# The Impact of Tax Knowledge on Tax Compliance Case Study in Kota Padang, Indonesia

P. Fauziati[*,1,a], A. F. Minovia[1,b], R. Y. Muslim[1,c] and R. Nasrah[2,d]

[1]Departement of Accounting, Faculty of Economics, Universitas Bung Hatta
Jl.Sumatera Ulak Karang, Padang 25113, Indonesia
[2]Departement of Management, Faculty of Economics, Universitas Mahaputra Muhammad
Yamin Solok, Indonesia

[a,*]popifauziati@bunghatta.ac.id, [b]ariefrinolaminovia@yahoo.com, [c]resti_yulistiam@yahoo.com,
[d]rasidahnasrah82@gmail.com

**Abstract** – *Tax compliance issue is a major problem in revenue generation by government in Kota Padang, Indonesia. This study therefore examines the impact of tax knowlwdge on tax compliance. The survey research design was used in conducting the investigation. The primary source of data was used and three hundred (300) copies of self- administered questionnaire were distributed. The number of questionnaire completed and returned was two hundred and thirty-seven (237), constituting 79% response rate. The simple linier regression models were used to estimate the relationship between tax knowledge and tax compliance. The t-statistics was used to test the significance of the study variables. It was revealed that; tax knowledge has no impact on tax compliance. It is therefore recommended that efforts be made to improve the taxpayers' knowledge so as to improve tax compliance and consequently improve government revenue generation.* **Copyright © 2016 Penerbit Akademia Baru - All rights reserved.**

**Keywords:** Tax knowledge, Tax compliance, Small Medium Enterprise (SMEs)

## 1.0 INTRODUCTION

Taxes are major source of state revenue which is used for funding the Government's expenditures and development programs. Tax contribution is very important for the organization of a Country beside other revenues such as natural resources, profits of state-owned enterprises, fees, and other revenue sources. It can be said that taxes revenue is worth the largest domestic revenue. Directorate General of Taxation as a government agency under the Ministry of Finance as the manager of the taxation system in Indonesia is continually trying to increase tax revenues by reforming the implementation of a more modern tax system. The action is very rational, because in fact the amount between the number of taxpayers compared with the population and number of businesses is relatively small, it can be seen from Table 1 below.

High number of SMEs growth is a tax source that can be used to increase state revenues and Indonesian current tax collection system which is called Self-Assessment System that has been implemented since 1983 is very dependable to the taxpayers' honesty and compliance to report their tax obligations.

There are many researches that have been done to identify taxpayer compliance. Defining element of compliance or non-compliance is different in various studies. Misu [20] divides tax compliance factor into two, which are economic and non-economic factor. One of those non-economic factors is tax fairness. This theory is supported by Richardson [28], who describes that one of non-economic variable that affects tax compliance behavior is the perception of tax fairness. According to Rajif [26] declare factor that has significance effect towards tax compliance which is tax knowledge. The research result done by Prasetyo declares that tax knowledge has negative significant effect on tax compliance. Without any tax knowledge, taxpayers are intent not to comply the tax law, deliberately or not [19,31]. Numerous tax laws and its changes that exist in Indonesia commonly takes the lay taxpayers such as small entrepreneurs out of their breath, because such of burden. The more complex a tax system is, the higher the compliance cost will be, and finally individual and business change their behavior in response to tax policies [14]. Erich, K et.al [13] claim that tax complexity results negative paradigm towards current tax law, and will further increase the unwillingness to fulfill their responsibility as a taxpayer.

**Table 1:** Number of enterprises in Indonesia

| Number of Enterprises | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| SME | 51.409.612 | 52.764.603 | 53.823.732 | 55,206,444 | 56,534,592 | 57.895.721 |
| Large Entities | 4.650 | 4.677 | 4.838 | 4,952 | 4,968 | 5.066 |

