians as a cluster score high to medium for UA, whereas NZ score medium to low (Hofstede, 2001). Maori and Pacific Peoples score low on UA (Crocombe, 2008; Frederick & Henry, 2004; Lucas, 2009).

Given the cultural differences of the ethnic groups, how might that affect their tax compliance behaviours and perceptions (if any) since research has shown that culture does

affect a person's behaviour. To answer this question, the next section discusses the research approach undertaken by this study to collect documentary evidences from the 59 participants.

## Research methodology and design

A qualitative research approach<sup>11</sup> with the use of in-depth interview method has been adopted for this study due to the diversity of the ethnic groups and the preference of non-Europeans for face-to-face interactions (Brown, Tower, & Taplin, 2005; Tsui-Auch, 2008; Warriner, 2007). 36 ethnic SME owners (nine from each ethnic group of European, Asian, indigenous Maori and Pacific Peoples), 15 business experts (tax and policy administration, government and business agencies) and eight tax practitioners (sole practitioners and chartered accounting firms) were interviewed from 2006 to 2010. The selection criteria for SME owners were based on ethnicity, business size and industry. The business experts and tax practitioners were selected based on their frequent and on-going working relationships with SMEs.

All the participants were from Auckland for it is the largest and the most culturally diverse city in New Zealand (Ministry of Economic Development, 2009). It has the highest number of SMEs in the country (Ministry of Economic Development, 2011) as well as having the highest net Maori asset base in the country which is necessary for their business undertakings (NZIER, 2007). Finally, Auckland has the highest Pacific population in the country and it is often described as the Polynesian capital of the world (Robie, 2009).

## Interview Questions and Data Analysis

Some fixed and open ended questions were adopted and the interview schedule was improvised to suit each participant. The open-ended questions allowed the researcher to enter the fieldwork without being constrained by predetermined categories of analysis (Patton, 2002; Punch, 2005). This approach allows the participants certain freedom in expressing what is important in terms of their beliefs and perceptions towards tax compliance (Gaskell, 2000; Liamputtong, 2009).

Specific questions for the SME owners explored their tax compliance practices and perceptions. Business experts were asked about the effects of cultural values on the tax compliance behaviours of SMEs. Tax practitioners were asked about the accounting and compliance challenges faced by SMEs. The accounts of the business experts and tax practitioners were used to triangulate the accounts given by SME owners.<sup>12</sup> The analysis of

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<sup>11</sup> For further discussion on the justification and advantages for using the qualitative research methodology see Lawrence Neuman, *Social Research Methods: Qualitative and Quantitative Approaches* (Pearson Education, 7<sup>th</sup> ed, 2001); Pranee Liamputtong, *Qualitative Research Methods* (Oxford University Press, 3<sup>rd</sup> ed, 2009); and Keith Punch, *Introduction to Social Research: Quantitative and Qualitative Approaches* (Sage Publications, 2<sup>nd</sup> ed, 2005).

<sup>12</sup> Triangulation using multiple sources is an important function for qualitative research in terms of validity. For further information see Lynne Oats, 'Gathering and interpreting qualitative data' in L. Oats (ed.) *Taxation: A Fieldwork Research Handbook* (Routledge, 2012) 19 ; and Dawn Snape and Liz Spencer, 'The Foundations of Qualitative Research' in J. Ritchie & J. Lewis (eds.) *Qualitative research practice* (Sage Publications, 2003) 1.

the findings follows a path as suggested by O’Dwyer (2004) which involves data reduction, data display, and data interpretation and conclusion drawing. O’Dwyer’s method is an adaptation of the analytical process developed by Miles and Huberman (1994).

This study examines two key compliance processes and perceptions of ethnic SME taxpayers which are tax payment experiences and the use of tax practitioners/accountants in NZ. The perceptions form their tax attitudes and their willingness to contribute to the taxes. Hofstede’s cultural dimensions are used to explain the differences (if any) of their tax compliance behaviours. Whilst this paper concentrates on using cultural values to help explain tax compliance differences, there may be other non-cultural, institutional and social factors that may affect tax compliance behaviours, but these do not form the focus of this study.

