



**FACTORS INFLUENCING THE COMPLIANCE  
BEHAVIOUR OF INDIVIDUAL TAXPAYERS IN RIAU  
INDONESIA**

**BY**

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degree of Master of Science in Accounting**

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## **ABSTRACT**

Tax is a prominent source of revenue to support the development of a country. In Indonesia, taxes are collected by the Directorate General of Taxes (DGT). The tax authority employs a Self-Assessment System (SAS) to collect taxes in Indonesia. However, the collection of taxes has not reached the target expected by the tax authority. This study aims to examine the factors that influence the compliance behaviour of individual taxpayers in Pelalawan Regency, Riau Province, Indonesia. It assumes that demographic and institutional factors have a significant influence on individual tax compliance behaviour. A self-administered survey was carried out among government officers in the Pelalawan Regency. Results of this study show that demographic factors (i.e. age, gender and level of education) do not have significant influence on individual tax compliance behaviour. However, institutional factors (tax knowledge, complexity, the probability of detection and the role of the tax authority) analysed reveal a significant influence for two of the factors, i.e. the probability of detection and the role of the tax authority. Therefore, this study suggests that the tax authority should devise strategies for detecting taxpayers who fail to comply. In addition, the tax authority should initiate methods to persuade taxpayers to fulfil their tax obligation.

## ملخص البحث

تعدُّ الضريبة دخلاً بارزاً، وتكتسب مكانة في دعم التنمية في إندونيسيا، حيث تجمع الضرائب من الممولين بواسطة المديرية العامة للضرائب. ومن أجل جمع الضرائب في إندونيسيا، وظّفت مصلحة الضرائب نظام التقييم الذاتي. ورغم ذلك، وفقاً للتقرير السنوي للمديرية العامة لسنة 2011م، لم تصل حصيلة الضرائب إلى المستوى الذي كان متوقّعا من طرف مصلحة الضرائب. هذه الدراسة تهدف إلى استقصاء العوامل التي من شأنها أن تؤثر في سلوك الفرد في الالتزام الضريبي في ريجنسي، بمقاطعة رياو باندونيسيا. تفترض هذه الدراسة أن العوامل الديموغرافية، والعوامل المؤسسية ذات تأثير كبير في سلوك الفرد لامتثال الضريبي. وقد تم توزيع استبيان على موظفي الحكومة وجمعهم في مدينة لاوان ريجنسي، بمقاطعة رياو باندونيسيا. وقد أظهرت نتائج هذه الدراسة أن العوامل الديموغرافية (العمر، الجنس، المستوى التعليمي)؛ لا تؤثر بشكل كبير في سلوك الفرد في الالتزام الضريبي، في حين أن العوامل المؤسسية وخصوصاً الدراية بالضرائب والتعقيد، واحتمالية الكشف، ودور السلطة الضريبية من شأنها أن تؤثر في سلوك الفرد في الالتزام الضريبي لهذا الغرض، تقترح هذه الدراسة أن دور مصلحة الضرائب يجب أن يتحسن من أجل الكشف عن دافعي الضرائب الذين لا يلتزمون بواجباتهم من خلال وضع استراتيجيات للكشف عن الذين لا يلتزمون بواجباتهم، وينبغي علم مصلحة الضرائب بتفعيل طرق إقناع دافعي الضرائب للوفاء بالتزامهم الضريبي.

## APPROVAL PAGE

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## DECLARATION

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## LIST OF ABBREVIATIONS

DGT	Directorate General of Taxes
ERP	Enterprise Resources Planning
H	Hypotheses
KMO	Kaiser-Meyer-Olkin
LTO	Large Taxpayer Officer
MFT	Marriage and Family Therapy
MTO	Medium Taxpayer Officer
OECD	Organization for Economic Cooperation & Development
OAS	Official Assessment System
PCA	Principal Component Analysis
POD	Probability of Detection
RO	Research Objective
ROTA	Role of Tax Authority
RQ	Research Question
SAS	Self-Assessment System
SE	Self Employed
STO	Small Taxpayer Officer
SW	Salary and Wage

# CHAPTER 1

## INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

Tax is a prominent source of revenue to support the development of a country. It is a mandatory contribution by the people to the state treasury which can be enforced and used to pay for general expenditure (Soemitro, 1992). Generally, taxes paid by the public will eventually be returned to them through facilities and services provided by the government. Hancock (1995) defined tax as a compulsory levy imposed by the government on the basis of income and expenditure or capital assets, for which the taxpayer receives nothing specific in return.

