

Culture's Influence on Tax Non-Compliance Among Small and Medium Sized Enterprise Owners in Malaysia

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The recognition of SMEs as the Malaysian backbone is undoubtedly due to their prominence in generating income for Malaysia. However, little has been focused on in terms of culture influence in determining non-compliance behaviour in tax studies. In a multicultural society with different cultures, beliefs and values, it is important to examine cultural influence on tax non-compliance. Therefore, this study attempts to examine cultural influence on intentional tax non-compliance by using the framework of Hofstede's Cultural Dimensions Theory as basis of the study. The survey has collected data from 248 usable SME owners from the northern region of Peninsular Malaysia. Findings reveal that power distance, individualism, masculinity, uncertainty avoidance and long-term orientation are significantly related to intentional tax non-compliance. Suggestions for policy makers and future researchers are also highlighted.

Key words: Culture Influence, Hofstede's Cultural Dimensions Theory, Intention; SME Owners, Tax Non-Compliance.

Introduction

SMEs, as the backbone of Malaysia, have lead national economic demand with a 99.2 percent contribution of the businesses and companies in Malaysia (Kamaruddin, 2014). Their contribution to Gross Domestic Product (GDP) has increased from 37.8 percent to 38.3 percent. It is believed it will grow higher by 2020, achieving a GDP of at least 40 percent. However, the likelihood of SME owners engaging in tax non-compliance is higher due to

huge opportunities involved in cash business transactions and avoiding cash declaration (Mohamad, Zakaria and Hamid, 2016). This is especially because their behaviours typically seem to be unnoticed by tax authorities (Mohd Ali, 2013). The serious problem of SME owners' behaviour in tax non-compliance has caught the attention of tax authorities, academicians and non-governmental organisations all over the world (Newman, Mwandambira, Charity and Ongayi, 2018). Nevertheless, little has focus has been directed to cultural influence in explaining tax non-compliance among SME owners. According to Roth, Scholz and Whitte (1989), cultural influence is very important in explaining tax non-compliance, since culture itself may reflected taxpayers' values and norms. These are constantly practiced in daily life, which can later shape attitudes towards non-compliance.

Besides that, this study has also been conducted to call upon studies done by Yong (2011) and Chau and Leung (2009). Suggestions were made to apply different methodological research approaches, such as surveys, due to limitations in applying qualitative research in explaining cultural influences on SME operators in New Zealand. It is also suggested to not only focus cultural study on Anglo-Saxon countries, but to extend it and conduct it in other multiracial and multicultural countries as well as in countries exercising self-assessment systems. Given this gap of knowledge, there appears to be considerable scope for further study. Thus, the objective of this study aims to examine cultural influence on SME owners' intention regarding tax non-compliance. To do so, five-dimensional measure of culture in Hofstede's Cultural Dimensions Theory known as power distance, individualism-collectivism, masculinity-femininity, uncertainty avoidance and long-term-short-term orientation are used in this study.

Literature Review

Hofstede's Cultural Dimension Theory

This theory has been introduced by a Dutch psychologist named Geert Hofstede. It is an approach using human values through cultural dimensions for the purpose of conflict management in a society. Hofstede (2001) defined culture as "the collecting programming of the mind that distinguishes the members of one group or category of people from another". A five-dimensional measure of culture known as (1) power distance, (2) individualism versus collectivism, (3) masculinity versus femininity, (4) uncertainty avoidance and (5) long-term versus short-term orientation, has been introduced (Hofstede, 1980, 1991).

First, power distance refers to the acceptance level of the society towards differences in distributing power and represents the solutions of basic problems in human inequality (Hofstede, 1980). According to Hofstede, Hofstede and Minkov (2010), Malaysia has a high score in the Power Distance Index. Second, individualism versus collectivism refers to how

individuals choose to be integrated in their own groups and show individual behaviour in groups (Hofstede and Bond, 1988). Third, masculinity versus femininity measurement shows that it does not refer to the dominance of gender but it represents the extent integration in social or community settings (Jones, 2007). It shows individuals' behaviour towards sex (Hofstede and Bond, 1988). According to Hofstede (1980), masculine societies are more focused on achievement and success as their dominant value and can be categorised as an assertive pole. This is opposed to feminine society, which prefers to have good quality in life and relationships as their dominant values and can be categorised as a nurturing pole. As for Malaysia, it was listed as a feminine country (Hofstede et al., 2010).