## Research Findings and Analysis

### Cultural Values and Taxpaying Decisions

One of the questions asked of SME owners relates to paying their taxes on time. This question is important due to section 15B of the Tax Administration Act 1994 (TAA 1994) which requires all NZ tax residents to pay their taxes and to file their tax returns on time. Table 1 summarises the responses from the 36 business owners with stark differences between the Asians and the other groups.

<b>Difficulty in meeting tax payment and/or having to make payment arrangements with the IRD</b>	<b>Europeans</b>	<b>Asians</b>	<b>Maoris</b>	<b>Pacific Peoples</b>	<b>Total</b>
Yes	3	0	6	7	16
No	6	9	3	2	20
Subtotal	9	9	9	9	36

**Table 1: Tax payment difficulties and payment arrangements with the IRD**

Table 1 shows that more than two-thirds of the Maori and Pacific owners in this study had difficulty paying their taxes on time compared to one-third for the Europeans and none for the Asians. The Asians’ behaviour can be traced to their thrifty nature (LT orientation which emphasises savings for difficult days) (Asia New Zealand Foundation, 2013; Begley & Tan, 2001), and assistance provided by in-group members (due to collectivism) (Podsiadlowski &

Fox, 2011). Their strong in-group collectivism allows them financial access from families to avoid business foreclosure:

*I see the Asian community very much work within their group, their own family, their own extended family ... They seldom use banks, the family is the bank. (Business Expert 9: Male and from a business agency)*

Being long term oriented, future financial planning is given priority by the Asians unlike short term oriented Pacific and Maori:

*No, we have not been in any tax payment difficulty before. We always have cash in the bank and we plan our outgoings all the time and I know when each payment is due. (Asian Owner 2: Male in the financial services and rental businesses)*

*But often times what we have seen among Pacific business owners are lack of business planning, no business experience and poor financial management and literacy skills and they start a business with no equity. (Business Expert 11: Male and from a government agency)*

*Maori haven't positioned themselves in their finances and they jumped too quickly into business without much business education or planning. (Business Expert 14: Male and from a government agency)*

The Europeans in this study had some difficulty with their tax payment is a reflection of their medium term orientation. Some of these difficulties were due to delays in debt collection and/or over-commitment in business investments. On the other hand, Maori and Pacific owners emphasised living for the present and maintaining their cultural traditions (which reflects ST orientation) and also in satisfying collectivistic obligations towards their groups:

*Family pressure, sending money home and the church impacts on their cash flows does put pressure on a lot of Pacific and Maori families here. (Business Expert 6: Male and from tax administration and policy)*

*The culture to give to your family is ingrained in you the minute that you are born. Your whole existence is to give to the church and to give to the family. (Pacific Owner 7: Female in the arts and craft business)*

The above discussion shows the interplay of LT and ST orientations, uncertainty avoidance and collectivism and how they influence business owners' taxpaying behaviours. Asians being LT oriented and high UA traits undertook measures to avoid tax payment difficulties. These measures include financial planning and managing cash flows to avoid tax penalties. Further, it is perceived as an unwise business practice to be on the wrong side with the tax authority (Gupta, Levenburg, Moore, Motwani, & Schwarz, 2008). The Asians' collectivistic trait also gave them financial access to their families' resources to avoid tax payment difficulties.

On the other hand, the collectivistic traits were detrimental to the Maori and Pacific owners in terms of paying their taxes on time. Allegiance to extended families and to the church giving are important aspects of Maori and Pacific cultures which led to adverse tax payment delays and difficulties (Macpherson, 1992; Meleisea, 1987; Warriner, 2007). By not paying their business taxes on time and by giving higher priority in meeting group's obligations over their own business obligations have resulted in higher tax compliance costs.<sup>13</sup> Their ST orientation and low UA traits meant that there is less tendency to plan ahead financially to meet tax payments.

