

Factors Leading to Tax Evasion and tax non-compliance among Small and Medium Enterprises in Burundi

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Abstract: *Fighting against tax evasion and non-compliance among SMEs is a big issue. Firstly, it requires the understanding of the reasons why they avoid them and how they do it in order to find a lasting solution to it. This study sought to understand the kinds of taxes that SMEs in Burundi pay and the reasons for evading them in order to suggest ways to fight it. Among the factors leading to tax evasion and tax non-compliance found are linked to history where political instability and war led to people ignoring laws, demotivation lack of exchange between taxpayers and the government, SMEs owners' lack of knowledge in tax matters, corruption characterizing some OBR agents, and the taxpayers' feeling that tax is a burden to them. As to solution, improving public services and access to development facility, emphasizing democratic principles, training SMEs owners in tax matters, and putting Lawson taxes in the national language would help to decrease the rate of tax evasion.*

Keywords: *Tax Evasion, Tax Non-Compliance, Factors, Solutions, SMEs*

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1. Introduction

As a matter of fact, all companies or individuals doing businesses have to pay taxes to the government. Taxes are then considered as one among other obligations that businesses have in order to continue operating in a country. Failure to pay or being late in paying them result in being inflicted penalties, the fact that constitutes the main reason why corporations and individuals rush to pay their taxes. According to [1], if they were not forced, individuals and corporations would not pay taxes. They do so because they fear that if they do not pay them, they will be liable to prosecution by the state.

Tax in some countries, Burundi being among them, is the main resource to finance their budgets. In the general budget of Burundi of the 2022-2023 fiscal year which was **2 194 884 320 835** BIF, 1 642 991 570 390 BIF (that is 74.85% of the budget) was from taxes [2]. Similarly in 2023-2024 fiscal year, among the 3 238 071 350 855 BIF voted as the budget, 1 724 018 800 291 BIF (representing 53.24%) is from taxes [3]. It is clear that the budget of 2023-2024 relies less on taxes than the one for 2022-2023, but it still depends on taxes as the high percentage is financed by money from taxes.

In order to help to collect the taxes, the “Office Burundain des Recettes” (Burundi revenue office) was established. It coordinates all the issues related to income and to make controls and audits [3]. This institution has implemented most important measures in order to increase revenue collection among which are: (i) recruitment of relevant personnel to achieve assigned performance goals; (ii) additional training to staff and assignment of SMART objectives; (iii) reinforcement of the localization of tax payers to enhanced payments; (iv) implementation of a more reliable tax account; (v) allocation of additional staff to reach out small and micro tax payers; and (vi) creation of a committee for a closer assessment of tax exemptions.

With reference to the paramount of taxes to a country, evading from paying them is putting the country into problems. In Burundi, for instance, if corporations and individual businessmen fail to pay taxes, many of its programmes could not be carried out. Development is also not possible if the country has no resources. Many researchers argue that tax evasion limits the amount of resources available for the government which has harmful effects on economic efficiency [4]; [5] and income distribution [6]. It also harms the implementation and outcomes of economic policies [7] and reduces government’s legitimacy [8]. Tax payers have

then to know that once they pay taxes, they are contributing to the development of their country.

2. Statement of the problem

With the establishment of the Burundi revenue office, there has been a progress in Burundi in the improvement of its currency management, especially by adopting a new charter of the Central Bank, which strengthens its independence, and intensifies internal checks [9]. However, issues related to tax evasion are still observed. The fact that fines and penalties are included among the income of both 2022-2023 and 2023-2024 fiscal year budgetary laws shows that there are corporations and individuals who are not willing to pay taxes in the set deadlines. Also, with reference to the two communiqués made by OBR on the 3 August 2021 to two taxpayers claiming that more than 52.6 billion [10] and 283 million [11] is owed to the office, it is obvious that there exist corporations and individuals who do not pay taxes that they are required. Another indication that proves that taxes are not paid well is the communiqué of the 16 February 2021 which informs the public and the OBR staff that OBR has set mechanisms to fight against corrupted agents and their wrong practices [12]. This proves that some taxpayers accept to pay corruption rather than paying the taxes, which is problematic to the country. This In literature, to the best of our knowledge, there are no research done in Burundi to study the factors that contribute to tax evasion and tax non-compliance. This work is then conducted to fill the gap.

