

Tax Compliance in Small and Medium Enterprises (SMEs) in Indonesia

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Abstract:

Through tax authority revenue targets, the tax authority strengthens its organisational capacity development, information technology application, and utilisation of taxation data from the third party. This study aims to examine tax compliance, especially for SMEs, using perceived tax fairness, tax knowledge, and tax administration variables. This research uses a quantitative approach. The data used are primary data collected using surveys filled in by respondents. Respondents were chosen using nonprobability sampling, and the sampling technique is purposive sampling. Data are analysed using multiple linear regression. The population of this study consists of small businesses and entrepreneurs. The results of this study indicate that perceived tax fairness, taxpayer knowledge, and tax administration influence SME tax compliance. The sample used in this study consisted of 86 respondents.

Keywords: Tax knowledge, tax administration, tax compliance;

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1. Introduction

The Governor of the Central Bank of the Republic of Indonesia stated that the Indonesian economy has tended to improve over the last three years. Domestic economic growth in 2015 was 4.88%, while in 2016 it was 5.02%, and in 2017 it reached 5.05%. Economic growth is closely related to government revenue from the tax sector. State income from taxes has become an essential element in supporting economic activities, thus moving the wheels of government and aiding the provision of public facilities. The target of increasing tax revenues occasionally requires the tax authority to optimise tax revenue. However, the percentage of tax revenue realisation in the period from 2012 to 2014 tended to decrease. The following data show the declining level of tax revenue realisation.

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Table 1: Targets and realisation of taxes in the ABPN (Indonesian government budget) from 2014 to 2016 (in trillions of IDR).

	Target	Realisation	Percentage
2014	1246.1	1146.9	92%
2015	1489.3	1240.4	83.3%
2016	1539.2	1285.0	83.5%

Source: www.kemenkeu.go.id

The tax authority undertakes organisational capacity building, strengthening information technology, strengthening organisation, strengthening budgets and business processes, and utilising taxation data from third parties. For the attainment of the tax revenue target, one potential area for development is the SME sector. This is because SMEs play an essential role in the Indonesian economy (Rekarti & Doktoralina, 2017). SMEs represent 99.99% of the total number of entrepreneurs in Indonesia, or 56.54 million units. The number of SMEs in Indonesia continued to grow from 2015 until 2017 (Ministry of Cooperatives and SMEs of The Republic of Indonesia, 2012).

The number of SMEs in Indonesia includes 59 million businesses (www.bappenas.go.id). Considering the number of SMEs in Indonesia, tax revenues from the SME sector should have grown. However, the tax extraction potential of the tax authorities is still low due to constraints in tax administration and the tax rate (Walsh, 2012). The taxation policy of 2013 states that the taxpayer tariff for SMEs is 1%, provided that the taxpayer has a maximum gross circulation of IDR 4.8 billion. From the survey, the tax authorities concluded that the level of public compliance in carrying out its tax obligations is still low, including compliance in submitting tax returns. The following data show the compliance rates in filing tax returns.

Table 2. Taxpayer compliance.

Description and year	2013	2014	2015	2016
Registered taxpayer	24,347,763	27,379,256	30,044,103	32,769,215
Mandatory listed taxpayer tax return	17,731,736	18,357,833	18,159,840	20,165,718
Percentage	73.83%	67.05%	60.44%	61.54%

Source: www.pajak.go.id

Table 2 shows that the taxpayer compliance level in filing tax returns in 2016 was only 61.54%, which is low. Therefore, the ease of tax administration becomes the determinant factor in the successful implementation of SME tax policy as regulated (PP) in Tax Regulation Number 46/2013. Tax administration plays a crucial role in the tax system because an effective tax system will be able to increase tax revenue (Abiola & Asiweh, 2012; Waluyo, 2018).