Fourth, uncertainty avoidance relates to the level of stress in a society to face the unknown future. It does not refer to social behaviour but more to searching for absolute truth (Hofstede and Bond, 1988). Societies with higher uncertainty avoidance are more rule-oriented and less tolerant towards accepting changes and risks (Hofstede, 1980). This contradicts low uncertainty avoidance societies, which are less rule-oriented and more tolerant in accepting changes as well as risks.

The last dimension is long-term versus short-term orientation. It posits time orientation concerned with persistence, thrift, past, present, tradition and social obligations (Bond and Chi, 1997) as well as how we plan our decisions. This relates to saving and spending because individual behaviour is also affected by time orientation (Phuong-Mai, Terlouw and Pilot, 2005). Phuong-Mai et al. (2005) believed that long-term oriented individuals always looks to the future, are always persistent in doing the best as they can, strategically plan their spending and still obey the rules as long as they may give benefits to them. This is because they believe in a "what works" approach. This contradicts short-term oriented individuals. They tend to look for what they experience in past and present. They love and appreciate others with gifts and other things. In complying with tradition, they tend to repeat or follow what has been practiced before because they believe in a "what is right" approach. Hofstede et al. (2010) present East Asian countries and Eastern and Central European countries as having long-term oriented cultures, while the United States of America, Australia, Latin American and African countries are considered short-term oriented. Muslim countries were also categorised as short-term oriented.

Prior Studies

A number of studies have been undertaken in determining the influence of culture in tax compliance. The Individualism-collectivism dimension has been studied by Chan, Troutman and O'Bryan (2000) and McGee, Ho and Li (2008), focusing on taxpayers in United States and Hong Kong. Chan et al. (2000) found a negative significant relationship between the culture and tax compliance behaviour of US and Hong Kong taxpayers. Taxpayers from the

United States are oriented more towards individualism as a cultural value. They were found to be more compliant and have favourable attitudes towards tax compared to Hong Kong, who were found to be collectivist taxpayers. These differences might have an effect on the taxpayers' ethical values and moral development, as well as tax compliance behaviour (Chan et al., 2000). The findings of McGee et al. are consistent with Chan et al. Due to limitations in responses among advanced undergraduate business students, it was suggested to extend the study towards business owners, since findings could be different and more remarkable.

There is also a study conducted by Tsakumis, Curatola and Porcano (2007) using this model. Malaysia was chosen to be one of the samples among 50 selected countries. Overall, the study concludes that, in explaining power distance dimensions, Malaysian still practices obedience and conformity, since there is still autocratic decision making under close supervision. Furthermore, Malaysia is considered to be more collectivist, since it has a tight social relationships between people, has moderate to weak uncertainty avoidance and leans more towards to femininity. People choose to have a good relationship with each other and are concerned with quality of life. Richardson (2008) extended Tsakumis' et al. (2007) study by using multiple measures of tax evasion across countries including Malaysia. The study found only individualism and uncertainty avoidance significantly influence tax evasion. Findings indicate individualist and lower uncertainty avoidance taxpayers tend to comply with tax. Power distance and masculinity (as a cultural value) were found to be insignificant in explaining tax evasion. However, these two studies did not discuss one of the dimensions in Hofstede's Cultural Dimensions Theory, which is long-term-short-term orientation.

A mixed method regarding cross-cultural studies in Malaysia and New Zealand, conducted by Hamid (2013) on tax agents, found that culture is positively and significantly associated with New Zealand tax agents in both the case of overstating expenses and understating income scenarios. Thus, this indicates that they have a tendency to practice individualism and higher uncertainty avoidance in performing their duties in tax compliance behaviour.

Malaysian tax agents were found not to be influenced by culture, neither in overstating expenses nor understating income scenarios. However, this study found inconclusive findings between surveys and interviews. Findings from surveys revealed that Malaysian tax agents have higher power distances where Malaysian tax agents were found to work under the close supervision of senior staff. Junior staff still had to practice obedience towards senior staff. Besides that, they also tended more towards masculinity as a cultural value, since they focused on achievement and success. On the other hand, New Zealand's tax agents were found to be more individualist and focused more on uncertainty avoidance. Contrary to interview findings, it revealed that Malaysian tax agents have lower power distances and higher individualism. New Zealand taxpayers were also found to be individualist taxpayers. Nevertheless, this study also does not discuss long-term-short-term orientation, due to the

unavailability of index data of Malaysia and New Zealand. Another study from Malaysia conducted by Kasipillai and Abdul-Jabbar (2006) involved taxpayers in the northern region of Peninsular Malaysia. The findings were different to other culture studies where it was found that there is no significant difference among ethnic groups in overall non-compliance attitudes. This is due to the limitation of the sample, since it was limited to only the northern region of Peninsular Malaysia.