Source : www.kemenkopmk.go.id

## 2.0 LITERATURE REVIEW AND HYPOTESES

### 2.1 Small Medium Enterprise (SMEs)

Small Medium Enterprise (SMEs) have varying definitions based on different fundamentals of measurement. They can be defined basing on the value of assets, capital employed, sales turnover or number of employees. In Indonesia, the grouping of micro, small and medium-sized SMEs based on the amount of gross income and the amount of labor. According to Budi [5] business sector, micro, small and medium enterprises play a role important in the structure of the Indonesian economy. Let's look at just the role of the SME sector in gross domestic product (GDP) of Indonesia Year 2009, approximately Rp 2.993 trillion or 56.5% of it comes from the SME sector. Not to mention, officially, there are about 53 million offender SMEs recorded the number of workers reached 99 million. According to Government Regulation No. 46 of 2013 concerning income tax on income of the business derived by a taxpayer who has a certain gross turnover. The intent of these regulations is the ease and simplification of tax laws, educate the public to administration. Educating the public for transparency and allowing the public to have the opportunity in operated the government. While the purpose of Government Regulation No. 46 Year 2013 is to provide convenience for the people in implementing their tax obligations, increase public knowledge about the benefits of taxation and the creation of conditions of social control in meeting tax obligations.

The tax object based PP 46 Year 2013 is income from business derived by the taxpayer with gross income (turnover) that does not exceed USD 4.8 billion in the first year pajak. Pajak due

and payable is 1% of the amount of gross income (turnover) . Gross income (turnover) the amount of gross income (turnover) of all outlets / counters / outlet or the like both central and branch. The tax subject under Regulation 46 of 2013 is the Individual and the Agency, not including permanent establishments who receive income from business with gross turnover (turnover) which do notexceeding USD 4.8 billion in 1 (one) tax year. For paying and reporting later than the 15th of the following month and tax reporting.

## 2.2 Tax Knowledge

Citizens' general understanding of essential tax policy concepts, such as progressive taxation is inadequate [29]. Relying on evidence from the US & Britain, Steinmo noted that: those who have carefully studied the public's attitudes, perceptions, knowledge of taxes and tax policy, have generally found that citizens are indeed remarkably misinformed and/or confused. Tax knowledge is an essential element in a voluntary compliance tax system [11], particularly in determining an accurate tax liability [23][31]. More recent studies undertaken in Malaysia [16][17][18] also suggested tax knowledge to be the most influential factor to determine taxpayers' compliance behavior under the self-assessment system. This is empirically established by several other studies [12][13], which documented that possessing tax knowledge would lead to higher compliance rates.

The influence of knowledge on compliance behaviour has been proven in various research [21]. Harris [8] divided tax knowledge into two aspects, namely, knowledge through common or formal education received as a matter of course and knowledge specifically directed at possible opportunities to evade tax. In the first case, the level of education received by taxpayers is an important factor that contributes to the general understanding about taxation especially regarding the laws and regulations of taxation [6]. Previous studies have evidenced that general tax knowledge has a very close relationship with taxpayers' ability to understand the laws and regulations of taxation, and their ability to comply with them [33]. Given evidence that tax knowledge affects understanding of taxpayers, an obvious next that has been raised by previous researchers [6][8][33] is whether enhancement of tax knowledge will increase tax compliance.

## 2.3 Tax Compliance

Roth et al. [30] defined tax compliance as filing all required tax returns at the proper time and that returns accurately report tax liability in accordance with the tax law applicable at the time the return is filed. The findings from a cross cultural study between Hong Kong and Australia indicated that Australian taxpayers were generally more compliant than the Hong Kong taxpayers [27]. Bobek et al. [2], on the other hand, used a hypothetical tax scenario in their experimental study to investigate the taxpayers' noncompliance behaviour in the US, Australia and Singapore. Results indicated that Singaporean taxpayers had the lowest noncompliance rate at almost 26 percent, while Australian taxpayers had the highest at 45 percent. The findings further suggested that complete compliance was highest in Singapore (54 percent) and lowest in Australia (30 percent). The US was in the middle in terms of both the compliance and noncompliance rates.