The issuance of PP No. 46 of 2013 is to facilitate SME taxpayers in fulfilling their tax obligation. The 1% tax is on gross revenue, which should be no more than IDR 4.8 billion per year. Some factors are considered critical for the successful implementation of PP No. 46 of 2013. These include the level of comprehension of the rule among SMEs and efforts by the tax authority to increase the awareness of the new state i.e. the tax system is operating under new conditions (hereafter referred to as "tax socialisation"). Also included are the sanctions imposed for violations of the rule and an understanding of the benefits of regulation.

Based on the background of this study, the following questions will be answered. Is tax justice (protection of his soul and possessions) felt? Are there perceived benefits for taxpayer knowledge and tax administration? Do tax sanctions and tax socialisation also affect tax compliance?

Literature review

Attribution theory

Attribution theory studies the process of how one interprets the occurrence of an event and the reason or cause of the consequent behaviour (Kelley, 1973). Attribution theory explains how we assess individuals; to put it differently, we seek to determine whether the response is internal or external (Robbins, 2008:177). Internally induced behaviour is behaviour that is influenced by an individual's control, whereas externally induced behaviour is behaviour caused by external sources. Apart from internal and external factors, the determination of an individual's behaviour largely depends on three factors: distinctiveness, consensus, and consistency.

Taxpayer compliance

Taxation requires the active participation of taxpayers in carrying out taxation. This involves a high level of taxpayer compliance, namely compliance in fulfilling tax obligation (Koessler, Torgler, Feld, & Frey, 2016). This voluntary agreement is the backbone of the self-assessment system, whereby the taxpayer is responsible for the self-determination of tax obligations and then accurately paying and reporting taxes in a timely manner. According to Saad (2014), tax compliance is a condition in which taxpayers fulfil all tax obligations and exercise taxation rights. According to Minister of Finance of the Republic of Indonesia Regulation Number 74/PMK 03/2012, taxpayers that meet specific criteria are never punished. These criteria include being timely in filing tax returns, having no tax arrears, and having a public accountant check financial statements.

Evaluation of the corporate taxpayer compliance level is carried out to assess the degree of compliance of a group of persons or entities which, under the provisions of taxation legislation (Jimenez & Iyer, 2016), file taxes jointly. It is performed to determine taxation obligations, including certain tax withholders or collectors, which constitute a unity of businesses or non-businesses.

Perceived tax fairness

The theory of fairness suggests that people will feel satisfied or dissatisfied depending on the presence or absence of equality in a system, in particular the work system (Spiegel, Kloss, & others, 2017). According to this theory, the main components of the method of fairness are output, results, justice, and injustice. Production is a valuable factor for taxpayers who are considered essential and have complied with government regulations, such as a system of taxation that is not one-sided or arbitrary. Tax justice can be either vertical or horizontal. Vertical tax fairness is when different tariffs are provided based on the diversity of business activities (Saad, 2012). Public perceptions of the truth of the prevailing tax system could significantly affect the implementation of proper taxation in the country. One such risk is that the public could change its tax compliance behaviour and tax evasion behaviour (Raaij, 2016) because they feel the tax system is unfair. Fairness therefore becomes a critical component in the tax system because it can generate taxpayer trust.

Perception is a direct response or the process through which one gains recognition through the five senses (Kotnal, 2017). Public perceptions concerning the fairness of the prevailing tax system significantly affect the implementation of proper taxation in the country. This public perception has the potential to change tax compliance behaviour and tax evasion behaviour. Communities will tend to disobey and avoid tax obligations if they feel the tax system is unfair.

According to Saad (2012), fairness is a reciprocal relationship between the contributions paid by the taxpayers and the perceived benefits. Taxpayers will have a good perception of the tax system if the benefits received are proportional to the gift given. According to Faizal, Palil, Maelah, & Ramli (2017), perceptions of fairness are challenging to define because of four main problems. One such problem is a dimensional problem determined at the individual level as well as in the broader community, which is related to complexity, and lack of fairness may result in non-compliance.

Tax knowledge

Tax knowledge is the tax information that can be used by taxpayers as a basis to act, make decisions, and take a specific direction or strategy in connection with the implementation of their rights and obligations in the field of taxation (Palil, Akir, & Ahmad, 2013; Waluyo, 2016). Tax knowledge is an essential element in a voluntary compliance tax system, particularly in determining an accurate tax liability (Saad, 2014).