3. Objective

The main objective of this work is to identify the factors that contribute to tax evasion and tax non-compliance in Burundi in order to suggest best strategies for all businesses to be involved in paying taxes.

4. Research questions

This study is conducted following two research questions:

1. What are the factors contributing to tax evasion and tax non-compliance among SMEs Burundi?
2. What solutions are there to fight against tax evasion?

5. Hypothesis

In line with the above research question, the hypothesis of interest is stated as follows:

H1: Small and medium enterprises in Burundi are subject to tax evasion because of having no knowledge about taxes and their wrong beliefs about the taxes and the government.

6. Significance of the study

This work is significant in that it identifies the factors that are susceptible to push taxpayers to evade paying taxes in. This will help tax policy makers get aware of these factors in order to decide accordingly. As to taxpayers reading it, they will get to understand the kinds of taxes they are called to pay and the role of them, and they will get involved enough in the payment of taxes and we hope that the number of tax evaders will considerably decrease. Tax collectors will learn about best ways of collecting taxes in order to insure that the highest percent of taxpayers have accomplished this duty.

7. Literature review

7.1. Understanding taxes

Tax as a compulsory levy imposed by government upon assesses of various categories and it is a compulsory and none-refundable contribution imposed by government for public purposes [13]. In other words, it is a required and non-refundable contribution that business individuals and corporations have to pay and which is executed by government for public purposes. Paying taxes does not follow with immediate or direct benefit. That is why [14] referred to it as a non-*quid-proquo* payment. However, paying taxes contribute to financial independence and autonomy of a country since, as people pay taxes, their government gets money to finance its projects and carry out all the activities planned in the fiscal year. Besides, civil servants are paid their salaries and schools, hospitals, roads and other development facilities such as water and electricity are made available to them, marking thus the benefits to the taxpayers.

7.2. Classification of taxes.

Taxes are of different classes. Considering the influence that taxes have on the taxpayer, [12] distinguishes two types of taxes: *direct* and *indirect*. *Direct taxes* are those that affect the individuals/firms directly through a deduction from earnings, Examples include; individual income tax, corporation tax, taxes on property and others. However, *Indirect taxes* are those taxes that are paid to government by an intermediary and then passed on to the final user by including the tax in the final price. Examples include; export and import duties, excise and local production, value added tax (VAT) and others. Burundi fiscal system has both direct and indirect taxes.

On the basis of equity, taxes are classified as *proportional* or *progressive/regressive*. According to [12], a *proportional tax*, also referred to as *flat tax*, is defined as the taxing mechanism in which all the taxpayers are charged at the same rate regardless of their income. *Progressive/regressive tax* is

a tax that increases/decreases with the increase/decrease in income. Research has shown that progressive/regressive taxes have a greater impact on lower-income individuals than on the wealthy. This is because wealthy people will pay much as tax contrary to poor people who pay less or nothing. A proportional/flat tax, however, affects low, middle- and high-income earners relatively equally. They all pay the same tax rate and this advantages the high-income. Burundi fiscal system imposes progressive/regressive tax as SMEs pay taxes with reference to their income.

7.3. Types of Tax that small and medium enterprises pay in Burundi

According to [15], the following are taxes paid by small and medium enterprises:

❖ **Property Tax:** These taxes are assessed on Real estimate or vehicles. This includes cars often called an auto registration fee, homes factories, airplanes and commercial properties such as malls. Tax on houses is calculated following the area covered by the house and the materials used to construct it. For non-built lands, the property tax is calculated following how developed is the locality of the land [16]. Apart from taxes imposed on houses and lands, the general code of taxes also imposes taxes on renting these properties. Property taxes are paid from the first of January to the 31st of March.

❖ **Business or corporate income Tax:** Burundi also levies income tax on the business income within the fiscal year. The tax rate for all businesses other than mining companies is 30%. Businesses with a net income of 100 M and more have to pay their taxes every three months.