Yong (2011) conducted a study on ethnic SME owners in New Zealand in terms of record keeping functions, seeking for tax assistance and tax payment difficulties. It involved different ethnic groups, namely Asian, European, Maori and Pacific groups. Regarding record keeping functions, European and Asian groups were found to have moderate to high uncertainty avoidance, medium to long-term orientation as well as masculinity as a cultural value. This showed that they were more confident and had a high level of proficiency in record keeping compared to Maori and Pacific groups. Asian groups were also found to be more collectivist in seeking for tax assistance as they relied more on friends and peers compared to Europeans, Maoris and Pacific groups, who sought paid tax practitioners. The study also found that SME owners with collectivistic, long-term orientation values and low power distance would encounter low compliance costs, as they do not depend too much on paid tax practitioners. In terms of tax payment difficulties, Maori and Pacific groups, which have lower uncertainty avoidance, tend to be more to collectivist, feminine and are short-term oriented, tend to face more tax payment difficulties compared to Asian and European groups. The study concludes that taxpayers with high power distances who are more individualist, have masculine cultural values, high uncertainty avoidance and are long-term oriented were able to pay their taxes in a timely manner in order to avoid tax penalties. Recommendations were made by Yong to extend cultural studies in other multicultural countries by implementing SAS. This is because study on the influence of culture among SME owners has lagged behind despite its importance in determining voluntary compliance levels.

A study from Nigeria by Alabede (2012) on tax compliance behaviour among individual taxpayers found significant differences in culture in Nigeria. The study found that the Igbo ethnic group tend to be individualistic and practice full compliance with tax laws whereas the Hausa and Yoruba were not in full compliance since they were found to be collectivist. A prior study by Malaya and Malaya (2012) in Cebu, Philippines has also been conducted due to the problem of non-compliance behaviour in paying tax. This situation continues to be unresolved, even though penalties and audits exist. The study found that culture played an important role in encouraging taxpayers to comply with tax laws. Specifically, three of five cultural dimensions, (1) power distance, (2) individualism-collectivism and (3) long-term-short-term orientation, have been identified to influence tax compliance in Cebu. Collectivistic Cebu taxpayers were found to have high power distances and short-term orientation regarding cultural values.

The study of cultural influence on tax non-compliance behaviour has been conducted intra-culturally and cross-culturally. Li (2010) argues that cross-cultural studies could misrepresent analysis due to some important factors that should be taken into consideration, such as the tax burden, origin of laws, culture and the distribution of the income of those countries. Torgler (2007) and Yong (2011) support this argument by stating that it is more useful and representative for intra-cultural study to be conducted in investigating cultural influence on tax compliance. This is due to differences in countries' tax laws and regulations, type of taxes as well as their environments. Overall, findings on culture are still inconclusive and need further study, especially in the Malaysian tax environment. This is consistent with suggestions by Alm and Torgler (2006) and Nerre (2008) indicating that tax culture in every country is not similar and relates to cultural norms and countries' tax environments. Therefore, this study believes that it could be interesting to discuss the influence of taxpayers' culture regarding dimensions introduced by Hofstede in influencing intentional tax non-compliance among SME owners. Based on the above discussion, the following hypotheses are made:

H₁: Power distance significantly influences intentional tax non-compliance among SME owners in Malaysia

H₂: Individualism significantly influences intentional tax non-compliance among SME owners in Malaysia

H₃: Masculinity significantly influences intentional tax non-compliance among SME owners in Malaysia

H₄: Uncertainty avoidance significantly influences intentional tax non-compliance among SME owners in Malaysia