Mardiasmo (2013) emphasised that there are several purposes for tax. The primary purpose of imposing a tax was to raise money for public purposes; the collected taxes could be used for the prosperity of the public (such as providing public transport and public welfare). Secondly, the imposition of tax could also be used as a social correction tool by the government to regulate on social and economic aspects in the country. For example, a tax could be imposed on liquor to minimize the consumption of liquor among the public. In addition, tax also plays an important role in supporting the export of local products internationally. For instance, the tax authority in Indonesia does not impose a tax for local products that are exported; on the contrary, it imposes a tax for imported goods.

There are two types of system employed by the tax authority to collect taxes, namely the Official Assessment System (OAS) and the Self-Assessment System (SAS). The OAS is a tax system that authorizes the government to determine the

amount of tax payable by the taxpayer. In contrast, the SAS gives authority to the taxpayer to decide on the amount of tax due (Mardiasmo, 2013). The SAS transfers the responsibility of calculating, paying and reporting tax returns from the tax authorities to the taxpayers.

The compliance ratio of taxpayers in Indonesia (individual and corporate) had been gradually increasing from 30 percent in 2007 to 58 percent in 2010(see Table 1.1), but decreased slightly in 2011 to 53 per cent. The annual report of the Directorate General of Taxes in 2011 stated that the total workforce in Indonesia was about 110 million. Of that figure, only 19.9 million (18%) was registered as individual taxpayers and out of the registered taxpayers, only up to 8.5 million (8%) submitted annual income tax returns.

Table 1.1 Annual Tax Return-Filing Compliance Ratio in Indonesia (2007–2011)

Description	2007	2008	2009	2010	2011
Number of all types of taxpayers obliged to file annual tax returns	4,231,117	6,341,828	9,996,620	14,101,933	17,694,317
Annual Tax Return Filed	1,278,290	2,097,849	5,413,114	8,202,309	9,332,626
Compliance Ratio	30.21%	33.08%	54.15%	58.16%	52.74%

Source: Annual Report Directorate General of Taxes 2011

From the perspective of Directorate General of Taxes (DGT), the compliance of taxpayers was at a minimum level as the revenue generated by the DGT from tax returns was still at an unsatisfactory level (Annual Report Directorate General of Taxes, 2011).

## **1.2 PROBLEM STATEMENT**

The tax compliance level of individual taxpayers in Indonesia is generally low. In 2013, the tax revenue collected from individual taxpayers amounted to Rp4, 383.38 billion, which reflected 68 percent of the revenue targeted by the DGT (Annual report DGT, 2013). Based on an OECD report, the acceptable compliance rate was 80 percent. Therefore, the improvement of tax compliance was crucial to generate sufficient income for the country and to reduce the tax gap between targeted and actual revenue collection. This study was thus carried out to identify factors that influenced the compliance of individual taxpayers in the Pelalawan Regency of Riau Province in Indonesia. Findings from this study could assist the government to improve the overall level of individual tax compliance in Indonesia.

## **1.3 MOTIVATION OF THE STUDY**

Indonesia began using SAS in 1983 and since then, the DGT has been upgrading its system and helping taxpayers to comply with their tax returns. Upgraded systems and facilities of the tax authorities could be seen through the enhancement of tax policies and administrative reforms. For instance in 2002, the tax authority of Indonesia established a Large Taxpayer Regional Office (LTRO) and two Large Taxpayer District Tax Offices (LTOs) that provided services to taxpayers. The LTO enhanced professionalism in tax administration of minority taxpayers through the provision of tools and infrastructure, systems and working methods, as well as the services of qualified staff.