Given the above analysis, there is a need to assist SME owners with their taxpaying behaviour to avoid tax penalties. In order to do so effectively, there is a need for tax authorities, tax practitioners and business experts to have some cultural awareness of the tax payment difficulties (if any) of ethnic business taxpayers. The importance of sound financial management and literacy skills is vital for SME owners to successfully pay their taxes on time. Financial incentives should be given by tax authorities to encourage early tax payments. This may be particularly relevant to the Maori and Pacific groups and to encourage them to prioritise their business obligations over their group's obligations. They should be educated to differentiate between business and personal needs and avoid using business monies for group purposes. In doing so, it will help lower their tax compliance costs in terms of tax penalties. Overall there is a need for tax administrators, tax practitioners, business experts and SME owners to have an awareness of the impact of culture on SME owners' taxpaying decisions.

### **Relationship with and Perceptions of Tax Practitioners and Tax Authority**

Tax literature has shown that SME owners used a variety of sources to assist with tax compliance: peers, networks, accountants, banks and tax authorities (Lewis, Ashby, Coetzer, Harris, & Massey, 2005; McKerchar, Hodgson, & Walpole, 2009). The most important source of tax assistance is the accountant/tax practitioner/tax agent (Klepper & Nagin, 1989; Marshall et al., 1998).

The SME owners in this sample also used similar sources of tax assistance but the reasons for using the accountants varied between ethnic groups. There are strong cultural underpinnings for using accountants and peers which have previously been overlooked. For example, most of the Asians in this study relied on their peers (free) thus reflecting their collectivistic traits and LT orientation to avoid paying high accounting fees:

*It can be very expensive for a small business to go to the accountant for tax issues and money can be difficult to come by ... I will ask my CA friend [free] first when I have a tax query (Asian Owner 8: Female in the information technology consulting and rental businesses)*

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<sup>13</sup> Refer to ss 120, 139 and 141 of the TAA 1994 for the various forms of penalties and interest charged for tax payment delays.

*In terms of tax query, I will speak with my peers [free] as they have the experience and I trust them to give me good advice. I sometimes speak to the IRD but the long telephone queue does put me off. (Asian Owner 3: Female in the export and retailing business)*

On the other hand, all the Europeans in this study except for one used their accountants as their main source of tax assistance. This is consistent with prior tax literature (Erard, 1993; Sakurai & Braithwaite, 2003). However the justification for using the accountants was due to their trust and good working relationship with the accountants (Tan, 1999). European business owners view their accountants as carrying on specialised functions (which is a reflection of their low PD values) and are therefore willing to pay for their services (Marshall et al., 1998). Unlike the Asians, the Europeans in this sample are less obsessed with tax cost savings thus reflecting their medium term orientation. Further, their individualistic traits meant that they do not have access to informal group's resources:

*We don't have a group of peers where we can go to pick their brains on tax issues ... and small businesses are so caught up with their business and it is just too hard to have to deal with tax issues. I would pay the accountant to deal with that. (European Owner 1: Female in the music and entertainment business)*

*My accountant is a safety check for us as I do not have the skills to do the income tax return. I prefer to go to my accountant instead of the IRD (tax authority) as my accountant will give us some solid business advice and I am more comfortable asking my accountant regarding tax issues. (European Owner 9: Female in the carpet retailing business)*

The Pacific and Maori groups also relied heavily on their accountants to assist with tax compliance. However the reasons for using the accountants can be traced to their high PD values where they esteem accountants as authority figures with tax expertise:

*I talk to my chartered accountant because she knows heaps and she is the tax expert. She is really valuable. (Maori Owner 1: Female in the construction and building business)*

*Like some Polynesians we do not question the accountants and ... I am always too scared to question my own accountant. It is kind of fear them as they will not look favourably at you and help you in the future. (Pacific Owner 3: Male in the catering and food business)*

One of the most interesting finding with this research is that all groups with the exception of the Maori did use the IRD (tax authority) as a form of tax assistance. Further exploration of the reason why Maori owners were reluctant to contact the tax authority was largely due to historical and cultural values and the fear of government:

*They (the Maori) are terrified of the IRD (tax authority) or anything relating to compliance due to the history of the land loss to the Crown ... and the injustices still remains in some people. (Business Expert 3: Female in the government agency)*

*Don't get on the bad books with the IRD as they are unforgiving and nasty. It is like you fall into a pool with the sharks and you get bitten with heavy tax penalties when you are filing late and there is no grace period. (Maori Owner 4: Male and in the television and production business)*

The reluctance of the Maori group in contacting the tax authority with their tax problems has led to dire consequences including suicide and potential foreclosure:

*This man committed suicide as he got into trouble with the IRD as he didn't pay his taxes and he has filed for his second bankruptcy. I should have seen it coming as he was behaving very peculiar. The IRD came in harsh on him in this case. (Tax Practitioner 7: Female and a partner in a small chartered accounting firm)*

*Leading up to having tax payment difficulties with the IRD, I had mountains of letters unopened from them. I was in denial. The letters and denial accumulated for about 6 years and I was hoping that the problem will just go away... finally I had to sell my house to pay off the debt when the IRD threatened to foreclose me. (Maori Owner 6: Female in the journalism and television business)*

The above findings showed that ethnic groups used their tax accountants – some more than the others. However, there are different rationales for using the accountants between the Europeans and the Maori and Pacific groups. The Asians are reluctant to use their accountants frequently to save on tax compliance costs. The Europeans perceived their accountants as promoting their financial affairs and therefore viewed them as serving important functions due to their low PD values. On the other hand, the high PD values amongst Maori and Pacific groups have caused them to view tax practitioners/accountants with great esteem as if they possess authoritative expertise in taxation.

The lack of use of the tax authority should also be noted. European SMEs do not trust tax authorities to work in favour of them which are consistent with prior literature (McKerchar, 1995; Noble, 2000). On the other hand Maori's reluctance to interact with the tax authority was due to cultural and historical values. One can interpret that Maori's non-contact with the IRD is not because they resist paying taxes but rather their perceptions of authorities in general. These factors ought to be considered when managing ethnic taxpayers. It is important for tax authorities to discern these varied perceptions to avoid any misunderstanding of the ethnic business tax compliance behaviours. Their non-response could be attributable to cultural value of power distance and historical reasons and not necessarily retaliation towards the tax system as suggested in previous studies (Abdul-Jabbar & Pope, 2009; Morse et al., 2009).

## **Implications, Conclusions and Suggestions for Future Research**

The outcome of this study shows that taxpayers' cultural values are important in tax compliance processes and perceptions. In particular, there appears to be some link between the cultural dimensions and the way in which ethnic SME owners view their tax payment

obligations and the sources of tax assistance used. In summary, there is preliminary evidence to suggest that tax may be ethnically connected based on the interview data in this study.

The results also build on past research outcomes concerning the tax compliance behaviours of SMEs and culture. The findings of this study have implications for tax authorities in charge of regulating ethnically diverse taxpayers. Since cultural values affect tax compliance, tax authorities should put in place someone who is culturally sensitive to the needs of ethnic taxpayers (John Hasseldine, Hite, James, & Toumi, 2007). In summary, a focus on cultural awareness within tax policies, tax regulations and tax assistance pertaining to SMEs ought to take into account multiculturalism values.

This research shows that cultural values of ethnic groups do to some extent influence their tax compliance practices and perceptions. Some cultural values encourage successful tax compliance in terms of lowering tax compliance costs and paying their taxes on time. On the other hand some cultural values impede successful tax compliance and SME owners had to bear the adverse financial and psychological consequences.

In designing tax policies and regulation, it would be beneficial to ensure that different perspectives of the ethnic taxpayers are understood especially when the non-mainstream population is gaining significance. Tax policies in multi-cultural societies need to be updated to meet the changing needs of its taxpayers thereby addressing some of the problems associated with the tax culture gap (Nerre, 2008). The information provided by this study can help inform and encourage the discussion around tax policies, regulation and assistance which includes the question around how to optimise tax compliance from culturally diverse SME taxpayers who have a history of high tax non-compliance.