❖ **Value added tax:** SMEs also pay VAT which is a requirement on every taxable supply made by a taxable person, every imported goods and the supply of any imported services by any person. Taxable supplies are goods and services made under the business activity of a taxable person. Taxable persons are people who make or are expected to make taxable supplies valued at one quarter of the annual registration. The standard rate for VAT in Burundi is 18%.

❖ **Sales tax:** Sales tax is form of fixed rate levies on the sale of goods or services. It is the tax that is the most visible since you typically pay it every time when you buy merchandize at the store.

❖ **Personal Income Tax:** Personal income tax refers to that tax levied on the income received by an individual over a period of time. Burundians are required to pay personal income tax on their worldwide income including their salaries and wages, commissions, dividends and any transaction made as a payment to a person. SMEs have to apply the rule concerning personal income taxes while paying their employees. According to the law on income tax, personal income tax is calculated following the income of a person. If your income is 1.8 M or below, you pay no tax. When it is

above 1.8 M up to 3.6 M, you pay 20% of the extra amount to 1.8 M; and when it is above 3.6 M, you pay 30% of the extra amount to 3.6 M.

❖ **Tax on Cars:** This is a tax imposed on cars and other means of transportation. These cars be for businesses or for personal transportation issues. This tax is calculated with reference to the type of their motor or their weight [15]

❖ **Capital gains tax:** Capital gains tax is assessed on goods sold more than was paid to purchase them. This includes the sale of homes stocks and securities for higher price than they were purchased for.

❖ **Tarrifs:** Tarrifs are assessed on goods entering or leaving the country. Primarily, they are assessed on goods entering the country and are aimed to protect an industry from foreign competition.

7.4. The purpose of taxation

The primary objective of taxation in underdeveloped countries is not related to stability of income and expenditure [17]. In other words, taxation is an important source of government revenue and an economic policy tool by government to attain economic growth. Without taxation, the country could not build schools, roads, hospitals, etc. or carry out all the development projects and pay all the employed people including the police and the soldiers. According to [18], taxation is a tool of raising revenue and it has the role of accelerating the economic growth and ensuring social justice. People have then know that paying taxes is a way of manifesting their love for the country and their support to its development. And the management board has to insure that taxpayers benefit from the taxes that they pay by making sure that the development comes from taxpayers and returns to them through receiving good services, accessing development facilities such as having good quality roads, nice schools, water and electricity.

7.5. Understanding tax evasion and tax non-compliance

The tax evasion and non-compliance with tax obligations encompasses both illegal and legitimate of the action of entities [1]. According to them, tax non-compliance, which is the source of tax penalties, may be in one of many forms; it could either be a failure to submit a tax return within the stipulated period or non-submission, understatement of income, overstatement of deductions, failure to pay assessed taxes by clue date. Noncompliance happen from tax payer carelessness i.e. forgetting to pay their tax, human error in calculating their taxes and even more critical is the lack of knowledge and information about taxes. In the other end, tax fraud or tax avoidance is a type of noncompliance clone intentionally by the tax payer.

7.6. Theories of tax evasion

1. **The Economic Theory of Tax Evasion:** According to [19] and [20], taxes are viewed economically as “burden” or windfall harm. The fact is that, if taxpayers feel that the taxes are high, they become demotivated to pay them. Also, if only taxes are paid by a category of people and not the others, they feel this injustice and try to find a way of evading from them. Also, in the model developed by [21], tax evasion is part of optimal portfolio choice. In this, taking a choice to evade taxes in effect is a risky bet that she/he will not be caught and convicted. However, people have to know that if the individual is caught evading taxes, the penalty is simply a constant multiple of the amount of tax evaded.

2. **Public Choice Approach:** The basic hypothesis of the field of economics known as “public choice” is that the citizens of democratic political jurisdictions perceive a connection between the taxes they pay and the government services they receive [22]. In other words, citizens elect governments to provide them with goods and services and there is a certain sense in which every citizen must be aware that taxes must be paid to finance public services, whether they think their own burden is too high or low. This implies that every citizen knows that if taxes are reduced, a reduction in public services will follow.