The LTO was structured according to functions and staff members were bound by a code of conduct. With the code of conduct in place, staffs were able to provide an excellent service and proper assurance of the taxpayer's compliance. In 2005, the LTO

increased compliance of income tax collection up to 40 per cent. The Ministry of Finance in Indonesia then expanded the application of modern tax administration to taxpayer offices throughout Indonesia. The modernization of tax administration grew further with the development of Medium Taxpayer Offices (MTOs) in all districts and Small Taxpayer Offices (STOs) for regencies. Action was also taken by the tax authority by launching an extensive programme in 2007 to register individual taxpayers who were eligible to pay taxes.

However, compliance rates have remained low relative to the target of the tax authority and research in this area with particular reference to Indonesia is scarce. This study aims to examine the factors that influence individual taxpayers to submit their tax returns.

This study was conducted among government officers in the Pelalawan Regency of Riau Province in Indonesia who were qualified to pay taxes from their incomes. It included government officers of grades III and IV who were subjected to income tax assessments. According to Ministry of Manpower and Transmigration of the Republic of Indonesia, the number of government officers in 2012 represented 11 percent of the work population in the country. According to statistical data in 2012, the majority of residents in Pelalawan Regency work in plantations as farmers (60%); a tenth (10%) are government officers while the rest work in trade (15%); construction (6%); industry (4%); transportation, warehousing and communication (4%); and finance (2%).

Of the residents in Pelalawan who work as farmers, the majority of them work at plantations owned by a private company and receive wages from the company owners. Their wages are normally below the taxable income. The situation is similar with traders, many of whom are traditional traders trading in local markets. It is for



this reason that this study chose to focus on government officers.

#### **1.4 OBJECTIVES OF THE STUDY**

Previous studies have been conducted to investigate the determinants of tax compliance behaviour. Determinants frequently suggested by past researchers have been demographic and institutional factors. For the demographic factors, measurements such as age, gender and level of education were used as a proxy. Previous studies showed that there was a relationship between demographic determinants and tax compliance behaviour (Jackson and Milliron, 1986; Chan et al., 2000; Richardson and Sawyer, 2001; Ritsema et al., 2003; Hasseldine and Hite, 2003; Kastlunger et al., 2010; Asante and Baba, 2011). Other researchers have found no relation between demographic factors and tax compliance behaviour (Dubin and Wilde, 1988; Chan et al., 2000; Palil, 2005; Kasipillai and Jabbar, 2006; Devos, 2007).

Institutional factors were also considered as determinants by researchers in previous studies, including tax complexity, the probability of detection and the role of the tax authority. Previous studies have generally noted that institutional factors have an influence on tax compliance behaviour (Jackson and Milliron, 1986; Carnes and Cuccia, 2001; Richardson and Sawyer, 2001; Chau and Leung, 2009; Torgler and Schneider, 2009; Alm et al., 2010; Alabede et al., 2011).

Therefore, the main objective of this study is to investigate the determinants that influence compliance among taxpayers, specifically in the Pelalawan Regency of Indonesia. The aims of this study are:

1. To examine if there is any significant difference among demographic factors towards the compliance behaviour of individual taxpayers in

Pelalawan Regency; and

2. To examine if there is any significant relationship between institutional factors and the compliance behaviour of individual taxpayers in the Pelalawan Regency.

## **1.5 RESEARCH QUESTIONS**

The following research questions were developed to satisfy the appropriate research objectives:

1. Is there any significant difference among demographic factors (i.e. age, gender and level of education) towards individual tax compliance behaviour?
2. Is there any significant relationship between institutional factors (tax knowledge, complexity, the probability of detection and the role of the tax authority) and individual tax compliance behaviour?

## **1.6 CONTRIBUTIONS OF THE STUDY**

Several new contributions can be made through this study. Firstly, it provides a better understanding of the compliance behaviour of individual taxpayers and an analysis of the determinants that might influence it. By analysing determinants that affect compliance behaviour directly or indirectly, one can also appreciate the rationale of taxpayers for compliance and non-compliance.

Secondly, this study could also develop a new approach for DGT to increase tax compliance and reduce non-compliance among taxpayers. Such an understanding could assist the tax authority to institute proper enforcement and devise new strategies to ensure taxpayers fulfil their obligation towards the state.