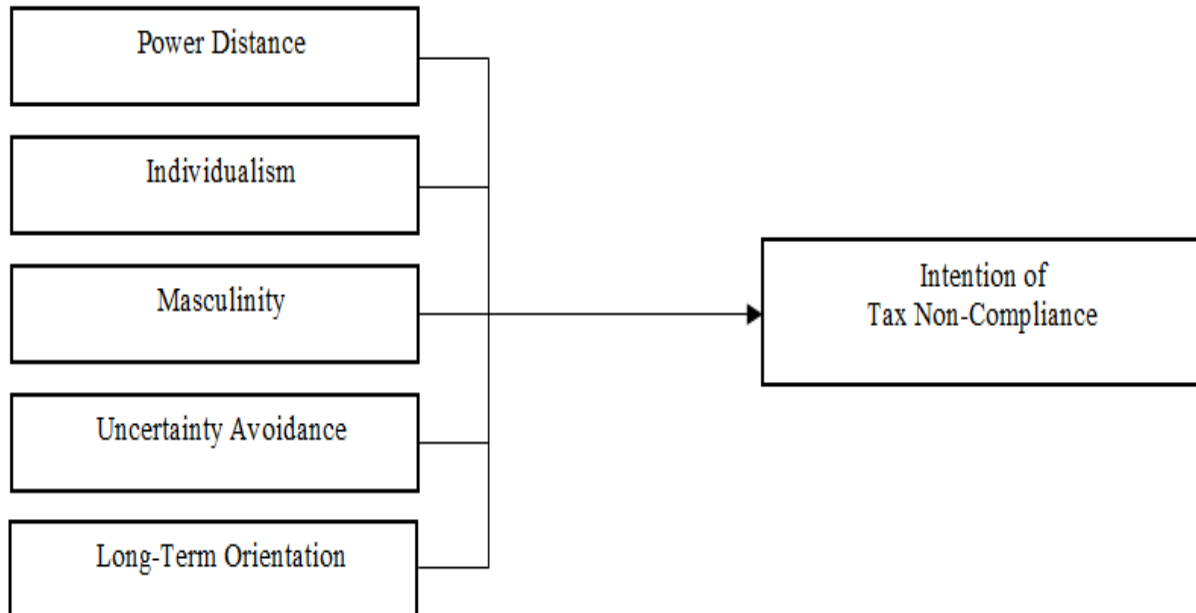
H₅: Long-term orientation significantly influences intentional tax non-compliance among SME owners in Malaysia

Methodology/Materials

Figure 1 illustrates the conceptual framework of this study, based on *Hofstede's Cultural Dimensions Theory*. It consists of power distance, individualism, masculinity, uncertainty avoidance and long-term orientation as independent variables and intentional tax non-compliance as a dependent variable.

Figure 1

Conceptual framework



The population of SMEs registered in Malaysia with the National SME Development Council (NSDC) in the northern region of Peninsular Malaysia amounts to 123,361 firms. A survey was self-administered using a structured questionnaire adapted from instruments used by Hamid (2013) and Minkov and Hofstede (2012). The questionnaire has also been modified to suit SME owners in measuring culture through intentional tax non-compliance. A Likert scale with five items was used, in which a score of 5 represented “strongly agree” and score of 1 represented “strongly disagree”. The questionnaire was randomly personally distributed and collected from the SME owners in five major urban towns located in the northern region of Peninsular Malaysia. These included Kangar, Alor Setar, Sungai Petani, Kulim and George Town. A total of 500 samples were distributed and 248 were usable, with a response rate of 49.6 percent.