This study has important implications for tax administrations, policy makers, tax practitioners, academics, business experts and SME owners. Due to the influence of cultural values on tax compliance practices and perceptions, one has a better understanding behind tax non-compliance. As seen from this study, some non-compliance can be attributable to cultural values and not necessary a deliberate resistance towards the tax system of which most tax literature seem to suggest.<sup>14</sup> Further, a better understanding of the different cultural values impinging on ethnic SME owners can alleviate any misunderstanding as to why there may be a divergence in tax compliance behaviours in certain ethnic groups from the mainstream. Further, the findings from this study may help explain the dichotomy of the New Zealand's world ranking in terms of doing business and the paying taxes indicators as recorded in the OECD reports from 2008 to 2012.

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<sup>14</sup> The approach to administering the taxation laws in New Zealand and Australia are based on the responsive regulation model whereby tax administrators sought to maximise voluntary compliance by majority of taxpayers whilst focusing limited enforcement resources on the recalcitrant minority; Grant Richardson, 'Determinants of Tax Evasion: A Cross-Country Investigation' (2006) 15 *Journal of International Accounting, Auditing and Taxation* 150; and David Joulfaian, 'Corporate Income Tax Evasion and Managerial Preferences' (2000) 82 *Review of Economics and Statistics* 698.

Like all research, this study is not without its limitation. A common feature of all qualitative studies is the small sample size<sup>15</sup> with participants who are willing to provide useful information about the phenomenon under study (Dunbar, Rodriguez, & Parker, 2002; Kvale & Brinkmann, 2009). Qualitative research is generally accepted as providing “a richer understanding of human behaviour” (McKerchar et al., 2009, p. 158) whereas quantitative research is directed at “examining causal relationships and empirically testing an existing theory” (McKerchar, 2010, p. 91).

Findings from qualitative research are usually aimed at “analytical generalisations which are limited in context to the population studied” (McKerchar, 2010, p. 94) whereas quantitative research is aimed at making statistical generalisations to the broader populations from the samples studied (McKerchar, 2010). Further, qualitative researchers have been encouraged to view their research findings as “multiple entry points, and as an entrance to ongoing dialogue, and not as the ending of research” (Koro-Ljungberg & Barko, 2012, p. 264). This sums up the purpose of this study, which is to provide further dialogues for more and varied research on the impact of multiculturalism and tax compliance.

As this research is an attempt to understand the effects of cultural values on tax compliance behaviours, samples of these ethnic groups can be extended to identify whether the association does hold. In addition, ethnic groups in other countries that exhibit diverse cultural values should also be explored. For example, in Australia the high percentage of Italian, Greek, Lebanese and Asian taxpayers should be explored using both the qualitative and quantitative approaches to investigate further the link between culture and tax compliance behaviours. This study can also be extended to other developed OECD countries with multi-cultural taxpayers including Australia, Canada, USA, UK, Western Europe and certain parts of South East Asia.

Tax authorities need to have a better understanding of the cultural values of their citizen-taxpayers and how they might impinge on their tax behaviour. This knowledge may assist them to customise their regulatory strategies in order to meet the needs of the taxpayers. This approach is therefore consistent with the call for responsive regulation (Braithwaite, 2007; Dabner & Burton, 2008; Feld & Frey, 2007; Job, Stout, & Smith, 2007) with the use of a suite of regulatory strategies (Burton & Dabner, 2009) instead of a “one size” fits all approach. Being responsive in their regulatory approach helps to ensure that their regulatory strategy is no long a hit and miss but rather targeted to get the best tax compliance outcomes from its culturally diverse citizen-taxpayers.

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<sup>15</sup> For further discussion on the rationale for the small sample size for qualitative research, see Patton, above n 122; and Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (2010, Thomas Reuters). Only 30 small business taxpayers were interviewed in the study by McKerchar, Hodgson and Walpole, above n 132 and 12 small businesses participated in another interview based Australian study undertaken by Philip Lignier ‘The Managerial Benefits of Tax Compliance: Perception by Small Business Taxpayers’ (2009) 7 *eJournal of Tax Research* 106.

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