Thirdly, this study could provide a better understanding on the tax system and tax enforcement in Indonesia, especially in the area of individual tax compliance. It could provide better insights and information on the tax system in Indonesia and its implementation and could add to the literature on taxation in Indonesia.

## **1.7 ORGANISATION OF THE STUDY**

This study comprises seven chapters which begin with Chapter One as the introduction of this study. Chapter Two provides an explanation of the Indonesian tax system. Chapter Three presents the literature review on the subject to reveal the gaps that this study attempts to bridge. It reviews tax compliance behaviour in Indonesia and gives an in-depth explanation of the determinants employed in this study and their relation to previous studies.

Chapter Four discusses theories applicable followed by the development of the hypothesis for this study. It provides an explanation of the theories and elaborates on the research objectives, questions and the hypothesis.

Chapter Five concerns the research method employed in this study, and explains the theoretical framework and the research design.

Chapter six provides the findings from the analysis conducted in this study, including the rate of response, the descriptive statistics, the analysis of the principal component, and the reliability test. It also provides the findings of this study from the multiple regression analysis which is employed to test the hypothesis. The finding of this study is thoroughly discussed in relation to previous studies. Chapter Seven is the conclusion and highlights the contributions of this study, its limitations and suggestions for future research.

## **CHAPTER 2**

### **THE INDONESIAN TAX SYSTEM**

#### **2.1 INTRODUCTION**

This chapter explains the tax system in Indonesia in general. It begins with a description of the Indonesia population and sources of federal revenue. It then explains the taxation system and how personal income tax is calculated in Indonesia. This chapter also presents a description of the Indonesian tax authorities and then provides a conclusion.

#### **2.2 INTRODUCTION ON INDONESIA**

Indonesia is part of Southeast Asia and with a population of about 238 million, is the fourth most populous country in the world (Statistic Indonesia, 2010). According to Statistic Indonesia (2013), the Total Gross Domestic product of this country is approximately IDR 9.1 billion (USD 0.9 million or MYR 2.7 million).

The sources of federal revenue are both tax and non-tax revenue. Tax revenue contributed approximately 78 percent of the total federal revenue to fund the activities of the Indonesian government (Statistic Indonesia, 2013) and income tax contributed about 49 percent of the tax revenue (Statistic Indonesia, 2013). Indonesia is one of the countries in Southeast Asia that depended on income tax for the development of the nation (Nurmantu, 2005). Table 2.1 summarises the sources of federal revenue for 2013.

Table 2.1 Source of Federal Revenue

Source of revenue	Revenue in 2013 IDR billion	Percentage	Percentage	
<b>Tax revenue</b>				
Domestic	Income tax	584,890	49	
	Value added tax	423,708	35	
	Land & building tax	27,344	2.3	
	Exercise duties	92,004	7.7	
	Other domestic tax	6,343	0.5	
International	Import duties	27,003	2.2	
	Export tax	31,702	2.7	
Total tax revenue		1,192,994	100	78
<b>Non-tax revenue</b>				
Natural sources revenue		197,205	59.4	
Profit transfer from SOE's		33,500	10.1	
Other non-tax revenues		77,992	23.5	
Revenue from public service institution		23,449	7.0	
Total non-tax revenue		332,196	100	22
<b>TOTAL FEDERAL REVENUES</b>		<b>1,525,190</b>	<b>100</b>	<b>100</b>

1 USD = IDR 12600

Source: Statistic Indonesia (2013)

### 2.3 TAXATION IN INDONESIA

The obligation to pay taxes existed even before the independence of the country in 1945. Sales tax was introduced after independence and tax reformation was said to have reached its climax on 1 January 1984. Reformation touched on improvement of the Taxes Act pertaining to the general provisions and procedures for taxation; and introduced a variety of new legislation such as Acts on income tax, value-added tax, sales tax on luxury goods, and land and building taxes (Harjo, 2013).

After significant reformations in 1984, various types of taxes emerged according to experts on taxation. These included direct tax on individuals, and indirect tax collected by intermediaries, such as value-added taxes. Taxes were also divided into central and county taxes based on the authorities that collect the taxes. Taxes

were also based on the nature of taxes and they were divided into subjective and objective taxes.