Tax disclosure is significant for taxpayers to fulfil their tax obligations and plays an essential role in the self-assessment system. Aspects of taxation knowledge for

taxpayers significantly affect tax attitudes towards the fairness or unfairness of a tax system (Mukhlis, Utomo, & Soesetio, 2015). A better quality of experience will provide the perspective of fulfilling obligations adequately through the existence of a taxation system that is considered reasonable. Taxpayer awareness will increase within society (Maseko, 2014).

Tax administration

Tax administration can be narrowly defined as the exercise of the obligations and rights of taxpayers, conducted at the tax office. The relevant paperwork includes recording, management (classifying), and storage (filling) (Walsh, 2012). Tax administration is the way in which taxpayers are assessed and made to pay their taxes to the government. It is subject to the assessment, collection, and monitoring of taxpayer compliance with tax laws and regulations by taxation agencies (Olaoye, Ayeni-Agbaje, & Alaran-Ajewole, 2017).

Tax administration plays an essential role in the taxation system of a government, and a government may successfully achieve the expected objective of generating an optimal tax revenue if its tax administration is capable of effectively implementing taxation systems in a selected state (Makori et al., 2013). Tax administration seeks to realize tax regulations and tax revenues and determine how to effectively resolve tax issues.

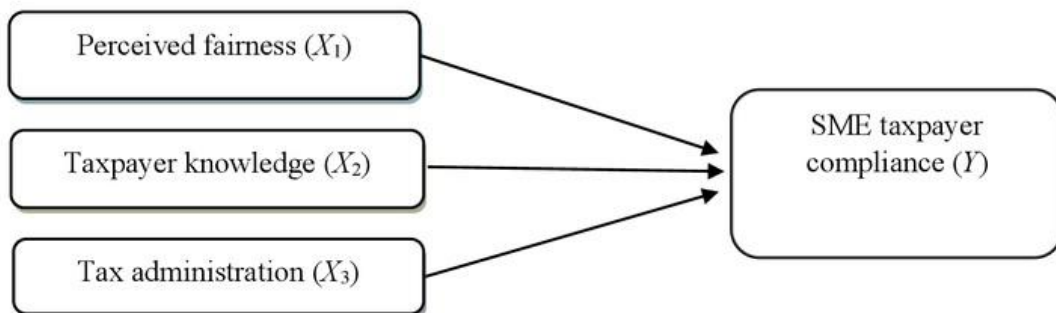
Based on the above arguments, the hypotheses proposed in this study are as follows.

H1: Perceived fairness influences SME taxpayer compliance.

H2: Tax knowledge has an effect on SME taxpayer compliance.

H3: Tax administration influences SME taxpayer compliance.

The theoretical framework which examines perceived tax fairness, taxpayer knowledge, and tax administration as connected to SME taxpayer compliance is presented in the following.



2. Methodology

This research uses a quantitative approach with a descriptive and explanative research method (Ghozali, 2016). This study aims to examine the effect of independent variables, namely perceived fairness (X1), tax knowledge (X2), and tax administration (X3), against the dependent variable, which is SME taxpayer compliance (Y). The data used are primary data collected through observation and the distribution of surveys to SMEs. Data processing was carried out using the SPSS 23 programme.

Primary data in the research come from a survey with 86 respondents conducted in Jakarta. The data collection method in the research was carried out in two ways through a survey and observation. The reason for the distribution of the survey relates to the role of informants. They are considered essential in the research because they can provide information regarding the research subject, and they can develop access to the related sources. The second data collection method was direct observation and non-participant observation, i.e. by observing interactions among the SMEs related to taxation. The observations were carried out through dialogue access to the SMEs by utilising "tracking" features for each informant.

3. Result and Discussion

Descriptive analysis

The following table shows the results of the descriptive statistical output from data processing using SPSS.

Table 3. Descriptive statistics.