According to Alm [1], the scope of tax compliance includes, reporting income and paying all taxes in accordance with the applicable laws, regulations, and court decision. Tax compliance typically means, true reporting of the tax base, correct computation of the liability (accuracy), timely filing of the return, and timely payment of the amounts due (timeliness) [7]. Another definition of tax compliance is a person's act of filling the Income Tax Form, declaring all

taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority [33]. Roth et al [30] explain that taxpayers need to prepare all the relevant information in the Income Tax Form within the period given, and the form must report accurate tax liability in accordance with the needs of laws, regulations, and court judgments. Those who fail to adhere to taxation laws intentionally or otherwise are considered as having committed an offence. Of exposure to theory and literature review of the above it can be derived hypothesis is as follows:

$H_1$:     Knowledge Tax effect has positive influence on Tax Compliance

## 3.0 RESEARCH METHODOLOGY

This section covers study population, sample selection, data sources, variable measurement, technique of data analysis and research model. The population in this study are all the SMEs located in the city of Padang. The sample in this study, SMEs are becoming individual taxpayers in Kota Padang, Sumatera Barat, Indonesia. Method Sampling used purposive sampling, so it was taken based on certain criteria. Some of the criteria that can be done in the sampling, namely:

a) Taxpayers who are active in paying a tax of 1% of turnover under  IDR 4.8 billion per year

b) Taxpayers have a TIN (Taxpayer Identification Number)

c) Taxpayers whose taxable turnover below 1% of IDR 4.8 billion  per year

d) Willing to fill out the Questionnaire

The first part of the questionnaire covered the demographics of respondents. The second part of the questionnaire covered tax knowledge and included questions relating to principles of taxation and some specific knowledge of the tax law. The third part of the questionnaire related to tax compliance attitudes. Tax compliance, the dependent variable, was measured by basing on the three items [4] which included; fillling on time, report his/her tax liability accurately and pay the full amount his/she reported as tax liability. Tax Knowledge, independent variable, was measured by the degree of compliance with tax law and administration without the need for enforcement activity.

In the early stages performed reliability tests to measure the extent and consistency of instrument validity test to measure the level of validity and the validity of an instrument. Furthermore, the Normality Test and Test Assumptions Classical. In the later stages of the normality test to determine the independent and dependent variables have contributed normal or not while in the classic test the assumptions made Multicollinearity Test, Heteroskedastity Test and autocorrelation Test. For hypothesis verification performed simple linear regression analysis techniques.

## 4.0 FINDINGS

This section presents the data, the analysis and the results of the analysis. Out of the 300 copies of the questionnaire distributed and 42 copies did not return the questionnaire so that

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questionnaires were returned as many as 258 people. Of the number of questionnaires returned, 21 copies cannot be processed further because the respondents did not fill out the questionnaire completely. The amount of data that can be processed further is as much as two hundred and thirty-seven (237) copies of questionnaires. This distribution can be seen in Table 2.

**Table 2:** Distribution of questionnaire

| No | Description | Amount | Percentage |
|----|-------------|--------|------------|
| 1 | Number of questionnaires distributed | 300 | 100 % |
| 2 | Number of questionnaires were not returned | 42 | 14 % |
| 3 | The number of questionnaires returned | 258 | 86 % |
| 4 | Number of questionnaires that could not be processed | 21 | 7% |
| 5 | Number of questionnaires that can be processed | 237 | 79% |

Characteristics of the respondents can be shown by age, sex and length becomes taxpayer. Data respondent characteristics are shown in Table 3 below:

**Table 3:** Respondent demographics

| | Description | Amount | Percentage |
|---|---|---|---|
| Gender | Pria | 126 | 53% |
| | Wanita | 111 | 47% |
| Age | 20 – 25 years | 64 | 27% |
| | 26 – 30 years | 66 | 28% |
| | 31 – 35 years | 48 | 20% |
| | >35 years | 59 | 25% |
| The duration of a taxpayer | < 1 year | 28 | 10% |
| | 1-2 years | 60 | 25% |
| | 2-5 years | 81 | 34% |
| | > 5 years | 68 | 31% |

Table 3 contains the demographic of data for the respondents. As most of the respondents were the males within the age of 26-30 years. There were slightly more females than the males. The number of respondents aged 20 -25 years as many as 64 people, while the number of respondents aged 26-30 years as many as 66 people. For the duration of a taxpayer at the most for 2-5 years.