3. **Introducing “Trust-Based Political Exchange”:** [23] believes that there is an exchange or an implicit contract between the citizenry and the government: the government provides goods and services to citizens in exchange for their support. According to [24], the political exchange idea, which in fiscal sociology is known as “the exchange between taxation and representation (i.e., democratic rules and accountability)”. This idea suggests that there is an exchange between citizens and government whereby citizens pay their taxes and in exchange the government provides them with the goods and services they want. In other words, as taxpayers pay their taxes, they desire a particular level of the public good which must be shared by all citizens equally. This “contract” is not enforceable nor written somewhere. However, a government which is in power for some time and proves to be honest can earn the trust of its citizens by foregoing opportunities to cheat them despite the infinite forms of corruption available to it [1]. Another issue said to influence the increase in trust in government is higher educational level.

4. Another theory is that of economic-political cause of tax evasion by [23]. According to them, the turbulence of the conditions in the context of the economic milieu (e.g. frequent changes in the tax code) constitutes the real underlying cause of tax evasion and non-compliance with tax obligations. In other words, evading taxes results in the establishment of taxes and making them obligatory. [1] argue that there is

emergence of conflicts between taxpayers and tax policy makers through the construction and the implementation of economic measures. Sometimes, tax policies are voted but taxpayers are not informed about them, resulting in not paying them. So, tax policy makers have to involve taxpayers as the design a tax policy.

8. Methodology

This study used a qualitative method research design. It consisted of analysing documents talking about tax in Burundi such as the general code of taxes and the tax law on the income which are being currently used in relation to the existing literature. Content analysis was used as the research instrument where we sought to identify the nature of taxes that SMEs in Burundi are required to pay and the reasons why these enterprises are reluctant to pay them. We also intended to suggest some strategies that the government can use in order to avoid tax evasion and non-compliance.

9. Causes of tax evasion and tax non-compliance: case of SMEs in Burundi

According to the research conducted on tax evasion and tax non-compliance, many factors contribute to this behaviour. These factors include the cultural norms of the society where the taxpayers are from, the feeling that the taxpayers are not gaining in return of the taxes they pay, the taxpayers' knowledge about taxes that they are required to pay, feeling that tax is a burden to the taxpayers, the political insecurity and instability of taxes [25]. For the case of Burundi, we found that tax evasion and non-compliance among SMEs is due to many factors such as (1) the political instability and wars that characterized the country in the past, (2) the SMEs owners' lack of motivation to pay taxes, (3) the SMEs owners' lack of knowledge in tax matters, (4) corruption among tax collectors, and (5) the taxpayers' feeling that tax is a burden to some.

Firstly, some research have suggested that the willingness to pay taxes can be culturally determined and it differs across countries [23]. It is sometimes viewed as a cultural norms or a product of values, which are specific to a particular country. In Burundi, the willingness to pay taxes went decreasing due to political instability and wars which followed its independence. People in the war were doing what they wanted and no one was there to control whether the law on tax was being put into effect. There was also no institution which was responsible for collection of taxes. With the establishment of the OBR, taxpayers claimed that they were imposed more taxes. They tried then to find ways of evading from them.

Secondly, the feeling that taxpayers do not get enough support from the government influences the way they pay taxes. [13] called this "the exchange between taxation and representation (i.e., democratic rules and accountability)". This ideology states that taxpayers are willing to pay taxes if they believe that they benefit in return from quality services

and public goods. This is not the same case with Burundi where good quality services are obtained in private sectors. Getting a good quality service or accessing to public goods is mostly conditioned by other issues such as being in the ruling party or having someone in the highest position who pleads for you. Taxpayer then have a feeling that few people are benefiting from the taxes they pay, which demotivates them from going on paying them. In Burundi, most citizens claims that there are poor public services and non-improved development facilities. This demotivates most SMEs owners in paying their taxes.

Thirdly, tax evasion is linked to the knowledge that taxpayers have on taxes [1]. According to him, non-compliance happen when taxpayers are careless i.e. they forget to pay their tax, make errors in calculating their taxes and even more critical they do not have knowledge and information about taxes. The fact is that the general code of tax and the law of taxes on income are in French while lots of taxpayers do not speak this language and they are reluctant to hire experts in tax matters to help them. Most businessmen have low degree of education. So, few would understand tax policies written in French.