Results and Findings

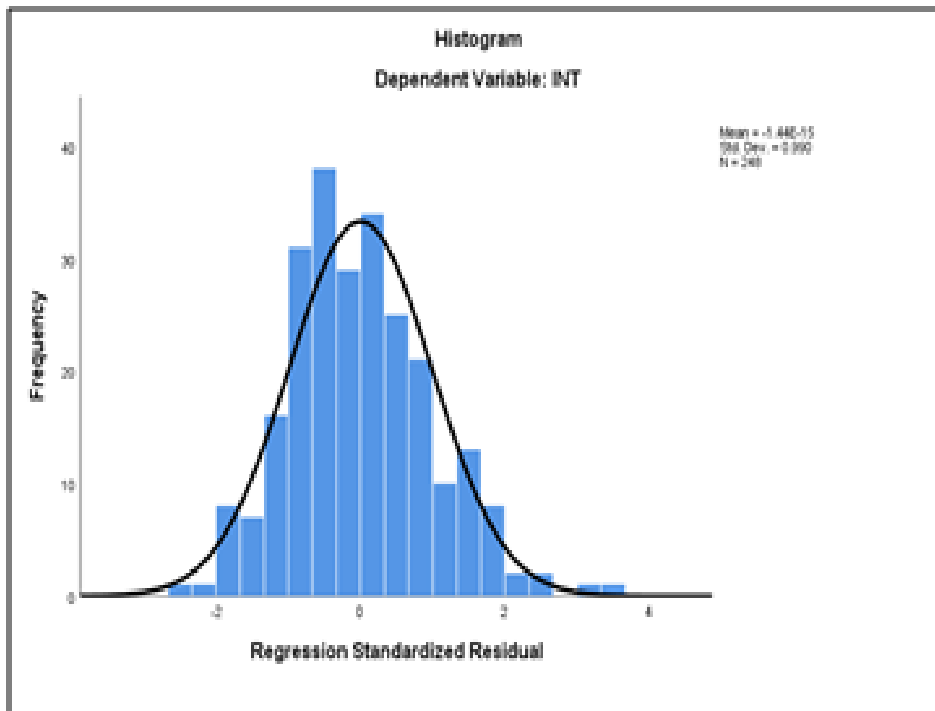
The Statistical Package for Social Science (SPSS), 25th version, was used to conduct and analyse data accordingly. According to Hair, Black, Babin and Anderson (2014) and Flury and Riedwyl (1988), a good regression model should be met in order to be called an empirical model. Thus, a series of tests that include normality, linearity and multicollinearity tests should be conducted.

Normality Test

The testing of data normality was checked by examining a histogram residual plot. Figure 2 indicates that the normality is achieved since the distribution of all bars in the histogram were close to a normal curve.