**Table 4:** Descriptive statistics

|  | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
|  | Statistic | Statistic | Statistic | Statistic | Statistic |
| X | 237 | 19.00 | 51.00 | 39.2658 | 6.56273 |
| Y | 237 | 3.00 | 15.00 | 11.6962 | 2.31137 |
| Valid N (listwise) | 237 |  |  |  |  |

Table 4 illustrates the minimum value for the variable Tax Knowledge (X) of 19 and a maximum value of 51. For the average value 39.2658 obtained with a standard deviation value of 6.56273. Variable Tax Compliance (Y) has a value and a minimum value of 3 and value maksiumum 15 while the average value 11.6962 and the value of the standard deviation 2.31137.

**Table 5:** Model Summary[b]

| Model | R | R *Square* | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .086[a] | .007 | .006 | .25002 |

a. Predictors: (Constant), X
b. Dependent Variable: Y

It can be observed in Table 5 that the R-value is 0.086 and the R-square is .007, this means that, approximately 7% of the variability of Tax compliance is accounted for by the predictor variables in the model. It means tax compliance was influenced by tax knowledge 7 %.

**Tabel 6:** Coefficients[a]

|  |  | Unstandardized Coefficients |  | Standardized Coefficients |  |  |
|---|---|---|---|---|---|---|
| Model |  | B | Std. Error | Beta | t | Sig. |
| 1 | (Constant) | 2.306 | .172 |  | 13.428 | .000 |
|  | X | .003 | .004 | .086 | .756 | .452 |

a. Dependent Variable: Y

In Table 6, the t-value for tax knowledge is 0.756 and the P-value is 0.452, since the P-value of tax knowlwdge is more than alpha of 0.05, therefore, it implies that tax knowledge has no a significant effect on tax compliance.

This is due to the differences in the views of each taxpayer to the tax, taxpayers who consider criteria taxpayer obedient too difficult and not worth the rewards or benefits derived by the taxpayer, the answers given by the respondents lot indicates the number ignorance Taxpayers will regulations that have been established. Knowledge of tax (tax knowledge) that are owned

by the individual taxpayer is not too extensive, regulatory changes quickly complicated and sanction tax levied create different views for each taxpayer, it requires taxpayers to learn a lot of things related to taxation, but it is not easy for the taxpayer because of the desire to learn self-taxation should arise from the taxpayer itself. Tax authorities should be able to motivate taxpayers to report their tax liability by increasing socialization, as well as transparency in the distribution of tax funds so that the taxpayer can trust and will report their tax properly. Socialization and counseling should be able to increase the knowledge of tax (tax knowledge) in the communities either through social media, tax training, and seminars are appointed by the Directorate General of Taxation, involving state and private universities.

People not only have difficulties to understand tax law, they also show poor knowledge about tax rates and basic concepts of taxation. For example, British citizens underestimated tax rate by about 11% when asked for actual tax rates for various income brackets [15]. Surveys on people's acceptance of flat and progressive tax showed different preferences depending on the mere manner of presentation: If income and tax were presented in absolute amounts, respondents preferred flat tax; if income and tax share were presented in percentages, respondents preferred progressive tax [29]. Poor knowledge can evoke distrust and negative attitudes towards tax, whereas good tax knowledge correlates with positive attitudes towards tax [22].

## 4.0 CONCLUSSION

The main objective of the study was to examine the impact of tax knowledge on tax compliance in Kota Padang. Survey design was used with questionnaire as the major tool of data collection. Copies of questionnaire were administered to 300 respondents and 79% of these respondents returned their questionnaires. The result showed that tax knowledge has no impacts on tax compliance among small and medium enterprises (SMEs) in Kota Padang. From the research findings, it can be summarized that tax knowledge no effect on tax compliance [15][22][29]. According Brainnyah, 2013 tax knowledge variable which consists of general knowledge, legal knowledge and technical knowledge in this study did not significantly affect tax compliance behavior of SMEs. Research conducted by Eriksen and Fallan reports significant changes in respondents attitude toward tax and tax behavior due to the increased level of tax knowledge and Palil [24] found tax knowledge is positively correlated with tax compliance.

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