	N	Minimum	Maximum	Mean	Std. deviation
Perceived fairness	86	17	26	21.0116	1.94328
Tax knowledge	86	21	32	27.3256	2.28263
Tax administration	86	18	28	23.9302	1.88362
Taxpayer compliance	86	17	24	20.8488	1.85674
Valid N (listwise)	86				

In Table 3, the descriptive analysis shows that the variable of perceived minimum value generated is 17, while the maximum value is 26, and the average value obtained from 86 respondents is 21.0116. This shows that perceived fairness is already in the maximum range. Variable tax knowledge with an average value of 27.3256 indicates that tax knowledge is also in the maximum range. Variable tax

administration, with an average value of 23.9302, shows that tax administration is in the maximum range.

Normality test

Table 4: Normality test and one-sample Kolmogorov–Smirnov test.

		Unstandardized residual
N		86
Normal parameters a, b	Mean	0.000000
	Std. deviation	1.12008031
Most extreme differences	Absolute	0.076
	Positive	0.076
	Negative	-0.054
Kolmogorov–Smirnov Z		0.706
Asymp. sig. (two-tailed)		0.701

The results of the Kolmogorov–Smirnov test in Table 2 show that the asymptomatic significance value is 0.701, which is higher than the significance level of 0.05. It can therefore be concluded that the data are usually distributed, if the regression model used fulfils the assumption of normality.

Table 5. Full model regression

coefficients.a

Model	Unstandardised coefficients		Standardised coefficients	t	Sig.
	β	Std. Error	Beta		
1 (Constant)	2.253	2.195		1.026	0.308
Perceived fairness	0.600	0.068	0.628	8.846	0.000
Tax knowledge	0.193	0.090	0.237	2.134	0.003
Tax administration	0.634	0.191	0.069	3.316	0.001

a. Dependent variable: taxpayer compliance.

The equation of regression is as follows.

$$Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

The equation includes the following variables.

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Y: taxpayer compliance
 X1: perceived fairness
 X2: tax knowledge
 X3: tax administration
 e: error

The following results were obtained from full model regression.

$$Y = 2,253 + 0,600 X_1 + 0,193 X_2 + 0,634 X_3 + e$$

The first hypothesis (H1), perceived fairness (X1), has a t value of 8.846, which indicates a positive relationship at a significance value of 0.000 or less than 0.05 ($0,000 < 0.05$). This means that perceived fairness (X1) has a significant effect on the dependent variable. We can therefore conclude that the hypothesis for perceived fairness cannot be rejected. It has a positive correlation with and a significant impact on taxpayer compliance (Y).

The second hypothesis (H2), tax knowledge (X2), has a t value of 2.134, which indicates a positive relationship at a significance value of 0.003 or less than 0.05 ($0,003 < 0.05$). This means that tax knowledge (X2) has a significant effect on the dependent variable, and the tax knowledge hypothesis (X2) is not accepted. It has a positive correlation with and a significant impact on taxpayer compliance (Y).

The third hypothesis (H3), tax administration (X3), has a t value of 3.316, which indicates a positive relationship at a significance value of 0.001 or less than 0.05 ($0,001 < 0.05$). This means that tax administration (X3) has a significant effect on the dependent variable. The tax administration hypothesis (X3) is accepted because it has a positive correlation with and a significant impact on taxpayer compliance (Y).

4. Conclusion

Indonesian SMEs generally have relatively low tax knowledge. Although the number of SMEs in the business category is very significant, they only have 5% value added. For big businesses, however, the value-added reaches 89%.

This low level of tax knowledge, in turn, will cause the level of compliance to also be low. The same case occurs in taxation administration. It can be said that weak tax administration leads to unfulfilled taxation obligations. Because of their tremendous contribution to the country's gross domestic product, SMEs need to be guided more by the government. From the fairness perspective, the 1% gross excise tax levied on SMEs has led those SMEs to perceive unfairness in the tax policy. Concerning this matter, the tax authority has planned to lower tax tariffs by up to 0.25 % and lower the limits for SME criteria.

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