Figure 2

Histogram Residual Plot

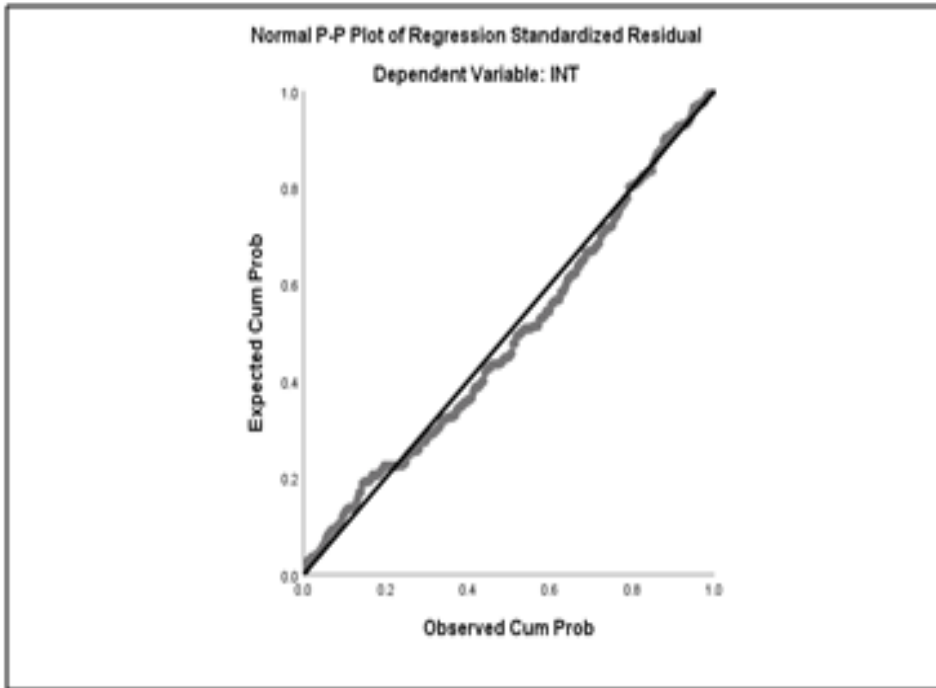


Source: Author

Linearity Test

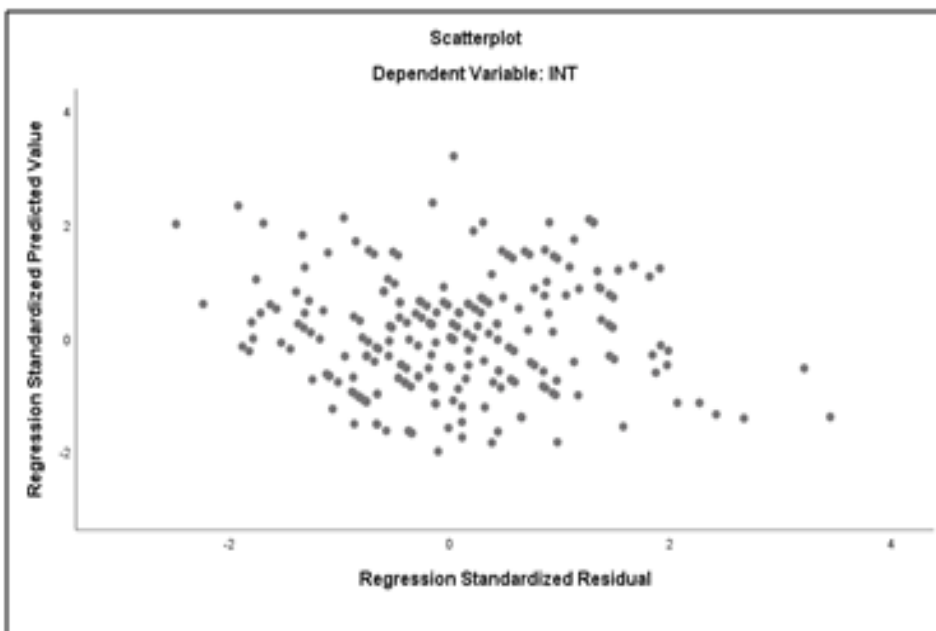
Linearity was checked by examining normal probability plots and a scatterplot. Figure 3 of the normal probability also indicates that linearity is achieved, since the actual data was distributed close to the diagonal line. In Figure 4, the scatterplot indicates that linearity is achieved since the majority of the scores were centred at the zero point.

Figure 3
Normal Probability Plots



Source: Author

Figure 4
Scatterplot



Source: Author

Multicollinearity Test

Multicollinearity testing shows tolerance values and variance inflation factors (VIF). Table 1 shows that tolerance values were ranged from 0.428 to 0.637, above the threshold value of 0.20 as recommended by Hair, Ringle and Sarstedt (2011). This indicates that there is no multicollinearity issue. The VIF ranged from 1.571 to 2.339, below the threshold value of 5, as recommended by Hair et al. (2011). This indicates that there is no multicollinearity issue.

Table 1

Results for Tolerance Values and Variance Inflation Factors

Variable	Collinearity Statistics	
	Tolerance	VIF
Power Distance	0.637	1.571
Individualism	0.428	2.339
Masculinity	0.543	1.840
Uncertainty Avoidance	0.523	1.910
Long-term Orientation	0.459	2.177

Source: Author

Evaluation of the Determination Coefficient

R-square is the most common measure used for structural model evaluation, which indicates the determination coefficient (Hair, Hult, Ringle and Marko, 2017). Table 2 illustrates the determination coefficient of the model.

Table 2

Determination Coefficient

Model	R	R-Square	Adjusted R-Square	Std. Error of the Estimate
1	0.600 ^a	0.360	0.347	0.83195

Source: Author

Based on the rule of thumb provided by Chin (1998), R-square in the above table was considered moderate. This indicates that power distance, individualism, masculinity, uncertainty avoidance and long-term orientation can explain 36.0 percent of the variance in intentional tax non-compliance.

Hypothesis Testing

Table 3

Hypothesis Testing

Model	Unstandardised Coefficients		Standardised Coefficients	t	Sig.	Decision	
	B	Std. Error	Beta				
1	(Constant)	3.317	0.425		7.801	0.000	
	PD	0.240	0.050	0.309	4.787*	0.000	Supported
	IND	-0.279	0.070	-0.312	-3.965*	0.000	Supported
	MAS	-0.131	0.056	-0.165	-2.360*	0.019	Supported
	UA	0.188	0.067	0.199	2.803*	0.005	Supported
	LTO	-0.172	0.087	-0.151	-1.986*	0.048	Supported

*significant at 0.05 (one-tailed)

Source: Author

Hypothesis H₁, concerning the significant relationship between power distance and intentional tax non-compliance, reveals that power distance had a significant positive influence on intentional tax non-compliance ($\beta = 0.309$, $t = 4.787$, $p < 0.05$). Thus, hypothesis H₁ is accepted, which indicates that the tendency of SME owners' intentions to engage in tax non-compliance is higher when the level of power distance is higher. This is consistent with the findings of Hofstede (1980) and Yong (2011), which found the tendency of taxpayers to engage in non-compliance is higher once they perceived inequality of income distribution, thus perceiving tax systems as being biased.