There are several types of tax structures in Indonesia which are either value-added taxes or taxes on luxury goods, such as land and building tax, local taxes and levies, fees for the acquisition of land and buildings, and stamp duty. All of these tax structures have their own legal basis for implementation. According to the Income Tax Act 21 number 17(1), the income tax used a progressive rate of between 5-30% for individual taxpayers and 10-35% for corporate taxpayers, while the rate for value-added tax was 10% (Harjo, 2013).

From an administration perspective, Indonesia is a unitary state with a central government but it has 33 provinces, 399 regencies and 98 municipalities (Statistic Indonesia, 2012). Indonesia was dependant on the collection of tax revenue to cover the central government's expenditures, with a contribution of 62 percent of the total domestic revenue in the country's budget (Directorate General of Taxes, 2011).

The tax revenue collected by the tax authority gives various benefits to the country. For example, the government expands and advances infrastructure and facilities for public welfare, such as highways, bridges, ports, water, electricity, health facilities, education, security, and other public facilities that help achieve the purpose of public prosperity. The contribution of citizens through the payment of taxes could help the government improve their services for education, provide better facilities, pay the salaries of government officers, and enhance the defences or upgrade the security of the country. Therefore, taxes can enhance the economic growth and prosperity of the citizens.

## **2.4 THE TAX SYSTEM IN INDONESIA**

There are three systems used by the country to collect taxes from incomes, namely the Official Assessment System (OAS), the Self-Assessment System (SAS) and the Withholding Tax System.

In the early implementation of taxes, Indonesia used the OAS to collect taxes from taxpayers. This system authorizes the tax authority to calculate the amount of tax imposed on taxpayers. In other words, in the OAS, taxpayers were passive because the obligations to pay taxes would be imposed only if official letters were issued by the tax authority. Thus, the amount of tax collection was highly dependent on the tax authority.

The OAS in Indonesia began during the colonial period and was in existence until tax reforms were made in 1983. The first tax imposed was on land owners, during the time when Indonesia was still colonised by England and led by Lieutenant General Raffles. Indonesia was subsequently ruled by the Netherlands until 1942. The imposition of taxes on land was still ongoing during this time with changes that ensured justice to citizens. From 1942 to 1945, when Indonesia was ruled by Japan, the land tax system implemented by the Netherlands was taken over by Japan and renamed the Land Tax. In 1945, Indonesia obtained independence from the Dutch and the tax system continued using the OAS until tax reforms in 1983.

In 1984, Indonesia changed its tax collection system from the OAS to the SAS and the country adopted the SAS method for corporate and individuals to report their income tax. The amount of tax collection then was highly dependent on the taxpayers themselves. According to this system, taxpayers were required to calculate and submit their own tax returns either monthly or annually. Although the SAS had been practiced in Indonesia since 1984, tax collection was still below the targeted amount

(Annual Report Directorate General of Taxes Indonesia, 2011).

Besides having the OAS and SAS, Indonesia also used another system, the withholding tax system, which functions at various sources, notably for salaries, interests and dividend incomes, and also for some inter-company payments for royalties, rentals and services. Taxes withheld at source constitute prepaid taxes for income that was credited against taxes due in the annual tax return forms. The exception was taxes withheld on interest from income, including from listed bonds, where the 15% withholding tax for residents was deemed the final tax.

Effectively, this meant that Indonesia operated a sort of dual income tax system where interest on income was taxed at a fixed rate regardless of the individual's marginal tax rate. Such explicitly scheduler tax systems made progressivity harder to implement, but they had in practice proven more effective in securing tax revenues and making use of third-party information, such as information provided by financial institutions (OECD, 2012).

## **2.5 PERSONAL INCOME TAX IN INDONESIA**

Individual taxpayers are permanent or temporary employees who work with employers with the agreement to perform jobs and get a certain amount of salary or wage in specified periods, whether the job is in or outside Indonesia (Hero, 2013). In addition, Pail (2005) asserted that personal or individual taxation also referred to the administration of income taxes that were applicable to self-employed individuals who earn a salary or wage. Individual taxpayers in these two categories were required to file their annual tax returns based on incomes derived during each calendar year or month.

The definition of income tax as applied in Indonesia referred to by Tax Laws