Fourthly, tax collection agents are corrupt and people have been accustomed to it that it has been a habit. People who ask corruption will demand less than the taxes that taxpayers had to pay and the latter feels that he is benefiting as he pays less. So they opt to pay corruption as it is less without knowing that this will have a bad effect on their country's economy in general and the quality of services that they get.

Lastly, the payment of taxes is viewed as an example of "pro-social" behaviour [24]. They take a further step by suggesting that taxpayers are willing to pay their taxes conditionally, depending on the pro-social behaviour of others. Put simply, people are more willing to pay taxes when they believe that others are paying them. In Burundi, the exonerations which are given to high political figures affect the way others pay taxes.

10. Solutions to tax evasion and non-compliance

According to [26], developing and emphasizing the logic of democracy is one important avenue of solution to the problem of tax evasion. By this is meant the improvement of an exchange relationship between the citizen (taxpayers) and the government. Zhang argues that this relationship can only be based on mutual trust, which can be built by the government delivery of its premises. Raising penalties is not necessarily the right solution, so trust in government, and in other citizens, that is, the belief that other citizens are going to pay their taxes, fills this gap [23]. According to him, "building trust implies de-emphasizing the relationship of coercion, implicit in economic models of taxation, which neglect the expenditure side of government. In Burundi context, this can be achieved through: (1) improving

relationships between the OBR and taxpayers so that implementation of Burundi's tax regime may be seen as a better negotiated, fair and transparent experience for citizens, which emphasizes the idea that the way that revenue is collected is as important as the amount of revenue collected; (2) seeking to improve life of the citizens through improving the services such as building nice schools and equipping them with up-to-date instruments, providing quality education, giving quality services in hospitals, public offices, ..., and making it easy to access to the development facilities such as water, electricity, network, etc.; and (3) improving political stability and security matters.

Another approach to reducing the rate of tax evasion is to emphasize education, since "more education has a positive effect on the propensity to pay taxes independently of its effect on trust-based political exchange" [27]. This comes to respond to the issue that some taxpayers evade taxes due to the lack of knowledge and it can be achieved through organizing session with taxpayers to discuss about new tax policies before their implementation, offering taxpayers trainings in finance issues including tax matters, setting up strong policies for fighting against corruption and providing enough assistance to SMEs in Burundi. Also, putting all the documents talking about taxes in Kirundi would help to reduce the tax evasion rate.

11. Conclusion

Understanding tax evasion has interested many researchers. This work has been carried out to identify the types of taxes that SMEs in Burundi are required to pay and to find out the reasons behind tax evasion in the country. It sought to answer the following two research questions; (1) What are the factors contributing to tax evasion and tax non-compliance among SMEs Burundi? And (2) What solutions are there to fight against tax evasion? The result showed that the following factors contribute to tax evasion: (1) the political instability and war that characterized the country in

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the past contributed a lot to changing the behaviour of Burundians in that they got used to working in the country where law was not applied because of these instabilities and war, (2) the lack of motivation to pay taxes on the part of the SMEs owners due to the beliefs that they do not benefit from taxes that they pay, (3) the SMEs owners' lack of knowledge in tax matters where many of them have law degree of schooling while the codes and the laws on taxes are in French, (4) corruption which characterizes some tax collectors, and (5) the taxpayers' feeling that tax is a burden to some. In line with the above results, the hypothesis which was stated as: "Small and medium enterprises in Burundi are subject to tax evasion because of having no knowledge about taxes and their wrong beliefs about the taxes and the government" was validated. As far as the solutions to tax evasion are concerned, the following strategies are recommended:

- The government of Burundi should make sure that the democratic rules are followed. It should set good policies intending to improve the quality of services that they provide and the quality of public infrastructure as well as the technological sector including the provision of full network. Through the national office of taxes (OBR), the government should organize trainings to taxpayers (owners of SMEs) to show them the importance of paying taxes and to discuss about the kinds of taxes that they are required to pay. Also, putting the laws on taxes in Kirundi was seen suitable for dealing with tax evasion.

- The SMEs owner should seek to know the taxes that they are required to pay and if they have no trainings in financial sector, they need to hire one to help them calculate the amount that they have to pay as taxes. They should know that when they pay less taxes, they put their country into economic problems where the government will get it hard to pay its staffs and development becomes impossible in this case.

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