As for hypothesis H₂, findings reveal that individualism is negatively and significantly related to intentional tax non-compliance ($\beta = -0.312$, $t = -3.965$, $p < 0.05$). Thus, hypothesis H₂ is accepted, which explains why individualist SME owners' intentions to engage in tax non-compliance is lower. One possible explanation given by Hofstede (1980) is that people with high individualism tend to comply with rules and regulations, since they perceive that policy makers are applying the same value standards to all people. This is supported by Alabede (2012), Richardson (2008) and Yong (2011), who indicate that individualist taxpayers tend to practice full compliance with tax laws, whereas collectivist taxpayers were not in full compliance.

With regards to hypothesis H₃, masculinity is negatively and significantly related to intentional tax non-compliance ($\beta = -0.165$, $t = -2.360$, $p < 0.05$). Thus, hypothesis H₃ is accepted. It means that SME owners with high masculinity are less likely to engage in tax non-compliance. This finding is consistent with the findings of Yong (2011), who indicates that taxpayers with more masculinity as a cultural value did not have a problem with tax

compliance and were able to pay their taxes in a timely manner to avoid being penalised by tax authorities. This is supported by Tsakumis et al. (2007), who stated that masculine cultural values are less tolerant of non-compliance behaviour. Hofstede (1980) also explained that despite living in an unjust world, people with high masculinity as a cultural value tend to strive for material success, including ego boosting, wealth, recognition and achievement.

Hypothesis H₄ shows that there is a positive and significant relationship between uncertainty avoidance and intentional tax non-compliance ($\beta = 0.199$, $t = 2.803$, $p < 0.05$). Thus, hypothesis H₄ is accepted. It indicates that the higher the uncertainty avoidance level, the higher the likelihood of SME owners' intention to engage in tax non-compliance. One possible explanation given by Hofstede (1980), Richardson (2008) and Yong (2011) is that taxpayers with higher uncertainty avoidance are more likely to engage in tax non-compliance. This is because taxpayers with higher uncertainty avoidance need written tax laws and regulations, since they will not tolerate uncertainty and ambiguity in complying with tax.

Lastly, findings regarding hypothesis H₅ reveal that long-term orientation is negatively and significantly related to intentional tax non-compliance ($\beta = -0.151$, $t = -1.986$, $p < 0.05$). Thus, hypothesis H₅ is accepted. This indicates that SME owners who are more long-term oriented are less likely to engage in tax non-compliance. This is in line with the findings of Yong (2011), who indicates taxpayers who practiced long-term orientation did not have problems with tax compliance and were able to pay their taxes in a timely manner to avoid being penalised by tax authorities (compared to short-term oriented cultural values).

Conclusion

Based on the empirical evidence and theoretical perspective, this study has aimed to explain Hofstede's Cultural Dimension Theory to examine cultural influence on intentional tax non-compliance among SME owners. It finds empirical support for the usefulness of Hofstede's Cultural Dimension Theory in predicting intentional tax non-compliance. Findings suggest that power distance, individualism, masculinity, uncertainty avoidance and long-term orientation directly influence intentional tax non-compliance, thus supporting hypotheses H₁, H₂, H₃, H₄ and H₅.

Besides the contribution of new empirical evidence and tax literature knowledge, it also hopes to propose new ideas to understand the behaviour of SME owners in engaging with tax non-compliance. Furthermore, it is also expected to help the understanding of taxpayers' culture in relating to intentional non-compliance. Although the dimensions were originally being used to determine behaviour in organisations, they are expected to assist the IRBM in implementing new strategies and in raising taxpayers' awareness of potential losses to the nation due to engaging in tax non-compliance.



This study also has some limitations and suggestions for future researchers. First, the study is limited to the northern region of Peninsular Malaysia. Thus, the generalisability of the findings may be limited. Ideally, future researchers are suggested to include other regions in Malaysia. Second, this study only uses a non-economic approach in examining intentional tax non-compliance. Preferably, future researchers are advised to consider underlying economic factors mentioned by other theories to solve the tax compliance puzzle. It is also suggested that future researchers further break down ethnic groups into subgroups (e.g. Malay, Chinese, Indian and others) because these subgroups' cultures may have different influences on tax non-compliance.

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